The City of Phoenix Employees' Retirement Board met at 17 S. 2nd Avenue, 2nd Floor Subcommittee Room, Phoenix, Arizona on May 21, 2008 at 8:30 a.m., to conduct regular business.

1. **Call to Order**

   Chairperson Gleason called the meeting to order at 8:35 a.m. She stated Mr. Barriga was unable to attend the meeting. She stated Mr. Naimark and Ms. Smith would join the meeting in progress.

2. **Approval of Investment Committee Meeting Minutes of April 23, 2008**

   Mr. Wingenroth moved approval of the Investment Committee minutes from April 23, 2008. Ms. Lang seconded the motion. The motion carried unanimously.


   a) Fund Performance – Period Ended March 31, 2008
Mr. Harvey stated the quarterly returns were the worst in 20 years for fixed income investments. He stated the equity markets underperformed 90% of quarters since 1926. He stated the COPERS portfolio held up well. He stated the diversification built into the portfolio had paid off during the quarter.

Mr. Harvey stated equities in general were down around -10% for the quarter. He stated for the quarter the S&P 500 Index was down -9.45%, small cap stocks were down -9.90%, international equities were down -8.82% and emerging markets were down -10.92%. Mr. Harvey stated the only assets which had done well during the quarter were inflation hedging assets like commodities, treasury inflation protected securities (TIPS) or low risk assets like Treasury bonds. He stated the Lehman Aggregate Index returned a positive 2.17% for the quarter. He stated the Lehman Aggregate Index was a diversified index of fixed income securities including treasuries, mortgage-backed bonds, asset-backed bonds and corporate bonds.

Ms. Smith entered the room.

Mr. Harvey stated for the most recent quarter the S & P 500 was down -9.45%. He stated since 1926 there have been 328 quarters. He stated this quarter underperformed 90% of all other quarters. He stated historically the bounce back during the four quarters following a very bad quarter had been to a greater magnitude than the decline. He stated this was the sixth worst first quarter return for equities since 1926. He stated the returns in the 4th year of a presidential term tended to be good.

Mr. Harvey stated the reasons managers underperformed or outperformed their index had a lot to do with how they approached the financial and technology sectors. He stated during the quarter values in the financial sector declined by -13.96% and in the technology sector declined by -15.19%. He stated financial and technology were the largest sectors of the S&P 500 Index. He stated the markets had behaved as if there was a recession. He stated sectors which held up relatively well were consumer staples, industrials and materials. He stated these were typical anti-recessionary sectors.

Mr. Harvey stated the total portfolio returned -4.97% during the quarter, gross of fees. He stated the bulk of the underperformance compared to the target benchmark was attributable to the returns of Western Asset Management. He stated compared to the universe of pension plans between $1 billion and $5 billion, COPERS ranked in the 41st percentile, outperforming about 60% of peers for the quarter. He stated for one year the plan ranked in the 62nd percentile, outperforming 38% of peers.

Mr. Harvey stated if the portfolio had not been diversified and invested based on the allocation in place three years ago the quarterly return would have been approximately -5.9%, ranking in the 61st percentile. He stated for one year the plan would have returned -2.4%, ranking in the 95th percentile if the previous allocation had been in place. He stated the diversification plan was working.

Mr. Harvey stated Dimensional Fund Advisors underperformed slightly due to stock selection in healthcare and being overweight in the consumer sector. He stated Dimensional had a return of -9.82% for the quarter versus the benchmark return of -8.72% for the quarter.
Mr. Harvey stated the goal of the Northern Trust Index Fund’s was to match the return of the S&P 500 Index, which had not been accomplished for the second quarter in a row. He stated Northern had underperformed the index by -11 basis points for the quarter. He stated the reason for the underperformance was because the Northern Trust securities lending pool had experienced losses which decreased the performance of the index fund. He stated the impact was pronounced in Northern Trust fund because it was a daily liquidity index fund. He stated unfortunately Northern Trust introduced some tracking error but he was optimistic they would recover the value.

Mr. Harvey stated Cadence had also underperformed during the quarter due to stock selection in the technology sector. He stated Cadence had been underweight in the consumer sector but had poor stock selection. He stated Cadence ranked in the 70th percentile for the quarter.

Mr. Harvey stated The Boston Company returned -5.68% for the quarter as opposed to the benchmark return of -9.98%, ranking in the 7th percentile. He stated The Boston Company had good stock selection in the consumer sector and was also overweight in the energy sector. He stated The Boston Company ranked in the 43rd percentile for one year.

Mr. Harvey stated Cramer Rosenthal McGlynn had not been in the portfolio for a full quarter. He stated since their inception date at the beginning of February 2008 the manager had added about 311 basis points return over their declining benchmark. He stated the manager had a marginally positive return in the face of the declining small-cap value index.

Mr. Harvey stated Eagle’s had a negative performance but not as much as the benchmark. He stated Eagle had good stock selection in the energy sector and was overweight in the financials sector. He stated Eagle returned a -11.90% versus the benchmark’s return of -12.83% for the quarter. He stated Eagle ranked in the 19th percentile for the quarter.

Mr. Harvey stated both GMO and Pyramis, the international managers, had a small allocation to emerging markets. He stated emerging markets declined more than the developed markets during the quarter. He stated both managers had also been overweight in Asia, which was the hardest hit part of the emerging markets. He stated GMO slightly outperformed for the quarter, ranking in the 41st percentile. He stated Pyramis returned -9.35% versus -8.82% for the benchmark for the quarter. He stated Pyramis attributed their underperformance to stock selection in the Pacific region and being overweight in the financials sector.

Mr. Harvey stated AXA Rosenberg slightly outperformed for the quarter declining less than the benchmark. He stated AXA Rosenberg had been underweight in the Pacific region and underweight in the materials sector. He stated AXA Rosenberg had outperformed significantly in the month of April 2008. He stated for the quarter AXA Rosenberg ranked in the 10th percentile.

Mr. Harvey stated the two fixed income managers had done two different things during the quarter. He stated Wells Capital had marginally underperformed for the second consecutive quarter. He stated Wells Capital always either outperformed or underperformed very marginally. He stated Wells Capital returned 2.11% for the quarter versus a benchmark return of 2.17%. He stated Wells Capital had been overweight in highly rated asset-backed securities, especially consumer asset-backed securities. He stated Wells Capital had experienced poor selection in mortgage-backed securities. He stated Wells Capital was very disappointed with
this second consecutive quarter of underperformance. He stated Wells Capital still ranked above median for the quarter.

Mr. Harvey stated Western Asset Management had returned -2.11% for the quarter versus a return for the benchmark of 2.17%. He stated Western ranked in the 99th percentile.

Mr. Wingenroth asked Mr. Harvey if the three-year performance for Western Asset Management had been influenced by the performance of this last quarter. Mr. Harvey stated the three year return was influenced by the last quarter’s performance. Mr. Kuhns stated R.V. Kuhns & Associates would be suggesting more diversification in the fixed income portion of the portfolio in a later agenda item.

Mr. Harvey stated Research Affiliates had a positive return of 2.31% for the quarter.

Mr. Flanagan asked Mr. Harvey if a percentile ranking was available for Research Affiliates. Mr. Harvey stated a percentile ranking was not available because the universe of managers utilizing similar tactical asset allocation strategies was not available. Mr. Kuhns stated only about four firms operated a similar strategy in the real return area.

Mr. Harvey stated the Morgan Stanley Real Estate portfolio had outperformed the benchmark for the quarter. He stated the JP Morgan Real Estate portfolio had underperformed the benchmark during the quarter. He stated since inception Morgan Stanley had added about 150 basis points and JP Morgan was under the benchmark by about -100 basis points. He stated Morgan Stanley was a bit more aggressive than JP Morgan.

Mr. Harvey stated the portfolio had a total value as of March 31, 2008 of $1.836 billion. He stated all asset classes were within their rebalancing ranges after the recent rebalancing. He stated on a monthly basis staff works with him to make sure the asset classes and manager remain within the acceptable ranges. Ms. Buelow stated staff had completed rebalancing activity based on the March 31, 2008 portfolio. She stated a report was included in the Board materials.


Mr. Harvey stated trading costs were decent on the New York Stock Exchange, but had been poor on the NASDAQ stock exchange. He stated this was partly due to the 1st quarter transition and the underperformance of the transition manager. He stated R.V. Kuhns & Associates did not have any concerns with the trading costs.

Mr. Kuhns stated at a future meeting R.V. Kuhns & Associates would like to introduce an additional asset class for the Board’s consideration. He stated the additional asset class was a long/short equity strategy. He stated a long/short equity strategy was where a manager had the ability to buy stocks they liked and short stocks they did not like. He stated the return for the quarter for the long/short benchmark was -5.3% compared to the S&P 500 Index return of -9.4%. He stated for the one-year period the S&P 500 Index returned -5.1% and the long/short benchmark returned 2.2%. He stated for the three-year period the S&P 500 Index had a 5.8% return and the long/short benchmark had a 9.25% return. He stated the five-year return for the S&P 500 Index was 11.3% versus the long/short benchmark of 11.9%.
15. **Charter Amendments/Policies and Procedures Committee Report**


a) **Consideration of Request From Ronald Sevey Regarding Revising the Survivorship Beneficiary Designation for His Retirement Benefit**

Mr. Ronald Sevey entered the room.

Ms. Smith stated Mr. Sevey recently experienced a divorce and would like to change his designated survivor. She stated the CAPP had reviewed the documentation and a previous legal opinion. She stated the Charter did not allow the removal of a designated survivor upon divorce. She stated Mr. Sevey had requested to remove his ex-wife as the designated survivor. She stated the CAPP Committee was recommending the Board deny Mr. Sevey’s request because the Charter did not allow any changes to retirement options after the first retirement check had been paid.

Mr. Sevey stated he should not be penalized for his error at the time of his retirement. He stated he picked the wrong retirement option. He stated he did not know why there were several retirement options. He stated he should not be penalized for the rest of his life.

Ms. Smith stated at the time of Mr. Sevey’s retirement he had completed an election form which stated if he wanted to change the designated survivor he would need to do so before he received his first pension check.

Mr. Sevey expressed his concern about having to obtain a spouse’s signature for the selection of retirement options. Ms. Buelow stated at the time of his retirement Mr. Sevey’s spouse had acknowledged and accepted Mr. Sevey had chosen an option which would provide her with 50% of his pension upon his death.

Mr. Sevey stated he had a Superior Court order indicating his ex-wife had nothing to with his retirement. Ms. Smith stated she understood Mr. Sevey’s desire to remove his ex-wife as a potential survivor. She stated unfortunately the Charter did not allow any changes.

Mr. Sevey asked when that provision in the Charter had been last amended. Atty. Chang stated this provision was put into the Charter in October 1989.

Mr. Wingenroth moved to accept the CAPP Committee’s recommendation to deny Mr. Sevey’s request. Ms. Bissa seconded the motion. The motion carried unanimously.

Mr. Sevey left the room.

b) **Consideration of Correspondence from Ms. Sandra Rodwan Regarding Service Purchase of City of Phoenix Job-Share, Full-Time temporary Employment and Non-Participatory Government Employment**

c) **Consideration of Correspondence from Atty. Catherine Langford Regarding Service Purchase of City of Phoenix Job-Share, Full-Time Temporary Employment and Non-Participatory Government Employment**
d) Consideration of Potential Policy to Allow Purchase of City of Phoenix Job-Share, Full-Time Temporary Employment and Non-Participatory Government Employment

Ms. Smith stated items b, c and d were related and could be discussed together. She stated the CAPP had reviewed a potential service purchase program change to allow the purchase of City of Phoenix job-share and full-time temporary employment. She stated the Committee had also considered allowing the purchase of non-participatory government employment. She stated the CAPP had given consideration to job-share and full-time temporary employment because they were alternatives to regular employment practices.

Ms. Smith stated the recommendation from the CAPP Committee was for the Board to allow current employee members the opportunity to purchase of service credits for City of Phoenix job-share employment and City of Phoenix full-time temporary employment. She stated non-participatory government employment was not included in the recommendation.

Ms. Buelow stated in regard to the purchase of job-share service she understood the Committee accepted the assumption job-share positions split employment and benefits on a 50/50 basis. Ms. Smith stated if the policy change was adopted by the Board staff would begin a soft implementation as of October 1, 2008 by advising all retiring members. She stated communication would be provided to all employee members in early 2009.

Ms. Bissa moved approval of the CAPP recommendation to amend the service purchase program to allow active employee members to purchase previous City of Phoenix job-share and City of Phoenix full-time temporary employment service. Mr. Wingenroth seconded the motion. The motion carried unanimously.

4. Consideration of Manager Presentations and Correspondence

b) Western Asset Management
   1) Organizational Changes
   2) Performance Review
   3) Downgrade of Countrywide Bonds
   4) Residential Capital Exchange Offer

Mr. Joe Carieri entered the room.

Mr. Carieri stated he was the head of Western’s Public Funds & Taft-Hartley team and the individual responsible for the City Phoenix relationship since February 2005. He apologized, on behalf of everyone at Western, for the poor performance in 2007. He stated COPERS has been with Western for about three years during which the fixed income markets had been at best sideways. He stated during 2007 and the first quarter of 2008 the markets had unprecedented volatility with spreads widening and uncertainty in the capital markets.

Mr. Carieri stated Western’s bias was one of a value manager. He stated they searched for cheap sectors of the market, cheap securities within those sectors and combined a top/down and bottom/up approach. He stated Western used non-treasury sectors of the market to add value. He stated Western’s bias has always been to use non-treasury sectors in lieu of treasuries. He stated in 2007 and the first quarter 2008 investors who held the most treasuries had the best returns. He stated the COPERS’ portfolio had a very small position of treasuries.
Mr. Carieri stated Western felt the markets had the sense the worst was behind them. He stated in April 2008 Western was up almost 200 basis points.

Mr. Carieri stated COPERS' portfolio was benchmarked against the Lehman Aggregate Index which was an investment grade U.S. dollar-only denominated benchmark. He stated the strategy Western had going into the end of the first quarter in 2008 was to be underweight in treasuries and agencies. He stated they also were overweight in AAA rated mortgages. He stated going into 2007 Western had been cautiously optimistically about the economy. He stated Western thought there was a potential for a slowdown in the economy. He stated they started to reconfigure the portfolio becoming more cautious on interest rates. He stated Western felt AAA rated mortgages were the place to invest. He stated they felt in lieu of treasuries, mortgages were going to provide an opportunity to pick up another 50 to 75 basis points in incremental yield over treasuries. He stated Western got the call wrong. He stated the portfolio was still very high quality, there had been no defaults in the portfolio and COPERS had not lost any money in the subprime debacle. He stated if nothing else happened Western felt they would have 3% excess return over the Lehman Aggregate Index during the next year.

Mr. Wingenroth asked Mr. Carieri why Western had decided to be overweight in the AAA rated mortgage bonds. Mr. Carieri stated Western did not feel the housing market was going to collapse as much as it did in 2007 and 2008. He stated they also considered the overall market risk of a potential recession which could hurt corporate earnings and credit spreads. He stated Western felt the best risk adjusted returns were going to be in AAA rated mortgages. He stated obviously Western misjudged because of the collapse of liquidity in the market. He stated agency and non-agency mortgages were among the worst performing sectors of the market last year.

Mr. Carieri stated the portfolio held very high quality securities. He stated the portfolio did have a very small allocation to below investment grade bonds. He stated these instruments were investment grade at the time purchased and had been downgraded at a later time. He stated the Board had allowed Western the opportunity to continue holding the downgraded bonds.

Mr. Carieri stated currently Western had a bias toward the financial and the energy sectors. He stated they also had a high quality bias to GNMA, FNMA and Freddie Mac securities. He stated the 61% of the portfolio was in the mortgage-backed sector.

Mr. Carieri stated every month Western analyzes each security in the portfolio.

Mr. Flanagan asked Mr. Carieri to review the April 2008 monthly return. Mr. Carieri stated in April 2008 Western returned almost 200 basis points while the market had a return of -20 basis points. He stated Western felt it would take a little more time for things in the markets to work out because of the uncertainty in the economy with the housing market.

Mr. Carieri stated the technical definition of a recession was two consecutive quarters of negative gross domestic product (GDP) growth. He stated there had not been a quarter with negative GDP yet. He stated Western sees a gradual recovery in the economy with growth in the second half of the year. He stated the tax stimulus checks should give the GDP a boost. He stated there would probably be stronger growth globally than in the United States. He stated Western did not expect high inflation.
Mr. Rick Naimark entered the room.

Mr. Carieri stated Western was trying to establish the portfolio as conservatively as possible. He stated Western had underestimated the amount of illiquidity in the system in terms of how much borrowing was going on at hedge funds, how these hedge funds would be forced to start liquidating securities and Wall Street’s inability or unwillingness to purchase the securities. He stated Western was hoping in the next 12 to 18 months the markets would return to status quo.

Mr. Carieri apologized for Western’s underperformance. He stated Western had not changed their process, style or philosophy.

Mr. Harvey asked Mr. Carieri to address the downgrade of Countrywide bonds and the Residential Capital offer.

Mr. Carieri stated Countrywide was one of the largest mortgage issuers and originators in the United States. He stated they had been forced to seek bankruptcy protection. He stated Countrywide was a brand name and had many different divisions beside the mortgage origination. He stated the sum of the parts of Countrywide were worth more than the organization as a whole. He stated Western’s recommendation was to hold the bonds.

Mr. Carieri stated there had recently been a Residential Capital tender offer. He stated Residential Capital was a division of GMAC. He stated GMAC had been providing funding to stop any losses and make sure the company remained viable. He stated GMAC had indicated they were not going to provide any additional funding until Residential Capital received a consensus from bondholders to extend the maturity of outstanding securities. He stated there had been sufficient support from bondholders to accept the terms of the tender offer. He stated the Board was not required to take any action.

Mr. Carieri stated one of the co-heads of Western’s investment efforts had taken a medical leave of absence for a few weeks.

Mr. Carieri stated Western appreciated the Board’s patience and support.

Mr. Carieri left the room.

16. Legal Review Committee Report

The Legal Review Committee met on May 20, 2008.

a) Consideration of Possible Revisions to Board Policy 172: Authority For the Board to Direct Issues to Outside Legal Counsel

Mr. Naimark stated a number of years ago the Board established Policy 172 which stated the Board, at its discretion, may refer issues to outside legal counsel and the Board was responsible for the payment of the fees when issues were referred to outside legal counsel. He stated the City Attorney’s office made it clear at the Legal Review Committee meeting the Charter states the City Attorney was assigned the responsibility for representing the Retirement Board in legal matters and it was their decision as to whether or not to employ outside counsel.
Mr. Naimark stated the Committee was recommending the Board rescind Policy 172 based upon the information presented by the Law Department in order to comply with the Charter. Mr. Naimark moved to rescind Policy 172. Chairperson Gleason seconded the motion.

Chairperson Gleason stated one of her biggest concerns with this change was where the Board’s interests may be divergent from the City’s interests in a lawsuit. She stated as a matter of practice she would recommend the Board ask the City Attorney to carefully consider allowing the Board to have separate counsel whenever the Board and the City are named in a lawsuit. She stated perhaps the outcome of this most recent lawsuit would have been different if the Board had separate counsel from the beginning of the lawsuit.

Mr. Naimark stated the City Attorney’s office would involve staff and the Board in cases where an item needed to be referred to outside counsel.

b) Consideration of Possible Assignment Regarding Compliance with New Internal Revenue Code Regulations Concerning Appropriate Retirement Ages and the Arizona Constitution Restrictions on Modifications on Benefits

c) Consideration of Possible Assignment Regarding Review of Federal Insurance Contributions Act (FICA) exemption for Excess Benefit Arrangement (EBA) Payments (Policy 174, Section X)

d) Consideration of Possible Assignment Regarding Possible Internal Revenue Service Filings

Mr. Naimark stated the Committee had discussed ongoing legal representation issues. He stated the Committee felt it was important for the Board to continue with the existing attorney for the issues. He stated Atty. Cassie Langford had already been involved with two current issues. He stated the Law Department had expressed they did not have a concern with her continuing the assignments. He stated the Committee was requesting Atty. Langford be involved in a potential legal matter. He stated staff was working on a memo to the Law Department regarding the reasons why the Board needed Atty. Langford to continue to represent the Board on these matters.

Mr. Naimark moved to request the Law Department authorize Yoder & Langford Law Office to complete assignments regarding compliance with new Internal Revenue Code regulations concerning appropriate retirement ages and the Arizona Constitution restrictions on modifications on benefits, review of Federal Insurance Contributions Act (FICA) exemption for Excess Benefit Arrangement (EBA) payments (Policy 174, Section X) and possible internal revenue service filings. Chairperson Gleason seconded the motion.

Mr. Flanagan stated his concern was the City had argued the Board was a separate entity during the Head Start lawsuit and now the City Attorney stated he was the legal counsel for the Board. Mr. Naimark stated the City Attorney has an ethical obligation to determine if there are conflict of interest issues when the City’s interests are separate and possibly divergent from the Retirement System’s interests.

Mr. Naimark stated the Charter requirement for the Civil Service Board was different. He stated the Charter was very specific with regard to the Retirement Board.
Chairperson Gleason called for the vote on the motions to rescind Policy 172 and request the Law Department to authorize Yoder & Langford Law Office to complete various assignments. The motion carried with Mr. Flanagan voting no.

4. **Consideration of Manager Presentations and Correspondence**

   a) **Cramer Rosenthal McGlynn**
      1) **Organizational Changes**

Mr. Jay Abramson entered the room.

Mr. Abramson thanked the Board for allowing him to discuss Cramer Rosenthal McGlynn’s (CRM) recent organizational changes. He stated seven weeks ago three analysts left CRM to start their own firm. He stated CRM’s management was not surprised and in fact had built the organization to withstand a departure like this one. He stated CRM also had a similar situation in 2002 when two analysts and a marketing person had left the firm. He stated part of their business plan since 2002 has been to make sure CRM had the requisite breadth, depth and redundancy in the organization to withstand any one group of individuals leaving the firm. Mr. Abramson stated he had been with CRM for 23 years. He stated CRM has never lost an analyst or investment professional to another organization. He stated CRM only had these two incidences of employees deciding they wanted to be entrepreneurs and start their own businesses.

Mr. Abramson stated the way CRM was organized was a little different from other firms. He stated CRM was a very team oriented organization. He stated CRM did not put their clients at the mercy of any one or two individuals to make all the right decisions. He stated by having a team approach they can have people who have various areas of expertise. He stated part of their whole approach to investing was change oriented investing. He stated change was very healthy for an organization. He stated over the past four or five years they had moved to more of a broad sector approach to investing.

Mr. Abramson stated CRM had hired a physician to be on their healthcare team. He stated it took almost two years to find the right person. He stated the physician would now be leading the healthcare team.

Mr. Abramson stated CRM hired aggressive, enthusiastic, high energy individuals. He stated the firm had a 35-year history of mentoring employees.

Mr. Abramson stated in 2002 when there were two departures for the hedge fund, CRM had lost one $10 million account and no accounts had been lost after the recent departures.

Mr. Abramson stated since inception COPERS’ portfolio was up about 8.5% through May 20, 2008 versus 5% for the benchmark. He stated he felt the portfolio would do fine on a relative basis as long as this environment persisted. He stated it was very hard for equities to get revalued upward when commodities were pulling disposable income away from the consumers. He stated CRM would continue to find opportunities they think are mispriced and companies who were doing what they could to increase value for shareholders.
Ms. Reidenbach asked Mr. Abramson to describe CRM’s ownership structure. Mr. Abramson stated CRM was partially owned by Wilmington Trust Company. He stated the transaction was done about 11 years ago to help transition ownership from the CRM founders who were now retired. He stated currently Wilmington Trust owns about 80% of CRM on a primary ownership basis and about 46% on an economic basis. He stated CRM was working on restructuring the ownership in order to get more direct equity ownership in the hands of active employees.

Mr. Kuhns stated R.V. Kuhns & Associates did not have any concerns with CRM’s organizational changes.

Mr. Abramson left the room.

5. **Consideration of Fixed Income Structure Analysis – Presentation by R. V. Kuhns & Associates**

Mr. Harvey stated R.V. Kuhns & Associates had been asked to comment on Western’s underperformance and to evaluate the structure of the fixed income portfolio.

Mr. Harvey stated Wells was very benchmark extreme and takes very small bets against the benchmark. He stated Western looked at the fixed income universe in an entirely different way. He stated Western was a value manager who takes very significant active bets away from the benchmark and invests in sectors which can be outside the benchmark.

Mr. Harvey stated in the last nine months all investments had underperformed treasuries so any manager taking risk by investing in higher yielding securities was punished.

Mr. Harvey stated over the long run, investing in spread securities added value to the portfolio at the risk of short-term underperformance. He stated Western was a good compliment to Wells. He stated the correlation of their excess returns over and above the benchmark was 0.3%. He stated only about 30% of the time were Wells and Western going to outperform at the same time. He stated the markets in which a manager like Wells did well, Western would do poorly. Mr. Harvey stated Western had done very poorly in the most recent nine month period, but all managers who approached the fixed income market like Western also underperformed the benchmark. Mr. Harvey stated it was probably not a good idea to make a decision in the middle of this extremely challenging market environment for spread sector fixed income investments. He stated the reason was because liquidity had not returned to the market creating a wide spread between buy and sell prices. He stated the closing of the gap would serve to increase the value of the securities in the portfolio. He stated he was confident most of the securities were going to recover in value.

Mr. Harvey stated the Western portfolio had underperformed for seven consecutive quarters in the late 1980’s and early 1990’s, two quarters in 1995 and 1996, six quarters in 1998 and 1999, one quarter in 2002 and then the current period of the most recent four quarters. He stated the current underperformance was the largest gap of underperformance since Western started managing this product. He stated every other time the portfolio had underperformed it had recovered.
Mr. Harvey stated R.V. Kuhns & Associates’ overall finding was they were alarmed at Western’s underperformance, but felt it was not a good time to change the portfolio. He stated R.V. Kuhns & Associates would advocate giving Western the balance of 2008 to allow the portfolio recover and reassess the question of the fixed income portfolio structure toward the end of the 2008 calendar year. Mr. Kuhns stated R.V. Kuhns & Associates would, at a later time, recommend more diversification in the fixed income portfolio. He stated he recommended the Board authorize a search, with additional information to be presented to the Board at a later meeting. He stated he recommended the Board wait until the portfolio recovered to make a decision as to whether the Board wanted this type of volatility in the fixed income portfolio or to diversify the portfolio through the inclusion of another manager.

Chairperson Gleason asked if the third fixed income manager was part of the asset allocation discussion or something separate the Board would need to act on. Mr. Kuhns stated R.V. Kuhns & Associates would present the results of a search for other fixed income managers for consideration later this year.

Mr. Naimark stated since the recovery time may take two or three years would the Board want to wait a longer period of time before making a decision. Mr. Harvey stated no one knows how long it would take for liquidity to return to the market. Mr. Kuhns stated R.V. Kuhns & Associates wanted to identify the players in the investment process to be ready to present them to the Board at the appropriate time.

Mr. Naimark moved approval of direction to R.V. Kuhns & Associates to begin a search process for a possible complementary fixed income manager with results to be presented to the Board later in 2008. Mr. Flanagan seconded the motion.

Ms. Reidenbach asked what R.V. Kuhns & Associates would recommend for the allocation between the proposed three fixed income managers. Mr. Kuhns stated R.V. Kuhns & Associates would have a recommendation regarding the allocation at a future meeting.

Ms. Lang asked which firms offered products in the macro universe. Mr. Kuhns stated the best known firm was PIMCO. Mr. Harvey stated Julius Baer offered a similar product.

Chairperson Gleason called for the vote. The motion carried unanimously.

Chairperson Gleason left the room.

6. **Consideration of Asset Allocation Study – Presentation by R.V. Kuhns & Associates**

Mr. Kuhns stated 18 months ago the Board started building diversity into the portfolio by adding allocations of 10% real estate and 9% real return strategies.

Mr. Kuhns stated he would review the return and risk assumptions for several investment strategies, which were in the asset allocation model including a long/short equity strategy. He stated US large cap stocks were expected to return 8% with a standard deviation of 16.5%. He stated the long/short strategy had a higher return expectation of 8.25% with a lower risk assumption. He stated core real estate investments had a return assumption of 7.25%. He stated value added and opportunistic real estate had higher return assumptions. He stated the assumption of risk was also higher and the funds were often locked up for eight to twelve years. He stated core real estate had a standard deviation of about 9.25%.
Mr. Harvey stated the manner in which the various asset classes worked together was the third item included in the asset allocation model. He stated a US fixed income allocation was included in the portfolio because it was not well correlated with the stock market. He stated if the assumptions were correct, the current target portfolio will have an average annual return of 7.5%.

Mr. Wingenroth left the room.

Mr. Kuhns stated new asset classes had been added to the asset allocation model for the Board’s consideration. He stated constraints had let the model pick value added real estate up to 6% of the portfolio, opportunistic real estate up to 3% of the portfolio and up to 10% of the portfolio in a long/short equity strategy. He stated if the Board approved the additional asset classes, after the educational sessions scheduled for June 25, 2008, R.V. Kuhns & Associates would proceed with the implementation of phase 1 and phase 2. He stated there was risk going into and getting out of the additional asset classes. He stated phase 1 would reduce the large cap portfolio allocation from a target of 25% to 22%, would reduce small/mid portfolio allocation from 13% to 11.5%, would reduce the broad international equity allocation by 1%, would reduce the international equity small/mid portfolio allocation by 1% and would reduce the fixed income allocation by 2%. He stated the decreased phase 1 allocation in equities and fixed income would fund the 1% allocation to value added real estate, the 1% allocation to opportunistic real estate and the 6.5% allocation to the long/short equity strategy. He stated he would recommend building the real estate portfolio over a three to five year period. He stated phase 2 would be completed three to five years in the future.

Mr. Kuhns stated the expected rate of return would go from 7.51% for the current target portfolio to 7.62% upon completion of phase 1. He stated the standard deviation for the target allocation would go from 10.8% to 10.3% after phase 1.

Mr. Flanagan asked what the advantages were of phasing in the allocation changes. Mr. Harvey stated phase 2 included an 8% allocation to the value added and opportunistic real estate strategies. He stated because of the way the asset class worked it was necessary to spread the allocation out over several years and take a very measured approach.

Ms. Smith left the room.

Mr. Flanagan asked if these new asset classes were within the legal restrictions. Mr. Kuhns stated after obtaining legal advice, the Board had allowed an equity shorting strategy in the Research Affiliates portfolio.

Ms. Lang asked if the portfolio would still have the same problem with real estate regarding purchasing property previously owned by a government entity. Ms. Buelow stated the contracts for the core real estate managers require notification if they purchase a property previously owned by a governmental entity and allow COPERS to exit the fund.

Mr. Naimark asked why R.V. Kuhns and Associates had not proposed these asset classes several years ago when the current asset allocation had been adopted. Mr. Kuhns stated he normally recommended the first entry into an asset class was into the less risky core strategies. He stated R.V. Kuhns & Associates had also hired staff with additional expertise in real estate investments.
It was a consensus of the Board to have R.V. Kuhns & Associates prepare educational sessions for a future Board meeting prior to making a decision on the proposed revised asset allocation.

7. **Consideration of Selection of Transition Manager Pool - Presentation by R. V. Kuhns & Associates**

Mr. Kowolik stated he was the head of R.V. Kuhns & Associates’ Investment Operations Solutions area with oversight of the vendor relationships including custodians, securities lending vendors and transition managers. He stated R.V. Kuhns & Associates recommended establishing a staff and consultant delegated authority for utilizing a pool of providers for transition management services. He stated this was an emerging best practice instead of a sole source provider. He stated during past transitions the Board utilized State Street Global Markets. He stated R.V. Kuhns & Associates believed State Street Global Markets was a qualified provider, but was not necessarily the best provider in all circumstances.

Mr. Kowolik stated R.V. Kuhns & Associates was recommending a delegation of authority for the transitions. He stated the memo to the Board outlined the underlying rational and recommended a list of five firms to form the core of an initial bench of transition managers to serve on a rotational bidding process. He stated R.V. Kuhns & Associates maintained substantial research relationships with the transition management community.

Mr. Kowolik stated some significant principal oriented broker dealers were excluded from the recommendation because the firms might not be able to assure best execution of transitions. He stated the goal of the transition manager bench was to ensure an orderly restructuring of assets with minimized risk. He stated other providers were eliminated because they were felt to have significant organizational issues. He stated the Board could delegate to staff the trade agreement negotiation.

Mr. Kowolik stated the memorandum explained how a transition event would work under this new recommendation, which would involve staff and R.V. Kuhns & Associates. He stated a report would be prepared after each transition indicating how the event went, the costs associated with the event, an opinion on the success of the event and the abilities of the transition management provider. He stated R.V. Kuhns & Associates would propose having an annual review of the vendors included in the program.

Mr. Harvey stated not much would change from the current process where staff has been handling the details of a transition. He stated under the recommendation, staff would pre-negotiate with several providers so there was competition for every transition event. He stated R.V. Kuhns & Associates identified good transition providers for the different asset classes.

Ms. Buelow asked if the time necessary for the bidding process would be problematic if there was a time sensitive transition. Mr. Kowolik stated in his experience with implementing transition manager benches, the managers have been responsive to time sensitive items. He stated with having a standing agreement in place the bid process generally could be performed in one or two days.

Mr. Kowolik stated R.V. Kuhns & Associates was very cognizant of the fiduciary responsibility of the Board. He stated he believed in reporting processes and procedures to assure the Board remained an informed participant in this process.
Mr. Harvey stated R.V. Kuhns & Associates would recommend delegating the selection of a transition manager to staff because once five good transition providers had been identified, the margin of difference between them was going to be minimal.

Ms. Reidenbach stated she felt the transition bench was a good idea. She stated having some competition was also good. She stated she felt the delegation was appropriate as long as the Board received a report on the transition. Ms. Buelow stated authorization of the transition event would follow existing procedures requiring dual signatures.

Ms. Reidenbach moved to establish the transition manager bench and to delegate the process to staff and the investment consultant with the requirement a report be presented to the Board after the transition. Mr. Naimark seconded the motion. The motion carried unanimously.

8. Consideration of Manager Fee Analysis - Presentation by R. V. Kuhns & Associates

Mr. Harvey stated there had been an error in the GMO information in the report included in the materials. He stated the fee was 63.4 basis points, ranking in the 90th percentile. Mr. Harvey stated the total cost of manager fees in the portfolio was 32.5 basis points. He stated the total costs were very low and competitive. He stated in almost every case staff had been able to negotiate a discount from the published fee schedules. He stated there were two managers which charged a fee higher than the median fee. He stated Cramer Rosenthal McGlynn (CRM) managed a capacity constrained asset class in which the opportunities for good small-cap value managers was very limited. He stated CRM charged a high fee but R.V. Kuhns & Associates was comfortable with the fee given the asset class. He stated The Boston Company’s fees were a little bit above median but R.V. Kuhns & Associates was comfortable with the fee level. Mr. Harvey stated overall the fee structure for the plan was in good shape.

9. Consideration of Report Regarding Impact of Bear Stearns and Investment Bank Holdings - Presentation by R. V. Kuhns & Associates

Mr. Harvey stated the impact of the Bear Stearns changes on the portfolio had been minimal. He stated the Federal Reserve had engineered the bailout of Bear Stearns, which was bought by JP Morgan. He stated Bear Stearns saw its stock decline in two days from $60 a share to $2 a share. He stated The Boston Company had held Bear Stearns stock on the date of the buyout. He stated it detracted from their performance by eight basis points. He stated this was offset by several other managers which held JP Morgan stock which benefited from the transition.

10. Consideration of Benchmarking Recommendation for Real Estate Managers - Presentation by R. V. Kuhns & Associates

Mr. Harvey stated the two real estate managers currently in the portfolio were open-end real estate funds. He stated for a long time the benchmark had been the NCREIF Property Index (NPI). He stated the NPI was a poor benchmark. He stated NCREIF had published the NCREIF Fund Index - Open-End Diversified Core Equity (NFI-ODCE) which matched the strategy followed by the two managers.

Mr. Harvey stated the problem with the NPI was it had three components. He stated a third of the index addressed open-end funds, like JP Morgan and Morgan Stanley, a third
addressed actual institutional direct ownership of real estate and a third addressed closed-end funds which tend to be more speculative with higher risk and higher returns. He stated two-thirds of the NPI disadvantaged the comparison to the performance by the core managers in the portfolio.

Mr. Harvey stated R.V. Kuhns & Associates recommended comparing the real estate managers to the NFI-ODCE. He stated R.V. Kuhns & Associates had constructed historical returns for this new index and the returns were very similar in the long-term. He stated the new benchmark eliminates some short-term variations.

Mr. Flanagan moved to begin use of the recommended benchmark, the NFI-ODCE. Ms. Lang seconded the motion. The motion carried unanimously.

11. **Presentation of Securities Lending Report and Consideration of Correspondence From R.V. Kuhns & Associates Regarding Outlook for 2008 Securities Lending Earnings**

Mr. Kowolik stated R.V. Kuhns & Associates and staff continued to monitor the plan’s securities lending program in light of the record earnings delivered to the fund and industry in general.

Mr. Kowolik stated the amount of assets on loan was driven by Treasuries and equity securities. He stated Treasuries were heavily loaned because of the demand for the security type. He stated equities, particularly the small-cap holdings, had a fair amount of speculation. He stated short sales were one of the primary drivers of securities lending. He stated R.V. Kuhns & Associates thought State Street had done a good job on utilization and had been a consistent lender of COPERS’ securities. He stated State Street has maintained sufficient collateral levels and had an appropriate mark-to-market process.

Mr. Kowolik stated earnings had been very strong. He stated in 16 months there had been $1.7 million in net earnings to the fund. He stated for the last four months there had been $766,000 in earnings. He stated State Street had delivered attractive earnings to COPERS. He stated R.V. Kuhns & Associates did not recommend any changes in the program.

Mr. Harvey, Mr. Kowolik and Mr. Kuhns left the room.

12. **Update Regarding Quarterly Portfolio Rebalancing (Per Policy 154)**

Ms. Buelow stated the Board had recently approved a policy for quarterly rebalancing. She stated the policy dictated staff would implement a rebalancing process if necessary and report the process to the Board. She stated based on March 31, 2008 market values there was approximately $20 million rebalanced amongst three managers. She stated through discussion with R.V. Kuhns & Associates it had been determined external transition management was not needed for this process. She stated two reports were included in the Board materials regarding the transition.


Ms. Buelow stated additional proceeds from the WorldCom lawsuit were listed in the report. She stated based on Board direction the report included the past 24 months of activity. She stated over the last 24 months the plan received more than $3 million from various class action filings.

14. **Proxy Vote Summary Report**
a) Cadence Capital Management – 1st Quarter 2008  
b) Dimensional Advisors – 1st Quarter 2008  
c) GMO Emerging Markets Quality Fund – 1st Quarter 2008  
d) GMO International Intrinsic Value Fund – 1st Quarter 2008  
e) Northern Trust – 1st Quarter 2008  
f) Pyramis Emerging Markets Commingled Pool – 1st Quarter 2008  
g) Pyramis International Growth Pool – 1st Quarter 2008  
h) The Boston Company – 1st Quarter 2008

Ms. Buelow stated the reports were informational.

17. **Consideration of Interest on Members Contributions and Pension Equalization Program (PEP) Reserve Account – June 30, 2008**

Ms. Buelow stated this was the annual event where the Board considered what interest rate to direct staff to use to credit both member accounts and the PEP reserve account. She stated Board policy required the interest rate be the lesser of the assumed investment return used in the most recent actuarial valuation and the annual average of the returns for the last five years. She stated the assumed investment return was 8% and the five-year annual average investment earnings were 12.25%. She stated staff was recommending a rate of 8% which would be posted early in the fiscal year beginning in July 2008.

Ms. Reidenbach moved to adopt the interest rate of 8% to be credited to member accounts and the PEP reserve account. Mr. Flanagan seconded the motion. The motion carried unanimously.

18. **Consideration of Request for Service Credit (Buyback) Forfeited Due to Refund of Member Contributions**

Ms. Reidenbach moved approval of the buyback request. Mr. Flanagan seconded the motion. The motion carried unanimously.

a) Michael Sotomayor

19. **Consideration of Request for Transfer of Member Credited Service from COPERS to Arizona State Retirement System (ASRS)**

Ms. Lang moved approval of the transfer request. Ms. Reidenbach seconded the motion. The motion carried unanimously.

a) Triana S. Dowrick $29,934.87

20. **Consideration of Requests for Purchase of In-State/Out-of-State Public Service Credits Pursuant to Board Policy 169**

Mr. Flanagan moved approval of the service purchase request. Mr. Naimark seconded the motion. The motion carried unanimously.

a) **Out-of-State**

1) Derek Fancon  
2) Diana Summers
21. **Consideration of Requests for Purchase of In-State/Out-of-State Public Service Credits Pursuant to Board Policy 180**

Mr. Naimark moved approval of the service purchase requests. Mr. Flanagan seconded the motion. The motion carried unanimously.

a) Dorielle Beck  
b) Charles Brueggeman  
c) Katherine Cobb  
d) Chester Flaxmayer  
e) Steven Haydukovich  
f) Frank Hernandez  
g) Sylvia Montoya  
h) Stephen Petrie  
i) Louise Smith  
j) Karen Romero-Leone  
k) Elizabeth Venis  
l) Benedict Vernille

22. **Bills to be Paid**

Ms. Lang moved approval of payment of the bills. Mr. Flanagan seconded the motion. The motion carried unanimously.

a) AXA Rosenberg  
   1st Quarter 2008 Fees $131,703.69

b) Cadence Capital Management  
   1st Quarter 2008 Fees $149,529.00

c) Cramer Rosenthal McGlynn  
   1st Quarter 2008 Fees $169,165.10

d) Dimensional Fund Advisors  
   1st Quarter 2008 Fees $90,127.33

e) Eagle Asset Management  
   1st Quarter 2008 Fees $120,230.90

f) Research Affiliates  
   1st Quarter 2008 Fees $285,064.90

g) State Street Corporation  
   March 2008 Fees $8,746.09

h) The Boston Company  
   1st Quarter 2008 Fees $87,026.40

i) The Northern Trust Company  
   1st Quarter 2008 Fees $10,632.20

j) Wells Capital Management  
   1st Quarter 2008 Fees $103,386.81

k) Western Asset Management  
   1st Quarter 2008 Fees $109,287.96

23. **Refunds - (through April 30, 2008)**

Vice Chairperson Bissa stated this item was informational.
24. **Pension Payroll – May 1, 2008**

Vice Chairperson Bissa stated this item was informational.

25. **Treasurer's Report as of April 30, 2008**

Vice Chairperson Bissa stated this item was informational.

26. **Pending Legal Opinions**

Vice Chairperson Bissa stated this item was informational.

27. **Administrator’s Report**

a) **Performance Management Reports**

Ms. Buelow stated the reports were informational.

b) **Continuing Education Report**

Ms. Buelow stated the report was informational.

c) **Update on CHRIS Upgrade**

Ms. Buelow stated the payroll system for the City transitioned to a new platform effective in early May 2008 for employees. She stated the transition for the retiree payroll would be effective with the May 30, 2008 payments.

d) **Update on Investment Manager Roundtable**

Ms. Buelow stated she appreciated the Board’s time in attending the investment roundtable.

e) **Quarterly Budget Report**

Ms. Buelow stated the report was informational.

28. **Discussion with Attorney to Consider Position and Instruct Attorney Regarding Lawsuit CV2002-020383 Regarding Former and Current Head Start Workers**

No action was taken.

29. **Discussion with Attorney Regarding COPERS v. Carroll/Stephens, Maricopa Superior Court Case CV2006-011541**

No action was taken.

30. **Future Agenda Items**

No future agenda items were identified.

31. **Call to the Public**

There was no response to the call.
32. **Next Board Meeting: Wednesday, June 25, 2008**

Vice Chairperson Bissa stated this item was informational.

33. **Close Session**

The meeting adjourned at 11:30 a.m.

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Donna M. Buelow  
Retirement Program Administrator

Paula Whisel  
Recording Secretary

APPROVED:

Ms. Cathleen Gleason, Chairperson  
COPERS Retirement Board

Ms. Elizabeth Bissa, Vice Chairperson  
COPERS Retirement Board

May 21, 2008