

NORWALK MUNICIPAL EMPLOYEES' PENSION BOARD MINUTES

DECEMBER 13, 2005

ATTENDANCE: James Murphy, Chairman; Charles Pirro; Francis Nash; Gerald Moran; Michael Salvator; Michael Sweeney; Patricia McCormick

STAFF: Sara LeTorneau, Director of Personnel & Labor Relations; Fred Gilden, Comptroller

OTHER: Ellen Petrino, EAI

CALL TO ORDER

Chairman Murphy called the meeting to order at 6:10 p.m.

APPROVAL OF MINUTES FOR NOVEMBER 9, 2005

Ms. Petrino made corrections to the minutes of November 9, 2005 and sent them to the members.

The corrections to the minutes of November 9, 2005 are as follows, and are in addition to the ones that Ms. Petrino made:

On page 1, under Attendance, Mr. Sweeney's name should be added.

On page 5, under Approval of Pension Applications, the following motion should be added:

**** MR. PIRRO MOVED TO APPROVE THE PENSION APPLICATION FOR MR. REICHENBACH.**

**** MR. SALVATOR SECONDED.**

**** MOTION PASSED UNANIMOUSLY.**

On page 5, under Other Business, 2nd paragraph, this sentence should be added before the last sentence, which starts with "After more discussion":

"Mr. Gilden said, that in discussions with Ms. Petrino, she requested a 5% increase."

**** MR. PIRRO MOVED TO APPROVE THE MINUTES OF NOVEMBER 9, 2005 AS AMENDED.**

**** MOTION PASSED UNANIMOUSLY.**

APPROVAL OF PENSION APPLICATIONS

Maynard Hall, Public Works Department, 36 yrs, 7 months of service, age 81, regular pension, \$52,241.89 final average salary, standard form, \$36,570.00 annual benefit, \$3,047.50 monthly benefit. 5 yr certain, commencement date is December 1, 2005.

Charles Batson, Parks & Recreation, 11 yrs 10 months of service, age 61, early pension, \$45,125.14 final average salary, Opt. #3 – 10 year certain benefit, \$10,164.00 annual benefit, \$847.00 monthly benefit, commencement date is February 1, 2006.

James Bradley, Planning & Zoning Enforcement Officer, 22 yrs, 1 month of service, age 62, regular pension, \$70,045.33 final average salary, standard form, \$30,936.00 annual benefit, \$2,578.00 monthly benefit, commencement date is November 15, 2005.

James Keitt, Jr, Board of Education Custodian, 8 yrs, 10 months of service, age 64, regular pension, \$36,209.60 final average salary, Opt. #2 – survivor benefit, \$5,370.00 annual benefit, \$447.50 monthly benefit, commencement date is January 1, 2006.

**** CHAIRMAN MURPHY MOVED TO APPROVE THE PENSION APPLICATIONS FOR MR. HALL, MR. BATSON, MR. BRADLEY, AND MR. KEITT.**

**** MOTION PASSED UNANIMOUSLY.**

DISCUSSION/ACTION ON ASSET ALLOCATION

Mr. Gilden gave an update of the subcommittee meeting, held recently at the EAI offices. He had agreed to chair the committee, and there were four members of the Board in attendance at that meeting. Ms. Petrino had emailed the information to everyone yesterday, and she distributed copies of it, entitled Asset Allocation Review, to everyone at the meeting. The report reflects the new format, as well as the old format. Mr. Gilden said that one of the major things they discussed was determining the percent of each manager in each group. He said that Ms. Petrino reflected that in her report, by taking every manager and putting them into all the various categories. For example, for a manager like Zesiger who has different allocations in international, small cap and private placement, is broken out into categories.

Ms. Petrino reviewed the written report, and said that page 3 reflected the previous way it had been reported for the quarterly report and adhoc basis, but she made one change that showed Zesiger being handled more appropriately. Each of the managers are listed on the left hand side. Zesiger is listed in three places, in Long U.S. Equity, International, and Private Equity. The adjusted approved targets are listed, which are the ones the Board has been operating with. They are adjusted because there is a 10% target for private equity, but the Fund is actually only at 3 ½ %. She said the Fund is close to the 30% approved target, with 28.3% of Long U.S. Equity. The approved target is 13% for hedge funds, and the Fund is at 11.9%. Combined, the Fund is at 40.2%, which is a bit below the adjusted target. The Fund is at 19.9% for international, which is above the target of 17%. There is 9% in emerging markets, which is above the 5% target. Overall, the Fund has 29% in international, which is above the target of 22.6%. In Private Equity, there is 3%, which is equal to the adjusted target. Overall, the Fund is at 72.5% in equity, versus a target of 69%. Being above in equity means the Fund is below in fixed income. The Fund is at

17.8% in fixed income, vs. the 22% target. The Pimco All Assets fund has 5%, which matches the target, and 3 ½% is in the Commodity Real Return. There is cash of 1.5%. On the right hand side of the report, she proposed some changes that will be discussed later.

Ms. Petrino said that the background to pages 4 and 5 shows the expanded way to look at asset allocations. The managers are again listed on the left hand side. Zesiger is listed only once under U.S. Equity Managers. The report covers two pages. These are catch-all strategies where they are not trying to have much market exposure. The bottom line asset class is in the boxes at the bottom of both page 4 and 5. The report shows U.S. Equities at 38%, 22% for International, and 11% for Emerging Markets. This shows it being categorized a bit differently. She asked if the new format is what they were looking for. Mr. Nash said that he likes the new format better. He asked if U.S. Equities is considered exchange traded, actively traded or an alternative investment. Ms. Petrino said it should be exchange traded, and that the Pantheon assets are invested primarily in venture capitals and leveraged buyouts. He said he would rather see that in the alternatives column. Mr. Salvator agreed. That would then bring the bottom line number for U.S. Equities went from 38% down to 35.6%. Mr. Gilden asked to have the asset class benchmarks shown on the new format. Ms. Petrino said she would do that for the next report. After some further adjustments were made, the bottom line number for U.S. Equities went from \$124.7M to \$116M, with 36%, and a new row was added to reflect a 43% target.

Mr. Sweeney asked where these targets came from, and Ms. Petrino said that the targets were derived from a target allocation study dating back to July of 2003. Mr. Nash asked about the money being moved over from equities for Pantheon, as it seemed that the Fund was only at half of the normal amount of money in equities. Chairman Murphy said that this discussion takes place every few years; the Fund was in the S&P and bond market at 60/40 for a long time. As some of the markets moved, the Board moved with them. They need to evaluate where they want to be for the next two or three years. The last time they did this they reduced their exposure to bonds. Ms. Petrino said they should decide where the boundary is between having an asset allocation that will be successful vs. a long-term environment that has prevailed. She felt that the Board seemed to be in favor of having flexibility on changing policy around. They had a successful run from the structure of two years ago. They are oversized in US markets, and they need to decide where to put the money when they take it away. They need to be diversified.

Ms. Petrino explained that Page 6 is a summary of the returns and risk measures of the various asset classes. She modeled out how the current managers in each asset class with the weight as of December 9, 2005 had done since 1/1/99, which is when Blackstone started its fund. The total fund shows the actual results. The table shows annualized returns and standard deviations, which is a measure of risk. It also shows the annualized semi-standard deviation, which is the variability of the fund for all returns below 0. The Sharpe ratio is the return divided by risk. She then did a regression to the S&P, EAFE, and the Lehman Brothers Aggregate to see how correlated these assets are with the various indices. A high r-squared means that when the market goes up, the portfolio's

return should be explained by the market movement. The total fund has a very high r -squared to the S&P 500. It was noted that the date on Page 6 should be corrected to 9/30/05, to reflect the full six year period, and the last three years. The results that jumped out have been put in bold print. The proposed changes brought down the standard deviation from 20.9% to 20.1% for U.S. Equity. The hedge funds stood out as well, with a semistandard deviation almost as low as bonds.

On page 7, it shows that during the years 2002-2005, the results weren't quite as good because there was less upside. The Fund had a high standard deviation, and a semi-standard deviation that was competitive with the benchmark. The current U.S. Equity fund has a standard deviation of 16.3%, which is higher than the benchmark, even when reduced by the proposed changes. She said she can provide more proposals at the next meeting. She said that she has the detail for the managers in the appendix. She continued on with the overview.

Pages 8 & 9 reflect what all the managers look like, their portfolio characteristics, and it is based on the holdings analysis for every quarter. They look at that for the attribution and the performance reporting. It shows the statistics of the portfolio at the end of the quarter. She pointed out the market capitalization. She said that there are a lot of small cap managers. The last two segments on page 8 are capitalization quintiles. The first grouping goes from 1-5, and the breakpoints are based on fairly equal distributions. In the second grouping, the breakpoints are fixed; in the Above \$5B group, the large cap managers have 98%, 100%, and 84% of their assets. Wellington has a little bit from \$1-5B. Small cap managers, like LSV, have everything under \$5B. Zesiger has 43% of the market cap of the equity fund in \$100M-\$500M, which is small cap. Chairman Murphy said that all the privates should be removed, as they do not amount to \$1M. There is 12% in the smaller grouping, which is the \$100M-\$500M group, whereas the Russell 3000 Index has 2% in the same grouping. She said that EAI is in favor of being double or triple weighted in small caps, but 4 times is the maximum level of comfort in being overweighted. The column on the right is the proposed reallocation within U.S. Equities, as she was keeping Zesiger as part of the portfolio. The first column on Page 9 shows Artisan and Silchester, which has very little in the large cap, first quintile, and 51% in the lowest quintile. Silchester starts at about \$500M and above. There is 30% in smaller cap in the developed market, and EAFE has 12%. Small cap value has been the strongest area of the international markets, which is where Silchester is. They got off to a slow start, and they are above the benchmarks. They are lagging this year. There are some closed products on the report, such as LSV, Silchester, and GMO.

Ms. Petrino said that the markets are in a rising inflation environment, not in a declining inflation environment, and certainly not in a declining interest rate environment. She measured the inflation by the CPI-U. There has to be active management, active asset allocation, or you have to be in investment areas that may have higher expected returns if you are going to obtain the returns that you want. Ms. Petrino would like to help the Board get the returns it wants, but the question is at what risk. Her solution is to try to be diversified at comfortable levels.

Page 12 is a schematic that shows cycles of the Dow Jones.

Page 13 shows the commodities. They have shown a great return in a stable inflationary environment.

Page 14 shows a summary of the optimistic and pessimistic views. Earnings are coming through from U.S. companies. Based on current evaluations, UBS Global (the optimistic firm) is seeing higher expected returns over the next three years. They are seeing an 11% return from U.S. stocks over the next three years, 5% from international, and 8% from emerging markets.

Mr. Sweeney asked about the possibility of owning Treasury Bills. The Board members agreed that it could be done, and they thought it would be a good idea. Capstone would do it for them.

Page 15 is the latest from Western Asset. They put together a strategy piece every quarter, and they think the probability of lower Treasury yields is about 35%, which is about the same as it's been. Rising inflation is at 40%, and rapid expansion at 25%, both of which suggest higher treasury yields.

Ms. Petrino did some modeling, and said that Page 17 has the assumptions that she used. On the top row are the return and standard deviation assumptions, and the bottom row are the correlations. The correlations are based on history. The base case came from lowering the expected returns from stocks and bonds.

Page 18 shows the base case Efficient Frontier. There are three portfolios. The unconstrained Efficient Frontier is the big arc going from Cash to Private Equity. The Efficient Frontier tells you the infinite combination of portfolios; at every level of risk, there is a highest expected returning portfolio. The assumptions are done for the next three to five years. The pessimistic case shows a 20% chance of earning the 8%. The optimistic case shows returns for a higher level of risk. There is a 30-40% chance of earning the 8%. She referred back to page 3 to show the proposed changes. She was proposing taking 1/3 of the money away from Zesiger. She would have either added a new hedge fund or allocated between the two. She would be taking away from Artisan and Silchester, because they were going to be above what they agreed upon for the allocation. The average amount that most funds have today in International is 17%. They can change the target. The emerging markets is the highest volatility, and it is the highest performing asset class in 2002, 2003, 2004 and likely for 2005. Ms. Petrino suggested that they give a little bit of money to Capstone and increase the Pimco All Asset Fund. That would most likely require a presentation from the Manager.

Mr. Pirro said that each time they propose taking money from Zesiger by taking it out of the segments, they said they couldn't do it. Ms. Petrino said that her proposal takes it from all segments pro rata. It comes 1/3 from U.S., and 1/3 from Emerging Markets. She had a substitute, Archstone, for the hedge fund, which is a conservative manager that has been in business for 15 years, and is one of the best older names for hedge funds. She is

impressed by the way they run their business. They are a fund of funds, and they are located in New York. Federal Street in Stamford was another name to consider, but they are global, mostly long-shore, and more aggressive. Chairman Murphy said he would prefer to stay with two, switch money around, and have Archstone come in and present before they make a decision. Mr. Nash asked for a performance comparison between Archstone and Federal Street for the last three-year period.

Mr. Nash said that at the end of the year, the performance can be evaluated. In January, they want to focus on hedge fund managers. They want Pimco to come in. The suggestion was made to possibly see Blackstone. Chairman Murphy said he wants to see Pimco so that everyone can understand the product, and have a full presentation of the product. Mr. Nash asked if representatives from Pimco's commodity fund could be at the presentation, and Ms. Petrino said that the same people could address the commodity fund. Mr. Moran said he likes the direction of what Ms. Petrino has done. He's willing to listen to the hedge fund idea. He is in favor of the idea of taking cash up to 5%.

Chairman Murphy asked if they wanted to execute the Zesiger move for January 1, or wait until they make a decision on other assets. Zesiger had a really good run in the 3rd quarter. The Total Fund was at \$309M on June 30, and they were at \$329M yesterday. Mr. Moran said there were several things wrong with emerging markets, and that could cost money. Ms. Petrino said that emerging markets can be very volatile. They can't get back into GMO if they come out of it. She was in favor of reducing the emerging markets, and is not comfortable with having any more than 5% in emerging markets. They could probably come out of Zesiger within a month or two.

Ms. McCormick said she was opposed to the reduction, as she was in favor of Zesiger and emerging markets.

Chairman Murphy asked that the motion be removed from the record so that everyone can review the asset allocation information. It was suggested that they vote on this at the January meeting.

OTHER BUSINESS

None.

ADJOURNMENT

** MR. SALVATOR MOVED TO ADJOURN.

** MOTION PASSED UNANIMOUSLY.

The meeting was adjourned at 8:10 p.m.

Respectfully submitted,

Carolyn Marr

Telesco Secretarial Services

