A meeting of the New Mexico Educational Retirement Board Investment Committee was called to order on this date at 12:00 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. H. Russell Goff, Chair
Ms. Mary Lou Cameron
Ms. Jan Goodwin

**Members Excused:**
None.

**Legal Counsel Present:**
None.

**Other ERB Members Present:**
Dr. Thomas McGuckin

**Staff Present:**
Mr. Bob Jacksha, CIO
Mr. Mark Canavan, Real Estate Portfolio Manager
Mr. Alan Myers, Investment Financial Analyst
Mr. Steve Neel, Deputy CIO
Mr. Jude Perez, Portfolio Manager

**Others Present:**
Mr. Allan Martin, NEPC
Mr. Kevin Tatlow, NEPC
Mr. Steve Gruber, RAPM
Mr. Howard Kaplan, RAPM
Ms. Judith Beatty, Recorder

**APPROVAL OF AGENDA**

“Approval of Minutes of 5/24/12” was amended to reflect the correct date of 6/14/12.
Ms. Goodwin moved approval of the agenda, as amended. Ms. Cameron seconded the motion, which passed unanimously by voice vote.

**APPROVAL OF MINUTES: June 14, 2012**

Ms. Goodwin moved approval of the June 14 minutes, as submitted. Ms. Cameron seconded the motion, which passed unanimously by voice vote.

**AMERRA AGRI FUND II, L.P. – REAL ASSETS APPROVAL**

Mr. Canavan appeared before the Committee with Howard Kaplan of RAPM and reviewed ERB staff’s recommendation of a $50 million investment in AMERRA Agri Fund II, L.P.

Mr. Canavan discussed why agriculture is a defensive investment with low correlation to other asset classes that also provides a hedge against inflation and downside protection in economic contractions. During the most recent downturn, the NCREIF Agriculture Index was up 15.8%, 6.3%, 8.8% and 15.2% for 2008, 2009, 2010 and 2011 respectively. Additionally, for the period ended March 2012, returns for the one, three and five year periods were 16.7%, 10.9% and 12.7%. He said this resiliency, in the face of one of the worst financial and economic downturns in history, is because agriculture provides for fundamental human needs regardless of the economic environment.

Mr. Canavan explained that AMERRA lends money to businesses in primarily agricultural industries, e.g., producers, processors, and distribution channels. He said they provide this financing through either senior secured debt – historically, 75% of their financing has been through senior secured debt, which is highly collateralized. Another tranche (about 20%) is junior debt, which is also frequently collateralized. He said the average secured loan has 110% to 150% collateralization.

Mr. Canavan stated that the most compelling factor arguing for investment with AMERRA is its management team. The firm’s five key personnel have 125+ years of combined experience in the field, and the core of the team has worked together for over 18 years investing in precisely the same markets and strategies offered in Fund II. Prior to the Fund, Craig Tashjian and Nancy Obler worked together at Société Générale, starting in 1997. Mr. Tashjian is responsible for having developed SocGen’s Commodities and Trade Finance group; and Ms. Obler led the soft commodities component of the platform.

Ms. Goodwin asked how AMERRA ensures good diversification in commodities in either the processor or the end purchasers, and Mr. Canavan responded that there are concentration limits imposed in any single region, country or commodity. Mr. Kaplan added that, based on what they have done in the past, they are very broadly diversified across different commodities; there is a 15% limitation on any single borrower.
Responding to Dr. McGuckin, Mr. Canavan said there have been only two defaults on loans made by AMERRA, and in both cases recovery was in the 50% to 75% range.

Responding to Chairman Goff’s concerns about losses from this year’s drought, Mr. Kaplan stated that, although this year’s drought has been the worst in decades, crop insurance covers up to 85% of the production. He commented that the insurance payment is many times better than what would have been realized through crop yield.

AMERRA principals Craig Tashjian and Nancy Obler appeared before the Committee with placement agent Frank Pfeffer of MD Sass and made a presentation.

-- AMERRA has invested $900+ million to date ($50 billion in prior organizations)

-- AUM of about $530 million

-- MD Sass and Macquarie Bank were AMERRA’s two sponsor capital investors.

-- Investment focus is in upstream and midstream agricultural companies (commodity producers, processors and distributors) in the Americas. AMERRA’s investments are in debt instruments that are obligations of these companies.

Mr. Tashjian said AMERRA underwrites loans largely in the private sector, as there are very few publicly available entities to investors. He said these companies are very appealing to AMERRA because the markets tend to be very inefficient; so on a relative risk basis, they can find very attractive returns on capital. At the same time, he said these companies have limited access to public equity and public debt markets, so rely on AMERRA to become their capital providers.

Mr. Tashjian commented that today is a very interesting time in the history of agriculture – population growth, people earning more income, and a desire to move diets in the emerging markets from rice and beans to chicken, pigs and eventually to beef has created an escalating demand for grains and soybeans that feed the animals and the uptick in diet. He said this puts more demand on the finite resources in agriculture – water, land, and soil – and there is more pressure for the industry to meet this demand. At the same time, the supply of capital to this sector is getting constricted; while the banking market for this sector has traditionally been coming from European multinational banks they now are under pressure to reduce activities and move away from foreign markets. He stated that this is where AMERRA is solving this challenge, but the demand is greater than what AMERRA can supply, and this allows them to pick and choose opportunities.

Mr. Tashjian reviewed correlation and volatility statistics of AMERRA’s Agri Fund and Agri Offshore Fund compared to other major asset classes. He stated that AMERRA is very proud of its volatility measures.
Responding to Mr. Jacksha, Mr. Tashjian said AMERRA lends in dollars and is repaid in dollars, largely because the borrower is actually conducting their business in dollars.

Responding to Ms. Goodwin, Mr. Tashjian said that, rather than lending to the company and taking the commodity as security, in some instances the company will sell AMERRA the underlying commodity and AMERRA purchases a sales contract at the same time – so AMERRA has bought it at a price and sold it at a price, typically to the end user.

Dr. McGuckin asked how AMERRA could be affected if banks began to aggressively move into this space.

Mr. Tashjian responded that, if the banks do come back, he and Ms. Obler believe they will not necessarily go into the same profiles that AMERRA is as far as the types of transactions they are doing. He said banks have not been very involved in production loans before this, particularly in Latin America. Additionally, AMERRA believes commodities will remain dollar based, in which case producers will want dollar loans or they are running a risk themselves. He said European banks do not have dollar deposits, so would have to enter into swaps to turn their euros into dollars, which adds risk.

Ms. Obler described the loan process and how loans are priced and secured.

Ms. Goodwin noted that the documents limit AMERRA’s investments in energy and metals to 20%, but she observed that AMERRA has no investments in these sectors at the current time.

Mr. Tashjian said he managed a large metals and energy business previously when he was in banking, and had quite a few robust relationships with industry groups in that world. Although AMERRA hasn’t made any investments in energy or minerals to date, they have been approached and might consider a small percentage but only with the same franchise of historical banking clients.

[Mr. Tashjian and Ms. Obler left the proceedings.]

Mr. Jacksha said this is a specialist team working in private companies where there is an information advantage, and staff feels AMERRA is well positioned to take advantage of that, given their expertise and experience. He stated that they are operating in a market where there is less competition from the large banks, allowing for better pricing and more opportunities; and this represents relatively secure financing transactions. With this combination of factors, and the fit for the portfolio as discussed in Mr. Canavan’s report, he feels this is a good investment for the ERB.

Dr. McGuckin commented that he understands the need to take risk in order to get return, but this appears somewhat riskier than the other investments the Committee has looked at, given the volatility of the commodities market.
Mr. Jacksha responded that he feels AMERRA has taken reasonable steps to mitigate that risk, depending on how a given transaction is structured; for instance, they require the producer or processor to hedge his forward sale, or they have a contract from someone where they can mitigate the commodity volatility pretty well, or take 150% collateral interest and then re-price.

Mr. Kaplan noted that they keep track of the collateral value; and if that value were to fall, loan covenants allow them to sit down with the borrower and increase the level of collateral if it reaches a certain point. He said that is another important indicator of their cautious and conservative approach to making the loans.

Ms. Cameron moved that the IC approve a commitment of $50 million to AMERRA Agri Fund II, 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. Ms. Goodwin seconded the motion, which passed unanimously by voice vote.

**ROBECO EMERGING MARKETS EQUITY CONTRACT EXTENSION**

Mr. Jacksha stated that Robeco is one of the ERB’s two emerging markets equity managers (the other being Alliance Bernstein), and their contract expires September 30.

NEPC adviser Allan Martin recommended that the ERB extend the contract currently in place with Robeco Group, N.V. for two years, but that Robeco be watch listed for performance.

Mr. Martin said NEPC will continue to monitor the performance of the portfolio throughout the remainder of the year, and suggests a full evaluation of the allocation to non-U.S. emerging markets in the coming months. This could include a search to potentially replace Robeco, depending on the results of the monitoring.

Mr. Martin said both of the ERB’s emerging market equity managers have underperformed in recent times, but Robeco has clearly done better than Alliance Bernstein over the three years, with less change to their organization and process.

Mr. Martin said there are several reasons why a change is not being recommended at the current time:

-- NEPC believes active managers will do better than passive managers in the emerging markets equities space.

-- The philosophy and process employed by Robeco to construct this portion of the ERB portfolio remains intact.

-- NEPC believes that this business is mean reverting; i.e., a manager that does well in one period is more likely to do less well in the next period, and so on.
This is a market where the cost to change, even moving to passive, is high. Depending on the portfolio, the cost is 3% or 4%.

Mr. Martin also stated that Robeco was unable to fully invest the portfolio until several months into the relationship, which contributed to some of the underperformance. The administrative process of establishing custody banking relationships in some foreign countries (Chile, India and Taiwan, for example) can be quite bureaucratic and can take several months to complete.

Chairman Goff asked NEPC to report to the Committee every six months on Robeco’s status.

Ms. Goodwin moved that the IC approve an extension of the Robeco Emerging Markets equity contract to September 30, 2014, 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. Ms. Cameron seconded the motion, which passed unanimously by voice vote.

ALLIANCE BERNSTEIN – REVIEW OF PUBLIC EQUITY MANDATES

Mr. Jacksha stated that AllianceBernstein manages two accounts for the ERB. One is in the Emerging Markets space, and the other is in the EAFE space for developed non-U.S. countries (International Strategic Value strategy).

Mr. Jacksha stated that the EAFE product has substantially underperformed for a long time, and he is inclined to go out for an RFP for replacement. He said staff has agreed to grant a request by Alliance to make a presentation to the Committee today explaining the reasons for their underperformance; and certainly Alliance will have the opportunity to respond to the RFP when it is issued.

Offering some history, Mr. Jacksha said the ERB used to have AllianceBernstein Emerging Markets Value and Growth combined in a 50-50 portfolio. The growth side had a lot of problems, while the value side was doing well, and the ERB instructed them to eliminate the growth side. Since then, the value side has not done terribly well, but only six months have elapsed. He said staff would like to continue with them, but with monitoring.

Mr. Martin stated that NEPC originally recommended terminating the International Strategic Value contract with Alliance and distributing the assets evenly between Pyramis and Barings, the Fund’s remaining active non-U.S. developed markets equity managers. He added, however, that this is a costly transaction; furthermore, Pyramis is a core manager and Barings is a growth manager, so the ERB would lose some of the value exposure in the portfolio.
Mr. Martin said Mr. Jacksha has suggested instead that the ERB issue an RFP; that way, NEPC and staff can bring forward a recommended change that would include the possibility of a passive manager. Upon reflection, NEPC feels that staff’s recommendation is more sensible.

Mr. Martin commented that NEPC feels a search is appropriate right now because 1) there have been organizational changes that have had more impact on the international strategic value product; 2) the magnitude of the underperformance is greater than it was in the emerging markets case; and 3) there are more options to consider to replace them, including the passive option. NEPC feels passive could be a good option in the international developed market.

Mr. Jacksha said Pyramis is a core manager, with Barings on one side of the barbell as a growth manager and Alliance on the other side providing value. He commented that replacing Alliance with an index fund would create a bias toward growth, which is not necessarily a good thing. Since the original idea was that the growth manager and value manager would outperform their respective indexes, then a consideration might be to eliminate the growth manager as well and go to the index.

Henry D’Auria, Chief Investment Officer, Emerging Markets Value Equities, and part of the team managing the international portfolio, appeared before the Committee with Managing Director Joe Lawrence. Mr. D’Auria and Mr. Lawrence made a presentation.

-- AllianceBernstein is in the top ten of global equity asset managers in the world.

-- AllianceBernstein has revenues of $2.5 billion, operating income of $400+ billion and an A1/A+ credit rating, with zero long-term debt.

-- AllianceBernstein’s portfolios have outperformed strongly when spreads narrowed. For the period April 2001 – June 2007, emerging markets value had a 31.6% annualized return (cumulative 456%).

-- Since the financial crisis, people have shied away from risk taking. In the past year, value stocks have underperformed expensive stocks by 13%. For the last three years, cheap stocks have underperformed expensive stocks by 11% a year. As a result, while the emerging portfolio managed for the ERB hasn’t always been as deep value as the one today, the one today is positioned to benefit the most from what Alliance believes will be a future resurgence of cheap stocks.

-- During Q2 2012, lower growth forecasts for key emerging market economies hurt Alliance’s holdings in financials, energy, technology and homebuilders. Stock selection in industrial commodities and capital equipment, and a rebound in Turkish banks, contributed most. Biggest detractors held are trading at 10-year lows.

-- The global retreat from risk has left high-beta stocks excessively cheap and low-beta stocks excessively expensive versus history. Thus, Alliance can build a portfolio of cheaper stocks whose balance sheets are as good as the balance sheets of the defensive companies.
-- Past periods of similarly extreme beta valuation disparity have signaled outsize performance of high-beta stocks. Each time when there have been spreads as wide as they are today, in the following year the high-beta stocks have outperformed the market significantly.

**International**

-- Value opportunity is still high. The spread between expensive and cheap stocks is among the highest in history. The ERB portfolio is positioned to be solidly in cheap stocks and to capture the rebound.

-- Low-beta “safety” stocks have become more expensive as the market focuses on near-term certainty while value stocks are more volatile than usual.

-- ERB portfolio continues to emphasize companies with strong earnings and cash flows, offering a deep discount to the market without sacrifice in quality.

[Messrs. D’Auria and Lawrence left the proceedings.]

**Ms. Cameron moved that the IC authorize staff to conduct an RFP process for an EAFE value equity manager. Ms. Goodwin seconded the motion, which passed unanimously by voice vote.**

Mr. Jacksha stated that the Investment staff member who would normally take the lead in the RFP process has left the ERB, and so there will be a delay of a few weeks while the position is being filled.

**TUCS PERFORMANCE COMPARISONS – BOB JACKSHA**

Mr. Jacksha distributed and reviewed Wilshire TUCS (Trust Universe Comparison Service) performance comparisons among 24 different funds over $1 billion.

-- ERB ranked #1 in total fixed income returns for the 3-year period.

-- ERB ranked #1 in real estate for the 3-year and 4-year periods, and is in the top 10% for the 5-year period.
Q1 2012 PRIVATE EQUITY PERFORMANCE REPORT

Mr. Neel and Mr. Tatlow presented this report, with the following highlights:

-- At the last quarter, the portfolio had earned a 6.7% IRR since inception.

-- Annualized IRR of the private equity portfolio since inception was 9.3% at quarter end.

-- At the last quarter, the portfolio was at 113% of what the ERB paid into it; since inception, it is 120%.

-- All of the strategies, including venture, are adding value for the first time in the portfolio.

-- There have been more than four IPOs in the portfolio, which are adding 4x, 5x and 6x returns.

Mr. Neel reported that there was recently a key man event with the passing of the founder/managing director of Perseus, and he and Mr. Tatlow conducted a portfolio review of this GP at their Washington, D.C. office about two weeks ago.

Mr. Tatlow stated that $982,840,000 in commitments have been made in the private equity portfolio. Commitments are about 58% called, with an 18% distribution ratio.

Mr. Tatlow commented that this portfolio is doing very well in the short run, which is intentional -- mezzanine, secondaries and distressed comprise 45% of the portfolio, and these are strategies that deliver return much earlier in their life.

Q2 2012 COMMISSION REPORT

This report was in the packet for review.

Q2 2012 PROXY VOTING REPORT

[Deferred.]

OTHER INVESTMENT REPORTS AND DISCUSSIONS

None.
ADJOURN

Its business completed, the Investment Committee adjourned the meeting at 3:55 p.m.

Accepted by:

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H. Russell Goff, Chair