

MINUTES OF THE
NEW MEXICO EDUCATIONAL RETIREMENT BOARD
INVESTMENT COMMITTEE

February 21, 2008

CALL TO ORDER

A Regular Meeting of the New Mexico Educational Retirement Board Investment Committee was called to order on this date at approximately 2:00 p.m. in the Educational Retirement Board Room, 6201 Uptown Boulevard, N.E., Ste. 203, Albuquerque, New Mexico.

A quorum was present:

Members Present:

Mr. Bruce Malott, Chair
Mr. James B. Lewis [by teleconference]
Mr. Jeffrey M. Riggs

Members Excused:

Mr. Gary B. Bland

Other ERB Members Present:

Mr. H. Russell Goff

Legal Counsel Present:

None.

Staff Present:

Mr. Mark Canavan, Portfolio Manager
Mr. Robert Cardon, Internal Auditor
Mr. Frank C. Foy, Deputy Chief Investment Officer
Mr. Bob Jacksha, CIO
Ms. LeAnne Larrañaga-Ruffy, Investment Officer
Mr. Steve Neel, Portfolio Manager
Mr. Greg Trujillo, IT Director

Others Present:

Mr. Allan Martin, New England Pension Consultants

APPROVAL OF AGENDA

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

APPROVAL OF MINUTES: December 6, 2007

[Postponed to later in Agenda.]

FLETCHER SPAGHT VENTURES II

[Postponed to later in Agenda.]

PERFORMANCE REVIEW, Q4 2007: ALLAN MARTIN, NEPC

NEPC financial adviser Allan Martin reported that, since issuance of the Q4 2007 report, the S&P is down 7%, the NASDAQ is down 14%, and the Median Public Fund is down an estimated 3.5%.

Mr. Martin stated that most of the traditional market indices were down for the fourth quarter with the exception of Emerging Markets and several of the bond market indices, as well as the recently maligned hedge funds — all were positive over this period. He said fourth quarter struggles with \$100-a-barrel oil, a fast-sinking housing market, and a sharp contraction in the availability of credit have all pushed the economy to the brink of recession. He commented that most economists anticipate a slowing, but not a sinking, economy, although that view is changing daily. He added that the Fed has lowered the Fed Funds rate by 75 basis points to 3.5% —well below last summer's 5.25%—and the present rates on a 30-year fixed home loan are now in the 5.5% range, and have rarely been lower than that. He said some think the rapid decline in prices and rates will actually create a bottom sooner than anticipated—but in the meantime, there is a return of volatility to the market.

In reviewing the Market Environment Overview, Mr. Martin noted that alternative assets did quite well for the quarter as well as for the year. He said Real Estate did 15.8% for the year, and Hedge Funds also did well.

Looking at the last 12 months, Mr. Martin reported that the Fund experienced a gross investment gain of \$542.5 million, and a gross investment loss of \$177.6 million for the quarter.

Mr. Martin said the Fund has returned 12.8% per annum over the past five years, trailing its policy index by .2%, and ranking in the top third of all public funds. He said the Fund returned 6.1% for the year, ranking in the 87th percentile of public funds—a disappointing result.

Mr. Martin commented that, from an exposure standpoint, all of the ERB's major asset classes are within target. He said absolute returns are at 8.3%, which is 3.3% over the target, because of the drop in value with private equities.

Mr. Jacksha added that this overweighting is not a concern because the ERB raised the asset allocation target on absolute returns to 10% at the December meeting. He stated that staff is still using the old asset allocation for the benchmark, and plans to do that for at least another quarter, but officially they can go to 10% in hedge funds and plan to do so.

Reviewing Total Fund Composite performance figures, Mr. Martin said the Fund has done well for the 3-year and 5-year periods, but then shows a -1.9% return for the fourth quarter and a 0.1% average for the fiscal year to date. In addition, he said, the Fund has dropped in the public fund universe relative ranking from the 30th percentile to the 80th and 90th percentile.

Mr. Martin explained that the reason for these disappointing returns is that the ERB's 5% real estate allocation is in REITs, and the REIT Index Fund was down 13.5% for Q4 and down 11.3% for the fiscal year to date. He contrasted this to the NCREIF Property Index, which was up 15.8% for the year and up 3.2% for the quarter; and although the Board voted a year ago to move the Real Estate into NCREIF kinds of institutional real estate, it takes time to do that.

Mr. Jacksha added that this move is in progress, and a couple of commitments have been made to date. He distributed and reviewed a chart reflecting REITs trades made by the ERB since January 2007. He stated that the chart shows the ERB avoided losses overall of about \$7 million from this trading activity.

Continuing with the performance summary, Mr. Martin noted that the Total Fixed Income Composite for the quarter was 1.7%, the Lehman Aggregate was 3% and returns were in the 85th percentile, so it was clear that the managers the ERB hired to manage fixed income have taken away a lot of value.

Addressing a second item that accounts for the difference, Mr. Martin stated that, while Vanderbilt was written off as of January 30, it is still in the performance numbers and always will be, and that \$40 million has affected returns.

Mr. Martin commented, "If I step back and say a lot of very good things have gone on with this Fund over the last couple of years, these three items have, at least in the short run, obscured a lot of that work."

Reviewing a performance summary in Domestic Equity, Mr. Martin said BGI Alpha Tilts (large cap) continues to show disappointing performance and are on watch. He said staff did visit their offices in January; and their numbers for January are 47 basis points above the index, but this is not a manager that has lost people or lost their way, and he felt the ERB would see an improvement. He noted that their contract is up in 2009, but the ERB has an option to terminate them earlier.

Reviewing a performance summary in International, Mr. Martin said the performance is good against the index, although Alliance's performance is disappointing. He stated that the Board authorized an increase in Emerging Markets, and the ERB will do a search; not only will there be more money to invest than previously, staff would like to check and see what other managers are doing versus Alliance.

Mr. Martin said Fixed Income performance is very disappointing, and all of the managers—Fidelity, Lehman and WAMCO in particular—have done worse than the Index over the last year by varying degrees. He commented that this is partly because managers who were conservative and had relatively lower duration were surprised when interest rates dropped the way they did, and part of it is because of specific strategies these managers recommended. He said staff will recommend putting WAMCO on watch.

Referring to Post Advisory's strong performance, Mr. Martin commented that these have been tough times for high yield, and this is an environment where Post does very well, given their emphasis on credit. He said staff will be recommending extending their contract and plans to talk with them about other things they could do within this mandate to add more value to the total.

Reviewing the performance summary in Alternatives, Mr. Martin pointed out that the absolute return managers brought in 9.7% for the year through November, versus the 90 Day T-Bill + 200 benchmark of 7.3%, versus the Lehman Ag return of 7% for that period — so the strategy of taking money out of interest rate sensitive bonds and putting it into absolute returns has paid off in what has otherwise been a very difficult period.

Mr. Martin stated that private equity performance numbers for the quarter come from the custodian, Northern Trust, but staff is not completely sure their figures are up to speed with Aldus, the financial advisor.

Mr. Jacksha distributed a memorandum advising the Committee that WAMCO has been put on watch.

APPROVAL OF MINUTES: December 6, 2007

Mr. Lewis moved approval of the December 6 minutes, as submitted. Mr. Riggs seconded the motion, which passed by voice vote.

FLETCHER SPAGHT VENTURES II

Mr. Jacksha stated that the PEIC did not have a quorum when it reviewed a recommendation by Aldus to make a \$15 commitment into Fletcher Spaght Ventures II, and asked the Investment Committee to give formal approval today.

Mr. Neel clarified that, while originally the recommendation was for \$15 million, the consultant later met with staff and recommended that it be increased to \$20 million.

Mr. Riggs moved that the Investment Committee approve a commitment of \$20 million plus any notional interest to Fletcher Spaght Ventures II. The commitment shall not exceed 20% of the committed capital of the fund, and is subject to New Mexico state law, Educational Retirement Board policies and negotiation of final terms and conditions and completion of appropriate paperwork. Mr. Lewis seconded the motion, which passed by voice vote.

FLASH REPORT, JANUARY 2008 – ERB STAFF

Mr. Jacksha reviewed the January Flash Report, reflecting a tough month for equities and for the Fund, which was down about 4% for the month and down about 7.75% for the three-month period.

POST ADVISORY CONTRACT EXTENSION — ERB STAFF

Mr. Jacksha said Post Advisory's contract expires on March 1, and it is the recommendation of staff and NEPC that the ERB extend Post's contract as high yield bond manager for one year. He said the Board will be asked to approve this extension tomorrow.

Mr. Martin reviewed NEPC's memorandum, which stated that Post has been a high yield fixed income manager for the ERB since early 2004, and historically they have consistently performed in line with their index (Citigroup High Yield Cash Pay Index—2% Capped). He stated that Post's ability to protect against volatility in

down markets has contributed to the Fund's recent outperformance, and Post has much lower volatility than the Index and other fixed income managers.

Mr. Riggs moved to extend Post Advisory's contract for one year. Mr. Lewis seconded the motion, which passed by voice vote.

HUNT FINANCIAL VENTURES, PERFORMANCE UPDATE: NEPC & ERB STAFF

Mr. Lewis moved to remove all of the remaining assets in Hunt Financial Ventures due to their poor performance. Mr. Riggs seconded the motion, which passed by voice vote.

Mr. Malott stated that he had a conversation with staff on where to redirect the approximately \$50 million involved, and the recommendation was that the money go to Austin Capital, the number one performer.

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

Mr. Jacksha said staff will do this in an orderly manner in the coming weeks in order to protect the value of these assets.

REAL ASSETS ALLOCATION — ERB STAFF

Mr. Jacksha stated that the Board approved a 5% allocation in December to Real Assets, which was described as having a number of potential components, including timber, commodities, energy and infrastructure. He said staff's plan is to invest this sub-allocation as follows: 2% to commodities, 1.5% to timber, farmland and mitigation banking, and the remaining 1.5% in infrastructure.

Mr. Jacksha stated that, accordingly, ORG would like to make a proposal to advise the Board on that particular piece.

**ORG REAL PROPERTY CONTRACT AMENDMENT FOR TIMBER,
FARMLAND
AND MITIGATION BANKING — ORG STAFF**

ORG advisor Steve Gruber was present with Howard Kaplan, owner of Farmvest, Inc. He stated that Mr. Kaplan has 25 years of background in agriculture and timber in the U.S. and internationally, and would act as consultant to ORG with

this proposal, which would identify attractive investments in global architecture and timber complemented by exposure to U.S. mitigation banks.

Mr. Kaplan proposed a non-discretionary consulting relationship to be expanded to include natural resources, renewal resources, timber, agriculture and mitigation banking. He said it would be geographically diversified with returns targeted at 6% real; so assuming a 2% inflation rate, there would be an 8% nominal return.

Mr. Kaplan reviewed matrices reflecting 17 years of returns in bonds, the S&P 500, timber, farmland and urban real estate based on NCREIF data, as well as historic agriculture and timber performance over this period. He also discussed the concept of mitigation banks, which are created, restored or improved wetlands or natural habitats, for which credits are sold to developers and others to offset impacts to similar wetlands and natural habitats. He said this is a wide open market, and the returns that are possible are significantly larger than from other asset classes, and completely uncorrelated to the other asset classes. He stated that they included this area because it is accretive to the portfolio and will improve overall returns.

Mr. Malott said that, as he understood it, ORG was asking to have the contract expanded to include this possibility, but it didn't obligate the ERB to anything, and it would be evaluated on a deal-by-deal basis.

Mr. Jacksha and Mr. Gruber said that was correct; it would be handled in the same way real estate is handled.

Responding to questioning from Mr. Jacksha, Mr. Kaplan said they are estimating that portfolio exposure would break down as 40% timber, 40% agriculture, and 20% mitigation banking, but that would be adjusted as market opportunities arise.

Mr. Jacksha said he has heard concerns from some other people invested in timber that the larger funds are paying up for timberland and now may not be the time to invest in them.

Mr. Kaplan responded that there are indeed financial constraints on the timber industry today, and there are apt to be some good opportunities for bringing patient capital to the marketplace for long-term returns.

Mr. Canavan commented that there are some opportunities where companies have non-core businesses and are beginning to sell off parts of their portfolio that have no strategic purpose, and ORG has relationships with some of these groups and can give access to some of these portfolios. He said staff was attracted to this proposal for that reason.

Mr. Gruber stated that ORG discussed a \$150,000 proposed fee increase with staff.

Mr. Canavan recommended voting for approval contingent upon successful negotiations with ORG.

Mr. Riggs moved recommendation of approval of this contract amendment subject to staff's satisfactory negotiations with ORG. Mr. Lewis seconded the motion, which passed by voice vote.

PROXY REPORTING — QUARTERS ENDED SEPT. AND DEC. 2007

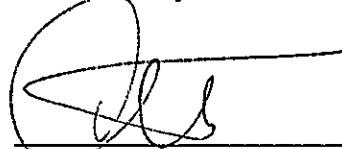
Mr. Jacksha said staff emailed 126 pages of these reports.

Mr. Riggs moved to accept the Proxy Reports. Mr. Lewis seconded the motion, which passed by voice vote.

ADJOURN

Its business completed, the Investment Committee adjourned the meeting at approximately 3:15 p.m.

Accepted by:

A handwritten signature in black ink, appearing to read 'B. Malott', written over a horizontal line.

Mr. Bruce Malott, Chair