

MINUTES OF THE
NEW MEXICO EDUCATIONAL RETIREMENT BOARD
INVESTMENT COMMITTEE/PRIVATE EQUITY COMMITTEE

~~February 22, 2007~~

April 12, 2007

CALL TO ORDER

A meeting of the New Mexico Educational Retirement Board Investment Committee and Private Equity Investment Committee was called to order on this date at approximately 12:00 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. Gary B. Bland [arriving 12:30]
Mr. Jeffrey M. Riggs

Members Excused:

Mr. James Lewis

Other ERB Members Present:

None.

Legal Counsel Present:

Mr. Robert Shulman

Staff Present:

Mr. Frank C. Foy, Deputy Chief Investment Officer
Mr. Bob Jacksha, Chief Investment Officer
Mr. Steve Neel, Portfolio Manager
Ms. LeAnne Larrañaga-Ruffy, Investment Officer
Mr. Greg Trujillo, IT Network Specialist

Others Present:

[See sign-in sheet.]

APPROVAL OF AGENDA

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

GOTTEX FUND PRESENTATION: RICHARD LEIBOVITCH, SENIOR MANAGING DIRECTOR, NORTH AMERICA; GEORGE YEPES, MANAGING DIRECTOR, DISTRIBUTION (WORKING LUNCH)

Mr. Neel said the Investment Committee will be asked to make a recommendation to the Board regarding investment in Gottex Funds Market Neutral Plus Fund.

Mr. Neel referred to a staff memorandum outlining the issues, which included a due diligence report and performance data.

Mr. Neel stated that, in February, the Committee met to reallocate fund equities to absolute return strategies, and this is part of that process. He added that Gottex has since closed their Market Neutral Fund, and the proposal today is to go into the Market Neutral Plus Fund with a \$115 million investment.

Richard Leibovitch, senior investment partner and portfolio manager of the Gottex Market Neutral Fund and the Market Neutral Plus Fund, and head of the North American business for Gottex, appeared before the Committee with George Yepes, head of North American distribution for Gottex and client relationship manager to the ERB.

Messrs. Leibovitch and Yepes reviewed a slide presentation.

Mr. Leibovitch said Gottex is a fund-of-hedge-fund group headquartered in Lausanne with offices in New York, Boston, London, Lausanne and Hong Kong. He said there are now 94 employees, with investment professionals in all the major centers. He said Gottex is independently owned, and the equity is widely distributed amongst the senior staff of the firm. He stated that Gottex has been regulated since its inception with the SEC in the United States, FSA in the UK, and the Swiss authorities and Hong Kong authorities.

Mr. Leibovitch said assets under management as of March 1, 2007, were \$8.7 billion, and as of April 1 are almost at \$10 billion; as a result of this significant inflow, they have decided to close their Market Neutral Fund. He explained that they told their investors a long time ago that when the Fund reached \$6 billion in assets under management, they thought they would close the Fund and revisit the capacity

within the Fund. At the same time, he said, they wanted to use that opportunity to create a new Fund where they could make some minor structural tweaks to actually improve the Market Neutral Fund. He said the new Fund, which will be launched on May 1, is very similar to the previous one with a couple of minor adjustments to improve performance at the margin of the Fund.

Mr. Leibovitch said Gottex invests in hedge funds that are market neutral, where hedge fund managers don't take directional bets on the market, and so they don't invest in 70% of the hedge fund universe. He said that includes equity long-short managers that typically have a long equity bias, macro hedge fund managers or CTAs (quantitative commodity trading advisors). He stated that they prefer to focus on hedge funds that do arbitrage and that are neutral with respect to bond markets, stock markets and commodity markets, so that any shock to those markets should not impact the performance of these Funds.

Mr. Leibovitch said they have created a diversified portfolio of market neutral managers, that is their area of expertise, and about 90% of their assets are in this category.

Mr. Leibovitch reviewed Gottex's client base, noting that most of their clients are in the pension or institutional category, and just over one-third of their assets are with pension funds, insurance companies and asset management firms. He said 50+% of their clients are European, but North America is rapidly growing — at the end of 2006, it was 17%, and today it is about 25%.

Mr. Leibovitch said their team is broad and seasoned in the area of derivatives, arbitrage and hedge funds, and their Market Neutral portfolio is headed by himself and Peter Bennett, who is based in Hong Kong. He stated that the Gottex investment team overall has 30 members, and is headed by himself, Peter Bennett and JP Bailey. He said there are 20 analysts on the team, each assigned to a particular strategy, with experience ranging from 5 to 25 years. He said they tend to hire analysts who have themselves traded the underlying investments at some point in their career.

Mr. Leibovitch said Gottex also has an independent risk team that reports independently to the CEO. He stated that these people do operational due diligence and risk monitoring and risk compliance — so it is an extra set of eyes on the portfolios that is independent of the investment team.

Responding to questioning from Mr. Malott, Mr. Leibovitch commented that there is almost no such thing as a "market neutral" manager because the only thing that is truly market neutral is an arbitrage, and there are few in the world today. He said, "What we mean by market neutral is that the managers aren't taking any intentional directional bets — that when they do take bets, they tend to be on slightly more complex areas where they may be correlated to the broader markets, but it's

not an explicit bet on the direction of the market.” He said Gottex feels that people who take directional bets on the market generally have low risk adjusted returns while generating a lot of volatility, and this is not consistent alpha. He said Gottex wants to make an equal amount of money in their Fund each month regardless of whether the markets are going up or down.

Mr. Leibovitch said financial markets have evolved over the last decade to the point where there are 15 very distinct market-neutral strategies, and Gottex invests in a wide array of them, and this has reduced the risk of their fund-of-funds portfolio by having allocations in all of them.

Mr. Leibovitch said Gottex allocates no more than 15% of the Fund’s capital to any one strategy; and typically, the average allocation is in the 8-9% range. He also noted that they have no more than 4% in a particular hedge fund manager.

Mr. Leibovitch stated that Gottex’s goal is to keep a low-risk fund-of-funds that generates a reasonable return for the risk being taken, and in their unlevered share class they have been able to generate LIBOR + 400 basis points annually for the last 7-8 years.

[Mr. Bland joined the proceedings.]

[Ten minute break.]

Mr. Leibovitch stated that, to approve a fund, Gottex has at least separate visits by the senior investment professionals, and they conduct a separate operational due diligence on the managers, do background checks, negotiate favorable terms to the extent possible, and tend to focus on managers with long track records.

Mr. Leibovitch reviewed fund performance of the Gottex Market Neutral Fund, with YTD returns in Class D shares (through February) of 3.79% and 2006 returns at 11.42% with low volatility of 3.88%, resulting a Sharpe ratio of 2. He said this ranks among the highest performing fund-of-funds on a Sharpe ratio basis.

Mr. Leibovitch stated that the philosophy of the Market Neutral Plus Fund (“MN Plus”) is identical to that of the Market Neutral Fund: It is a fund-of-funds that is going to invest in hedge funds that are individually market neutral in a diversified portfolio. He said what is different is that MN Plus will be able to invest in some funds that the Market Neutral Fund does not invest in because of liquidity constraints. He commented that the Market Neutral Fund is very liquid; because of that, they have to invest in hedge funds that are themselves liquid. He said some of the best opportunities in hedge funds tend to do with managers that want the money for longer periods of time, and this is a challenge for Gottex. He said the idea behind MN Plus is to make the liquidity a bit more restrictive to their investors,

and in turn that will enable Gottex at the margin to invest in a few hedge fund managers it would otherwise not have invested in Market Neutral.

Mr. Leibovitch stated that MN Plus should generate another percent of return than the LIBOR + 4% because of liquidity and concentration, with volatility about 1/2% higher. He stated that most of their investors will probably be in the unlevered share class.

Mr. Leibovitch concluded his presentation and stood for questions.

Mr. Bland stated that he was "very comfortable here with the reallocation," and pleased with this selection.

Mr. Riggs asked how big this Fund was expected to get, and Mr. Leibovitch responded that, given the state of the market today, they think the Fund will be about \$2 billion to \$3 billion in size. At that point, he said, they will shut down their market neutral strategies completely.

Mr. Bland moved that the Investment Committee recommend to the Educational Retirement Board to approve an investment in Gottex Market Neutral Plus Fund of \$115 million contingent upon New Mexico State law, Educational Retirement Board policies, and negotiation of final terms and conditions and completion of appropriate paperwork.

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

RECESS: 12:45 p.m.

[There was a recess called from 12:45 until 4:20 p.m., during which time the Committee interviewed and evaluated real estate consultant RFI finalists.]

RECONVENE: 4:20 p.m.

The Committee reconvened at approximately 4:20 p.m.

MOTION FOR APPROVAL OF REAL ESTATE CONSULTING CONTRACTS

Mr. Bland moved to allocate \$400 million to ORG Group for general real estate consultation and \$50 million to Courtland Partners for infrastructure consulting, subject to staff's negotiation of appropriate contracts.

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

APPROVE INVESTMENTS: ALDUS EQUITY

Psilos Group Partners III, L.P.

Psilos Group founder and managing general partner Dr. Albert Waxman appeared before the Committee with colleagues Steve Krupa and Darlene Collins and gave a slide presentation.

Also present were Saul Meyer and Holland Gary of Aldus Equity Partners.

Dr. Waxman stated that Psilos has offices in San Francisco, New York and Santa Fe, with a focus on the intermountain region. He said they have a very interesting pipeline in New Mexico and in Colorado at the current time.

Dr. Waxman said they have closed on \$195 million in this Fund, and will close on another \$50-\$60 million in the next two months, which will exceed their targeted fund size of \$250 million. He said they will cap the Fund at \$300 million.

Mr. Krupa said Psilos I (\$111 million, 1998-99 vintage) was a top quartile fund, and Psilos II (\$140 million, 2000-01 vintage) was a top decile fund.

Mr. Krupa stated that Psilos focuses on the healthcare economy and invests in four elements in particular: healthcare services; healthcare information technology; medical devices, and specialty pharmaceuticals. He said they look for businesses that address the economic needs of healthcare,

Mr. Krupa said there are 17 healthcare companies in Fund II, 15 of which will be successful investments.

Dr. Waxman said Psilos sits on the boards of all of its companies, although in general they do not have majority positions, representing 40-45% of the chairmanships. He added that they have never suffered a negative vote in the approximately nine years they have been in this business.

Mr. Malott observed that this Fund will be twice the size of the previous one, and asked if there will be a change in strategy to go with that.

Mr. Krupa responded that, in Fund II, they were very good syndicators of their portfolio company deals to other venture funds, so they are expecting to put larger amounts of capital into roughly the same number of deals.

Mr. Meyer asked how long their investment period would be on this Fund, and Dr. Waxman responded that they have invested in five companies and a sixth has been selected. He said they would probably invest in 12-15 companies and he

personally would be surprised if this Fund lasted more than a total of 4 to 4-1/2 years, and they are already 18 months into it.

Mr. Krupa said he thought that was correct, assuming the deal flow remains as strong as it is now.

Dr. Waxman stated that all of the partners will invest a total of \$13 million into the Fund, representing 5%, and he is the largest single investor. He said this is a significant amount of the partners' net worth.

Mr. Neel asked for discussion on the fact that, while Psilos is focused on the healthcare industry, it does not have medical doctors and nurses in the partnership.

Dr. Waxman stressed that Psilos has a very strong appreciation of the whole thrust of healthcare and has a large set of advisors that they specifically pick for the various areas of healthcare. He said one of their advisors was one of the country's top cardiologists with expertise in angioplasty in connection with one investment, and they also consulted with some of the country's leading endocrinologists in connection with another investment.

Ms. Collins stated that the bandwidth of Psilos' investment professional team is also noteworthy, as all of the partners come from the healthcare sector and sit on multiple national advisory boards with colleagues who represent numerous different subsectors within the healthcare industry. She said they tap this broad expertise as it is needed.

Mr. Krupa noted that that MD-based venture funds also need to bring in specialists as necessary. He added that Psilos brings in the best doctors they can find when there is a due diligence process involving a clinical outcome issue that is pivotal to an investment.

Mr. Jacksha noted that Psilos is a venture fund with some early stage investments, and asked how they mitigate the downside in early stage investments particularly.

Dr. Waxman responded that their goal is to eliminate anything that doesn't work. He said they invest where the business principle is good and the people they are investing in will have a lot of business. He stated their goal is to invest at the time they are past proof of concept, yet where they can get it at the right price and make an important enough contribution that they can enhance value.

Dr. Waxman said Psilos went through the "nuclear winter" of venture capital in 2001-03 and worked hard with the companies to get through this period. Mr. Krupa added that this experience strengthened the partnership.

Mr. Gary reviewed Aldus' investment memorandum to the Committee. He said Aldus found Psilos' strategy to be distinctive and compelling from an economic standpoint in terms of the alignment of interest across all of the constituencies and the stakeholders in the healthcare industry.

Mr. Gary also stated that their approach to risk mitigation, in terms of finding things that have been proven out, being actively engaged, and bringing in the necessary expertise to the table, was supported by the reference calls that Aldus made as part of the due diligence process.

Mr. Gary stated that Aldus "sliced and diced" Psilos's track record a couple of different ways to align with the focus and strategy of Fund III, and found remarkable consistency. He said Aldus was impressed with relatively low volatility in their venture investments during a difficult time, and also with the ability to drive more than one set of strong returns that have since exited.

Mr. Gary also noted that

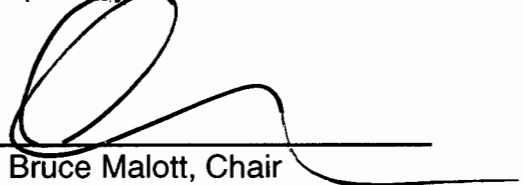
Mr. Bland moved that the PEIC approve a commitment of \$10 million, not to exceed 20% of the committed capital of the fund, to Psilos Group Partners III, L.P. subject to and contingent upon New Mexico state law, Educational Retirement Board policies and negotiation of final terms and conditions and completion of appropriate paperwork.

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

ADJOURN

Its business completed, the Investment Committee/Private Equity Committee adjourned at approximately 5:15 p.m.

Accepted by:



Mr. Bruce Malott, Chair