CITY OF PONTIAC, MICHIGAN
GENERAL EMPLOYEES RETIREMENT SYSTEM
BOARD OF TRUSTEES
SPECIAL MEETING
AUGUST 27, 2013

A special meeting of the Board of Trustees was held on Tuesday, August 27, 2013 at the Marriott Hotel at Centerpoint Parkway, Pontiac, Michigan. The meeting was called to order at 8:54 a.m.

TRUSTEES PRESENT
Shirley Barnett *(arrived at 8:57 a.m.)*
Koné Bowman
Jan Gaffney
Robert Giddings
Charlie Harrison, Chairman
Walter Moore
John Naglick
Patrice Waterman

TRUSTEES ABSENT
Leon Jukowski *(absent)*
Kevin Williams *(excused)*

OTHERS PRESENT
Chris Kuhn, Gray & Company/GrayCo
Ellen Zimmermann, Retirement Administrator
Jane Arndt, M-Administrative Assistant
Talmadge Gunn, Ambassador Capital
Gregory Prost, Ambassador Capital
Allan Meyers, AMBS Investment Counsel
Greg Cassano, First Eagle Investment Mgmt.
James Nelson, III, Herndon Capital Mgmt.
Antoinette Scroggins, Herndon Capital Mgmt.
Britt Joyce, Lombardia Capital Partners
Kevin Sapanli, Lombardia Capital Partners
Ryan Fedronich, Mesirow Financial
Tracey Savage, Mesirow Financial
Clarissa Parker, Piedmont Investment Advisors
Amit Sanyal, Piedmont Investment Advisors
Ruairi O'Neill, PNC Capital Advisors
Kirk VanDagens, PNC Capital Advisors
Aman Patel, Systematic Financial Mgmt.
James Wallerius, Systematic Financial Mgmt.
Linda Watson, Retiree

The meeting was called to order at 8:54 a.m.

Chairman Harrison welcomed the Board to the manager review meeting.

Gray & Company - Second Quarter 2012 Performance Review
Mr. Kuhn told the Board that he will not take a lot of time covering the capital markets review. The Board will cover that during the round table session.

The global market performance for the second quarter saw the S&P 500 return around 3% and the Russell 2000 at 3.1%. The equity market was able to grind out performance during the quarter. The market went into a tailspin but was able to climb out by the end of the quarter.

One-year performance numbers were over 20% for the S&P and Russell 2000 with strong summer 2012 and first quarter 2013 performance.

International equity experienced a slight loss for the quarter. Stocks in Japan and the U.S. experienced the strongest performance with most of the markets in Europe experiencing minor losses. The emerging markets experienced the largest losses at 8% due to global economic projections. The Barclays Aggregate experienced negative performance for the quarter at -2.3% and -0.7% for the year.

European currencies realized modest gains while the yen continued its sharp decline versus the dollar.

The world's second largest economy, China, was experiencing double digit growth but has seen a slowdown in their economic growth at 7%. Many are questioning what global growth will be going forward.

Gray & Company was two years early with their preaching of rising rates and its effect on fixed income assets. With the Fed hinting at the tapering of government purchases, yields on the ten-year treasuries jumped 65 basis points to 2.5%. The spark in treasury rates did not help other segments.

Fixed income usually does better until the Fed reset the rates. The market is seeing negative returns. Corporate bonds were the weakest performer.

Interest rates were also climbing in other areas of the world. Parts of Europe were the exception where the Central Bank's bailout programs have helped stabilize borrowing cost in Ireland, Italy and Spain.

The Fund realized another positive quarter with returns of 0.92% versus the policy index at 0.95%. One-year returns were 15.93% versus the policy index of 16.61%. The three-year returns of 13.13% versus the benchmark at 13.8% include all the good years. The five-year returns of 7.11% versus the index at 6.87 included a portion of the credit crisis.

Equities were the strong part of the portfolio with domestic equities performance at 1.92%; international equities at 0.93% and domestic fixed income of -1.36%.

Private equity investments have not reported their performance, which has a small impact on the Fund's performance.

Large cap manager Sawgrass was in line with the benchmark with performance returns of 2.12% versus 2.06%.

The Gray Emerging Manager Large Cap Core portfolio underperformed the benchmark by 100 basis points at 1.95% versus 2.92%.

The Gray Michigan Large Cap Value portfolio slightly outperformed the benchmark at 3.28% versus 3.20%.

Both of these investments' three-year numbers lagged behind the index.

Mid cap manager value manager Systematic has historically been a strong manager. They underperformed this quarter which affected their one and three year performance numbers. They ran into a rough patch.

Small cap manager Loomis Sayles was slightly ahead of the benchmark with strong long-term numbers.

Trustee Moore asked what the total cost to manage this System is.

Mr. Kuhn stated that it costs approximately 60 basis points to manage the System's assets.

Trustee Naglick stated that it has cost $1.6 million to manage the System's assets for the past seven months.

Terminated international equity manager Aberdeen, formerly Artio, outperformed the benchmark for the quarter 2.61% versus the index at -0.98%.

First Eagle slightly underperformed this quarter due to the gold in their portfolio. Having gold in the portfolio usually helps in a down period, especially when there is a sharp selloff of equities. Having it in the portfolio normally provides strong downside protection.

They are having a slow start. For the year performance was up 12% versus the benchmark at 16%. This is not the right market for them to shine.

Fixed income performance for the quarter did well overall, down -1.36% versus the benchmark at -2.32%.

High yield manager Peritus Asset Management outperformed their benchmark 0.38% versus -1.35%.

Both fixed income managers outperformed the benchmark and did relatively well during the quarter.

There are no updated performance numbers this quarter for the private equity investments.

He reviewed the performance of the Fund versus the public fund universe. Quarterly returns of 1% ranked in the 23rd percentile with over 70% of public funds doing worse. This is not a perfect comparison. Longer term, the Fund has performed in the top third over the past ten years, averaging 7.6% and hitting the actuarial target. The Fund's performance for the past fifteen years was 5.92% which included both market crises.

He described the Fund’s asset allocation versus the policy index as of June 30, 2013. The fund was slightly over in equities and under to fixed income but within expectations.

He reviewed the updated market values as of August 22, 2013. The good news is that the allocation to equities is slightly over at 72% but closer to the State guidelines of 70%. The semi-annual rebalancing was just completed with a sell-off of equities. Approximately $14 million was shuffled from equities to cash to pay for benefits and expenses.

He provided an overview of the Gray Large Cap Emerging Manager Portfolio by manager.

Herndon Capital historically has provided strong returns, but the manager has struggled recently, underperforming the benchmark by 1.4% for the quarter and over6% for the one-year period. This performance is within expectations, but very disappointing. Gray & Company looks at the manager’s underperforming periods to determine if they are within their weaker periods based on the market. They are expecting to see the same performance rebound this time.

Lombardia Capital outperformed the benchmark for the quarter 4.82% versus 3.20%, and the year 28.02% versus 25.32%.

Piedmont continues to struggle, underperforming the benchmark for the quarter 1.99% versus 2.92% and 16.72% versus 20.6% for the year. They are watching this manager closely.

Oakbrook slightly underperformed the benchmark for the period at 1.62% versus 2.06% but longer term they are slightly ahead of the benchmark.

Ativio Capital is a relatively new manager. They have underperformed since inception.

Large cap value manager AMBS is currently struggling. Their performance usually comes out good.

Northpointe Capital experienced one difficult quarter to date.

Seizert Capital had a great quarter outperforming the benchmark 5.47% versus 3.20%.

Overall, total returns for the period for the Gray Michigan Large Cap Value portfolio eked out performance at 3.28% versus the benchmark at 3.20%.

Trustee Barnett asked how long Gray & Company have been watching large cap manager Piedmont.

Mr. Kuhn stated that Piedmont’s strategy offers excess performance when other managers struggle. They have reduced their allocation in the portfolio. The manager is going through a weak patch.

Ms. Zimmermann asked how long Gray & Company has been watching Piedmont.

Mr. Kuhn indicated that they have been watching the manager's performance over the past two years.

Ms. Zimmermann questioned whether the manager should be put on the watch list.

Mr. Kuhn stated that these are Gray & Company's managers to fire and replace. They are more flexible than other managers. They would hate to buy high and sell low and replace the manager right before their strategy is ready to outperform.

Chairman Harrison agreed stating that if you buy a manager at their performance peak you have to ride their strategy going down.

Trustee Gaffney indicated that is why she puts such importance on the manager's risk adjusted performance.

Chairman Harrison noted that the Board needs to look at the manager's downside risk.

Trustee Naglick stated that he agrees with Trustee Moore's earlier statement regarding the cost to administer the System. Why should the Board ride the manager on the downside if they can put the assets into an index fund and avoid expensive fees?

Mr. Kuhn told the Board that it is difficult to pick an active manager in that space which is why you see a lot of index funds in that space.

Trustee Naglick stated that he had heard Gray & Company say on many occasions that it is hard to pick a manager in that space and investing in an index fund saves on fees in that space.

Chairman Harrison noted that Gray & Company has told the Board that active management works well in that space.

Mr. Kuhn stated that opinions are mixed with regard to the large cap space.

He reviewed the large cap growth cumulative performance for the System. The benchmark has been a median performer at 7.73% versus the median at 7.28%.

Five-year performance has active managers performing in line with the benchmark gross of fees with some end point sensitivity. Five-year performance for Sawgrass was 7.7% versus the benchmark at 7.4%. Net of fees they were slightly behind the benchmark.

When the S&P reverses performance the trend line falls in the middle and the net would see active management slightly ahead. Large cap growth tends to favor active as the benchmark is more volatile.

Trustee Moore asked what is the bottom line.

The firm does not have a strong opinion one way or the other. They provide their clients with the information and let the client make that determination. Funds spend more time looking at large cap managers and worrying about them. Five years can go by without concerns in the small cap space.

Trustee Moore indicated that the Board looks to Gray & Company for advice with regard to these investments.

Mr. Kuhn stated that they provide the information with some funds liking active management and some liking index funds.

Chairman Harrison suggested moving forward. This argument could go either way. Gray & Company is split with some recommending active management and some recommending passive management in the large cap space.

Trustee Moore asked how the fees fit into this argument.

Chairman Harrison indicated that the overall performance with fees is very close.

Active management has outperformed the benchmark. The System had an index fund with World Asset Management at one time.

Mr. Kuhn distributed strategy sheets for the managers including attribution and what type of strategy they manage.

Trustee Moore asked if Mr. Kuhn has a list of the questions sent to the managers and questions for the Trustees to ask the managers.

Mr. Kuhn indicated that the managers were asked to discuss their performance and attribution. They were sent a list of questions.

Ms. Zimmermann explained that the managers were sent a standard list of questions.

Mr. Kuhn stated that the managers will also provide information pertaining to material changes, assets and personnel.

Chairman Harrison recommended that going forward that the Trustees are provided with a copy of the list of questions.

Trustee Gaffney noted that the document distributed by Mr. Kuhn provides the managers' information with regard to the list of questions sent.

Meeting break at 10:00 a.m.
Trustees Naglick & Waterman left at 10:00 a.m.
Meeting resumed at 10:10 a.m.

Economic Overview/Markets Roundtable
Chairman Harrison welcomed the managers and began the introductions around the table.

He indicated that the round table discussion talks about the market as a whole and how you deal with it globally and domestically. He asked which managers have never taken part in a round table discussion.

Mr. Kuhn stated that he will throw out questions regarding the market. The Trustees receive a lot of information listening to the viewpoints of the managers.

He asked the managers what "tapering" means to the capital markets.

Gregory Prost from Ambassador Capital stated that as fixed income guys they do not know where the Fed is going. The markets reflected an initial backup but not more than 3%. Short rates will hold for longer maturities and are close to zero. The yield curve is as steep as it will get. If the Fed truly raises rates the market will have a hard time getting more yield.

Chairman Harrison asked the managers if Ben Bernanke comes out hinting that he may taper quantitative easing next time, will it have a total opposite effect on the markets or will it continue to act. He asked the managers what timeframe they see for the tapering back of quantitative easing, whether it will remain at $85 billion and what effects there will be economically.

Mr. Prost stated that Ben Bernanke will be done in January and does not feel he will make any aggressive moves this fall. The Fed has no ammunition left. Somewhere downstream something has to give back to the marketplace. He feels the Fed will start to taper back.

Chairman Harrison asked what effects it will have.

Mr. Prost stated that it will affect the global markets.

Ruairi O'Neill from PNC Capital Advisors stated that Bernanke's predecessor Alan Greenspan was never clear on what direction the Fed would move in. Bernanke has been more data driven and clear with regard to rate direction. A decline in quantitative easing does not mean rates will increase. They will just reduce their buying of Treasuries and mortgage backed securities.

Alan Meyer from AMBS stated that once quantitative easing tapers back. Look at Japan when they took off their economy was weaker. The Fed will do the same thing if unemployment levels off and the economy increases. Either Larry Summers or Janet Yellen will replace Bernanke as the Fed Chair with a 77% probability that it will be Summers.

Chairman Harrison questioned whether the market likes Summers or Yellen.

Mr. Meyers indicated that he is not sure that the market likes Summers.

Chairman Harrison stated that the market wants Yellen.

Mr. Prost stated that the market wants Yellen because they assume that Summers will scale back quantitative easing.

Amit Sanyal from Piedmont stated that the normal Gross Domestic Product matches with ten year yields. As the data improves it will back up the rates. It will not just be based on quantitative easing. The new data is weak with regard to durable goods and home sales. Full tapering will not happen.

James Nelson from Herndon Capital stated that the equity markets will improve based on fundamentals. This is the worst recovery since World War II. With low unemployment the goal, the Fed will not make any dramatic moves. They may cut $10 billion from the stimulus but will provide some funding with a focus on growth. They will not derail the economy from reaching its course. On a positive side they are looking at companies with unique fundamentals.

Aman Patel from Systematic indicated that they are not seeing signs of inflation. The U.S. economy is growing slowly. Commodity levels and housing are at an even taper. Emerging market currencies are weak. Foreign investors will do a currency arbitrage to keep rates at a moderate level.

Britt Joyce from Lombardia Capital indicated that when the equity markets underperform interest rates rise. Fixed income led the equity market in the performance upturn. However, there have been some small shudders in the equities market. You have to be cautious in the equities market due to valuation risk and free interest rates. The tapering of quantitative easing has not had much of a reaction in the equity market.

Greg Cassano from First Eagle stated that they are positioning their portfolio for the tapering or even the whiff of interest rates rising. There is still a lot of turbulence in the market. The problem of how we got there five years ago has not been corrected. The Eurozone crisis has not played out. The U.S. is propped up on the dollar printing press. A resolution has not been determined.

Kevin Sapanli from Lombardia Capital stated that we have to keep in mind that no matter how defensive we are we can still get it wrong. The market is saying be cautious and focus on GDP which will determine the output. The Bank of England has been talking about raising rates. We have to rely on fundamentals. With high unemployment it is hard to see people cutting back quickly.

Mr. Kuhn asked the managers about the relation between economic growth and unemployment. There was a lot of enthusiasm during the second quarter in the housing market and auto sales which benefitted from low interest rates. There is a huge gap with nothing else keeping pace. With the numbers softening, will the economy come back to average on a cyclical nature? He asked what part job growth will play and if the managers are bullish on the economy. He also asked if this is the new normal.

Mr. O'Neill stated that you have seen improvements in employment. Retail is linked to consumers. When the automobile companies are doing well it imprints in employment and the wealth effect. Values of homes are going up which means consumers spend money. This is a big positive driver for the economy. The stock market has been a surprise with the S&P up 15%. The oil and natural gas shale revolution is also a driver for the economy and the wealth effect.

Mr. Sanyal discussed the implications of unemployment. Unemployment for those with college degrees and above is 4%; for high school graduates it is 10%. He agrees with Mr. O'Neill that it is a structural problem. The economy is seeing improvements in housing which can help the economy out of the recession. Currently, there are 400,000 new households being created and one million households making improvements. Housing is more affordable with mortgage rates at 4.5%. There is a structural employment problem. He indicated that there are opportunities out there especially in the aerospace industry which is a U.S. based industry. There is a need for this industry.

Mr. Joyce stated that he agrees that upper income and middle income households are benefitting from lower interest rates for home and automobile purchases. The rising wealth effect helps the economy. Lower income households are also seeing improvements. However, it does take a while for it to trickle down to different classes in the economy.

Mr. Kuhn asked the managers if they have concerns that companies like Blackstone are the largest homeowner in the United States.

Mr. Sapanli stated that his wife works in real estate and Blackstone is picking up a lot of homes in cash deals which is a problem. There are also a lot of people out there with money going in to the market to flip homes.

Chairman Harrison asked if Blackstone's huge presence in the housing market is skewing or throwing the numbers off.

Mr. O'Neill stated that the excess supply distorts the market initially. But they have to clear the inventory so it will bring the supply back down and back into balance.

Kirk VanDagens from PNC stated that it hurts when there are no buyers for homes. When Bernanke terminated QEII mortgage rates rose and business slowed. Now that there is evidence that housing prices will appreciate over time it looks like the start of a recovery.

Mr. Meyers stated that home affordability is positive for the economy.

Mr. Kuhn told the managers that this is his third round table session he has conducted and is surprised that the equity managers are so bullish on the economy. He questioned whether the market is looking at intrinsic value.

Mr. Cassano agreed with Mr. Kuhn. He noted that the global markets are still experiencing turbulence. He would be curious to hear the opinions based on the dynamics of the table. Looking at the statistics and fundamentals it is still unclear how quantitative easing and the issues overseas will work out. The statistics are still skewed. People are just taking jobs to have a job. Private equity is buying up condominium associations in Florida which does not help the situation.

This is his first round table discussion since the beginning of the year. There is still a lot of turbulence in the market. The valuation gap has closed and there has been some stock growth based on market noise. It is difficult to know what defensive position to take. They own gold as an insurance policy in their portfolio.

Mr. Sanyal stated that he feels the market has reasonably valued stocks. The best stocks are have good earnings characteristics and growth.

Mr. Patel stated that there has been market growth and expansion. Geopolitics is another issue. Oil prices have not fallen for the past three years even with concerns. When Congress goes back in session they will have the debt ceiling issue to deal with. There is also the question whether Europe is getting better.

Mr. Prost stated that he has seen similar pockets of prosperity so he feels the economy is moving in the right direction. There has not been a long-term solution to fix the banking issues.

Mr. VanDagens stated that the market thinks things have been fixed. He believes that domestic banks have been fixed.

Chairman Harrison asked about the overall performance of the equity markets. Unemployment has not moved enough to represent equity market growth. He asked what is causing the growth and what role do the Central Banks play in the recovery.

Mr. Prost stated that the Fed is propping up the market wherever it can. They dropped rates which increased the amount of risk investors would take.

Mr. Kuhn stated that it seems the market is playing musical chairs and the Fed is in control of the music and people seem to think there will be more music before it stops.

Mr. Prost indicated that there is more liquidity in the system now than ever before but the economy is not taking off. Inflation should be rising. Until there are true investments in the economy we will not see a real recovery.

Mr. O'Neill stated that equities will hold up. Manufacturing is strong however we are not seeing that in employment numbers. The low price of natural gas has a lot of benefits including producing products cheaper than other countries. Chemical companies are also seeing lower costs. This should help drive the economy and we should see an earnings recovery despite the bumps.

Mr. Meyers stated that his old boss worked at the Federal Reserve and he said that rule number one is "Do not fight the Fed". Rule number two is to remember rule number one. Earnings should grow overtime despite the slowdown and restructuring of quantitative easing.

There has been some semblance of growth with stock prices and earnings. You need to be positioned for economic growth. Banks are increasing their level of profitability. Electric utilities have been a good investment with a price to earnings ratio of 15.5.

Mr. Wallerius stated that there are two types of returns, absolute and relative. As a Trustee you are looking at the absolute returns. He told the Board that absolute value is less. The last three years it has been hard to beat the benchmark Last year's absolute returns were 35% and the benchmark was at 40%. These returns will decrease going forward due to the high correlation in stocks and the Fed's involvement in the market. Correlations are coming down along with the indexes. They are more in favor in that style of market.

Mr. Joyce stated that he feels the same way as Mr. Wallerius. It is hard to talk about performance without looking at fair value. Stocks are trading below their long-term average.

Mr. Sapanli noted that you have to dig deeper to find the right companies. Their year-to-date performance is up 21% and their strategy is up 35%. As managers they need to position themselves for when the correction comes.

Amit stated that companies have strong cash positions and are in better shape than during the last cycle.

Mr. Nelson indicated that the increased pricing in the market was not in step with fundamentals. Only four sectors outperformed in the equity market. They were still able to find good companies. There are opportunities in energy and materials. China's growth has weakened but on an absolute level it is still growing. As investors they are still positive because there are opportunities.

Mr. Kuhn asked if the trustees had any questions. He asked the managers about the international markets. Emerging markets are weak with decelerating economies and negative asset flows, which is surprising since they are still growing. Japan's economy is an experiment.

Mr. Cassano stated that they are modestly exposed to emerging markets since May, 2012. They have a 6% to 7% exposure or lower. They are focused on developed nations. The big push in China is now slowing and trickling down to the emerging markets. Japan is going through a policy experiment. Not sure how their policy will play out.

He indicated that they invested in a company in Japan that makes fishing reels; 80% of their revenue comes from outside of Japan.

They still have access to the companies at a fair discount to intrinsic value.

Mr. O'Neill told the group that they do not invest in international companies but they do invest in companies that are domiciled in the United States that generate revenue outside of the U.S., including General Electric and Eaton.

There have been a number of positive comments made regarding the stability in Europe. Ford has said positive things regarding Europe. European financial companies have rebuilt which is reflected in better earnings. Government bond yields in Europe have decreased from where they existed a year ago and are now at 2.8%. Italy and Spain are at 4.5% and 4.8%, respectively. Ten year bond rates are marginally or directionally positive.

Systematic stated that they are seeing some opportunities in the international markets but still have currency concerns. They have looked at Brazilian steel companies that benefit from U.S. manufacturers. European data points are more positive. Manpower a temporary employment provider does 60% of their business in Europe. The aggregates are a little better and there is more stabilization in Europe.

Chairman Harrison indicated that Christine Lagarde warned the Fed that the termination of quantitative easing could be the weak point for international banking. He asked what role the Central Banks will play overall going forward and whether it is important for them to play nice.

Mr. Sapanli stated that the European Central Banks could see some drop off. It is not the same culture as the U.S. In Europe it is crucial for the banks to be on the same page. As an equity manager it is foolish not to think that the Central Banks have saved equities.

Trustee Moore left at 11:06 a.m.

Mr. O'Neill felt that Ms. Lagarde would not tell the Fed to increase rates because her biggest fear would be that funds would flow out of Europe.

Mr. Meyers indicated that Ms. Lagarde wants more international standards for banks. European banks are more standardized. The banks in Europe are larger than the economies of most countries they are in.

Mr. Cassano noted that we are in uncharted territory and when the money stops no one knows what will happen. The European Central Banks are tinkering with policies. The saving grace will be to wait and see how things will play out. The market is being propped up across all sectors. Managers are focusing on fundamentals.

Chairman Harrison asked what impact to the economy there will be if the United States gets involved in war in Syria.

Mr. Sapanli said that it would depend on the involvement of Russia, Israel, Iran, Iraq, Egypt and Kazakhstan. The instability could affect gasoline prices. Ultimately nothing may happen.

Mr. Kuhn indicated that the format for the manager presentations has changed. Their commentary should be limited to portfolio performance and attribution.

Systematic– Mid Cap Value
Jim Wallerius, Partner – Client Services & Marketing
Aman Patel, CFA, Partner & Portfolio Management

Mr. Wallerius told the Board that they have been managing money for the System for the past seven years. The firm is located in Teaneck, New Jersey. There have been no team personnel changes. Their performance numbers are in line with the consultant's. They are also in compliance with the Investment Policy Statement. They do not have any relationships with the Retirement Staff or Trustees.

They have had strong absolute returns but have trailed the benchmark's performance. Their three year trailing performance is 17.4% versus the benchmark at 19.5%. Their second quarter performance was flat versus the benchmark at 1.7%. As of August 26, 2013 their portfolio is up 6.2% and is outperforming the benchmark by 2.3%.

Performance from January 1, 2013 through August 26, 2013 is 20.6%. This is the first day that they pulled ahead of the benchmark. Since inception they have outperformed the benchmark 7.6% versus 6.1%. The market value as of June 30, 2013 was $47.9 million with net gains of $24.7 million since inception.

They look for companies that are not broken with better than expected earnings that are not imaginary numbers but based on cash flow.

Mr. Patel told the Board that the macro environment over the last three years has been challenging with the market focused on yields. They are a deep value manager. There has been a lot of risk on/risk off. Their strategy is starting to work and they should outperform the market.

Trustee Bowman asked about their allocation to healthcare.

Mr. Patel indicated that OmniCare is a healthcare service company that provides prescription drugs with strong earnings. Aetna along with AHCA has done a great job with cost management and good cash flow compared to their peers.

Trustee Bowman commented that Aetna is the second largest healthcare carrier in the United States outside of Blue Cross/Blue Shield.

Mr. Patel confirmed Trustee Bowman's statement and indicated that is why Aetna is in the mid cap space.

Chairman Harrison asked why Systematic has lagged the benchmark.

Mr. Wallerius stated that in 2012 the worst small cap companies out performed. Companies with the best estimates performed the worst. Mid cap followed the same cycle. It now seems that the trend is reversing.

Trustee Moore asked how they would rate their performance on a scale from A to E.

Mr. Wallerius stated that he would rate their performance an E. However, they understand why they have underperformed. They did not change their strategy and have outperformed over the last thirteen years and the past seven years for the GERS System. They would like to see more consistent performance.

Trustee Moore asked where they expect to be one year from now.

Mr. Wallerius replied that they expect above benchmark returns and strong performance based on where they are in the market cycle.

First Eagle Asset Management
Greg Cassano, Vice President

Mr. Cassano indicated that First Eagle has been managing assets for the System since the fourth quarter of 2011. The majority of the firm is still held by the founding family. Their management team is in place. They have three portfolio managers and ten analysts. Their performance numbers were in line with the consultant's. They strategy/style has not changed.

They are an all cap global equity manager. Their strategy is to protect and preserve capital in volatile markets. There are 90 to 130 names in their portfolio. They are bottom up fund managers. They look for good businesses at good prices. They hold most of their stocks for an average of three to five years.

They do own gold to protect the portfolio during periods of distress like in 2008. They understand the volatility. Gold has been in the portfolio at high single and low double digits. The allocation as of June 30, 2013 was 9%. They are buying more miners and less bullion. This will cause the portfolio to lag in bull markets.

Since inception their performance based on absolute returns was up 8.1% versus the benchmark at 11%. They are not pleased to report relative underperformance. The biggest detractor in the portfolio was gold and miners. This does not take away from their discipline. They take advantage of the dislocation in pricing. If they took gold and mining out of the portfolio their performance would be up 3%.

Their position in the United States is overweight at about 20%. Their second largest position is Japan. In the short-term they are overweight to the U.S. and Japan and will not change. The allocation to cash in the portfolio is approximately 10% to 15%. They can put these assets to use at any given time. They never want to be forced to sell a position. Cash has ticked up to 20% in order for them to build their portfolio approach. They are comfortable holding cash so they are able to put the capital to work.

They see turbulence coming in the broader market. They are positioning the portfolio in energy and tech. They have sold financials and are underweight domestically and overseas.

Chairman Harrison said that he likes their strategy of holding gold. In the long-run gold will go up. When prices started going down the Central Banks began buying gold. George Soros and Warren Buffet have been buying gold and shorting the strategy. When gold goes up he told Mr. Cassano that he could be the hero at the table.

Mr. Cassano replied that is why gold is still hedged in the portfolio. They view it as a good bet.

Herndon Capital Management – Large Cap Growth
James H. Nelson, III, CFA & Associate Portfolio Manager
Antoinette Bing Scroggins, Vice President, Client Services

Ms. Scroggins introduced herself and Mr. Nelson to the Board. She noted that their firm has $9 billion in assets under management.

They currently have forty-three employees in the firm including the recent hire of two senior analysts. They have not had any organizational changes outside of the firm's growth. They have invested in the firm's infrastructure and technology. They are proud of how the firm has grown.

Mr. Nelson stated that as of August 31, 2012 their mandate changed to core with absolute returns up 12% versus the benchmark at 16%. They underperformed the benchmark.

Since June 30, 2013 they have seen signs of acceleration with performance up 107 basis points. Half of their underperformance has been made up in July and August.

Their underperformance was due to the narrow market with only four sectors outperforming. They are a bottom up manager. They were underweight to healthcare which hurt their performance. Their performance was positive but underweight to their names in those sectors.

Quarter-to-date they have added 70 basis points to their performance due to their selections in healthcare and financials. They are happy with their names.

Consumer staples and discretionary hurt their performance. It is hard to find high quality names at good prices. This has also flowed into the global space.

He used Herbalife as an example of how hard it is to make money in that space. Even though there were rumors that they were going private they maintained their position and were rewarded. The company's performance is up 40%, so they recaptured losses.

Mr. Kuhn asked if they added to their position after the December, 2012 announcement.

Mr. Nelson indicated that they are investors, not speculators. After evaluating the stock they did not want to add to that position at that time.

He indicated that their position in Herbalife has helped their performance. Being overweight to pro cyclical and to pro growth stocks also helped their performance.

Hurdles to their performance would be the continued sluggishness of the U.S. economy. Good news would help on the consumer staples side. They are not banking on big names.

Lombardia Capital

Britt Joyce, Managing Director & Sr. Research Analyst
Kevin Sapanli, Client Service Manager

Mr. Sapanli indicated that he is new to the firm, joining in April, 2013. They have had a temporary change in CEO with Jorge Castro being replaced by Alvin Marley due to a medical leave. Their company is 80% minority owned. That number may have come down slightly due to more ownership.

He was impressed with the story told by Trustee Moore regarding the System's assistance with the City of Pontiac. This helps them from a communications standpoint. He confirmed their compliance with the System's Investment Policy Statement.

Mr. Joyce told the Board that they appreciate their support. The firm currently has $3.5 billion in assets under management which is at their peak. The firm is strong with the interim CEO leading effectively. They are a large cap value firm. They have added a research associate since last year.

Their year-to-date and three-year performance has done well. They lagged coming out of the credit crisis but they stuck with their strategy and philosophy.

Kelly Kho is the portfolio manager. They restructured the team when their TARP mandate wound down and after closing down their mid cap strategy which has given them more time to work on their large cap strategy.

Their sector model contributed to their positive performance and a more fundamentally-driven stock market. The market was more normal which resulted in closer correlations. Stocks with stronger fundamentals are starting to perform better. Financials, consumer staples and industrials attributed to their outperformance and technology, energy and materials to their underperformance.

Whirlpool was their best performing stock. They did have concerns that their pricing could not keep them in the marketplace but they increased margins from 2.5% to 6% due to the recovery in the housing market.

Eaton is a diversified industrial company which benefitted from the improvement in the aerospace cycle and auto production in the U.S.

CF Industry Holdings specializing in nitrogen fertilizer primarily for corn and wheat did not perform well due to access to cheap natural gas in 2012. The stock was up to $8.00 but went down to $5.00 so they closed the position and moved into DuPont.

The macro driven risk on/risk off market has been a hurdle and hurt their performance as bottom up stock pickers. They perform better in softer markets.

They run a high conviction strategy with about thirty-five stocks. If they underperform, they decreased the number of positions in their strategy.

Piedmont Investment Advisors, LLC
Amit Sanyal, Sr. Vice President, Managing Analyst
Clarissa Parker, Vice President, Investor Services

Ms. Parker told the Board that she and Mr. Sanyal are happy to be at the meeting and for the opportunity to manage the System's assets.

She provided an overview of the organization. The firm was founded in 2000. They have twenty-five employees with thirteen employee partners. They are a majority employee owned company. As of June 30, 2013 they have $3.1 billion in assets under management.

Their large cap core product strategy represents $1.7 billion of their assets under management.

She reviewed the firm's investment team and told the Board that Mr. Sanyal was promoted to Senior Vice President during the last quarter. One of the co-founders of the firm is Mr. Sanyal's wife. He has worked for the firm for seven years and prior to joining Piedmont he worked for the Chrysler Corporation.

She described the firm's performance for the first and second quarters of 2013 as of June 30, 2013. Gross returns for the second quarter were 2.00% versus the benchmark at 2.91%. They were in line with the benchmark until treasury rates increased. The current value of assets is $7.19 million.

Performance returns for July, 2013 are 5.94% versus the benchmark at 5.09 with the current value of assets at $7.6 million.

She provided a comparison of the strategic core historical performance for the three and five year rolling returns versus the benchmark. Their batting average for the rolling three-year period is 70% and for the rolling five-year period it is 78%.

Mr. Sanyal described the portfolio attribution. They look for stocks with improving fundamentals with earnings potential. Earnings potential has been put to the test over the past five years.

He showed performance based on relative strength versus price reversal since 2008. Over the long-term earnings momentum keeps working and sell discipline becomes most important. The strongest stock performance has seen a price reversal but that has improved recently.

He reviewed their sector selections indicating that they did not keep pace with the benchmark. Industrials and materials hurt performance as did global cyclicals, REITS and utilities. They recently added a home construction company for a good price that added performance. Energy, telecom and technology helped performance. Growth and quality under performed. He provided detail on some of their acquisitions including Terex, a crane making company, whose stock is up 18% this quarter.

He described various investments in their portfolio.

They invested in Freeport-McMoRan one of the largest gold and copper mining companies in the world. The stock has underperformed due to an accident in Indonesia where lives were lost and also by a decline in copper and gold prices.

Hess Corporation is an oil exploration and production company in North Dakota. They have been a prolific producer harnessing returns.

Halliburton was at $40.00 and is now at $48.00 but has recently experienced some issues.

They hold Microsoft in their portfolio which has recently experienced CEO issues. There have been some headwinds about Windows and Cloud Computing. Recently, Microsoft has become more of a service company. Their stocks went up when Steve Ballmer announced his retirement. They still believe in Microsoft and it has always performed well for them.

Starbucks has seen strong U.S. performance results even with commodity prices down.

They had a mixed quarter with a couple names detracting from performance. They could not beat the quarter but made up the losses. As correlations go down it becomes a stock picker's market. They do better in a trending market and are in good position. They have a well balanced portfolio with good sector allocations.

They own Delta which has been a good performer. Industry consolidation means that all their profits go into the bottom line. The merger between American Airlines and U.S. Airways was delayed and there was a stock downturn.

They have added new names to the portfolio including Hertz which is bad for consumers but a good stock. Celanese Corporation, a chemical company that uses coal to make ethanol, is benefiting from sales to China and India where ethanol can be used.

Mesirow Financial – Private Equity
Ryan Fedronich, Vice President
Tracey Savage, Vice President, Institutional Sales & Marketing

Ms. Savage thanked the Board for their investment. She indicated Mr. Fedronich is with the private equity group in Chicago, Illinois.

Mr. Fedronich stated that last year was the firm's seventy-fifth anniversary. They are financially stable and employee owned.

They have $78 billion in assets under management with the majority in currency management and alternatives. They are currently raising capital for their sixth private equity fund.

They have $750 million in assets under management in private equity fund of funds. There has been no change in the management team.

The System has $5 million committed to Fund IV and $3 million committed to Fund VI.

Fund IV was started in November, 2006 and is fully funded with fifty-one underlying partnerships. The fund is in line with its targets with thirty-six U.S. and twenty-seven non-U.S. funds. The fund is 72% drawn with $3.6 million distributed. The gross internal rate of return is 9.6% with the System's IRR at 5.6%.

Fund VI had its first capital call this year. It is 4% drawn. Commitments began in April, 2013. To date $58.5 million has been drawn.

Closed commitments to Fund VI include KPS Special Situations Fund, Olympus Partners Growth Fund V, Thoma Bravo Software Fund and Madison Dearborn Partners Fund VI

One of the drivers of their performance is working with Thomas Bravo which performs mid-market buyout deals with an IRR of 38%. They have also benefitted from a favorable debt environment and strong equity markets that have allowed them to pay out dividends.

Fortress Investment Fund a special situation fund has been a detractor from their performance. They originally had an IRR of 37% and are now breaking even. Their exposure to 2006 and 2007 buyout funds with too much leverage have lowered returns.

Their investment philosophy and strategy has largely stayed unchanged. They have made some small tweaks. They shifted their venture capital out of healthcare and pharmaceuticals which do not make sense for a ten year fund.

He expressed what they see as hurdles going forward. These include the lack of liquidity across the private equity industry, increased cost of debt in the credit markets and financial instability issues which have created challenges.

Chairman Harrison asked where Fund IV sits on the J curve.

Mr. Fedronich stated that Fund IV should have a twelve year life and possibly fifteen years with extensions. Fund IV is in its seventh year and through the J curve with an IRR of 9.4%. It is a 2006 vintage fund.

AMBS Investment Council
Allan Meyers, Senior Vice President

Mr. Meyers told the Board that in May, 2013 they sold themselves to the parent company City National who had owned 30% of the firm for many years. They were able to maintain their value strategy. They lost one analyst in the process. The change in ownership was the reason for the loss.

Their performance is close to the S&P benchmark but behind the value benchmarks due to the risk on/risk off nature of the financial markets since it came out of the 2009 depression. Their portfolio is positioned for economic growth. The economy should pick up based on corporate earnings and they are positioned to take advantage.

They would have outperformed the benchmark during the second quarter but interest rates began to rise and they held gold in their portfolio.

He reviewed the portfolio fundamentals based on price to earnings and the earnings per share percent change for 2013 and 2014. Valuations were less than the market and price to earnings was less than overall earnings growth. Rates grew faster than the market. They look for companies with good balance sheets, honest management and a catalyst for growth.

In 2013, the portfolio's price to earnings ratio was 12.2 versus the benchmark at 14.9. Their portfolio's earnings per share was 5% versus 3% for the benchmark. The portfolio's 2014 price to earnings ratio is projected to be 11.1 versus 13.9 for the index and earnings per share at 10% versus 8%.

He reviewed the sector weighting and the winning and losing positions in their portfolio. They were overweight in technology, consumer discretionary and industrials and underweight to the financials in the Russell 1000 Value Index including Bank of America, Morgan Stanley and U.S. Bancorp. They missed REITS which hurt performance. Their performance was up the first part of May, 2013. They do not have any utilities in their portfolio. He noted that consumer stocks do not fit into a value portfolio.

He described the fifteen largest holdings in their portfolio and examined the best and worst performers in their portfolio. Best performers included Microsoft and Cisco. The worst performers included Barrick Gold Corporation which they have held as a hedge since the inception of the firm representing 1.6% of their portfolio. During the first six months of 2013 the investment blew up.

They sold Abbott Labs when the company divided into two segments labs and drugs. They recently bought Cummins Engines. This company makes and sells truck engines and a leading edge emission product. They are looking at companies that will continue to grow and for safe stocks that are a preferred investment.

PNC Institutional Investments
Ruairi O'Neill, Sr. Vice President & Sr. Portfolio Manager
Kirk VanDagens, Vice President & Senior Client Advisor

Mr. VanDagens told the Board that they are in compliance with the consultant's performance number and with the System's Investment Policy Statement.

There have been a couple of management changes. The PNC and National City teams have transitioned to the Advantage team in Philadelphia. The PNC team has been together for ten years and has achieved better performance. Since 2003 large cap value performance returns are 8.22% versus the index at 7.18%. It was in their best interest to transition to the Philadelphia investment group.

Mr. O'Neill said that there are two things required to manage an investment portfolio; process and earnings. The largest focus is on earnings. There are different ways for managers to manage money but most importantly earnings must correlate with stock prices. Issues occur but companies have to step up and report earnings at least four times a year.

Their one year performance is up 22%; however their one year numbers lag the benchmark. This was due to an underweight to financial services specifically to larger investment banks.

St. Jude Medical hurt their performance due to issues with their heart defibrillators. Hewlett Packard helped their performance due to earnings growth and management changes. Omnicare, a pharmaceutical services provider that distributes to senior living facilities, helped their performance. They are ahead of the benchmark by 50 basis points for the quarter.

He indicated that if they could do something differently it would be to more closely focus on earnings. They will not focus on the Fed announcement. They would also avoid torpedoes but they will not change their strategy but will sharpen their focus.

A headwind could be a macro event that would move the market. Currently there is no distinction in the market between earnings and missing.

The Board can help them by giving them their support and having an open line of communication with Mr. VanDagens. They appreciate the Board's business and will work diligently on the System's behalf.

Chairman Harrison asked if the reason they were not heavily weighted in financials was due to the new BASIL III compliance.

Mr. O'Neill indicated that they would increase their weighting to financials to those banks that are well capitalized with a good weighting to regional banks. Many financial institutions are returning dividends to shareholders and delivering earnings.

Chairman Harrison asked what happens to financial institutions that are not BASIL III compliant.

Mr. O'Neill said that if a company does not meet the requirements their multiple is lowered or they are penalized.

Chairman Harrison asked about their top holdings in Exxon & Chevron due to the issues in the Middle East.

Mr. O'Neill said that they have held Exxon in their portfolio for quite some time. They have been underweight to energy. They added other oil companies like Conoco Phillips. It is difficult for large oil companies to get a foothold on oil in the U.S. They try to tilt the portfolio to that end.

Ambassador Capital Management – Intermediate Fixed Income
Talmadge Gunn, Sr. Vice President & Sr. Portfolio Manager

Mr. Gunn told the Board that he has been a bond guy for thirty years. So he will keep it brief.

It is their job to provide cash flows for liabilities and liquidity for the portfolio.

They have been managing assets for the System for just over three years. He expressed his appreciation to the Board. He also noted that the System has been recognized nationally for its performance and management.

Since inception their performance returns are 4% versus the benchmark at 3%. It is not often that you see this kind of spread. They were able to capture attribution up 1% versus the index at 0.28% last year with the market selling at the bottom of rates.

When you are preparing to protect principal and generate performance there are only four ways: sector, yield curve, issue selection and duration. It is a challenge keeping performance up. You cannot recover from a bad investment as a bond manager. You have to manage liquidity.
It will be a challenge keeping performance up. As a bond manager you cannot recover from a bad investment. You need to manage liquidity. Performance is generated by investing in the right sectors. Corporate bonds performed well and they are positioned with the benchmark.

They have a bias to higher quality which did well when interest rates declined. It will be harder going forward. They are looking to add mortgage backed securities which will add more performance to the portfolio than corporate bonds going forward.

Mortgage backed securities will add more yield to the portfolio, generating more yield than the index and reducing their credit risk. Corporates had a great run.

They are not concerned about growth and earnings; only whether the issuer can repay.

They added two senior analysts prior to the retirement of Senior Portfolio Manager and Vice President, Gary Schaefer.

They currently have $1.5 billion in assets under management. They are also looking for more traction in their strategy and will soon be launching a $100 million commitment. They are in compliance with the System's Investment Policy Statement.

Municipal bonds are a fairly interesting segment. There are a lot of higher quality issues. He asked the Board to consider adding them to their intermediate strategy.

Mr. Kuhn will bring the request to the Board.

They are happy to be part of the System's investment team.

Chairman Harrison asked if the municipal bond strategy would help to offset the interest rate risk with the elimination of quantitative easing.

Mr. Gunn stated that there are a lot of states like Utah and Georgia that are AAA rated and offer higher yields than an A-rated corporate bonds. This would add diversity to the portfolio.

The managers left at 2:55 p.m.

Gray & Company Wrap-up

Mr. Kuhn asked whether the Board had any questions.

Trustee Moore asked whether Gray & Company feels good about the managers.

Mr. Kuhn stated that Piedmont's outperformance consistency is 87% historically. It is too quick to pull the trigger. He also indicated that many of the managers have the same issues with their strategies in this market environment.

Trustee Moore asked Mr. Kuhn whether the number of questions needs to be narrowed down.

Mr. Kuhn explained that some of the managers adhered to the list of questions they were given and others went through their entire strategy.

The Board felt that Mr. Kuhn needs to make sure the managers adhere to the guidelines.

He told the Board that he would like the Trustees to evaluate other fixed income strategies. Ambassador alluded to using a negative duration approach. The average duration of the Plan's fixed income portfolio is four to five years.

Trustee Moore asked if the Police & Fire Retirement System is looking at that type of strategy.

Mr. Kuhn explained the negative duration strategy noting that if interest rates go up the firm makes money and if they go down they lose money. It is the way the market is today. You lose a little, stay the same or make money.

Trustee Moore asked what timeframe they would be looking at.

Mr. Kuhn and Chairman Harrison stated that it would be sooner than later.

Trustee Moore confirmed that it would be good in a rising interest rate environment.

Chairman Harrison also told the Board that John Dean of Bloomfield Capital has a fund he would like to present to the Board.

Mr. Kuhn stated that Mr. Dean's fund is a real estate debt fund. The System would not be paid back until the note comes due. The System would pay 60¢ on the dollar of real estate collateral. He is indicating that performance would be high single digit to low double digit. This is an illiquid investment. The Board should also be concerned about the size of the strategy at $20 million.

Ms. Billings asked if the Ambassador Capital Management strategy involves derivatives.

Mr. Kuhn confirmed that it does.

Ms. Billings indicated that the Board would have to address the derivative issue in Public Act 314.

Trustee Moore indicated that he will not be at the meeting being held on Wednesday, August 28, 2013 and that he is concerned about what is on the agenda.

Ms. Zimmermann explained that she tried to coordinate the meeting with MERS and Trustee Naglick but she does not expect them to be at the meeting.

She communicated via email with the MERS representative and Trustee Naglick. The MERS contact person told her that in order for them to make a presentation to the Board on obtaining retiree healthcare the retirees would be required to be invested in a MERS product such as a defined contribution plan.

<u>Investment Policy Statement Review</u>
Mr. Kuhn described the changes and revisions to the Investment Policy Statement.

The Retirement System's address was changed on page two.

On page five under Regulatory Environment, domestic equity was changed to equity under Public Act 314 limits.

On page six under Retirement Administrator the position title has been changed to Executive Director. That position's duties will be delegated by State and Federal laws or as delegated by the Board of Trustees. The Finance Director was removed from that section.

On page six under Investment Consultant, the sentence "Final decision making authority and responsibility, however, resides with the Board" was removed.

Ms. Billings indicated this was removed because it was a liability issue.

Trustee Moore indicated that removing the sentence does not remove the Board's liability.

Ms. Billings agreed that from a legal authority the Board cannot negate their fiduciary responsibility.

Trustee Moore asked what the Board is doing to monitor costs of administering and managing the portfolio.

Trustee Giddings stated that the real costs are recorded under accounts payable each month.

Chairman Harrison explained that the managers' costs are approved by the Board each month,

Trustee Gaffney stated that the System is able to continue to pay pensions, expenses and fees and continue to increase the size of the Fund. All of this is being done without chipping away at the over funding.

Chairman Harrison stated that the System could lose the $9.9 million in additional pension benefit payouts over a two year period in investments.

Trustee Moore asked if smoothing could be used to offset the $9.9 million.

Trustee Gaffney stated that you would not want to take the assets out and set them aside because the System would be losing earnings.

Chairman Harrison stated that this is part of Ms. Zimmermann's and Mr. Kuhn's responsibility of projecting and rebalancing the portfolio.

Mr. Kuhn continued to describe changes made to the IPS.

On page seven under Actuary the words and supplemental was added to "To perform annual actuarial and supplemental valuations to determine liability and funding requirements for the System.

Ms. Billings explained that this is now required by Statute.

Mr. Kuhn stated that on page eight the reference to the Police & Fire Retirement System was deleted under Placement Agents Policy.

On page eleven under Target Asset Mix the permissible range for equities was changed to 65% to 70%.

On page fourteen item number nine will be deleted.

Trustee Giddings asked if there is something that prohibits tax exempt securities.

Ms. Billings told the Board that she is checking on that.

Mr. Kuhn told the Board that on page sixteen under International Equity Managers the asset allocation limit has increased from 10% to 15% for international equity investments.

On page twenty under Commissions & Trading Costs the annual commission report may be required has been changed to "is required."

Ms. Billings noted that an item will be added to indicate the reporting of campaign contributions.

Trustee Giddings indicated that he would like to see a cleaner statement in the IPS designating which roles have fiduciary responsibility to the Fund.

The meeting adjourned at 3:49 p.m.