State of Rhode Island and Providence Plantations
STATE INVESTMENT COMMISSION

Monthly Meeting April 27, 2011

A State Investment Commission (SIC) meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, April 27, 2011. General Treasurer Raimondo called the meeting to order at 9:05 a.m.

Membership Roll Call. Present were: Ms. Rosemary Booth Gallogly, Mr. Thomas Fay, Mr. Robert Giudici, Ms. Marcia Reback, Mr. Andrew Reilly and General Treasurer Gina Raimondo, establishing a quorum. Also present were: Ms. Sally Dowling, of Adler Pollock, & Sheehan, and Joe Rodio Jr.,of Rodio & Ursillo, Legal Counsel to the Commission; Mr. John Burns of Pension Consulting Alliance (PCA), General Policy Consultant to the Commission; Mr. Nicholas Katsikis of State Street Corporation; Thomas Lynch of Cliffwater and members of the Treasurer's staff.

State Investment Commission Minutes. Treasurer Raimondo entertained a motion to approve the minutes for the meeting of March 23, 2011. Ms. Reback moved, Mr. Fay seconded, and the subsequent motion passed. The following members voted in favor: Ms. Rosemary Booth Gallogly, Mr. Thomas Fay, Mr. Robert Giudici, Ms. Marcia Reback, Mr. Andrew Reilly and General Treasurer Gina Raimondo

VOTED: To approve the Minutes of the March 23, 2011 monthly meeting.

Update on Asset Liability Study. Treasurer Raimondo called upon Mr. Burns to update the board on the asset liability study. Mr. Burns referenced the handout to review the strategic asset classes and the role of assets. Mr. Burns described the asset classes to be modeled. Mr. Burns explained how he would model undefined classes such as real return and real estate to best reflect the portfolio.
Ms. Booth Gallogly asked if we are modifying it to get us to where Townsend is now or is that a starting point.
Mr. Burns said it is a starting point, but it will be a little more conservative. He pointed out, if you are aggressive today, it is going to take years to get out of that posture. This is why you can blend those models together now and not give up a lot.
Mr. Fay asked how consistent this is with other institutional portfolios looking at the real estate space.
Mr. Burns responded nearly everyone was surprised with their real estate portfolios. They thought they had core real estate and they actually had private equity. Many of PCA's clients are trying to adjust their portfolio to fix this.
Treasurer Raimondo explained the key objective of this study is to provide guidance on the role of real estate and fixed income in our portfolio. The reason Mr. Burns is making it more aggressive is to reflect what we actually own.
Mr. Burns said it is going to be aggressive for awhile no matter what the policy. Also, they don't assume any manager alpha. Just because you have active managers doesn't mean you automatically account for that. It is less the case for Rhode Island because they have less active managers, but this is what the market will give you. Mr. Burns then explained that PCA does not rely on mean variance optimization (MVO), and explained the reasons it was out-dated. He then pointed out how PCA does it differently to create a more realistic set of possible outcomes. He went on to describe allocation restraints used in asset-liability simulations to account for the possibility that the current asset allocation policy might change. Mr. Burns explained that the portfolio is 2:1 U.S. equity to non-U.S. equity. He explained the benefits of diversifying more globally including less risk, greater participation in emerging markets and a better alignment with the investment opportunity universe. The potential risks are larger geopolitical risk and increased currency risk.

Mr. Fay pointed out that most of the models will separate emerging from developed because the characteristics are so different. They are aggregated in this model.
Mr. Burns said that international gets a marginally higher expected return and slightly higher risk. Once you start parsing the portfolio too tightly, mathematically it gets unwieldy, so sometimes you have to refine it more simply.
Ms. Booth Gallogly asked if there are any geopolitical and currency risk in other asset classes.
Mr. Burns said everything is dollar based including foreign based bonds.
Treasurer Raimondo asked Mr. Burns how he will engage the board in the process, because some decisions have to be made.
Mr. Burns said the actuary who is doing the study has all the liability work from Gabriel, Roeder, Smith & Company and is in the process of modeling that as we speak. After today, we will give him the return data. He will have the first attempt at the study and Mr. Burns hopes the board will point out where they want to spend their limited time and resources.
Treasurer Raimondo let the board know she and Mark Dingley spent some time with the actuary Robert McCrory and she was impressed with his experience, diligence and ability to get his arms around the portfolio.
Mr. Burns went on to show the expected return in 2003 compared to 2011 and pointed out the main difference is interest rates.

Cliffwater Presentation: Treasurer Raimondo praised Pacific Corporate Group for being cooperative in the transition process. All of the general partners have been notified of the transition. Cliffwater has done a fantastic job getting started.
Mr. Lynch updated the board on the short-term and long-term objectives with the mandated objective to build a superior alternative investment portfolio to meet strategic asset allocation. In the short-term, Cliffwater will complete the transition from PCG, develop goals and objectives for the portfolio, provide an assessment of the current portfolio and develop an investment plan for the portfolio.
Mr. Goodreau mentioned, if any of the board finds something they want to be more involved in that opportunity is available.
Mr. Lynch then went over the timeline for the objectives on page 4 of the handout.
Treasurer Raimondo asked when Cliffwater anticipates coming to the board with specific recommendations in private equity.
Mr. Lynch reported at the end of May.
Treasurer Raimondo asked if there is any detriment to waiting.
Mr. Lynch said you will not miss anything in the next 30 days.
Treasurer Raimondo asked if Cliffwater is recommending any secondary sales.
My. Lynch says yes, to be opportunistic. Cliffwater will put the portfolio into three categories: buy, hold and sell.
Treasurer Raimondo asked if we have has a private equity subcommittee.
Mr. Reilly replied yes, it was Mr. Goodreau, Michelle Davidson and Mr. Reilly.
Mr. Reilly pointed out, if you monitor funds, there are times when people would be willing to pay a lot in the secondary market for funds they weren't willing to buy before.
Mr. Goodreau pointed out the secondary approach before was a big macro decision to get back in line with cash flows. Now we have positive cash flow so we don't feel we have to sell private equity. Now we can approach it from an opportunistic standpoint.
Mr. Reilly said what is important now is active portfolio management to reduce drag to the IRR.
Mr. Lynch reviewed the specific objectives for the alternative portfolio: generating the right kind of alpha and avoiding added equity, beta restructuring the existing alternative investment portfolio and facilitating an investment process that allows for efficient execution and implementation. The target is to generate annual alpha of 300bps with an information ratio of 1.0 or greater. He explained the Cliffwater conducts a survey of 97 public pension funds with $2.1 trillion in assets and their alternative investment allocations. Roughly 20% of all pension fund assets are invested in alternative investments and they are increasing about 1-2% per year with hedge funds as the fastest growing subgroup.
Treasurer Raimondo asked why hedge funds would be a separate category from real assets.
Mr. Lynch answered that real assets have a positive correlation to unexpected inflation and hedge funds do not have that component. But there is still a little beta exposure and some have positive correlation to equities, interest rates, credit spreads and commodities. It is only a small part of the hedge fund world that has commodity exposure, which is why it is looked at as a separate allocation.
Treasurer Raimondo asked, if you have a long-short U.S. equity fund that is unlevered, should that be in the hedge fund or equity?

Mr. Lynch responded that he would break out the hedge fund strategies to produce alpha and apply it to the traditional asset class as it associates to beta. He would put the long-short manager in the equity portfolio. The best practice would be to apply the hedge fund strategies which are trying to approve alpha to the beta they are investing in.
Mr. Reilly pointed out the board has never had the conversation of the allocation within the private equity allocation. There are certain areas within this where we have no exposure.
Mr. Lynch agreed and said mezzanine is an area the portfolio doesn't have exposure. He then explained a chart of public pension funds and their allocation to alternatives, including MOSERS which has a 54% allocation to alternatives and is similar in size to ERSRI. The median is 17% and the average is 20%. He then explained the types of alternative investment used by public funds. The biggest systematic shift is from real estate to hedge funds.
Treasurer Raimondo explained the slide on page 7 showing public funds allocation to alternatives is useful, but would be more useful if we knew the liability side of the equation for those funds.
Ms. Booth Gallogly asked about the plans with the largest allocation to alternatives and if that is where they wanted to be. Do they have cash problems?
Mr. Lynch said they didn't necessarily want to be that high.
Mr. Goodreau explained MOSERS has made a collective decision and Pennsylvania has a lot of portable alpha and real estate they didn't necessarily want to be in.
Mr. Lynch then provided a brief private equity market outlook. He pointed out the buyout market continues expansion with more credit and the buyout volume is expanding with larger buyout deals. Cliffwater believes the opportunities going forward are in the buyout space more weighted in the small to medium size funds. Venture capital is still attractive in the early stage because of social media companies. There are distressed opportunities in Europe as banks restructure and growth in emerging markets in Asia, South America and Eastern Europe.

Legal Counsel Report. Legal Counsel had no other report.

Chief Investment Officer Report. Mr. Goodreau reported performance is more reflective of reality because private equity accounting was lagging dramatically. Our three year number is 2.8% and the benchmark is 2.1%. Our one year is 13% and our benchmark is 12.9% so we are either modestly above or below. Year to date is 4.3% with a 4.0% benchmark. There is still some lag in the S &P, with a benchmark of S& P plus 300bps. The private equity has a quarter of lag, so it is catching up and that is where the drag was before. We are north of $7.5 billion as of last night's close and $7.48 billion in this report.

Treasurer's Report. Treasurer Raimondo pointed out the board received a copy of the experience study from the Rhode Island Retirement Board. The retirement board voted to approve the recommendations in the actuary's report which include the adjustment of the mortality assumptions and a reduction in the assumed rate of return. She let the board know the next fiduciary training is in June.
Mr. Goodreau asked the board to let him know if they have an interest in the private equity subcommittee.

New Business. There was no new business.

There being no new business, Mr. Reilly moved to adjourn, Ms. Booth Gallogly seconded and the subsequent motion passed. The following members voted in favor: Ms. Rosemary Booth Gallogly, Mr. Thomas Fay, Mr. Robert Giudici, Ms. Marcia Reback, Mr. Andrew Reilly and General Treasurer Gina Raimondo

VOTED: To adjourn the meeting.

There being no further business, the meeting was adjourned at 10:15 a.m.

Respectfully submitted,

Gina Raimondo

Gina M. Raimondo
General Treasurer