

ACTION SUMMARY

NEW MEXICO EDUCATIONAL RETIREMENT BOARD

April 23, 2008

<u>Item</u>	<u>Action</u>	<u>Page #</u>
APPROVAL OF AGENDA	Approved	2
<u>APPROVAL OF MINUTES:</u> 2-22-08 and 3-26-08	Approved	2
<u>CONSENT AGENDA-BOARD TRAVEL</u> Wharton Investment Conference— June 23-25, San Francisco, Mr. Malott	Approved	2
Wharton School Investment Courses— May 18-22, in Philadelphia— Treasurer Lewis		
<u>INVESTMENT REPORTS:</u>		
Board Education: Hedge Funds	Informational	2
Post Advisory Contract Amendment Goldman Sachs—Large Cap Growth Contract Extension	Approved	5
March Flash Report	Approved	8
Private Equity Committee Update	Informational	8
Other Investment Reports	Informational	9
<u>DISABILITY RETIREMENTS</u>		
New Applicants (Perm & Continuing)	Approved	10
COLAs	Approved	10
Appeals (none)		
<u>AGE & SERVICE REQUIREMENTS</u>	Approved	10
<u>FISCAL 2009 OPERATING BUDGET</u>	Approved	10
RETIREE HEALTH CARE AUTHORITY REPORT	Informational	11
<u>DIRECTOR'S REPORT</u>		
Update 2008 Retirement Season	Informational	12
2008 COLA for Retirees	Approved	12
Equipment Disposal	Approved	12
<u>TRUSTEE REPORT ON CONFERENCES</u>		
Search for Alpha Forum 3/10-11	Informational	13

<u>Item</u>	<u>Action</u>	<u>Page #</u>
<u>EXECUTIVE SESSION</u> FY 2007 Audit	None	13

MINUTES OF THE
NEW MEXICO EDUCATIONAL RETIREMENT BOARD
REGULAR MEETING

April 23, 2008

A Regular Meeting of the New Mexico Educational Retirement Board was called to order on this date at approximately 9:05 a.m. in the Educational Retirement Board Room, 6201 Uptown Boulevard, N.E., Ste. 203, Albuquerque, New Mexico.

ROLL CALL – QUORUM PRESENT:

Members Present:

Mr. Bruce F. Malott, Chairman
Mr. Gary B. Bland, Secretary [arriving 9:35]
Ms. Mary Lou Cameron, Vice-chair
Dr. Veronica Garcia
Mr. H. Russell Goff
Mr. James B. Lewis

Members Excused:

Dr. Pauline Turner

Legal Counsel Present:

Mr. Robert Shulman, Staff Attorney

Staff Present:

Mr. Robert Cardon, Internal Auditor
Ms. Jan Goodwin, Executive Director
Mr. Bob Jacksha, Chief Investment Officer
Ms. Linda Kissko, Executive Admin. Assistant
Ms. LeAnne Larrañaga-Ruffy, Investment Officer
Mr. Steve Moreno, Benefits Manager
Mr. Steve Neel, Portfolio Manager
Mr. Jeff Riggs, Deputy Director
Mr. Paul Swanson, Member Services
Mr. Greg Trujillo, IT Director
Mr. Robert Westervelt, CFO

Others Present:

Mr. Allan Martin, New England Pension Consultants
Ms. Judith Beatty, Recorder
[Also see sign-in sheet]

a. Approval of Agenda

Mr. Lewis moved approval of the Agenda, as published. Mr. Goff seconded the motion, which passed by voice vote.

b. Approval of Minutes: 2/22/08 and 3/26/08 Board Meetings

Mr. Lewis moved approval of the Minutes of the February 22 and March 26 Board meetings, as submitted. Dr. Garcia seconded the motion, which passed by voice vote.

c. Introduction of Guests

Mr. Malott introduced ERB Executive Director Jan Goodwin.

[The Agenda was reprioritized.]

INVESTMENT REPORTS

a) Board Education: Hedge Funds — Bob Jacksha and Steve Neel

Mr. Jacksha and Mr. Neel distributed and reviewed a slide presentation.

Mr. Neel noted that SEC rules state that there is no regulatory definition of a hedge fund. He said a hedge fund is a structure, and there are a host of different strategies that go into hedge funds in general.

Mr. Neel stated that many hedge funds share common characteristics; one is that the professional investment managers often have a significant stake in the funds and their management fee includes a substantial share of performance/profit—typically 20%.

In reviewing a graph representing growth in this industry, Mr. Neel said investment in absolute return strategies has exploded and is now at about \$1.2 trillion with more than 6,000 managers.

In reviewing the ERB's entry into this strategy, Mr. Neel said the ERB invested about \$400 million in December 2006, and later increased the allocation in April and May 2007 to about \$770 million. He said the ERB recently revised its asset allocation to allow for upwards of 10% in hedge fund strategy, or about \$900 million.

Mr. Neel reported that performance has been quite good; for calendar year 2007, returns were just under 10%. He said that, while FYTD '08 performance is down – 2.51% and first quarter returns are –0.96%, these returns are quite good when compared to broader equity market, which has been hit hard.

Mr. Lewis pointed out that there is not a regulatory definition of hedge funds, and he was concerned about how to explain this relatively new strategy to the ERB Fund's beneficiaries in a way that people can understand. He noted that a State Legislator is now pushing to ban hedge fund investing altogether, and is saying on the radio that New Mexico's retirement funds should not be investing in hedge fund strategies at all.

Mr. Lewis commented that this type of investment structure is relatively new, and the Board members are expected to be educated about it, and all over the country pension funds are bringing people onto their boards who have financial expertise. He cited the suit filed against San Diego's retirement board members and staff for investing in a hedge fund that ultimately collapsed.

Mr. Lewis said another thing people talk about is the high fees charged by these hedge fund managers, and there seems to be a problem grasping the idea that it is the net returns that are important to focus on.

Mr. Lewis asked Mr. Jacksha how he would respond to questions around these issues.

Mr. Jacksha responded that hedge funds comprise a wide spectrum of risk, and the ERB's absolute return strategy is a way of employing them in a low risk manner. He said that is done using fund-of-funds, which provides a lot of diversification and professional management to oversee these funds. He said these managers are tasked with risk management and risk monitoring, and they provide regular reports to ERB staff on those activities.

Mr. Jacksha said the fees are indeed higher than one would pay for a public stock or bond manager, but the ERB expects overall, on a risk and reward basis, that it is getting a better payoff than it would from stock and bond managers. He said this fits well into the portfolio in terms of offsetting risk that one sees everyday in the stock market—for example, this year, the S&P has had about 50% of its trading days up or down 1% in a day and is the most volatile it has been since the 1930s.

Mr. Malott commented that he looked forward to working with staff in communicating to the ERB's constituents and legislators what hedge funds are. He said there was a very good meeting yesterday of the Legislative Finance Committee, where Allan Martin explained that it is not possible to get an 8% return in long-only strategies on a consistent basis.

Mr. Jacksha added that, if one looks at the history of the ERB's returns, the largest downturns have come from stock market downturns, not from hedge funds. He said the stock market is still the ERB's biggest risk, and tools are needed to mitigate that.

Dr. Garcia commented that she does not have the financial expertise of Mr. Lewis, Mr. Bland and Mr. Malott, and relies on their deeper knowledge. By the same token, she said she has common sense and can think logically, and recognizes the importance of a diversified portfolio and studying the quarterly reports.

Dr. Garcia said she would not want to see the Board's hands tied in terms of being able to use various tools in order to reach the 8% annual target. She said she gathered from this presentation that it is the strategy that is important to focus on, not the idea that the Board is investing in a hedge fund.

Ms. Cameron pointed out that the ERB didn't jump into hedge funds after the Legislature passed the law, and in fact waited nearly two years before it made its first investment. She said she told NEA New Mexico, in her annual report to them last March, that this particular strategy has been very beneficial to the Fund.

Mr. Goff thanked Messrs. Jacksha and Neel for this presentation, which he said has been very helpful and informative.

Mr. Goff concurred with Mr. Malott that the word "hedge" is misleading. He said a lot of retirees have fear around the whole issue of hedge funds, and he would encourage continued communication with retirees about this issue.

Mr. Malott commented that there is a perception among many people that bonds are more solid and less risky. He pointed out that the returns on them have been so low that the ERB could have been faced with an estimated \$20 billion unfunded liability because bonds have only been returning 2% or 3%. He said the ERB can go to a bond-only strategy, but it will require a massive capital injection from the Legislature to offset the result. He said the ERB is committed to getting an 8% annual return, which is impossible to achieve with a risk-free strategy.

Mr. Lewis stated that the Investments and Pensions Oversight Committee has had a lot of discussion about what the composition of a board should and shouldn't be, and that the ERB should have people with ten years of experience with finance, for instance, which he did not necessarily agree with. He said the Committee is looking at the complexity of investment activity, however, and is continuing its dialogue on who should be serving on the ERB.

Mr. Jacksha pointed out that the ERB's composition isn't all financial people, but the ERB has the Investment Committee and the Private Equity Investment Committee, which has people who are more focused on financial matters.

CONSENT AGENDA – BOARD TRAVEL

- a) **Wharton Investment Conference — June 23-25, 2008, in San Francisco, CA —Bruce Malott**

- b) **Wharton School Investment Courses — May 18-22, 2008, in Philadelphia, PA—Treasurer Lewis**

Mr. Bland moved for approval of the Consent Agenda. Ms. Cameron seconded the motion, which passed by voice vote.

INVESTMENT REPORTS (Cont'd)

- b) **Post Advisory—Contract Amendment—Bob Jacksha and Allan Martin, NEPC**

Mr. Jacksha stated that, since last October, when the asset allocation was changed to include high yield debt or bank loans as an alternative to high yield bonds, staff has talked with the current high yield bond manager, Post Advisory, about changing the allocation.

Mr. Jacksha said staff now proposes changing the allocation to a broader allocation than bonds or bank debt to include some other items. He said this proposal would allow them to do what they are currently doing in bonds (which is a single B or better rated bond and some lower-rated bonds) but also some that may be in bankruptcy, which Post Advisory has expertise with. In addition, he said, they would have the ability to do some shorting, but only in order to do hedging. He said they could do direct investments, where they would make a loan directly to a company and negotiate their own terms, and it would not be a publicly traded instrument. Mr. Jacksha said they could also do a small amount of equities with a limit of 10%. He said the equities would include straight stock or a convertible bond that would then be converted into equity.

Mr. Jacksha referred to a recommendation memorandum prepared by NEPC which explained the investment policy guideline changes in depth. He said NEPC and staff spent a day with Post Advisory at their offices in Los Angeles and has had ongoing conversations with them about this subject.

Reflecting back on the philosophy discussed by Messrs. Jacksha and Neel about hedge funds, which is to not restrict a manager to only buy long-only instruments, Mr. Martin said the best example of the advantage of that is what has happened with the subprime mortgage market. He said managers who could only invest positively and buy subprime mortgages have had problems. He said some other managers shorted the subprime mortgage market and did extremely well. He noted that Paulsen, who is contained in one of the ERB's fund of funds, made 300% by shorting that market.

Mr. Martin pointed out that having managers who do both creates more opportunities of generating consistent returns. He said Post Advisory happens to have the skills to do both, and the proposal is to go with this manager — they have performed well and the ERB has a history with them.

Mr. Martin said this is a relatively new product for Post, which is doing it for their most sophisticated clients, including the State of Virginia and General Motors, and they are hiding behind an MFN (Most Favored Nation clause). He said Post is therefore saying that they cannot give the ERB a better price than what they have offered their other clients within this structure. Mr. Martin said staff and NEPC have told them that they expect a better price and are willing to accept a slightly different structure, and that is now under negotiation.

Mr. Bland questioned the difference between what Post would be doing with this broadened mandate versus buying an individual hedge fund. He said Post will be taking illiquid positions, can short, and can buy equities.

Mr. Martin responded that, at the highest level, the ERB would certainly be allowing them to do what would generally be called hedge fund strategies. He said he could name a hundred high yield managers the ERB would never do this with. He said Post is well known in the business, has a very deep staff, and has already been approached on these things by others. He said NEPC and staff are convinced that Post has the skillsets to do the credit research and to be able to do this.

As discussion continued, Mr. Martin said Mr. Bland was 100 percent accurate on the concept that this would technically be a hedge fund, but right now Mr. Bland would certainly agree that the opportunities to take advantage of mispriced debt and invest in distressed securities is at an all-time high. He said a lot of people are talking about credit strategy, and the vehicle to execute on those strategies could be a private equity fund, a hedge fund, or a manager who is only taking long positions. He said the strategy here is to take advantage of high yield floating rate bank debt opportunities with an existing manager, and to do that allowing the manager to do some things they haven't been allowed to do before, which would be called hedging strategies.

Mr. Lewis asked Mr. Martin if he thought this might be a trend and that the ERB might be offering this kind of flexibility to some of its other managers.

Mr. Martin responded that he suspected that, as hedge funds continue to succeed, traditional firms will begin looking at their ability to increase returns by shorting, and this strategy will be offered to the ERB. He said that the industry is moving in that direction, but how rapidly client sponsors decide to employ this strategy will be a matter of education, knowledge and development.

Mr. Malott asked Mr. Jacksha how much money is involved, and Mr. Jacksha responded about \$450 million. He said the target is 5% of the assets in high yield bonds currently, and staff is looking at converting all of it to a total return account.

Mr. Malott asked if splitting the money would be prudent, and Mr. Jacksha said he was not opposed to that. He added that he didn't disagree that this could be called a hedge fund, but he tended to think of it as a hybrid.

Mr. Bland said his discomfort is not that the strategy is inappropriate; his discomfort is that the ERB's policy is fund of funds, and this could be circumventing it.

Mr. Jacksha referred to the ERB Investment Policy and noted that the section on hedge funds does not specifically refer to fund of funds.

Mr. Bland commented, then, that he was in favor of trying this strategy. He said he implicitly trusted the judgment of Mr. Martin and Mr. Jacksha.

Referring to Mr. Malott's suggestion about splitting the money, Mr. Jacksha said he would be comfortable with just putting half of the high yield bond money into the total return account and then revisiting this at another time.

Mr. Bland indicated that he did not think that was necessary, given that this doesn't violate policy and that Messrs. Jacksha and Martin have researched this thoroughly. He said he thought Mr. Jacksha's judgment was excellent.

Responding to a question from Dr. Garcia, Mr. Malott explained that the Private Equity Investment Committee vetted this recommendation, but Mr. Bland had not been present at that meeting.

Mr. Bland moved that the Board authorize staff to renegotiate the terms of the existing Post Advisors investment management contract to broaden the mandate to a Total Return Credit strategy as previously discussed.

Mr. Lewis seconded the motion, which passed by voice vote.

**c) Goldman Sachs—Large Cap Growth Contract Extension—
Bob Jacksha and Allan Martin**

Mr. Jacksha stated that Goldman Sachs' contract (\$475 million) expires on June 30, and staff is asking the Board to extend the contract for one year. He referred to a memorandum from NEPC discussing their performance.

Mr. Martin stated that Goldman Sachs' performance since inception has trailed the Index, and a year ago they were on the watch list but were not terminated. He said they have outperformed by 125 basis points in the last year, and in the last two years by 5 basis points.

Mr. Martin said Goldman Sachs is an organization that isn't damaged, they have kept their people, and they have done a good job. He said they are the kind of manager that will do well in this market environment, and NEPC therefore recommends that the contract be extended for one year.

Mr. Martin pointed out that, over the next year, the Board will be looking at hedge fund strategies, emerging market equities, co-investment vehicles, GTAA, commodities and small cap international. He recommended against adding to this busy agenda by doing a search for another large cap growth manager given the small likelihood of finding a better one than Goldman Sachs.

Mr. Bland moved to extend the contract of Goldman Sachs for one year. Mr. Lewis seconded the motion, which passed by voice vote.

d) March Flash Report—Bob Jacksha

Mr. Jacksha said it was a difficult month for many of the ERB's managers, and the ERB underperformed the benchmark by about 39 basis points.

Mr. Jacksha said WAMCO, which has been on the watch list, appeared before the Investment Committee yesterday and discussed the reasons behind their underperformance. He said they were heavily in mortgage-backed securities, and the entire mortgage-based arena has taken a hit; and although there have been no defaults, WAMCO has seen the market price of those securities written down substantially. He said they are typically a spread product manager, which means corporate bonds, mortgage backs and asset backs, but not Treasuries, and it is Treasuries that have done the best over the last 18 months or so.

Mr. Jacksha said WAMCO's premise is that spreads logically ought to compress again as the market stabilizes and then they will outperform the Index. Mr. Jacksha said he thought this a reasonable scenario.

Mr. Jacksha said no action is recommended at this time.

Mr. Malott pointed out that there were whispers and innuendos about an impending mortgage crisis last summer, yet WAMCO didn't do anything about it. He said he thought they took a big risk by deciding against resting their money in safer Treasuries while trying to figure out what was happening in the market. He said he would like to pursue replacing WAMCO once the market stabilizes.

Mr. Goff stated that, four years ago, the Legislature provided a fix of additional contributions through employers and employees. He asked what the prognosis is with that in another three years. He said Senator Smith raised the issue yesterday and asked whether this actually fixed the solvency problem.

Mr. Jacksha responded that the actuarial projections assume an average annual rate of return of 8%, meaning that the ERB would be in GASB compliance in 2010.

Mr. Riggs concurred and added that, under that scenario, the ERB will be fully funded by 2026.

e) Private Equity Committee Update—Steve Neel

Mr. Neel reported that the Private Equity Investment Committee met about ten days ago and vetted two investment recommendations, one for \$25 million in ComVest Investment Partners III, and the other for \$40 million in Clayton, Dubilier & Rice VIII. He said the Investment Committee met yesterday and approved both recommendations.

Mr. Neel said ComVest is a \$400 million distressed for control fund that focuses on the lower end of the middle market in companies with enterprise value of \$250 million or less. He said Clayton, Dubilier & Rice is a \$7.5 billion buyout fund that focuses on operational improvements to drive returns.

f) Other Investment Reports—ERB Staff

On the matter of the October asset allocation, Mr. Jacksha said staff increased the allocation to Emerging Markets from 2% to 10%, and will issue an RFP by the end of this week for another Emerging Markets manager. He said staff will bring that to the Investment Committee in July and to the Board in August for approval. He said a contract should be in place on October 1.

DISABILITY RETIREMENTS

a) New Applicants (Permanent & Continuing)

Ms. Cameron moved for approval. Dr. Garcia seconded the motion, which passed by voice vote.

b) COLAs

Ms. Cameron moved for approval. Mr. Goff seconded the motion, which passed by voice vote.

c) Appeals

None.

AGE & SERVICE RETIREMENTS

Ms. Cameron moved for approval. Mr. Lewis seconded the motion, which passed by voice vote.

FISCAL 2009 OPERATING BUDGET—JEFF RIGGS

Mr. Riggs reported that the total budget for next fiscal year will be \$32,423,300, and the total amount requested was \$32,569,300.

Mr. Riggs said he is projecting a shortfall of \$180,000 in salaries and benefits, but he thought that was manageable.

Mr. Riggs stated that, of the five positions requested, four were granted. He said the ERB is in the process of establishing two term positions that will work on data cleansing and bringing older files up to date. He said those were originally requested as two-year term positions; however, he is anticipating that he will eventually request that the positions be made permanent, since there is extensive work to be done.

Mr. Riggs said there is also a new position in Payroll, which he hopes to fill quickly. He said Payroll hears from a number of retirees each time the checks are issued. He stated that most of the checks are direct deposit, but about 1,400 are still getting manual checks.

Mr. Riggs stated that the compensation package included a 1/2% that the Legislature said they would not fund. He said that, since the ERB is in other State funds, it is allowed to budget that additional 1/2%, or about \$14,000, to Classified employees.

Mr. Lewis moved for approval of the FY 2009 operating budget. Dr. Garcia seconded the motion.

Ms. Cameron asked how the ERB will fund the \$180,000 shortfall in salaries and benefits, and Mr. Riggs responded that the money can come from savings realized from vacant positions (there are currently a half dozen), and can also be managed through BARs.

The motion passed by voice vote.

**REPORT ON MEETINGS OF RETIREE HEALTH CARE AUTHORITY
BOARD—
ROBERT SHULMAN**

Mr. Malott reported that he was just reappointed to the Retiree Health Care Authority Board.

Mr. Shulman added that the RHCA Board's new chair is Alfredo Santistevan, Tom Sullivan is secretary, and Mr. Malott is secretary.

Mr. Shulman stated that, while there have been some serious staffing problems, many of these positions have been filled—especially those that deal with the public. He commented that there have been tremendous problems with the members not getting through to a real person and getting answers. He said part of that was a dysfunctional phone system, and apparently there is a new system in place.

Mr. Shulman stated that, in order to save some money, the RHCA will be looking at a disease management program. He said many of the RHCA vendors already have such programs in place, and the RHCA will see which ones may make sense.

Mr. Shulman also reported that Switch Enrollment will be going forward; the last time that occurred, there were serious problems with wrong information going out and the members not being able to talk to anyone to find out what was really going on.

Mr. Shulman said there was a suggestion to look at the idea of hiring in-house counsel rather than contracting for outside legal services, which is more expensive.

DIRECTOR'S REPORT

a) Update 2008 Retirement Season

Mr. Moreno reported that 359 retirement applications have been received and processed for July 1, which is considerably fewer than expected. He said he expects about 800.

Mr. Moreno said there is a very well trained staff that has adapted well to the new computer system, and the turnaround time for processing an application is now only 3-4 days. He added that the auditing process is also moving along very nicely. He commented that this is one of the smoothest years that his department has experienced in a long time.

Ms. Cameron commented that the Retiree Health Care Authority's problems have scared many of her colleagues in terms of planning for their retirement because of the uncertainty of future health insurance costs. She said she knows two people who are planning to postpone retirement.

Mr. Malott responded that, as a CPA, financial planner and a member of the RHCA Board, he thought that very wise. He said no one knows what is going to happen to the Authority, and fixing it will be very expensive.

b) 2008 Cost of Living Adjustment for Retirees

Mr. Riggs distributed copies of a letter from GRS, actuaries for the ERB, reporting a cost of living adjustment of 2% for retirees.

Mr. Bland moved for approval. Ms. Cameron seconded the motion, which passed by voice vote.

c) Equipment Disposal

Ms. Goodwin referred to the Asset Disposal List, which listed five items.

Ms. Cameron moved for approval. Mr. Bland seconded the motion, which passed by voice vote.

d) Other

Ms. Goodwin reported that the actuaries will be providing a day-long training for staff on Thursday, June 19. She said Board members are welcome to attend.

TRUSTEE REPORT ON CONFERENCES

a) The Search for Alpha Forum—March 10-11, 2008, in San Francisco— Bruce Malott

Mr. Malott reported that the China phenomenon was on everyone's mind at this conference, and was discussed by a number of speakers. He said it was a good conference.

EXECUTIVE SESSION

a) FY 2007 Audit

Ms. Cameron moved to go into Executive Session to discuss the confidential audit report under Section 12-6-5. Mr. Goff seconded the motion, which passed on the following roll call vote:

For: Mr. Malott; Ms. Cameron; Mr. Bland; Mr. Goff; Dr. Garcia; Mr. Lewis.

Against: None.

[The Board was in Executive Session from approximately 10:55 a.m. until approximately 11:30 a.m.]

Mr. Bland moved to come out of Executive Session. Mr. Goff seconded the motion.

Mr. Malott stated that the only item discussed was the audit report.

The motion passed on the following roll call vote:

For: Mr. Malott; Ms. Cameron; Mr. Bland; Mr. Goff; Dr. Garcia.

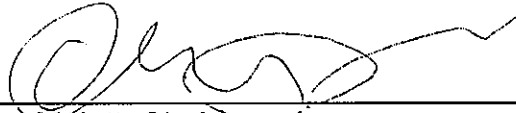
Against: None.

Not present: Mr. Lewis.

NEXT MEETING: JUNE 27, 2008 – ALBUQUERQUE

ADJOURN

Its business completed, the Educational Retirement Board adjourned the meeting at approximately 11:30 a.m.



Bruce Malott, Chairman

ATTEST:



Gary B. Bland, Secretary