October 13, 2009
Minutes #452

Minutes of the Board of Trustees' Meeting -1-

Call to Order: Chairman, Donald Pinard called the meeting to order at 8:45 a.m.

Present: Trustees: Chairman, Donald Pinard, Jennie Angell, Richard Molan, Chuck Hungler, and Kevin Barry
MECRS Staff: Gerard Fleury, Sandi Aboshar and Suzanne Wilson

Absent: Trustees: Mayor Frank Guinta and Bill Sanders

In Attendance: Attorney John Rich of McLane Law Firm
Mr. Kevin Leonard and Mr. Sebastian Grzejka of NEPC
Mr. Robert Fitzpatrick, CFA, Portfolio Manager and Mr. Peter McManus, CFP, Principal Account Manger, both from Cadence Capital Mgmt., also Mr. James Thorsen, CFA and Ms. Heather McGoldrick, both from State Street Global Advisors
Also, Mr. Guy Beloin of the Finance Dept.

Approval of the Minutes of the Previous Board Meeting:

A motion was made by Trustee Hungler to approve the minutes of the September 8, 2009 board meeting, seconded by Trustee Molan and passed unanimously by all those trustees present.

Approval of the Immediate Meeting Agenda:

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

Report of the Executive Director:

Update – Request From a Vested Deferred Member - Mr. Fleury began by reporting that based upon a preliminary response from counsel, the MECRS has taken an administrative position that vested deferred members generally may not make additional contributions. The basis for this position can be found in Internal Revenue Section 415(c) which imposes limits on voluntary pension fund contributions. Since those limits are generally the lesser of annual salaries paid by the participating employer or the IRS ceiling as adjusted for inflation annually, a vested deferred member would have a limit of zero after one year of separation.

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7th Annual NEPERS Conference – Next, Mr. Fleury noted there is still time for the trustees to register for the 7th annual NEPERS Conference in Boston on October 27th.

Computer Hardware Replacement- Mr. Fleury explained that after the complete failure of one of the staff's desktop computers, the desktop computer units for all three staff members have been replaced. Replacing the failed unit with like kind would not have made sense and all three units needed to be the same in order to standardize configurations and functionality. In order to keep costs down, existing flat screen monitors which were perfectly good and could be used with the new computer were retained. The previous machines had served since 2003 and had been budgeted for replacement. The new units meet or exceed the recommended specification for desktop units should MECRS eventually proceed with a pension software upgrade and replacement server. Also, Mr. Fleury noted that in order to ensure that confidential data is not compromised when the old machines are disposed, the hard drives will either be erased or destroyed.

Status of Cash Management Proposals - Mr. Fleury then informed the board that little had transpired in the last month regarding the cash investment options being investigated because of delayed response from State Street Bank, the system's current custodial bank. Repeated requests for information had yielded little more than phone calls and nothing written or printed to date. Unlike Citizens and TD Bank which each issued written proposals, State Street Bank & Trust was disappointingly slow in providing any information on cash options. While materials have been promised, MECRS is still awaiting receipt as of the end of September.

Experience Study With GRS - In closing his report Mr. Fleury stated that the experience study commissioned by the Board and being performed by Gabriel, Roeder Smith & Co. is underway and should be completed and ready for presentation at the December Board of Trustees meeting.

Trustee Hungler referred to the Informational Item, MECRS Proforma Cash Flow Schedule, included in the trustees' agenda packets and asked Mr. Fleury if the decrease in the Cash Inflow Contributions, Weekly Accumulation, was due to the 5 week period versus the 4 week period.

Mr. Fleury responded that the decrease is possibly due to the lump sum distributions from the school department which occur at the end of employee contracts. He noted that as actual terminations occur, those values replace averaged projection and effect ending balances as well as future projections. As with all categories in the schedule, as actual amounts become know, they replaced estimated amounts in the original schedule.

Chairman Pinard requested that the schedule include the variance amount.

Mr. Fleury responded that he would be happy to include a new row indicating the amount of monthly variance going forward.

Administrative Accounting Committee:

Committee Chairman Barry reported on the Administrative & Accounting Committee meeting held 8:00 a.m. that morning. He commented that the committee had reviewed the first draft of the MECRS operating budget for 2010 and that it is expecting to receive the final budget for approval at the A & A meeting on November 9, 2009. Also, Chairman Barry indicated that the committee had discussed staff salaries and that Mr. Fleury will be providing the committee members with the Condrey Study results, adopted by the MECRS board in January, 2007, and its history. Mr. Fleury noted that materials provided to the committee and the board would disclose the entire salary scale and each employee's history on the scale, for review purposes.

Benefits Committee:

Mr. Fleury commented that there is a scheduled meeting of the Advisory Committee on October 15, 2009.

Mr. Fleury also informed the board that MERCS had just received the 2009 Public Pension Standards Award for funding and administration standards presented by the National Association of State Retirement Administrators, National Conference of Public Employees' Retirement System and the National Council of Teacher Retirement Systems which together form the Public Pension Coordinating Counsel.
For the sixth year the MECRS has met the standard for excellence.

Previous Business:

Ratification of Amendment to MECRS Asset Allocation - Mr. Kevin Leonard, of NEPC recommended that as a result of assets being allocated from Global TAA to Credit Opportunities, that the asset allocation target weight for Global TAA be reduced from 17% to 12%. Formal recognition of this change in the policy was overlooked and should be ratified by the board in recognition of decisions in July.

Adoption of Cosmetic Amendments to Investment Policy Guidelines – Also, Mr. Leonard noted that performance of various fixed income managers had previously been indexed to an average calculated and published by Lehman Brothers. As a result of the failure of Lehman Brothers, the index is now being maintained by Barclay Capital and carries that name. He recommended that in addition to the target allocation change previously mentioned, that the board should act to accept an amended policy where all references to Lehmann Brothers have been replaced with Barclay Capital.

It was moved by Trustee Molan to accept both amendments as stated by Mr. Leonard, seconded by Trustee Hungler and passed unanimously by all those trustees present.

Continuing, Mr. Leonard reviewed the Investment Market Update as of September 30, 2009. He referred to page 2 of the handout distributed to the trustees at the start of the meeting. The chart indicated the 2009 returns from January 1st thru September 30th, ranking from high to low. Mr. Leonard indicated that the highest rate of return is International Emerging Markets, with equities up almost 65%, and with the lowest return being global fixed income at 4.6%. He also pointed out that all major categories are showing positive results since 2008.

Mr. Grzejka, briefly reviewed the System's, key manager performance through September 30, 2009 and noted that Mellon Capital is up 28% year-to-date thus outperforming their benchmark by over 13%. The two portable alpha managers are up year-to-date in comparison to their benchmark of 19%. Gottex, which is the more conservative of the two managers, is up 29% or 10% over the benchmark. Benchmark is up 48% or 29% over the benchmark S&P500.

In terms of international equity managers, Mr. Grzejka informed the trustees that Grphyon is up over 45% for the year-to-date, Causeway up over 31%, both beating the MSCI benchmark of 29%. City of London is up 65% for the year-to-date which was in line with its MSCI Emerging Markets benchmark. In summary, Mr. Grzejka expressed his assessment that the System's portfolio has experienced a very nice rebound.

New Business:

Investment Manager Reviews - NEPC Representatives Mr. Kevin Leonard and Mr. Sebastian Grzejka also coordinated the performance reviews of both MECRS Large Cap Equity Managers.

Representatives, Mr. Jim Thorsen and Ms. Heather McGoldrick of State Street Global Advisors introduced themselves to the trustees and staff and began their performance review at 9:30 a.m.

Mr. Jim Thorsen, CFA began by providing brief biographies of Ms. Heather McGoldrick and himself, stating that Ms. McGoldrick is a Vice President of State Street Global Advisors and a Senior Portfolio Manager for the US Active Quantitative Equity Team. He informed the trustees that he is also a Vice President of SSGA, a Senior Relationship Manager, and a Public Funds Team Leader.

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Mr. Thorsen referred to page 4, of the presentation materials that had been included in the trustees' agenda packets. He noted that the market value of the MECRS account as of August 31, 2009 was not quite $9 million and since then had improved somewhat. He also noted the participation of dedicated employees at SSGA on the public funds team.

Mr. Thorsen stated that it has been a very challenging year. SSGA began the year undergoing a stress test as one of the largest banks in the country. He noted that he was happy to report that SSGA's minimum capital ratios were more than twice that of the adverse scenario posed by the Treasury.

Mr. Fleury stated that he was concerned comparing SSGA's returns to the Russell 1000 Value Index. He questioned whether the System would have been better off with active management or with just simply buying an index fund and he asked, " What can the System expect in the coming quarters?"

Ms. Heather McGoldrick referred to tab 3, page 12 of the presentation, Large Cap Value Strategy-Performance. She noted that 2008 had been all about stocks that the System didn't own. She rationalized that the System didn't own certain financials which really benefited the System's portfolio by preserving capital and avoided further losses relative to the benchmark. Higher quality stocks were held and SSGA did a good job in identifying the companies that were the worse.

She commented that the System's portfolio was positioned defensively. The first quarter of 2009 the portfolio was up 9.80%, the bad news was that is trailed the index by about 6%. As always is the case, Ms. McGoldrick commented that when the market initially rallies, it last about 8 to 10 weeks as it surges forward and then slows down. The turning point was in July when the earnings came out for the second quarter. Ms. McGoldrick stated that SSGA feels confident that they have seen the bottom in the market and during this time period SSGA has more visibility in forecasting how companies are going to fare over the next year.

Mr. Thorsen reviewed SSGA's investment philosophy suggesting that security mispricing does exist and persist in the market. SSGA uses a quantitative approach providing best identification of opportunities to remove behavioral bias and impose discipline. The quantitative approach reacts quickly to new information and allows forecasts for every stock in a broad universe. Mr. Thorsen noted that SSGA conducts meaningful research which is key to continued success.

Trustee Hungler asked about the portfolio's best and worst performers relative to their benchmark and asked when portfolio securities are evaluated. Ms. McGoldrick commented that SSGA tends to rebalance portfolios about once a month.

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Ms. McGoldrick reviewed the sector weights, defined fundamentals and the process in evaluating stocks over the next year.

The SSGA presentation having concluded and there being no further questions, Mr. Thorsen thanked the trustees for the opportunity to come before them to address SSGA's Investment Performance.

At 10:00 a.m. Chairman Pinard recessed the meeting.

Chairman Pinard reconvened the meeting at 10:10 a.m.

NEPC representatives escorted Cadence Capital Management, (CCM) in for their presentation. Mr. Peter McManus, Principal and Account Manager of CCM and Mr. Bob Fitzpatrick, Managing Director and one of the portfolio managers of Allianz/CCM Capital Appreciation Fund introduced themselves and distributed their presentation booklets. They apologized for not being able to send them in advance of the meeting but wanted to include performance results to the end of September.

Mr. McManus provided a brief history of CCM and noted that today CCM is 51% employee owned. Ownership is shared with PIMCO Rosemont Partners out of Philadelphia which own 49% interest in CCM. Twenty three of the thirty two employees are owners of the business. He also noted that everything that CCM does is focused on the client interest. CCM gets new clients from managing money for existing clients and through the consultant community.

Next, Mr. McManus referred to the investment philosophy based upon reasonable growth and stated that CCM likes to buy companies that are profitable, growing, and at reasonable prices. He commented that the investment process has not changed over the past 12 months but has been stress tested to the max. The characteristics that CCM has sought in an investment, has been harder to find and has not been rewarded as much as in the past. Also, he noted that there had been no additions or deletions to the investment team over the past 12 months.

In addressing how the portfolio is managed, Mr. McManus turned the presentation over to his partner Mr. Bob Fitzpatrick. Mr. Fitzpatrick requested that the trustees to turn to page 7 of the presentation booklets. Reiterating Mr. McManus's comments, Mr. Fitzpatrick noted that the firm has always believed in the implementation of a disciplined investment process. He asserted that the discipline process implemented by their team over time leads to positive investment results. CCM begins their stock selection process with a proprietary quantitative model inclusive of all the stocks in the beginning universe consisting of the Russell 1000 and the S&P 500 Indices. Mr. Fitzpatrick provided a list of growth and valuation characteristics that are reviewed during the screening process, which narrows the list down to a more manageable number. CCM also conducts fundamental research on companies and team investment decisions are made by the analyst and portfolio managers.

Mr. McManus spoke about historical performance and referred to a mutual fund chart which goes back to the MECRS inception date of April, 1998. The portfolio was lagging from 1998 to 1999. In the year 2000 CCM continued to face challenges. CCM believes that they are

in a similar position today experiencing a bubble of sorts last fall when Lehman Brothers fell from the market environment. During that time, no one could see what was happening while the credit system was locking up. As a result, in 2008 the System's CCM investment dropped approximately 41% in value along with the index in 2008.

Mr. Fitzpatick stated that since March 9, 2009 the System's portfolio is up 42% and the benchmark was up 53%. The portfolio has recovered but not to the same extent as the benchmark.

Mr. Leonard of NEPC asked the CCM representatives, "What makes CCM have confidence or degree of surety that they will do better than their peers or other asset classes?"

Mr. McManus replied that CCM has more confidence and surety about its sector than other asset classes. CCM has taken a hard look at the investment process and has reviewed the quantitative inputs to the process. CCM has asked itself of its model, are there others that are better, are there other inputs or factors that are more relevant in today's market place than there were 10 years ago in a prior market, and has the global economy changed at how a growth stock is obtained. After a lot of qualitative discussion backed up by quantitative research, CCM feels more committed than ever that the current process is valid over long periods of time. Continuing, Mr. McManus noted that it is CCM's belief, that the philosophy that CCM represents and the process which is still in place, will withstand difficult market environments.

Mr. McManus noted that MECRS has been a client of CCM for a long period of time and has enjoyed a significant amount of outperformance. Had CCM turned the investment process off, CCM might have run the risk of having been terminated for abandoning their process. CCM would like the opportunity to earn back the System's confidence.

Mr. Fleury summarized his interpretation of Mr. McManus's presentation, that it is CCM's plan is to outperform the Russell 1000 Growth benchmark in the 4th quarter of 2009 and 1st quarter 2010.

Mr. MacManus responded that if there is a reconnection between earnings fundamentals and stock price then CCM should capture a significant portion of it, leading to outperformance.

Mr. Fleury then asked, "Is the Russell 1000 Growth index is a fair benchmark?"

Mr. McManus replied, "For Growth Managers, it is the benchmark that has been determined by the market place to be the one."

The trustees continued to ask questions regarding CCM's philosophy and process.

Finally, having concluded their presentation and there being no further questions for CCM, Mr. McManus and Mr. Fitzpatrick thanked the trustees for their time and departed at 11:05 a.m.

Mr. Leonard provided commentary on CCM's and SSGA's presentation reminding the board that one is a Core and the other a Value manager. He stated that NEPC does not feel that either of the two managers needs to be terminated today but that in light of their extensive period of underperformance against their benchmarks, that he would like to conduct an educational discussion at next month's monthly board meeting on active versus passive management, and how each has performed on a historical basis. Mr. Leonard also recommended that he be allowed to present a search book on other large cap value, large cap growth managers for future consideration by the board.

The trustees agreed to conduct the educational meeting on active and passive managers as well as a review on large cap value and large cap growth managers.

At 11:25 AM, Chairman Pinard entertained a motion to extend the meeting beyond the 3 hour limitation, pursuant to Article XIII of the MECRS By-Laws. It was moved by Trustee Angell to extend the meeting, seconded by Trustee Molan and passed unanimously by all those trustees present.

Previous Business:

Investment on Private Equity Fund of Funds with a Mezzanine Focus - Mr. Leonard reminded the board that they had adopted the mezzanine strategy as part of the MECRS' Private Equity Allocation last year. Three PEFOF Mezzanine Mangers had been interviewed, and at that time an actual manager selection had been narrowed down to Newstone and Kayne Anderson before the board had opted to delay a final selection. Mr. Leonard stated that at this time NEPC is still recommending that the MECRS continue with the mezzanine strategy.

Trustee Hungler stated that he would like to table the hiring of a mezzanine manager until next month when all the trustees can be present. He expressed his concern over a difference of opinion between himself and Trustee Sanders who could not be present today on which manager might be best suited and stated that he would be more conformable have Trustee Sanders input on the section process. Chairman Pinard saw no reason for a formal motion and absent opposition; it was agreed that the decision would be delayed until the November meeting.

Trustee Hungler addressed a past email which had indicated that NEPC is consulting with the State of Vermont regarding commodities and he asked Mr. Leonard to elaborate on that issue.

Mr. Leonard responded that more broadly than just commodities, real assets are an investment asset class that NEPC is recommending. The premise behind the recommendation is that inflation is on its way, that it will eat away at the investment portfolios values, and that NEPC feels that there are steps which can be taken to insulate against such an eventuality. The simplest method would be to invest in TIPS (treasury inflation protection securities). This is a dedicated asset class above and beyond just straight real estate or other real asset class components. Mr. Leonard stated that NEPC is recommending that at some future meeting, the trustees consider include TIPS in their portfolio.

NEPC's review of investment related issues having been completed and there being no further questions of the consultants, Mr. Leonard and Mr. Grzejka departed the meeting.

Consent Agenda:

It was moved by Trustee Molan to approve the Consent Agenda, seconded by Trustee Hungler and passed unanimously by all those trustees present.

New Business:

Request For a Motion - Executive Director, Mr. Fleury, explained that there are two issues which need to be addressed. He is requesting a transfer of previously approved and budgeted amounts from an area of surplus to areas where expenses have exceeded expected and budgeted amounts. The first shortfall identified was in the Retirement Employer Contribution. Actual costs for retirement contributions exceeded the budget by $1,589, due to the rate increase on July 1st. Funds are available from the health insurance line because coverage reductions elected by one staff member had resulted in lower premiums and generated a surplus.

Next, premiums for Liability & Equipment coverage exceeded the budget estimate by $5. Funds are available from Workers Comp. line of the budget because there was at least five dollars of cushion in that budget line.

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It was moved by Trustee Hungler approve the transfers, seconded by Trustee Molan and passed unanimously by all those trustees present.

Trustee Hungler moved to adjourn the meeting at11:39 a.m., seconded by Trustee Barry and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury
Executive Director