

**State of Rhode Island and Providence Plantations  
STATE INVESTMENT COMMISSION**

**Regular Meeting July 25, 2007**

A State Investment Commission (SIC) meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, July 25, 2007. The Treasurer called the meeting to order at 9:10 a.m.

Membership Roll Call. Present were: Mr. Michael Costello, Ms. Rosemary Booth Gallogly, Mr. Robert Gaudreau, Mr. Robert Giudici, Dr. Robert McKenna, Mr. Andrew Reilly, Mr. John Treat, and General Treasurer Frank T. Caprio. Ms. Marcia Reback was absent. Also present were: Mr. Kenneth E. Goodreau, Deputy General Treasurer for Finance; Mr. Brian Gallogly, Esq., of Brown Rudnick Berlack Israels, Legal Counsel to the Commission; Mr. William Bensur, of Wilshire Associates Incorporated, General Consultant to the Commission; Ms. Lisa Tyrrell and Ms. Lara Callahan of State Street Corporation; and other members of the Treasurer's staff.

State Investment Commission Minutes. Treasurer Caprio noted the omission of Mr. Treat's name from the list of members present at the June 27, 2007 meeting. With this correction noted, the Treasurer entertained a motion for approval of the minutes. Mr. Costello moved, Ms. Gallogly seconded and the following motion was passed unanimously. The following members voted in favor: Ms. Gallogly, Mr. Gaudreau, Mr. Reilly, Mr. Treat, and Treasurer Caprio. Mr. Giudici and Dr. McKenna recused themselves from this vote given their absence from the previous meeting.

**VOTED: To approve the Minutes of the June 27, 2007 regular meeting.**

Treasurer Caprio noted that the presentations by Pacific Corporate Group (PCG), Alternative Investments Consultants to the Commission, and Point Judith Capital, as listed on the meeting agenda, were postponed until the August SIC meeting.

Treasurer Caprio then introduced representatives of Wellington Capital Management for a review of and update on their firm, with particular respect to the Wellington Technical Equity Product (WTEP) that the Commission approved for investment in the July SIC meeting. Present as representatives of Wellington were Mr. DJ Fitzpatrick, CFA, Equity Research Analyst; Ms. Elizabeth O'Hara, CFA, Relationship Manager; and Mr. Frank Taxeira, CFA, CMT, Director of Technical Analysis.

Mr. Bensur of Wilshire gave a brief overview of Wellington and the company's small cap opportunities, stating that the company had seen some relatively low third-quarter performance. Mr. Goodreau added that during the last few months, Wellington had beaten their index by more than 400 basis points as of June 30. Mr. Bensur concluded that Wilshire regards Wellington as a high quality, institutionally focused firm, and a great partner for institutions such as the ERSRI.

Ms. O'Hara began the presentation by alerting the Commission that recent SEC investigations of Wellington, instigated in 2004, have been dismissed with no further action impending.

Mr. Fitzpatrick continued with a brief overview of the company and its general strategy, which he characterized as a bottom-up approach to investments. Mr. Fitzpatrick stated that, in the current, decelerating economy, Wellington looks for secular opportunities that can grow independent of the economy itself.

Mr. Treat inquired as to Wellington's "sell discipline" with regards to criteria that would dictate the sale of stocks and/or other investments. Mr. Fitzpatrick replied that Wellington's criteria are threefold, selling when (1) stocks grow too large for the portfolio, (2) stocks meet price targets for sale as determined by Wellington, and/or (3) poorly performing stocks are dragging down the overall performance of the portfolio and it is judged that they should be removed.

Mr. Bensur asked how long Wellington typically takes for a "graceful" exit from investment. Mr. Fitzpatrick stated that exit times are entirely dependent upon the context of each case.

Mr. Giudici inquired as to Wellington's investment approach in terms of timing and assessing various sectors or specific stocks, with particular respect to small cap sectors. Mr. Fitzpatrick answered that Wellington's approach focuses more on the details of specific stocks versus broader sector analysis.

Ms. O'Hara then introduced Mr. Taxeira for his presentation. Mr. Taxeira discussed his eighteen years of professional experience. He stated that technical analysis is not practiced at every firm, but that it is not something new, describing it as a form of market research that identifies persistent behavioral patterns that can indicate the future directions of stock prices. In an overview of his analytic philosophy, Mr. Taxeira stated that he believes disciplined implementation of technical analysis can, over time, provide consistent risk control. He characterized his overall approach as adhering to a "leadership model," which seeks out and invests in the best stocks within strong performing groups, based on a belief that stock prices move concomitant with economic fundamentals. He further stated his belief that these fundamentals are themselves "perfect," but that the analyses of these fundamentals are imperfect due to the natural incorporation of human bias and error.

Mr. Taxeira stated that he oversees more than \$600 million in WTEP, which he characterized as a comparatively large allotment for technical analysis within an organization. Mr. Taxeira stated that WTEP serves two primary functions for its clients: (1) money management and (2) technical research. He likened Wellington to a large shop containing many boutiques, which as a whole work to eliminate bias and error in market predictions for clients.

Mr. Taxeira stated that WTEP employs conceptual pictures of stocks, rather than specific names, in their analyses. He reiterated a belief that good stocks do well over time and rejected the idea of “cheap” stocks, believing the notion to be irrelevant as a motivating factor for investment.

Mr. Reilly inquired as to how WTEP considers anomalies in performance of various stocks. Mr. Taxeira answered that WTEP analyzes both specific stocks and their sectors, and acknowledges anomalies as outlier events that are not significant in terms of broad, long-range analyses. He further stated that he views valuation as an overused tool.

With regards to ERSRI portfolio allocation, Ms. Gallogly inquired as to how, specifically, WTEP would be classified. Mr. Goodreau replied that WTEP does not constitute small cap per se, and emphasized WTEP’s blended benchmark, concluding that WTEP has no real precedent in terms of ERSRI portfolio allocation. Mr. Goodreau raised the issue of addressing the flexibility of the portfolio, and his interest in exploring tactics and opportunities for the portfolio to best maintain an edge. Mr. Costello concurred, acknowledging there may be some discomfort in adopting non-traditional entities such as WTEP, and that investing a small amount with WTEP as the Commission approved is an intelligent way to test its capabilities. Mr. Treat agreed with Mr. Costello but emphasized that the Commission must have a way of defining and assessing all its investments, traditional and non-traditional.

Ms. Gallogly inquired as to the other institutional investors in WTEP, with specific interest in their amounts of investment. Ms. O’Hara answered that one state investor recently raised its investment from \$100 million to \$500 million, but that many other institutional entities have invested at lower numbers.

Bill Bensur inquired as to the capacity of WTEP. Mr. Taxeira answered that the capacity ranges between \$2.0-2.5 billion.

There being no further questions, Treasurer Caprio introduced Mr. Vincent Izzo, Cash Manager, for his presentation on Short-Term Investments.

Short-Term Investments – Manager Selection (The Reserve). Treasurer Caprio informed the Commission that Mr. Izzo has been promoted from Acting Cash Manager to Cash Manager for the ERSRI, and thanked him for his work for the Commission. Mr. Izzo thanked the Treasurer and began by stating that he and his staff have attempted to eliminate risk aggressively, and observed that the money market area has been successful for some time. He then gave an overview of The Reserve, which was founded in 1970 as the world’s first money market fund and currently manages \$30 billion in total assets. Mr. Izzo proposed replacing Dreyfus with The Reserve on the list of Short-Term Investment Managers for the portfolio. Mr. Izzo stated that the New York-based The Reserve is AAA-rated, and satisfies all other SIC criteria for short-term vendor selection. Mr. Izzo concluded that The Reserve consistently outperforms other such firms by 10-15 basis points, and that their rates have equaled or exceed those of the current supplier.

Mr. Goodreau added that the Investments staff has been seeking technologies or methods for rate shopping that would streamline and improve the process to ensure that the ERSRI consistently obtains the best rates available.

Treasurer Caprio entertained a motion to adopt The Reserve as a short-term vendor, to replace Dreyfus. Ms. Gallogly moved, Mr. Costello seconded and the following motion was passed unanimously. The following members voted in favor: Ms. Gallogly, Mr. Gaudreau, Mr. Giudici, Dr. McKenna, Mr. Reilly, Mr. Treat, and Treasurer Caprio.

**VOTED: To adopt The Reserve to the list of Short Term investments vendors, in replacement of Dreyfus, contingent upon satisfactory review and negotiation of investment and other legal documents.**

Capital Market Review – Wilshire Associates. Mr. Bensus began his overview with general market observations, stating that economic growth had been slower to date in 2007; Mr. Bensus expects this trend to continue. In terms of businesses, quarterly earnings growth in 2007 has exceeded expectations; the service sector remains healthy, but the factory sector shows some signs of slowing. Weekly unemployment claims have continued to fall. With respect to consumers, retail sales posted a healthy increase in the second quarter, but job growth is sluggish and unemployment remains at 4.5%. Overall consumer net worth, however, continues to rise. In terms of the housing market, new home sales and starts decreased, and prices on the whole have fallen.

Mr. Bensus noted that the U.S. equity market has been volatile, but that markets have been encouraged by profit reports. He commented that private equity, as exemplified by the Blackstone Group's recent foray into public offerings, has been unusually active in public markets. In the year to date, large cap stocks outperformed small cap stocks for the first time in roughly six years. In terms of international markets, Mr. Bensus observed that emerging markets continue to lead developed markets. European returns have tempered somewhat in 2007 after a strong showing in 2006. In Asia the yen has rallied, reducing the attractiveness of the yen-dollar carry trade, and Mr. Bensus noted some concern over the safety of Chinese imports has cautioned investors towards that market area.

The Federal Reserve has paused rate hikes, with federal funds at a rate of 5.25%. The Federal Reserve Chairman has warned Congress about deficits. Ten-year Treasury yields are near 5.00%. Mr. Bensus predicted that the federal government is unlikely to reduce rates in 2007, and that subprime mortgage issues will continue to be cause for concern. In conclusion, Mr. Bensus stated that the overall portfolio has met its benchmarks in the year to date.

It was noted for the record that Mr. Treat excused himself from the meeting to attend another commitment at 10:50 a.m.

Legal Counsel Report. Mr. Gallogly stated that there was no report for the month.

Deputy Treasurer for Finance Report. Mr. Goodreau addressed the ongoing matter of accounting discrepancies, and the newly implemented practice of separating private equity as its own category of accounting. Mr. Goodreau reiterated that he has classified private equity as a sub-sector in performance reports to more accurately portray performance. For the past month, Mr. Goodreau stated that this new practice portrays the fund in a somewhat more negative light than the former practice would have calculated; he concluded, however, that overall performance is roughly in line with all benchmarks.

Treasurer's Report. Treasurer Caprio added to Mr. Goodreau's report on portfolio accounting, stating that calculations based on private equity as a separate sub-sector saw returns of 15.8% for the previous month, versus 17.4% as calculated using the previous accounting practice. Treasurer Caprio also announced a new position of in-house auditor, as recommended by the Auditor General. The new position will perform auditing duties in addition to the yearly visits from external auditors. Finally, the Treasurer announced that the contract with the current legal counsel, Brown, Rudnick, Berlack Israels, LLP, will expire in October 2007; he informed the Commission that requests have been made for bids from law firms, and that the process will be directed by Chief of Staff and Chief Legal Counsel Mark Dingley.

As a matter of new business, Mr. Reilly raised the matter of reviewing aged funds, with respect to the trend of declining value in aged funds. Mr. Reilly observed that there are fifteen to sixteen such funds within the portfolio, and suggested that the Commission as a group make a closer review of these funds in an effort to prevent them from bringing down overall returns.

Treasurer Caprio asked Mr. Reilly and Mr. Goodreau to draft a related item to be included on a future meeting agenda; Mr. Reilly and Mr. Goodreau agreed.

Ms. Gallogly inquired as to whether there would be a meeting held in August. Mr. Goodreau confirmed there would be a meeting given the time sensitivity with respect to a vote on potential investment in Point Judith Capital.

There being no questions from the members and no new business, Treasurer Caprio entertained a motion to adjourn the meeting. Mr. Giudici moved, Mr. Reilly seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Ms. Gallogly, Mr. Giudici, Mr. Gaudreau, Dr. McKenna, Mr. Reilly, and Treasurer Caprio.

**VOTED: To adjourn the meeting.**

There being no further business, the meeting was adjourned at 11:05 a.m.

Respectfully submitted,

Frank T. Caprio  
General Treasurer