

MINUTES OF THE
NEW MEXICO EDUCATIONAL RETIREMENT BOARD
INVESTMENT COMMITTEE

May 14, 2009

CALL TO ORDER

A meeting of the New Mexico Educational Retirement Board Investment Committee was called to order on this date at approximately 1:10 p.m. in the Educational Retirement Board Room, 6201 Uptown Boulevard, N.E., Ste. 203, Albuquerque, New Mexico.

A quorum was present, as follows:

Members Present:

Mr. Bruce Malott, Chair
Mr. H. Russell Goff
Ms. Jan Goodwin

Members Excused:

Mr. Gary B. Bland

Other ERB Members Present:

None.

Legal Counsel Present:

Mr. Chris Schatzman

Staff Present:

Mr. Bob Jacksha, Chief Investment Officer
Ms. LeAnne Larrañaga-Ruffy, Investment Officer
Mr. Steve Neel, Portfolio Manager
Mr. Jeff Riggs, Deputy Director
Mr. Greg Trujillo, IT Director

Others Present:

Mr. Allan Martin, NEPC
Mr. Bill Monagle, NEPC
Mr. Brian Schneider, NEPC [teleconference]
Ms. Michelle Aubel, LFC

APPROVAL OF AGENDA

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

APPROVAL OF MINUTES: April 9, 2009

Ms. Goodwin moved approval of the April 9 Minutes, as submitted. Mr. Goff seconded the motion, which passed by voice vote.

QUARTERLY PERFORMANCE Q1-2009: NEPC

NEPC adviser Allan Martin reported that, since the period ending 3-31-09, the market has rallied in some of the segments where ERB has strategic exposure; for instance, the REIT market has bounced back extraordinarily, and some of the market neutral strategies have started to recover.

Mr. Martin said the ERB's asset value as of 3-31 was \$6.207 billion.

Mr. Martin commented that, even though March performance shows a negative number, the ERB has positioned its portfolio to take advantage of even a modest recovery in the market over the long term. He added that many unusual events in the first quarter and last twelve months, including global de-leveraging and the meltdown in the banking system, had a disproportionate negative effect on the ERB portfolio.

Mr. Martin referred to graphs in NEPC's report reflecting general economic information as of 3-31-09. He noted that the economy remains mired in a deep recession, and GDP is likely to decline again in the first quarter. He said GDP declined 6.3% in Q4, the largest drop in 26 years.

Mr. Martin noted that virtually all segments of the equity markets went down in the first quarter, reflecting ongoing concerns about a deepening recession. He commented that the S&P 500 was down 4.8% per annum for the 5-year period, and for 10 years it was down 3% per annum.

Mr. Martin pointed out that, with respect to some critics who might feel the ERB should put everything in bonds, most professionals would say that this is the worst time ever to do that. He said it is expected that long bonds (particularly government long bonds) will have particularly bad performance going forward.

Addressing alternatives, Mr. Martin said that real estate and private equity in particular are not traded daily in the markets, and the valuations are determined through an appraisal process, and not all properties are appraised on the same cycle. He stated that, as those appraisals come out, the ERB will continue to see bad news in these asset classes.

Mr. Martin stated that there are elements of the ERB portfolio that are conservatively positioned, but the ERB is well positioned for a gradual recovery or better—and while the ERB would be underexposed to equities if there were a sharp upturn in the equity market, its fixed income would come back much sooner.

Mr. Jacksha added that the ERB is “spot on” on its total equity exposure versus its policy—yesterday, its overall exposure was 45.3%.

Mr. Martin reported that, over the last 12 months, the Fund experienced a gross investment loss of \$2.5 billion, with \$155.1 million in net distributions during that period. He said total assets decreased from \$6.6 billion at the beginning of the quarter to \$6.2 billion on 3-31-09.

Mr. Martin also reported that, over the past five years, the Fund returned –0.4% per annum, trailing its policy index by 0.7%, and ranking in the 62nd percentile of the public fund universe.

Mr. Martin said the Fund returned –28.2% for the one-year period ending 3-31-09, trailing its policy benchmark by 2.4% and ranking in the 70th percentile of public funds. He said the Fund posted a –5.5% return for the quarter, ranking in the 45th percentile of public funds—so the strategies the ERB has embraced have been through a tough period, but during the recovery period should recover faster than others may.

Reviewing the Fund Allocation page, Mr. Martin noted that all of the asset classes are within target ranges.

Referring to the fact that the Fund is 4.1% overweight in U.S. equities and 1.4% underweight in international, Mr. Jacksha explained that the ERB hasn't implemented the international small cap yet, so has left that amount in U.S. equities rather than switching into international and then switching again and incurring more transaction costs.

Reviewing a performance attribution chart (gains/losses through policy impact, allocation impact and manager impact), Mr. Martin stressed that the variable NEPC uses to measure the ERB's policy for real estate is the REIT Index. He said that, had institutional real estate been used as the proxy for the real estate policy, the ERB's policy contribution would have been much higher. He commented that REITs behave more like small cap stocks than they do like real estate, and are quite volatile.

Prior to Mr. Martin's review of manager performance, Mr. Jacksha pointed out that there has been a marked positive change in performance since NEPC's 3-31 report. Reporting on Northern Trust's report delivered yesterday, he stated that current assets are at approximately \$6.8 billion and the majority of public securities managers for the calendar year to date were in a positive situation as of yesterday. He said all of the fixed income managers are 200 to 500 basis points over their benchmark for the year to date, and equity manager performance ranges from 100 basis points over the index to 1,000 basis points in the case of Wells.

Following up on last month's Investment Committee meeting, Mr. Jacksha said the ERB did not fire Wells, but did fire Mellon after Mellon declined to negotiate further on fees, and because of their poor performance.

Mr. Jacksha stated that, assuming the trend upward continues through the end of the current quarter and calendar year, the numbers in NEPC's next performance summary will look much more positive. He said the ERB's ranking relative to other public funds would undoubtedly improve, as well.

DISCUSSION OF THIRD PARTY MARKETERS LISTING

As a recap, Mr. Jacksha stated that, after the news about Aldus Equity broke in New York in March, ERB staff did a very quick review of placement agent information available to staff, plus made phone calls to limited partners, etc., to gather more information. He said staff subsequently suggested to the Investment Committee and Board that Aldus be suspended.

Mr. Jacksha said staff (with Mr. Schatzman) subsequently created a formal questionnaire and sent it out to all investment managers. He referred to a spreadsheet developed from the responses received.

Mr. Jacksha noted that, as reported in the press and elsewhere, Marc Correra is named a number of times in association with a number of different companies, either his own or sharing fees with another company. He commented that most troubling was the discovery by staff that this was also the case in some sub-agent situations, because staff had no way of knowing that that was going on. He said not only was the ERB not a party to the original contract between Private Equity Fund A and the GP Third Party Marketer, Company B, but the ERB had no idea that Company B then had another contract with Company C to share the fee with them.

Responding to questioning from Mr. Malott, Mr. Jacksha said Aldus in many cases gave either incomplete or inaccurate reporting on placement agents.

Mr. Schatzman commented that the pattern suggests that there was an attempt to deceive as opposed to sloppy reporting.

Mr. Jacksha distributed a timeline of staff's repeated attempts to get Aldus to provide placement agent information. He said it took about six months for Aldus to provide the information, some of which was incorrect and Aldus was asked to correct the information provided on their investment memorandums. He said staff did not discover Ajax Investments, LLC was connected with Marc Correra until late last year.

Mr. Malott asked Mr. Jacksha to bring any such difficulties with a manager to the Board's attention in the future.

Mr. Goff asked what steps are being taken to strengthen contracts.

Mr. Malott said he has written up some recommendations for strengthening contracts and those will be on the agenda for the next meeting.

Mr. Jacksha added that, since all of the news has broken, no new contracts have been completed. He said there is a new statute related to placement agent disclosure information, laying out what must be disclosed and making it a fourth degree felony for a manager or consultant to fail to disclose this information.

Referring to the Governor's request that there be no payment of third party placement agents for the next six months, Mr. Schatzman stated that any contracts entered into over the next six months would include that stipulation, and that would also apply to any investments in contracts currently under suspension. He said staff is also discussing fee amounts, terms, principals and so forth.

Mr. Jacksha said he stated before the LFC that he has not met with Marc Correra since joining ERB . He added that he and Mr. Neel did meet with Martin Cabrera once, but on a deal that never took place. He stated that he also told the LFC that placement agents were not previously viewed by anybody as a real priority item—based on contract language, the ERB does not directly pay those fees and if the general partner pays the fee out of the fund, he reimburses the ERB. He said he also pointed out to the LFC that staff compares fees with other funds to ensure that ERB does not pay more than the “going rate” for the kind of fund involved.

Mr. Schatzman said there are four transactions involving placement agents that the ERB has ceased negotiations on. If the Investment Committee approves them going forward, he said the ERB will redo the due diligence if the Committee so directs and no placement agent fees will be paid.

Mr. Malott asked staff to schedule a special meeting/work session to discuss best practices, investments going forward, payment of fees, and other issues.

Mr. Schatzman pointed out that one of the four transactions, Lee Equity, has a placement agent in place. He said it will be up to the Board to adopt or not adopt the policy prohibiting the payment of third party fees; and while the Governor has asked for six months, the Board can choose any length of time it wishes if it decides to adopt the policy.

Mr. Malott said he also plans to suggest that NEPC look at every private equity deal the ERB has done and whether these are deals the ERB should be in. [There was further discussion on this under the next agenda item.]

Mr. Jacksha and Mr. Neel stated that staff plans to schedule a work session that includes outside experts in various fields.

Mr. Malott said the Board should be included in that session.

PRIVATE EQUITY — PERFORMANCE Q4-2008: NEPC

NEPC Partner and private equity consultant Bill Monagle reviewed NEPC's fourth quarter performance report, including trailing performance, performance by lifecycle, vintage year and strategy.

Mr. Monagle noted that the ERB experienced a negative fourth quarter, earning a nominal IRR of -12.42%. He said the portfolio has an IRR of -30.76% for the trailing 12-month period.

Referring to Mr. Malott's earlier suggestion that NEPC go back and look at all of the private equity deals the ERB has done, Mr. Jacksha asked Mr. Malott if he was suggesting that the ERB might not want to continue with some of the deals.

Mr. Malott responded that, if the ERB has entered into a deal where it has been misled, and the deal was not a good one to start with, and there are bad managers involved, the ERB should consider whether it wants to write any more checks.

Mr. Monagle agreed that NEPC could develop facts on each deal and determine whether NEPC would have recommended an investment at the time it was originally brought forward by Aldus.

Mr. Schatzman said he would have to determine whether or not these business and investment evaluation discussions could take place in executive session. He noted that staff has already referred a number of matters to outside counsel to evaluate the ERB's legal position on various contracts, including not just termination but probable causes of action.

Mr. Monagle reviewed the format of performance reports that NEPC would be presenting to the ERB.

Mr. Monagle then reviewed a Private Equity Program Review and 2009 Strategic Investment Plan.

Mr. Monagle noted that the ERB has committed \$295 million to 2009 vintage year funds. He recommended that the commitment pace for 2009 be reviewed with the possibility that the fund may have overcommitted.

Mr. Monagle reviewed a proposed schedule with the goal of \$175 million to \$200 million in commitments in each year between 2009 and 2012.

Mr. Martin noted that NEPC's other clients typically have their governing board approve the commitment schedule each year. He said this sets the stage for staff and NEPC to find the managers to fill the slots.

PRIVATE EQUITY INVESTMENT REVIEW: LEXINGTON PARTNERS VII

Mr. Jacksha noted that Lexington Partners originally had Parkhill Group as placement agent and asked Mr. Neel if that was the case with today's proposed investment. Mr. Neel responded that the Parkhill relationship is for new LPs, so doesn't apply to ERB as a returning investor.

Mr. Monagle distributed a market overview report on secondary strategies that included a report on Lexington Capital Partners VII, L.P.

Mr. Jacksha stated that the Investment Committee previously approved a \$45 million commitment in Lexington Capital Partners VII, and asked Mr. Monagle to comment on the size.

Mr. Monagle responded that NEPC plans to look at the investment pace and the actual commitment in relationship to the overall total to be committed in 2009. He added, however, that exposure to secondaries provides for broad diversification.

Mr. Jacksha recommended staying with the \$45 million commitment and making adjustments as necessary with other commitments.

Ms. Goodwin moved that the Investment Committee authorize NMERB staff to negotiate investment documents for a commitment of \$45 million to Lexington Capital Partners VII, L.P., previously approved on March 12, 2009.

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

Mr. Schatzman noted that there were no placement fees associated with this commitment.

PRIVATE EQUITY: TERMINATION OF ALDUS CO-INVESTMENT CONTRACT

Mr. Jacksha stated that the ERB has invested about \$5 million of the total \$75 million commitment involved in this contract.

Mr. Jacksha said there are two clauses in the Aldus Co-Investment contract that allow the NMERB to withdraw. He said one allows the NMERB to withdraw anytime it wishes with 90 days' notice; however, if it does that, there is a continuing carry to Aldus on existing investments. He stated that there is also a clause regarding dissolution of Aldus Equity Partners, which appears will happen, so the ERB could withdraw under either or both of those clauses with 90 days' notice.

Mr. Jacksha stated that staff is reviewing what options are available to the ERB and then will make recommendations to the Board.

Mr. Jacksha asked for authority to terminate the contract.

Mr. Goff moved that the Investment Committee terminate the Aldus co-investment agreement and authorize NMERB staff to initiate appropriate legal action necessary to recoup expenses incurred in association with the program and avoid any further payment to Aldus Equity.

Ms. Goodwin seconded the motion and it passed 3-0 by voice vote.

PRIVATE EQUITY INVESTMENT REVIEW: NGP ENERGY TECHNOLOGY PARTNERS: NEPC

[Postponed.]

PRIVATE EQUITY: NEPC CONTRACT

Mr. Schatzman stated that a revised version of the contract with NEPC as private equity adviser (pending staff's preparation of an RFP) was distributed last night by outside counsel, and he would like additional time to discuss some changes with him. He said the final form of the contract would be available to give to NEPC on Monday.

Mr. Schatzman stated that he would like language stating that, when the Board adopts a placement agent policy, the contractor will be subject to it, but in the interim with the Board's approval there will be no placement agents.

ABSOLUTE RETURN STRATEGIES: GOTTEX MARKET NEUTRAL EMERGENCE FROM SUSPENSION

Mr. Neel reported that, in February, the Investment Committee voted to continue in Gottex's Market Neutral Plus fund contingent upon a successful due diligence visit completed within 120 days. He said the due diligence visit is scheduled for June 10-11, and in that spirit staff is recommending the election of retention share class contingent upon the aforementioned successful due diligence visit. He said this would be a sister fund.

Mr. Neel noted that Gottex is reducing their management fee from 1% to 65 basis points, and they are in effect giving a high water mark based off of the leverage share class, which means they will be working for a management fee until they recoup approximately 30%.

Mr. Neel also pointed to NEPC's recommendation that the ERB retain Gottex.

NEPC adviser Brian Schneider stated that, as a way of addressing their 2008 performance, Gottex has made some changes to their portfolio construction that NEPC feels will be an enhancement going forward. He said the team is intact, and Richard Leibovitch has been promoted to sole CIO. He stated that Mr. Leibovitch is located in

Boston and is a very strong individual for Gottex in the portfolio management role. He said NEPC sees it as a good sign that Mr. Leibovitch now has sole discretion.

Mr. Schneider said Gottex has also added a macro team to their process, and Kevin Maloney has been promoted to head of the risk department. He said both of these are considered by NEPC to be positive changes.

Mr. Jacksha noted that the ERB always retains the right to give Gottex a redemption notice under the normal terms of the contract, which would be contingent upon the results of the due diligence visit.

Mr. Schneider stressed that there would be no lockup for clients in the continuing share class.

Ms. Goodwin moved to authorize staff to elect the continuing share class for Gottex. Mr. Goff seconded the motion, which passed by voice vote.

PROXY REPORTS Q1-2009

Ms. Goodwin moved to approve the March quarter proxy voting. Mr. Goff seconded the motion, which passed by voice vote.

OTHER INVESTMENT REPORTS

Mr. Malott said he would like the Board to hold a brief special meeting to dispense with the Aldus issue and other action items.

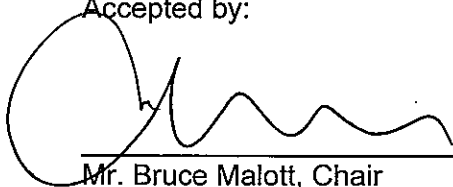
Mr. Malott stated that, after the June Board meeting, he would like to schedule an all-day educational work session.

Mr. Schatzman requested that the work session be held during the week of June 15.

ADJOURN

Its business completed, the Investment Committee adjourned the meeting at approximately 3:45 p.m.

Accepted by:



Mr. Bruce Malott, Chair

