

NORWALK MUNICIPAL EMPLOYEES' PENSION BOARD MINUTES

Minutes from Meeting

FEBRUARY 9, 2005

ATTENDANCE: Jim Murphy, Chairman; Charles Pirro, Rebecca Hoefer, Michael Salvator, Patricia McCormick

STAFF: Sara LeTourneau, Director of Personnel & Labor Relations; Frederic Gilden, Comptroller

OTHERS: Ken Whitman, NASA representative; Ellen Petrino, EAI

CALL TO ORDER

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

CAROLYN NELSON/MARCO VANGELISTI (VIA PHONE)

Ms. Nelson introduced herself as the Client Relations Manager and stated that Mr. Vangelisti has been with the firm for two years. She said he would give an update on the GMO, which was passed around to the board. With reference to page two of the report, Ms. Nelson stated that she was proud of the investment culture. She said they were steadfast to the investment principles and stick to the strategies. Investment management is their only business. She said they were sticking to their convictions.

With regard to assets, Ms. Nelson said they were able to constrain strategies. Firm wise, there has been a growth to \$82b in assets. 43% of the assets are in capacity constrained products. Ms. Nelson stated that she was proud of the diversity and quality of the client base. About 30% of the clients have been with the firm for over ten years. They also sub advise for other investment firms.

Referring to page four of the report, Ms. Nelson read the information regarding global equities into the record. She requested that the board note the fixed income products. She said they manage many customized portfolios. Referring to page five, Ms. Nelson said the firm would be coming up on its two-year anniversary with the City of Norwalk. There has been a 55.7% return. In more recent times, there has been a 26.6% return for 2004. She said they were slightly behind their benchmark. The team has over 40 years of experience. The portfolio management team is very dedicated.

Mr. Vangelisti reviewed the expectations in terms of the return and generating alpha (page eight). The colored portion represents the returns that are expected from market indices for the next seven years. The white area represents the alpha they expect to

deliver on top of that. Referring to page nine, Mr. Vangelesti said the components of total return are changes in P/E expansion, profit margins and real sales growth per share plus the dividend yield. If the earnings stay the same, people will pay higher multiples. Once all factors are added up, 5.9% is the resulting expected return from emerging markets. He said he believed earnings would revert to historic means. The price to earnings ratio should revert to a long-term mean.

Mr. Salvator asked why there was a decrease in the profit margin. Mr. Vangelisti said earnings were low towards the peak of the business cycle. The profit margins seen in the past years are not sustainable. Earnings are at a peak right now. Page eleven references the measurement to be used. According to this measure, the over valuation is between 10-20%. Page 12 shows how good the measure of the adjusted earnings is. Mr. Vangelisti told the board that they did a good job picking the timing of the asset class. Page 13 shows the vulnerability of the asset class. Hungary and the Czech Republic are the only countries that are vulnerable to a currency crisis.

Mr. Murphy asked where the United States is placed. Mr. Vangelisti said it would be considered slightly cheap or at fair value. There are structural issues out there as far as twin deficits. Of the 28% estimated returns last year, 8% was due to the dollar decline. Page 15 shows the percentage of countries vulnerable to a crisis. Almost 50% of the market in the IFC was in the danger zone when we had the last two crises. On page 16, the bubbles indicate the activity in the last 12 months. The asset class was expensive when it was at its most dangerous in 1997. Today, P/E's are moderately expensive but with a low percentage of markets vulnerable. The intent is to deliver 4% alpha over the business cycle. Unlike the more developed markets, country influence continues to dominate returns in the emerging markets. According to Mr. Vangelisti, value and momentum are both important strategies.

Mr. Vangelisti said page 20 referred to the emerging markets investment process. He said they must decide on how much to have in the country. A trade off does this. Pure value and momentum models have been built. Page 22 notes the investment process with regard to the country selection philosophy. The perfect country has a valuation that is cheap on every measure of value. With regard to macroeconomics, there will be strong "future" growth, declining risk, and a stable currency. With momentum, there will be robust fundamentals with a high probability of continued improvement. Good judgment means the "right" long-term policies and conditions. Page 24 shows that the cheap countries are relatively expensive now. Page 25 references portfolio positioning and the GMO emerging markets strategy. Korea Republic, Brazil, Turkey, and Indonesia represent the overweight countries, and Russia, Israel, China, and India represent the underweight countries.

Regarding page 27, Mr. Murphy requested insight and asked why China was underweighted by 3%. Mr. Vangelisti said it was because there was negative alpha on it. Ms. Petrino said the macro judgment factors were larger in China. Mr. Vangelisti said there was negative judgment in China because they have been driving the growth. There has been higher growth for materials. The economy grew at a rate of 10%. There will be

a head wind for China's economy. The model dislikes countries that grow fast. Fast growth is likely to bring disappointment.

According to Mr. Vangelisti, page 29 indicates the changes in weights during the course of 2004. The most important change was in Korea. It was once the largest underweight country, and now it is the largest overweight country. Changes for all other countries are very gradual. According to page 31, the robust value portfolio is 70% of the total portfolio and the momentum portfolio is 30%. Mr. Vangelisti said we could get a sense for the power of signaling. He said that combining value and momentum really helps to reduce risk. Referring to page 34, cheap stocks have become more expensive. He said they were looking for other possible pools for alpha. Quality stocks ended up going from an 8% premium to trading at almost no premium. The premium does not have to be paid. The return on equity is higher than the benchmark. The final analysis is important to the future earnings gross.

Ms. Petrino asked whether there are three portfolios now. Mr. Vangelisti said there were still two portfolios, which are value and momentum. Ms. Petrino asked whether the parts come in 12 monthly slices. Mr. Vangelisti stated that they do not do slicing. He said having a transaction cost or turnover of certain amounts controls turnover. The asset class has grown in the past years. In reference to page 39, Mr. Vangelisti said that the performance relative to the benchmark was 9% in 2003 and there has been a reversal of -3% in 2004. Page 4 shows the return of emerging markets; the losers in 2003 were the winners in the first half of 2004.

Ms. Petrino asked what would happen if global balanced accounts reduced emerging markets exposure. Mr. Vangelisti said it would be easier to manage less money than it would to manage more. Ms. Nelson said they had about 8-9% in the global balance product. She said they were showing a positive real return for the asset class. Mr. Murphy asked them to send the board all of the information. Ms. Nelson said she would send the information.

Mr. Murphy asked if there were any collection issues on tax reclaims with GMO or any outstanding money owed. Mr. Vangelisti said everything had been collected with no problem. Mr. Murphy asked whether there were 100% collections in the portfolio. Mr. Vangelisti asked him what he meant. Mr. Murphy asked Mr. Vangelisti whether he was sure that they would be getting 100% of taxes in other countries. Mr. Vangelisti said he was unaware of this issue. Ms. Nelson said they would get back to the board and confirm.

EAI-ELLEN PETRINO

Ms. Petrino passed around updated asset allocation sheets to the board and discussed the year-end report. She stated that the asset allocation was over in equities and below in fixed incomes. Small caps should be pared back. The last quarter was terrific. It is still possible to earn good returns from certain opportunistic programs. GMO would be a good candidate, but a lot of their programs have been closed. Wellington also has an interesting product. The GMO comes from a more conservative point-of-view. Pimco has a portfolio

that is more fixed-income based. They love derivatives and are fairly tax efficient. The Federal Street has put a good emerging market hedge fund program together. They also have multi-strategy programs. Ms. Petrino said the rest of the portfolio is fairly aggressive. Blackstone was trailing Rising Stars. September 30, 2005 is the key date to decide on a shift from Blackstone. Artisan and Silchester have a low correlation to one another. GMO is broadly diversified but volatile. Pages 7-8 show total funding. The United States is still currently underweight. Mr. Murphy suggested moving things around and said they should have a meeting about this. He said they would probably give a smaller amount to a new manager. Ms. Hoefer suggested having a conference call. Ms. Petrino said they would have to arrange for books to be sent. Mr. Murphy asked what the fee structure for Pimco was. Ms. Petrino said there are 14 of Pimco's funds identified as core funds and 85 basis points is the maximum fee.

**** MS. HOEFER MADE A MOTION TO HAVE \$5M MOVED FROM BOSTON PARTNERS, TCW, AND ZIEZIGER TO THE MONEY MARKET ACCOUNTS.**

**** MR. WHITMAN SECONDED.**

**** MOTION PASSED UNANIMOUSLY.**

APPROVAL OF MINUTES-JANUARY 12, 2005

The following correction were made to the minutes:

Page 1: 5th paragraph, last sentence: "over the benchmark" should be added to the end of the sentence.

Page 1: 6th paragraph, first sentence: "and he reviewed the asset management pension fund" should be omitted from the end of the sentence.

Page 2: Under "Other Business," first paragraph, third sentence: "the policy target in fixed income" should replace "where they want to be."

**** MR. PIRRO MOVED APPROVAL OF THE MINUTES OF JANUARY 12, 2005 WITH CORRECTIONS.**

**** MS. HOEFER SECONDED.**

**** MOTION PASSED UNANIMOUSLY.**

APPROVAL OF PENSION APPLICATIONS

Mr. Murphy read the names from the pension applications into the record. Regarding Roselee Miller, Mr. Murphy asked whether they were allowed to commence in the middle of the month. Ms. LeTourneau said yes. Mr. Murphy asked whether they were up to date with the food service. Mr. Gilden said payments were usually made by February.

** MR. PIRRO MOVED APPROVAL OF THE PENSION APPLICATIONS.
** HOEFER SECONDED.
** MOTION PASSED UNANIMOUSLY.

OTHER BUSINESS

Ms. Petrino passed out the large cap growth search update. She said Columbus Circle had a very nice growth process. Mr. Salvator said he heard there was a lot of turnover in the past year. Ms. Petrino said 70% was sold to the Principal Group. There were ownership issues in the past. The investment group has been together since 1996. Wellington has two different products. TCW had the highest return and risk level. Mr. Murphy said no one was anywhere close to TCW on the chart. Ms. Petrino said Transamerica was very similar and they are looking for stocks with good growth. Mr. Murphy suggested that Wellington and Transamerica come speak with the board. He said a decision should be made at the next meeting. Mr. Murphy also suggested that Mr. Zesiger be sent a copy of the information received and offer the board his view, not give a performance review. Ms. Petrino will arrange a conference call with Pimco.

Ms. McCormick asked where the administrative manual and SPD stand at this point. Ms. McCormick said it was supposed to have been done quickly. Mr. Murphy said it was currently being worked on.

As there was no further business, the meeting was adjourned at 8:00 p.m.

Respectfully Submitted,

Michelle Joseph
Telesco Secretarial Services