November 10, 2008
Minutes # 442

Minutes of the Board of Trustees' Meeting

Call to Order: Chairman, Donald Pinard called the meeting to order at 8:30 a.m.

Present: Trustees: Chairman, Donald Pinard, Chuck Hungler, Jennie Angell, Bill Sanders, and Jeff Duval
MECRS Staff: Gerard Fleury, Sandi Aboshar and Suzanne Wilson

Absent: Trustee: Mayor Frank Guinta and Kevin Barry

In Attendance: Attorney John Rich legal counsel from the McLane Law Firm
Sebastian Grzejka, Analyst and Kevin Leonard, Partner, of New England Pension Consultants.
Joseph Miletich, CFA and Tim Conry, Relationship Manager of Mellon Capital Management

Approval of the Minutes of the Previous Board Meeting:

A motion was made by Trustee Sanders to approve the minutes of the October 14, 2008 seconded by Trustee Hungler and passed unanimously by all those trustees present.

Approval of the Immediate Meeting Agenda:

Trustee Duval made a motion to accept the immediate meeting agenda, seconded by Trustee Sanders and passed unanimously by all those trustees present.

New Business:

NEPC Presentation – Mr. Kevin Leonard, Senior Consultant and Mr. Sebastian Grzejka, Analyst of NEPC were present to review the third quarter performance numbers and to also reevaluate the performance of Mellon Capital Management within the MECRS portfolio.

After distributing Third Quarter 2008 Investment Review Booklets to the trustees Mr. Leonard referred to the section entitled "Market Environment Overview" and noted that most equity benchmarks had negative double digit returns. Specifically, the S&P 500 was down 8.4% for the quarter, year to date down 19.3% and trailing 1yr, down 22%. He further noted that the Russell 1000, Large Growth, Large Value, the Russell 2000, Small Core, Small Growth, were all down significantly. Moving on to the International Equity

Benchmarks, Mr. Leonard reported that they had also experienced poor performance for the quarter.

Mr. Leonard provided a breakdown of universe ranking verses the System's active managers. He pointed out that Core Fixed Income was down 0.5% which ranked in the 15 percentile, therefore indicating that 85% of the active bond managers underperformed by .5%. He further noted that most active managers are underperforming the Lehman aggregate.

Through October, equity markets lost between 25% and 55%, U.S. Treasuries and sovereign debt were the only place which preserved capital. Mr. Leonard noted that Hedge Funds were not spared from the liquidity crunch and lost about 10% on average, a loss level about halfway between that experienced by U.S. equities and fixed income.

Trustee Sanders asked Mr. Leonard if it is his sense that the financial crisis has reached it's lowest point.

Mr. Leonard responded that he felt that the overall crisis has not reached its lowest point. He added that what the government is doing to stimulate the credit crisis is somewhat positive. There are still additional issues to consider however including investment return measures and economic factors such as rising unemployment, inflation and falling consumer confidence.

A short lull ensued and Mr. Fleury took the opportunity to interject that the System has yet to receive the draft subscription agreement from the newly hired Private Equity Fund of Funds, Lexington Capital Management and asked Mr. Leonard what the System should expect in the form of delays from Lexington. Mr. Fleury cited recent articles reporting difficulties being experienced by private equity fund of funds in secondary markets and he speculated on whether related factors could be in play with Lexington. He also made reference to NEPC's previous recommendation for the board to consider a "SMID" Cap Core Equity Manager Search in January. He noted that NASDAQ volatility and performance appeared to demonstrate return expectations which correlated to SMID Managers, and he asked Mr. Leonard what might be expected from the SMID managers moving forward.

Mr. Leonard noted that he had been in Richmond, VA at Lexington's office last week and that the subscription documents should be forwarded to the System by the end of the year and are expecting to have their first call, either the first quarter or second quarter of next year. The System shouldn't be concerned that there is not any opportunities in the secondary market.

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In response to Mr. Fleury's second question regarding NEPC's recommendation for the inclusion of small and midcap managers "SMID" in the System's portfolio, Mr. Leonard noted that NEPC is going to proceed with the SMID Core Search and provided the trustees with a short list of potential managers for the trustees' review and consideration.

Mr. Fleury followed up with a commented that the entry into Portable Alpha has been disappointing due to the S&P performance coupled with negative alpha.

Mr. Leonard stated MECRS' entry into Portable Alpha was at the worse time, however NEPC's recommendation to invest into Portable Alpha was not for a short term recommendation and should been seen as a long term investment.

On that note, Mr. Leonard referred to page 17 of the Investment Review and pointed out that for the third quarter Benchmark Plus had been down 17.4% and Gottex down 16.7%. He continued with a review of the performance summary list, reported investment returns for each manager, quarterly and year to date. He noted that the domestic equity composite underperformed the S&P 500, which was down 22.4%. On the international side he reported that the equity composite had been down 30.1%.

Attorney Rich asked Mr. Leonard why there is such a disparity with the respect to the MECRS' performance against its peer pension funds for the 3 and 5 year periods, when the MECRS had outperformed peer pension funds and the current year where the MECRS underperformed those same peers.

Mr. Leonard responded that a big factor is the underperformance of Mellon Capital which is 15.7% of the MECRS' overall portfolio and also the System being over weight in equities verses fixed income. MECRS' target to fixed income of 18% is lower than the average but Hedge Fund exposure is meant to offset that.

Mr. Leonard reported MECRS' overall portfolio results down 16.4% and the policy index down 13.2%.

Trustee Sanders referred to the Asset Growth Summary of the Review and compared the market value of assets with the Systems liabilities and expressed concern that at the end of the year the System might end up with a funded ratio of 60% or less.

The trustees continued to discuss different scenarios with the changing demographics of the Plan and the unprecedented market volatility.

In closing his presentation, Mr. Leonard stated that NEPC in not recommending any re-balancing of the MECRS' portfolio at this time. Moving forward the board needs to stay on track to what is prudent and in line with policy but also recognizing, at some point, that the board may need to take some risk and expand opportunities in these extreme times.

Mellon Capital Portfolio Presentation - Mr. Joseph Miletich, CFA and Tim Conry, Relationship Manager from Mellon Capital Management introduced themselves and began by distributing presentation booklets to the trustees. Mr. Conry referred to page one of the booklets and noted that on April, 2007 the MECRS invested $23.9 million dollars with Mellon Capital and as of September 30, 2008 that amount has fallen to $19,767,249.

Mr. Conry explained that the System once participated in two funds, the domestic only asset allocation fund and the global tactical asset allocation fund, long only. In April of 2007, the investments in those two funds were consolidated into the Global Alpha I which allowed for shorting.

Mr. Conry referred to a chart of the Global Alpha I Fund and its historical performance since inception which indicates positive performance results. He described 2008 as being uncharacteristically poor with a negative return of 23.84% against a benchmark of 13.67%.

Mr. Conry explained that the premise of Mellon's strategy has been to remain long in equities. For further elaboration, he turns the presentation over to Mr. Miletich.

Mr. Miletich provided the trustees with a detailed description of Mellon's investment philosophy and stated that Mellon's two core competencies are indexing and asset allocation.

Trustee Sanders asked Mr. Miletich about the current fee structure between Mellon Capital and the MECRS. He specifically inquired about the amount paid to Mellon last year and the cost due this year.

Mr. Conry was unable to provide Trustee Sanders with the dollar amount but indicated that the System paid Mellon 80 basis points on the total asset value.

Trustee Sanders then asked if Mellon anticipated reducing the percentage fees charged to their customers in light of suboptimal performance and whether the returns cited in Mellon's handouts were reflective of the investment manager's fee.

Mr. Miletich replied that Mellon currently does not plan to reduce the fees structure, that the fund operates like a hedge fund, and that they are able to take long and short positions. The goal of Mellon is to try to make 5% above the benchmark for an additional risk of 5%. These are typical goals for hedge funds which charge 2% plus an additional 20% of any profit. Mellon Capital, being an index base manager and a low cost provider, has always offered very good terms to their clients and at .8%. Mellon feels that this is the best deal available for this kind of product if return expectations are met over time.

In response to the second part of Trustee Sanders question, Mr. Miletich stated that the booklet does not reflect the fees charged to the System.

Mr. Fleury commented that had the System opted to merge the domestic portfolio into the global and not allowed Mellon to short, a lower fee schedule would have applied but the option of allowing the manager to use shorts resulted in the higher fees. Obviously there are costs associated with executing those shorts. He questioned whether the decision to move into a portfolio that allowed Mellon to short, proved to be to the Systems advantage or disadvantage net of all fees?

Mr. Miletich replied that it has been to the Systems disadvantage for the period of time that the MECRS has been in the fund. He referred to page 22 of his presentation regarding Mellon's proven record of success across their product line, indicating their historical excess return relative to the benchmark of the U.S. TAA Fund as well as GTAA Fund, Global Alpha and EB Global Alpha.

In concluding his presentation, Mr. Miletich stated that this is actually Mellon's fourth bad cycle and after each of the prior three cycles, Mellon has bounced back with their best performance in the period immediately following. He stated that if Mellon were to be fired for poor performance, chances are it will turn out to be a bad decision; however he indicated that Mellon fully understands the board's concerns.

Trustee Angell asked Mr. Miletich how many employees the Mellon Organization has and whether that number is reflective of number employed at peer managers in this stage of the market cycle. He responded that there are about 400 staff members at Mellon Capital, with 100 employees in Mellon's Research Investment Management Section.

Mr. Miletich explained to the trustees that Mellon achieves a measure of market exposure through the use of index funds. Other inputs to their model are derived from expected bond yields, which are observable in the marketplace and can be determined without intensive internal analysis. He went on to explain that as a whole, Mellon's' portfolio management process is more lean in terms of human resource needs than some other managers because of its use of marketplace information and index funds.

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Mr. Leonard and the board continued by asking Mr. Miletech a number of generic investment questions, some dealing with liquidity and Mellon's positions in the bond markets.

In the absence of any further questions from the board or its representatives and having otherwise covered their planned presentation materials, Mr. Miletich and Mr. Conry thanked the board for their time and departed.

Following the departure of the Mellon representatives, Mr. Leonard reiterated NEPCs' recommendation that the MECRS not consider terminating Mellon Capital. He explained that NEPC has had very few of their clients withdraw their investment with Mellon, that NEPC was in frequent contact with Mellon, and that they could not justify termination at this time. He also noted that NEPC has invested some of its own capital in this product and has no plans to terminate the investment. He closed on the subject by assuring the board that NEPC will continue to monitor the Mellon's performance very carefully over the coming quarters and that if the situation continued to appear bleak after nine months that we could revisit the matter.

Prior to departing Mr. Leonard asked the board of their preference regarding the "SMID" Manager Search and if they were satisfied with the three managers identified in handout materials and recommended by NEPC or if they would like an additional manger added.

Trustee Hungler replied that as Chairman of the Investment Committee, he felt that three managers were adequate for January interview purposes. There was no opposition to his position.

Mr. Fleury noted for all present that the next Investment Committee Meeting at which SMID Managers would be interviewed is scheduled for Monday, January 12, 2009, at 8:30 am.

<u>New Business:</u>

<u>Application for Disability Retirement –</u> Administrative recommendation for disability application filed by Mr. Roger Olheiser.

Moved by Mr. Duval, seconded by Mr. Hungler that the Trustees convene into executive session at 10:50 a.m. under the provisions of RSA-91-A: 3, II (c) to discuss disability benefit applications.

Ayes: Messrs. Pinard, Sanders, Angell, Hungler and Duval

Nays: None.
Motion carried unanimously.

Moved by Mr. Duval, seconded by Mr. Hungler, that the Trustees conclude executive session at 11:12 a.m.

Roll call vote:

Ayes: Messrs. Pinard, Sanders, Angell, Hungler, and Duval

Nays: None.

Motion carried unanimously.

Moved by Chairman Pinard to seal the minutes of the Executive Session, seconded by Trustee Duval and passed by all trustees present.

Trustee Hungler offered a motion to approve the disability retirement applicant of Mr. Roger Olheiser, seconded by Trustee Pinard and passed unanimously by all those trustees present.

Other Business:

Trustee Duval announced that he has submitted a letter to the Board of Mayor and Alderman informing them that due to personal matters, he will not be seeking re-appointment to the MECRS Board of Trustees.

Report of the Executive Direcrtor:

Status of MECRS Trustee Election 2008 - Mr. Fleury began by reporting that the City Clerk's Office has notified the System that as of the deadline for this year's trustee election, only one candidate filed to appear on the ballot. The name of Donald Pinard will therefore be the only name on the ballot. The election is scheduled for Thursday, December 11, 2008. Retirees and vested deferred members have been advised of this by direct mail.

MECRS Receives 2008 PPCC Award – Mr. Fleury notified the board that for the last five years the MECRS has applied for and received the Public Pension Coordinating council's

"Public Pension Standard Award". The PPCC is a confederation of the National Association of State Retirement Administrators (NASRA), the National Conference on Public Employees Retirement Systems) NCPERS, and National Council on Teacher Retirement (NCTR). This year the PPCC raised the requirements for qualification and therefore split the award into two categories, one for meeting funding standards and the other for meeting administrative standards with applicants being allowed to apply for either or both. For 2008, the MECRS applied for and received the award for both categories.

Project Preparation for Pension Software Upgrade - Next, Mr. Fleury informed the board that in preparation for the pension software upgrade project which may move forward in 2009, a survey of other public plans which have purchased and are using the application we are considering has been drafted. Since this will be an IT project, Mr. Fleury stated that he has sought assistance for the City IT Department to provide advice and to act as a sounding board on any technology issues related to the project which might arise. Mr. Fleury stated that while he felt very comfortable with his role overseeing such a project, he appreciated and welcomed the alternative prospective of people in the information technology field.

Military Service Eligibility Question Resolved - Concluding his report, Mr. Fleury noted that in September, a member questioned whether they could purchase service credit for time while enlisted in the military almost 25 years ago. Whereas present federal regulations only took effect in 1991, the question justified an opinion from counsel. That opinion was received and placed on file on October 28th and the short answer to question given the circumstances in this particular case is that the member can buy service credit for his four years of military service. Mr. Fleury noted that the System will be careful not to equate this to blanket eligibility in all circumstances because there are numerous which must be met which were clearly within the scope of compliance this time but such might not always be the case.

Previous Business:

Ratification of Amended Personnel Policy – At its October meeting the board implemented a longevity policy scheduled to go into effect on July 1, 2009. Since that action effectively amends the MECRS Personnel Policy by adding a new section defining longevity, the board is hereby asked to ratify the policy inclusive of the new section.

A motion was offered by Trustee Duval to ratify the MECRS Personnel Policy inclusive of the new section regarding longevity. Seconded by Trustee Hungler and passed unanimously by all those trustees present.

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Revision of Investment Policy & Guidelines – Next, Mr. Fleury reported the need for a minor revision to the MECRS Investment Policy & Guidelines. Due to the addition of Gottex, Benchmark and Lexington to our stable of managers, the policy now has an additional page for each new manager in the appendix. The board is hereby asked to ratify the policy inclusive of the new pages in the appendix which have been designated sections 14, 18 & 19.

It was moved by Trustee Hungler ratify the Investment Policy & Guidelines inclusive of the new pages in the appendix and a last minute associated update distributed at the start of the meeting, seconded by Trustee Duval.

Trustee Hungler observed that the target allocation page of the monthly performance reports received from NEPC were not in complete agreement with the target allocations listed in the policy for two of the investment managers and that the report needs to be revised to reflect that the benchmarks cited in the policy.

Mr. Fleury noted the affected managers and assured the board that he would communicate the need to NEPC so that in future reports would properly correlate to the policy on file.

Motion carried unanimously.

Consent Agenda:

A motion was offered by Trustee Duval to accept the Consent Agenda, seconded by Trustee Angell and passed unanimously by all those trustees present.

Next Meeting Schedule:

Chairman Pinard noted that the next scheduled board meeting is Tuesday, December 9, 2008 at 8:30 a.m.

There being no further business to transact, Trustee Duval offered a motion to adjourn at 11:27 a.m. seconded by Trustee Hungler and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury
Executive Director