Oregon Investment Council

January 26, 2011 - 9:00 AM

PERS Headquarters
11410 S.W. 68th Parkway
Tigard, OR 97223

Oregon Investment Council

Harry Demorest
Chair

Office of The State Treasurer
Ted Wheeler
State Treasurer

Ronald Schmitz
Chief Investment Officer

OREGON INVESTMENT COUNCIL

2011 Meeting Schedule

Meetings Begin at 9:00 am
at
PERS Headquarters Building
11410 SW 68th Parkway
Tigard, OR 97223

January 7, 2011
(Special Meeting)

January 26, 2011

February 23, 2011

April 27, 2011

June 1, 2011

July 27, 2011

September 28, 2011

November 2, 2011

December 7, 2011

OREGON INVESTMENT COUNCIL

Agenda

January 26, 2010
9:00 AM

PERS Headquarters
11410 S.W. 68th Parkway
Tigard, Oregon

Time	A. Action Items	Presenter	Tab
9:00-9:05	**1. Review & Approval of Minutes** December 1, 2010 Regular Meeting January 7, 2011 Special Meeting	**Ron Schmitz** *Chief Investment Officer*	**1**
9:05-9:45	**2. KKR North American XI Fund, LP** *OPERF Private Equity*	**Jay Fewel** *Senior Investment Officer* **George Roberts** *Founding Member* **Mike Michelson** *Member* **David Fann** *Pacific Corporate Group*	**2**
9:45-10:20	**3. OPERF Alternative Portfolio Proposal**	**John Hershey** *Investment Officer*	**3**
10:20-10:30	**---------------------BREAK----------------------**		
10:30-11:15	**4. OPERF Core Real Estate Review**	**Brad Child** *Senior Investment Officer* **Nori Lietz** *PCA Real Estate Advisors*	**4**
	B. Information Items		
11:15-11:20	**5. Annual Placement Agent Summary**	**Mike Mueller** *Deputy CIO*	**5**
11:20-11:30	**6. Asset Allocations & NAV Updates** a. Oregon Public Employees Retirement Fund b. SAIF Corporation c. Common School Fund d. HIED Pooled Endowment Fund	**Ron Schmitz**	**6**

7.	**Calendar—Future Agenda Items**	**Ron Schmitz**	**7**
8.	**Other Items**	**Council Staff Consultants**	

C. Public Comment Invited

15 Minutes

TAB 1 – REVIEW & APPROVAL OF MINUTES

December 1, 2010 Regular Meeting

January 7, 2011 Special Meeting

RONALD D. SCHMITZ
CHIEF INVESTMENT OFFICER
INVESTMENT DIVISION

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STATE OF OREGON
OFFICE OF THE STATE TREASURER
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OREGON INVESTMENT COUNCIL
DECEMBER 1, 2010
MEETING MINUTES

Members Present:	Paul Cleary, Harry Demorest, Katy Durant, Dick Solomon, Treasurer Ted Wheeler
Member Absent:	Keith Larson
Staff Present:	Andrea Belz, Darren Bond, Tony Breault, Brad Child, Jay Fewel, Sam Green, Ellen Hanby, Andy Hayes, John Hershey, Julie Jackson, Perrin Lim, Tom Lofton, Ben Mahon, Mike Mueller, Kevin Nordhill, Tom Rinehart, Ron Schmitz, James Sinks, Michael Viteri, Sally Wood
Consultants Present:	Allan Emkin, John Linder, Mike Moy (PCA), Mike Beasley and John Meier (SIS), David Fann and Sundeep Rana (PCG)
Legal Counsel Present:	Dee Carlson, Oregon Department of Justice Deena Bothello, Oregon Department of Justice

The OIC meeting was called to order at 9:00 am by Harry Demorest, Chair.

I. 9:00 a.m.: Review and Approval of Minutes

MOTION: Mr. Demorest brought approval of the October 27, 2010 OIC minutes to the table. Treasurer Wheeler moved to approve the minutes. The motion was seconded by Mr. Solomon and passed by a vote of 4/0.

II. 9:01 a.m.: GSO Capital Opportunities Fund II, L.P. – *OPERF Private Equity Portfolio*

Staff recommended a commitment of $100 million to GSO Capital Opportunities Fund II, L.P., a $3.0 billion (target) fund pursuing investments in the middle market, leveraged finance marketplace. The Fund will have a flexible investment strategy, with an emphasis on providing junior capital to target companies in connection with buyouts, recapitalizations, acquisitions, and growth financing transactions. These investments will include secured debt, subordinated debt, mezzanine securities, preferred stock, and private equity. The current market environment for

GSO's strategy is particularly attractive as reduced liquidity in financing markets has increased the demand for junior capital.

Jay Fewel, Senior Investment Officer introduced Bennett Goodman, Senior Managing Director and Beth Chartoff, Investor Relations with GSO Capital. GSO was founded in 2005 by former CSFB executives Bennett Goodman, Tripp Smith and Doug Ostrover. Since inception, the firm has grown to 179 employees, staffing offices in New York, Houston and London, and managing nearly $30 billion in assets in five different debt strategies: mezzanine, hedge funds, distressed, rescue finance, and structured finance.

Fund II will employ a continuation of the mezzanine debt strategy of Fund I, providing acquisition financing for upper-middle market companies, primarily in sponsored buyout transactions. Following the onset of the "credit crisis" in 2008, mezzanine debt has come back into favor, as banks have only been willing to lend at significantly reduced leverage multiples, and private equity sponsors are reluctant to fill the financing void with equity, as it is dilutive to returns. Mezzanine debt bridges this financing gap with junior capital that is less dilutive than equity, yet provides another layer of protection subordinate to the senior-secured lenders.

There was a brief question and answer period following the presentation.

MOTION: Staff recommended a commitment of $100 million to GSO Capital Opportunities Fund II, L.P. subject to the satisfactory negotiation of terms and conditions, and completion of the requisite legal documents by the Department of Justice working in concert with OST staff. Ms. Durant moved approval of the staff recommendation. Mr. Solomon seconded the motion. The motion was passed unanimously by a vote of 4/0.

III. 9:28 a.m.: OPERF Opportunity Portfolio Annual Review

Staff provided the OIC with an update on the OPERF Opportunity Portfolio. This was an informational item only. There are currently ten active investment funds in the Opportunity Portfolio:

- Fidelity
- Sheridan
- BCI I
- BCI I Co-Investment
- Oaktree Loan Fund
- BCI II
- Providence SS TMT
- Apollo Credit II
- Alinda
- Endeavour SEAM

The Opportunity Portfolio objectives include opportunistic/dislocation oriented funds as well as innovation oriented funds. Strategies of interest:

- Dislocation oriented
- Life settlements
- Credit strategies
- Long dated volatility
- Innovation oriented
- Frontier markets
- Aviation finance
- Trade finance

- Legal settlements
- Drug royalty streams
- Reinsurance

The question arose as to whether the OIC supports the idea of creating an “Opportunity Portfolio Committee” for time sensitive investment opportunities, re-ups, and Corporate Governance.

IV. 9:55 a.m.: OPERF Fixed Income Structure

Perrin Lim, Senior Investment Officer and John Meier with SIS presented to the Board. Given the changes in the composition of bond market indexes and the relative value tradeoff of developed versus emerging country economies, staff recommended OIC approval of benchmark revisions, applicable to policy 4.03.01 (Strategic Role of Fixed Income for OPERF), 4.03.03 (Investment Manager Selection, Monitoring & Termination), and the OIC Statement of Investment Objectives and Policy Framework for OPERF.

Staff believes the current structure of the OPERF fixed income portfolio requires very little change. Rather, this revision to the long-standing Core Plus benchmark (and weighted revision to the asset class benchmark) reflects the perceived future trends in fixed income and increases the potential for expected returns, while modestly increasing risk.

MOTION: Treasurer Wheeler moved approval of the staff recommendation. Ms. Durant seconded the motion. The motion was passed by a vote of 3/0 with Mr. Solomon abstaining.

V. 10:40 a.m.: HIED Endowment Fund Annual Review

Mike Mueller, Deputy CIO and John Meier with SIS provided the OIC with an update on the Higher Education Endowment Fund as required by OIC Policy. The HIED Endowment Fund returned 10.7 percent for the quarter, and 13.0 percent for the most recent 12 month period. This performance exceeded the passive policy benchmark by 2.6 percent for the quarter, and 2.3 percent for the 12 months ended. This performance was driven by the domestic equity portfolio which returned 11.5 for the year and international equities which delivered an even better 15.4 percent return (7.8 percent over the benchmark). Western Asset’s one year performance was still at a robust 16.3 percent. When compared to the TUCS universe of “Endowment Plans,” the fund ranked in the top third over the past one and two-year periods. This is the period over which the plan has undergone significant investment changes.

MOTION: Staff recommended an adjustment to policy to implement the 15 percent “real assets” target as 7.5 percent TIPS and 7.5 percent real estate, due to lack of attractive alternatives, at present, that can be cost effectively implemented. This will be revisited if attractive alternatives develop. Mr. Solomon moved approval of the staff recommendation. Ms. Durant seconded the motion. The motion was passed by a vote of 4/0.

VI. 10:50 a.m.: Proposed Policy Revisions

Mike Mueller, Deputy CIO recommended approval of proposed revisions to OIC Policies 4.00.03 and 4.01.13 regarding the OIC Standards of Ethics and Consulting Contracts, respectively. This topic was previously presented at the October meeting

MOTION: Mr. Solomon moved approval of the staff recommendation. Ms. Durant seconded the motion. The motion was passed unanimously by a vote of 4/0.

VII. 10:51 a.m.: 2011 OIC Meeting Dates

Treasurer Wheeler moved approval of the 2011 OIC Meeting schedule. Ms. Durant seconded the motion. The motion was passed by a vote of 4/0.

VIII. 10:52 a.m.: OPERF 3rd Quarter Performance Review

Mike Beasley of SIS presented the OPERF Performance Summary for the quarter ending September 30, 2010. Prior to Mr. Beasley's presentation, Mr. Demorest acknowledged Mr. Beasley's retirement and thanked him for all the work he has done for the OIC.

IX. 11:05 a.m.: Asset Allocation and NAV Updates

Mr. Schmitz reviewed the Asset Allocations and NAV's for the period ended October 31, 2010. All asset classes are within their allocation ranges.

X. 11:06 a.m.: Calendar – Future Agenda Items

Mr. Schmitz highlighted future agenda topics.

XI. 11:07 a.m.: Other Business

There was no other business discussed.

11:07 a.m.: Public Comments

There were no public comments.

The meeting adjourned at 11:07 a.m.

Respectfully submitted,

Julie Jackson

Julie Jackson
Executive Support Specialist

RONALD D. SCHMITZ
CHIEF INVESTMENT OFFICER
INVESTMENT DIVISION

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OREGON INVESTMENT COUNCIL
JANUARY 7, 2011
SPECIAL TELECONFERENCE MEETING

Members on the Phone:	Harry Demorest, Katy Durant, Keith Larson, Dick Solomon, Treasurer Ted Wheeler
Member Present:	Paul Cleary
Staff Present:	Julie Jackson, Ben Mahon, Mike Mueller, Kevin Nordhill, Jen Peet, Tom Rinehart, Ron Schmitz, Michael Viteri
Legal Counsel Present:	Dee Carlson, Oregon Department of Justice

The OIC was called to order at 3:00 pm by Harry Demorest, Chair.

Staff recommended that the OIC override the recommendation of its proxy voting agent (Glass Lewis) and vote in favor of the partial acquisition of Massmart Holdings Limited ("Massmart"), a South African-based consumer goods wholesaler and retailer, by Walmart. Glass Lewis has recommended that shareholders vote against the proposal. While the Glass Lewis analysis concludes that the agreement is based on sound strategic rationale, they have recommended that shareholders vote against the proposal on the basis of two issues:

- The transaction allows Walmart to acquire control of the Company by only paying for 51 percent of the outstanding equity, and;
- The offer price Walmart proposes does not offer a substantial enough premium.

One of OPERF' public equity managers requested that OPERF consider voting in favor of the acquisition. They believe the transaction has the dual benefit of allowing Massmart shareholders the opportunity to realize an attractive premium on part of the investment while also affording them the opportunity to participate in the future value of the Massmart ordinary shares that remain listed on the Johannesburg Stock Exchange.

Recommendation
In short, staff has listened to the manager's rationale and agrees with the suggestion to override Glass Lewis' recommendation. The manager presented information that Glass Lewis does not mention in its analysis and staff feels the manager has a good view of the big picture and is taking a long term view.
ACTION: Mr. Demorest requested that a discussion of proxy voting services be added to the February agenda.

MOTION: Mr. Solomon moved approval of the staff recommendation. Ms. Durant seconded the motion. The motion was passed by a vote of 5/0.

The meeting was adjourned at 3:15 pm.

Respectfully submitted,

Julie Jackson

Julie Jackson
Executive Support Specialist

TAB 2 – KKR North American XI Fund, LP

OPERF Private Equity

KKR North American XI Fund, L.P.

Purpose

Staff is recommending a commitment of $500 million to KKR North American XI Fund, L.P. (the Fund), a $8-10 billion target fund, to pursue equity and equity related investments, primarily in large, North American companies. The Fund will continue the strategy employed in 14 previous global private equity funds invested over the past 30 years, acquiring controlling ownership positions in mature companies, then creating value through growth, strategic redirection, cost optimization, and deleveraging

Background

KKR was founded in 1976 by Jerome Kohlberg, Henry Kravis, and George Roberts after working together for several years in corporate finance at Bear Stearns & Company. The founders are widely credited as pioneering and institutionalizing the strategy of leveraged buyouts, and since inception, the firm has completed over 175 transactions valued at over $430 billion. Since inception, KKR has systematically expanded both its geographic focus, and investment strategies, to become a global asset-management platform, and one of the leading private equity houses in the world. Starting with an expansion of its core buyout business, first to Europe and then to Asia, in recent years, the firm has launched new asset management strategies focusing on credit opportunities, infrastructure, natural resources, mezzanine debt, and China growth investments. In 2009, the firm merged with a publicly-traded affiliate, and became public on Amsterdam's Euronext Exchange. In 2010, it transferred its listing to the New York Stock Exchange and trades under the ticker symbol 'KKR'. Under the leadership of Mssrs. Kravis and Roberts, the firm today consists of over 600 professionals, including over 140 investment professionals, with offices in New York, Menlo Park, San Francisco, London, Paris, Hong Kong, Tokyo, Beijing, Sydney, and Dubai. Staff notes that while the remaining founders will continue to lead the firm and be actively involved in the investment process, the other Members (partners) of the firm comprise a deep and experienced bench of professionals, and the firm has focused on succession planning. While Mr. Kravis and Mr. Roberts bring a wealth of connections and experience to the table, staff firmly believes that KKR as a firm is now an institution that will endure and succeed after a transition of leadership.

Strategy

The Fund will continue the control-oriented, sector-focused strategy that the firm has successfully executed since 1980. Targeted sectors will include consumer products, energy, infrastructure, financial services, health care, industrials, media and communications, retail, and technology. Investments will be focused on large-cap companies, with equity investments of $300 to $800 million, in transactions of at least $1.0 billion. KKR tends toward longer holding periods for portfolio companies, and three to seven year investments are anticipated. After acquisition, the firm implements and monitors the execution of its value creation thesis via the company's deal team, reporting to the Portfolio Management Committee. The Portfolio Management Committee is composed of eleven professionals, including the founders, two senior KKR Members, two Capstone senior managers, and five Senior Advisors. Capstone and the Senior Advisors are both additional resources the firm can bring to bear to assist in value creation. Capstone is a KKR in-house, 60 person, operations-focused consulting firm that works only for KKR portfolio companies, to create and implement process reengineering, cost restructuring, sales and marketing optimization, and strategic redirection. The Senior Advisors are a team of 20 former executives from major corporations and public agencies that can be tapped for their industry experience and personal networks.

Track Record

KKR has generated strong performance over three decades in its North American focused funds, and has been a cornerstone of the OPERF Private Equity portfolio since its inception. As of September 30, 2010:

- KKR 1980 Fund has been fully exited at a net IRR of 22.5 percent, and a net TVM of 3.4x. OPERF committed $194 million to this fund.
- KKR 1982 Fund has been fully exited at a net IRR of 39.7 percent, and a net TVM of 3.3x. OPERF committed $25 million to this fund.
- KKR 1984 Fund has been fully exited at a net IRR of 28.6 percent, and a net TVM of 4.3x. OPERF committed $100 million to this fund.
- KKR 1986 Fund has been fully exited at a net IRR of 26.3 percent, and a net TVM of 4.5x. OPERF committed $100 million to this fund.
- KKR 1987 Fund has generated a net IRR of 8.7 percent, and a net TVM of 1.6x. OPERF committed $800 million to this fund.
- KKR 1993 Fund has generated a net IRR of 16.7 percent, and a net TVM of 1.6x. OPERF committed $350 million to this fund.
- KKR 1996 Fund has generated a net IRR of 13.1 percent, and a net TVM of 1.7x, both of which rank in the first quartile according to Venture Economics data. OPERF committed $800 million to this fund.
- KKR Millenium Fund has generated a net IRR of 18.1 percent, and a net TVM of 1.6x, both of which rank in the second quartile according to Venture Economics data. OPERF committed $1.0 billion to this fund.

- KKR 2006 Fund has generated a net IRR of 1.6 percent, and a net TVM of 1.1x, both of which rank in the second quartile according to Venture Economics data. OPERF committed $1.312 billion to this fund.

- KKR 2006 Co-investment Fund has generated a net IRR of 10.2 percent, and a net TVM of 1.3x, both of which rank in the first quartile according to Venture Economics data. OPERF committed $187 million to this fund.

A new commitment will be allocated 100 percent to the Corporate Finance subsector. As of September 30, 2010, OPERF's allocation to Corporate Finance is targeted at 65-85 percent, with a current fair market value plus unfunded commitments exposure totaling 70 percent.

Portfolio Fit and Commitment Sizing

KKR funds have historically been the cornerstone of OPERF's Large Corporate Finance (LCF) subsector. This recommended commitment of $500 million is one-third of the combined amount committed to the KKR 2006 and 2006 Co-Investment Funds. Staff wishes to highlight that this reduction is not a result of any doubts about KKR's ability to generate future returns, or the attractiveness of the investment opportunity. The reduction in the recommended commitment is driven by two factors: First, the OPERF Private Equity portfolio is above its policy range of 12-20 percent, and in an effort to "manage down" the allocation, staff has reduced the planned commitment amounts for most managers returning to market in 2011. Second, the larger commitments OPERF made to the KKR Millennium Fund and the 2006 Fund introduced higher levels of fund and manager concentration risks than staff believes is optimal, going forward. As the LCF subsector represents 70 percent of the value of the OPERF Private Equity portfolio, it is critical that this subsector continue to be well diversified. Over the past several years, staff has been increasing the recommended commitments to other, core LCF managers (e.g., TPG and Apollo), and selectively introducing new LCF managers (Blackstone). Staff believes that more consistent returns, at a lower level of risk, can be generated by having several top-tier LCF managers, each with average commitment sizes of $300-$500 million per fund, rather than an outsized commitment to any single manager.

Oregon Common School Fund Allocation

Beginning in 2007, the Common School Fund started a direct private equity investment program, following on some key OPERF relationships. To date, these commitments include:

Oak Hill Capital Partners III
Warburg Pincus Private Equity X
Apollo Investment Fund VII
TPG Partners VI
JP Morgan VC Fund IV (not OPERF relationship)
Oaktree Opportunities Fund VIII & VIIIb

Each CSF commitment was $25 million, except the JP Morgan VC Fund, which was $20 million, for a total committed amount of $145 million. Through September 30, 2010, $66.4 million has been called across the six funds. Private equity currently represents about five percent of the Common School Fund, which has a target of 10 percent to the asset class, per OIC Policy.

Recommendations

1. Staff recommends that the OIC authorize a $500 million commitment to the KKR North American XI Fund, L.P., on behalf of OPERF, subject to the satisfactory negotiation of terms and conditions, and completion of the requisite legal documents by DOJ legal counsel working in concert with OST staff.

2. Staff recommends that the OIC authorize a $25 million commitment to the KKR North American XI Fund, L.P., on behalf of the Common School Fund, subject to the satisfactory negotiation of terms and conditions, and completion of the requisite legal documents by DOJ legal counsel working in concert with OST staff.

MEMORANDUM

TO: Oregon Public Employees Retirement Fund ("OPERF")

FROM: PCG Asset Management LLC ("PCG AM")

DATE: 1/10/2011

RE: KKR North American XI Fund, L.P. ("the Fund")

Strategy:

Kohlberg Kravis Roberts & Co. L.P. ("KKR," the "Firm" or the "General Partner") is sponsoring KKR North American XI Fund, Limited Partnership ("Fund XI," the "Partnership" or the "Fund") to pursue a broad range of equity and equity-related investments, primarily in large cap companies in North America. The Fund will continue the strategy implemented over the three decades in the prior 14 global private equity investment funds sponsored by KKR, targeting aggregate capital commitments between $8.0 and $10.0 billion. A hard-cap for the Fund has yet to be determined.

KKR's investment strategy will consist of acquiring controlling ownership stakes in mature companies, primarily located in North America, and creating value through a combination of growth (organic or by acquisition), strategic redirection, and cost optimization. Given the current market environment, the Partnership will seek to invest in three to five businesses annually, and will have an anticipated holding period ranging from three to seven years per portfolio company. It is anticipated that the Fund will consist of smaller deals and implement a slower investment pace compared to the 2006 Fund's deployment, with less leverage being applied at the portfolio company level.

The Partnership will target transactions in excess of $1.0 billion of transaction value with an equity investment size ranging from $200.0 to $500.0 million. In addition, KKR may invest in transactions alongside major global operating companies, as well as other private equity firms.

The General Partner plans to hold the first closing for the Fund during the first half of 2011. KKR will commit at least 3% of the total capital commitments to the Fund, financed through a combination of cash and management fee offsets.

Please see attached investment memorandum for further detail on the investment opportunity.

Allocation:

A new commitment to the Fund would be allocated 100% to the Corporate Finance investment sub-sector. As of September 30, 2010 OPERF's allocation to Corporate Finance is listed in the table below. It is important to note that since allocation is based on fair market value, a commitment to the Fund would not have an immediate impact on OPERF's current portfolio allocation. A commitment to the Fund is complementary to OPERF's existing fund commitments and provides the overall portfolio with a further degree of diversification.

As of September 30, 2010	Target	FMV	FMV + Unfunded
Corporate Finance	65-85%	76%	70%

Conclusion:

The Fund offers OPERF an opportunity to participate in a differentiated private equity investment. PCG AM's review of the General Partner and the proposed Fund indicates that the potential returns available justify the risks associated with an investment in the Fund. PCG AM recommends that OPERF consider a commitment of $500 million to the Fund. PCG AM's recommendation is contingent upon the following:

(1) Satisfactory negotiation or clarification of certain terms of the investment;

(2) Satisfactory completion of legal documents;

(3) Satisfactory continuation and finalization of due diligence;

(4) No material changes to the investment opportunity as presented; and

(5) Confidentiality maintained regarding the commitment of OPERF to the Partnership until such time as all the preceding conditions are met.

TAB 3 – OPERF Alternative Portfolio Proposal

Proposed Alternatives Portfolio

Purpose
Staff recommends the creation of a new Alternatives Portfolio asset class, with a strategic portfolio allocation target.

Background
In July 2010, the OIC met at a workshop to hear a presentation by PCA on the merits of creating a new asset class comprised of a set of diversifying assets and strategies. These assets and strategies would include infrastructure and natural resource assets (oil and gas, timberland, agriculture land, commodities), and diversifying, low correlated hedge fund strategies. This workshop was the continuation of a longer term discussion the OIC has had on the merits of adding diversifying assets to the portfolio.

Considerations
Merits:

- *Increased diversification.* A strategic allocation to real assets and real return strategies should provide increased diversification to the overall OPERF portfolio;

- *Downside protection (left tail risk mitigation).* These assets and strategies should provide correlation benefits which help "normalize" overall OPERF return distributions;

- *Inflation hedge.* Real assets and commodities tend to exhibit inflation hedging properties. Infrastructure revenue models often have implicit or explicit inflation links. Commodities are a major input to raw materials and finished goods;

- *Expansion potential.* A measured rollout approach provides the OIC with the option, but not the requirement, to expand the program.

Concerns:

- *Entry point risk.* Real asset prices may be on the upswing; this can be mitigated by a measured investment pace into this sector;

- *Strategy or manager capacity.* Investor interest increases fund flows which can swamp capacity; however, strategies and opportunities are many;

- *Asset class history.* These assets/strategies have a more limited history from which to assess definitions, benchmarks and correlation behavior than traditional asset classes. This is mitigated by the relatively small allocation to the asset class which will grow to the strategic target over time;

- *Liquidity.* Some strategies are in illiquid "private equity like" structures. This can be mitigated by including more liquid strategies as well.

Recommendation
Staff, SIS, and PCA recommend approval of a new Alternatives Program with a 5 percent strategic target allocation.

OPERF Alternatives Portfolio Proposal

John Hershey, Alternatives Investment Officer

January 26, 2011

Table of Contents

Purpose

- Current Issues:
  - Existing OPERF portfolio performance highly tied to equity performance (90% beta to equity markets)
  - Potentially vulnerable to large capital market downturns
  - Little explicit allocation to assets that hedge unexpected inflation

- Proposal:
  - Create a real assets/real return oriented Alternatives Portfolio designed to exhibit low correlation to capital market returns
  - 5% target allocation, but with a measured build up
  - Diversify OPERF portfolio with risk reduction and tail risk benefits with an expectation of little to no return penalty

Portfolio asset mix

Sub sector	Range
Infrastructure	25-35%
Natural Resources	40-50%
• Oil & Gas	
• Timberland	
• Ag Land	
• Commodities	
Hedge Funds *	15-25%
Other	0-10%
TOTAL	100%

* Unlike a broad hedge fund program, would focus on diversifying hedge fund strategies with low correlation to equity markets.

Merits:

- Increased diversification
  - Strategic allocation to real assets and real return strategies should provide increased diversification
- Downside protection (left tail risk mitigation)
  - These assets and strategies should provide correlation benefits which help "normalize" over all OPERF return distributions
- Inflation hedge
  - Real assets and commodities tend to exhibit inflation hedging properties
  - Revenue models have implicit or explicit inflation links
  - Commodities are a major input to raw materials and finished goods
- Expansion potential
  - Measured rollout provides the OIC with the option, but not the requirement, to expand the program

Concerns:

- Entry point risk
  - Real asset prices may be on the upswing

- Strategy or manager capacity
  - Investor interest increases fund flows which can swamp capacity

- Asset class history
  - These assets/strategies have a more limited history than traditional asset classes
  - Uncertainty how correlations may behave in different market scenarios
  - Potential definition and benchmark challenges

- Liquidity
  - Some strategies are in illiquid "private equity like" structures

Benchmark

- CPI plus 4%
  - Appropriate for "real assets" and "real return" strategies
  - Similar to other programs at other State Plan Sponsors
    - WSIB Tangible Asset Class (CPI + 4%)
    - Calpers Inflation Linked Class (CPI + 4%)
    - Alaska Permanent Real Asset Class (T-bills + 4%)
    - Texas Teachers Absolute Return (T-bills + 0%)
    - Oregon Opportunity Portfolio (CPI + 5%)

Seeding from Opportunity Portfolio

Sheridan Production Partners	$100 million (committed capital)
Sheridan Production Partners II	$132 million (committed capital)
Alinda Infrastructure II	$200 million (committed capital)
Total	$432 million (0.8% of new 5% allocation)

Funding source

- Staff recommends pro rata from Public Equity (~3%) and Fixed Income (~2%)
  - Sourced pro rata from capital markets portion of OPERF portfolio
  - SIS modeling indicates improvement in overall risk adjusted return
  - PCA modeling suggests significant downside protection and improved distribution of returns resulting in potentially greater wealth creation over time

Summary/next steps

- Staff summary:
  - Request approval to establish a 5% strategic allocation to an Alternatives Portfolio
- SIS summary:
  - Including Alternatives Portfolio improves the expected risk/reward tradeoff
  - Implementation plan, portfolio terminology, objectives, benchmarks, and approval process need agreement
- PCA summary:
  - The Diversifying Betas class is expected to improve the risk profile of the overall OPERF investment portfolio, leading to higher-confidence levels of wealth creation
  - The role of the Diversifying Betas class would be to (i) provide complementary, largely non-equity returns to the overall OPERF investment portfolio and (ii) protect asset purchasing power, particularly during accelerating inflation environments

Appendix I – Asset Allocation summary

Updated Alternatives Portfolio Analysis

	CURRENT	5% ALTS PRO RATA PUBLIC
PUBLIC EQUITY	46.0%	43.0%
FIXED INCOME	27.0%	25.0%
REAL ESTEATE	11.0%	11.0%
PRIVATE EQUITY	16.0%	16.0%
ALTERNATIVES PORT.	0.0%	5.0%
SIS BASE CASE		
EXPECTED RETURN	8.13%	8.22%
EXPECTED STD DEV	13.2%	12.9%
SIS CONSERVATIVE CASE		
EXPECTED RETURN	8.13%	8.19%
EXPECTED STD DEV	13.2%	13.1%
PCA CASE		
EXPECTED RETURN	8.13%	8.22%
EXPECTED STD DEV	13.2%	12.7%

Staff Recommendation

	EXPECTED RETURN	EXPECTED STD DEV
PUBLIC EQUITY	8.6%	17.4%
FIXED INCOME	4.1%	4.6%
REAL ESTEATE	7.5%	20.0%
PRIVATE EQUITY	10.6%	25.0%
ALT. PORT. SIS	7.6%	17.0%
ALT. PORT. PCA	8.2%	8.0%

CORRELATIONS WITH ALTERNATIVES PORTFOLIO	SIS BASE CASE	SIS CONSERVATIVE CASE	PCA CASE
PUBLIC EQUITY	0.30	0.58	0.22
FIXED INCOME	0.20	0.39	0.16
REAL ESTEATE	0.27	0.51	0.37
PRIVATE EQUITY	0.15	0.29	0.03

- Returns relatively stable among varying options.
- Potential increase in total fund risk and loss of equity crisis offset if funded entirely from fixed income.
- Mean Variance Analysis does not highlight improvements in downside risk probabilities and potential equity crisis outcomes.

Appendix II – SIS Presentation

OREGON PUBLIC EMPLOYEES RETIREMENT FUND

ASSET ALLOCATION DISCUSSION:
ALTERNATIVES PORTFOLIO

JANUARY 2011

STRATEGIC INVESTMENT SOLUTIONS, INC.

333 Bush Street, Suite 2000
San Francisco, CA 94104
(415) 362-3484

John P. Meier, CFA
Managing Director

Appendix II – SIS Presentation

May 2010 SIS/OIC Asset-Liability Study

- Findings:
  - Study did not suggest taking less risk.
  - Liquidity is not a problem.
    - IAP is the wildcard.
  - Scenario Analysis demonstrated diversification tenets of current policy.
  - Alternatives, if included as an asset class, was attractive in all mixes.
- Result:
  - OIC took no action on current policy pending further analysis/discussion.

	ASSET CLASS	EXP. RETURN %	EXP. RISK %
PUBLIC EQUITIES	46%	9.0	17.2
FIXED INCOME	27%	4.6	4.3
REAL ESTATE	11%	8.0	20.0
PRIVATE EQUITY	16%	11.0	25.0
ALTERNATIVES PORTFOLIO	0%	8.0	17.0
	100%		
EXPECTED RETURN	8.43%		
EXPECTED STD DEV	13.01%		

STRATEGIC INVESTMENT SOLUTIONS, INC. PAGE 2

Appendix II – SIS Presentation

July 2010 PCA Presentation "A Discussion About Reconfiguring the Opportunity Portfolio"

- Reduce OPERF Fund's volatility.
- Reorient total fund perspective towards functional/strategic classes: growth-oriented, inflation-oriented, and protection-oriented.
- Create Alternatives Portfolio with Diversifying Beta Portfolio for downside risk control – Dislocation Portfolio (current Opportunity Portfolio) to exploit unusual opportunities.
- Long-term 10% allocation; 5% initially.

STRATEGIC INVESTMENT SOLUTIONS, INC.

PAGE 3

Appendix II – SIS Presentation

Updated Alternatives Portfolio Analysis

	CURRENT	5% ALTS PRO RATA PUBLIC
PUBLIC EQUITY	46.0%	43.0%
FIXED INCOME	27.0%	25.0%
REAL ESTEATE	11.0%	11.0%
PRIVATE EQUITY	16.0%	16.0%
ALTERNATIVES PORT.	0.0%	5.0%
SIS BASE CASE		
EXPECTED RETURN	8.13%	8.22%
EXPECTED STD DEV	13.2%	12.9%
SIS CONSERVATIVE CASE		
EXPECTED RETURN	8.13%	8.19%
EXPECTED STD DEV	13.2%	13.1%
PCA CASE		
EXPECTED RETURN	8.13%	8.22%
EXPECTED STD DEV	13.2%	12.7%

	EXPECTED RETURN	EXPECTED STD DEV
PUBLIC EQUITY	8.6%	17.4%
FIXED INCOME	4.1%	4.6%
REAL ESTEATE	7.5%	20.0%
PRIVATE EQUITY	10.6%	25.0%
ALT. PORT. SIS	7.6%	17.0%
ALT. PORT. PCA	8.2%	8.0%

CORRELATIONS WITH ALTERNATIVES PORTFOLIO	SIS BASE CASE	SIS CONSERVATIVE CASE	PCA CASE
PUBLIC EQUITY	0.30	0.58	0.22
FIXED INCOME	0.20	0.39	0.16
REAL ESTEATE	0.27	0.51	0.37
PRIVATE EQUITY	0.15	0.29	0.03

- Returns relatively stable among varying options.
- Potential increase in total fund risk and loss of equity crisis offset if funded entirely from fixed income.
- Mean Variance Analysis does not highlight improvements in downside risk probabilities and potential equity crisis outcomes.

STRATEGIC INVESTMENT SOLUTIONS, INC.

PAGE 4

Appendix II – SIS Presentation

Summary

- Including Alternatives Portfolio should improve the expected risk/reward tradeoff at the Total Portfolio level.
- Implementation plan, portfolio terminology, objectives, benchmarks, and investment approval process need agreement.

Appendix II – SIS Presentation

APPENDIX

Appendix II – SIS Presentation

Current Asset Class “Implementation Assumptions”

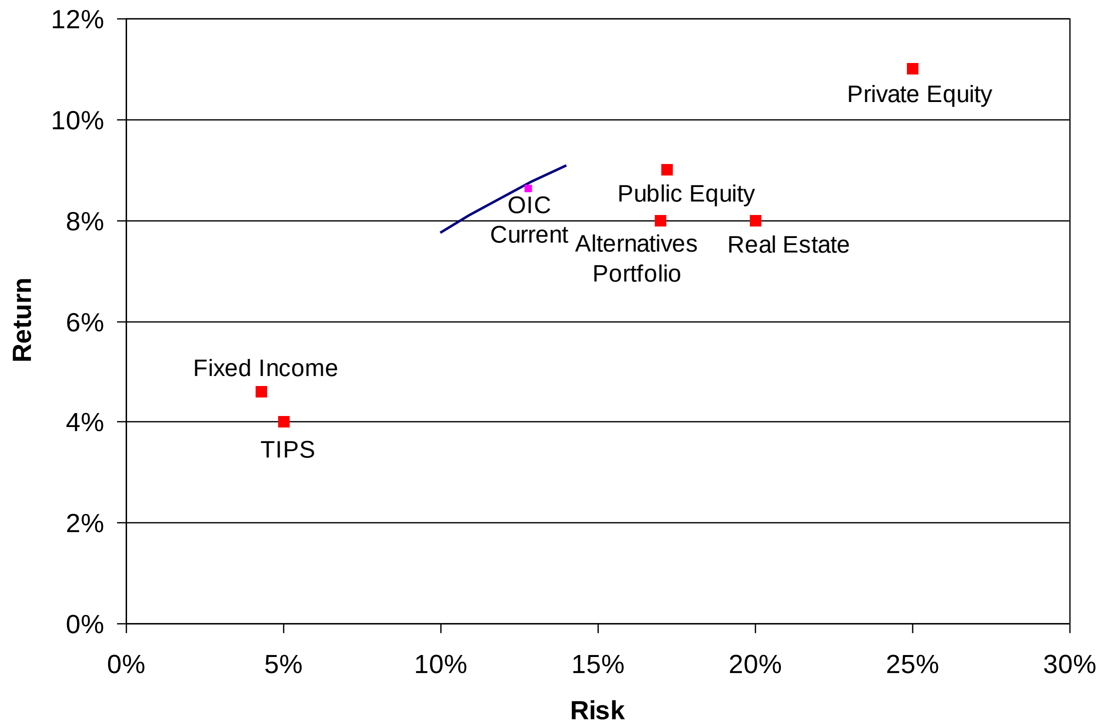
Asset Class	Expected Return*	Expected Risk*
Public Equity	8.6%	17.4%
Fixed Income	4.1%	4.6%
Private Equity	10.6%	25.0%
Real Estate	7.5%	20.0%
Alternatives Portfolio	7.6%	17.0%

- Alternatives Portfolio– Permanent, Non Traditional, Real/Absolute Return Objective
  - Infrastructure, Absolute Return, Hard Assets/Commodities, etc.
- Lower Risk in PE than SIS Base Case to reflect OIC Capabilities and Experience
- Higher Return/Risk in RE than SIS Base Case to reflect OIC’s Risk Strategy and Experience

* SIS Expectations as of 11/30/2010

Appendix II – SIS Presentation

Expected Risk vs Return



STRATEGIC INVESTMENT SOLUTIONS, INC.

PAGE 8

Appendix II – SIS Presentation

Alternatives Portfolio

- 33% Absolute Return
- 33% Infrastructure
- 34% Hard Assets
  - 11% Commodities
  - 11% Timber and Agriculture
  - 12% Industrial Commodity Producers

Appendix II – SIS Presentation

Defining Risk

- The basic definition of investment risk is variability of return. The alternative policies, or “asset mixes,” examined here are built to minimize this variability given an expected level of return over a long period of time. These mixes we call efficient. The method used to build them is an improved version of standard mean-variance optimization. The probabilities of continuously compounded returns to each asset class are assumed to approximate a bell shaped curve, or normal distribution. In other words, returns are random, and returns near the expected average are more likely than extreme returns. The likelihood of extreme returns is expressed as standard deviation. The probability of a particular asset-class return depends on the returns provided by every other asset class; this interdependence is expressed as correlation. Thus asset-class return expectations are commonly presented as three sets of numbers: mean returns, standard deviations, and correlations.

STRATEGIC INVESTMENT SOLUTIONS, INC. PAGE 10

Definitions

STRATEGIC ASSET ALLOCATION

The discipline used to determine which assets and what proportion among those assets meet an investor's cash flow requirements, planning horizon, and attitude toward risk.

EXPECTED RATE OF RETURN

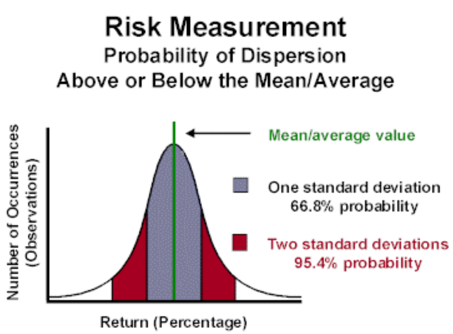
The expected value or mean of a probability distribution of returns. In our case, the expected return is the compounded annual return which is the same as the geometric mean. After tax expected return nets out the expected income and capital gains taxes paid by the trust.

STANDARD DEVIATION

A statistical measure of the degree to which an individual value in a probability distribution tends to vary from the mean of the distribution. The square root of the **variance**. When returns are normally distributed, an individual return will fall within one standard deviation of the mean about two-thirds of the time. For example, if a portfolio had an expected return of 5% and an expected risk (standard deviation) of 13, then:

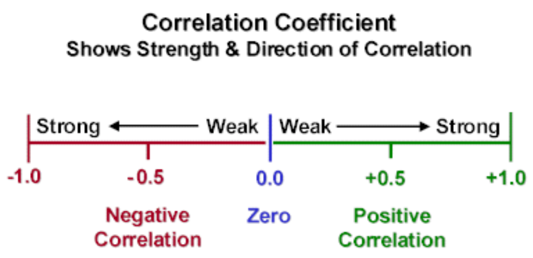
One Standard Deviation	68% of the time, returns can be expected to fall between –8.0% and +18%
Two Standard Deviations	95% of the time, returns can be expected to fall between -21% and +31%

Standard deviation is a useful historical measure of the variability of return earned by an investment portfolio. In performance measurement, it is generally assumed that a larger degree of dispersion implies that greater risk was taken to achieve the return.



Definitions

CORRELATION COEFFICIENT



Correlation coefficient (r) is a measure of the degree of **correlation** between two quantities or variables, such as the rates of return on stocks and on bonds. A negative coefficient of correlation indicates an inverse or negative relationship, whereas a positive value indicates a direct or positive relationship. The range of values is from -1 to +1 inclusive. A zero (0) value indicates that no correlation exists. Correlation coefficients are useful in **asset class** identification and portfolio **diversification**.

Appendix III – PCA Presentation

A Recap of the

July 2010 Opportunity Portfolio Discussion

Oregon Investment Council

Pension Consulting Alliance, Inc

December 2010

Appendix III – PCA Presentation

Summary of Project

- Materially higher volatility in the global investment markets is now evident
- Increased emphasis on investment risk management is necessary
- One approach: designing a strategic class that diversifies against other major risks
- PCA modeled and recommended that the OIC establish a dedicated Diversifying Betas portfolio, utilizing existing Opportunity Portfolio investments as a starting point
- Implementation plan: an initial target of 5%
- Benchmark: TBills+X% or CPI+X%

PCA

Appendix III – PCA Presentation

Examination of OIC's Current Opportunity Portfolio

OPPORTUNITY PORTFOLIO CONSISTS OF TWO EVOLVING SEGMENTS:

- Dislocation-oriented
  - Timing is right
  - Dislocation is the driver of abovemarket returns
  - Hard to model
  - Strategy applied on opportunistic, not continuous, basis
- Diversifying Betas
  - Alternative sources of return
  - And/or manager skill (active management) drives return
  - Easier to model, harder to find
  - Complements existing Total Portfolio
- Dislocation-oriented investments tend to be highly tactical and often temporary; Diversifying Beta investments may have an ongoing significant strategic role

Appendix III – PCA Presentation

Examination of OIC's Current Opportunity Portfolio

- Preliminary conclusions:
  - Both segments of the Opportunity Portfolio have a role to play within the OPERF portfolio
  - Each segment has completely different roles and characteristics
  - The Dislocation segment should continue to operate "as is", exploiting dislocation-oriented investment opportunities as they present themselves
  - The OIC should consider developing/establishing a separate long-term allocation for a more robust Diversifying Betas strategic class

Appendix III – PCA Presentation

Proposed Diversifying Betas Class

PURPOSE of the DIVERSIFYING BETAS CLASS

- The *role* of the Diversifying Betas class would be to (i) provide complementary, largely non-equity returns to the overall OPERF investment portfolio and (ii) protect asset purchasing power, particularly during accelerating inflation environments
- The Diversifying Betas class would be expected to *outperform fixed income* investments over the long-term and *modestly underperform equities*
- Initial indication is that the Diversifying Betas class may significantly *alter the downside risk characteristics* of the overall OPERF portfolio
- The Diversifying Betas class is expected to *improve the risk profile* of the overall OPERF investment portfolio, leading to higher-confidence levels of wealth creation

Appendix III – PCA Presentation

Modeling a Diversifying Betas Class

REVIEW of POTENTIAL MODELING STRUCTURES

Model Options of Diversified Betas Class

	SIS' "Alternative Portfolio"	*Optimized* "Diversified Betas" Class	PCA/Staff "Diversifying Betas" Class	Reference: Public Equity Assumption	Reference: Fixed Income Assumption
Infrastructure	33	22	30		
Natural Resources	33	20	45		
Hedge Funds	34	58	25		
Total	100%	100%	100%		
Expected Geo. Return (%)	8.6	9.2	8.2	9.0	4.7
Expected Volatility (%)	8.5	10.3	8.0	17.2	4.3
Modeled Correlation to Pub. Equity	0.18	0.05	0.21	1.00	0.25
Modeled 2008 Return (%)	-12.5	-7.6	-13.1	-38.1	0.8
Modeled 2009 Return (%)	1.8	-0.5	2.4	28.9	4.8
Avg. Annual Return During Crises (%)	6.1	7.7	6.0	-12.8	3.4

- Each structural alternative produced compelling results; particularly during various crisis periods (1970s stagflation, 1980s/1990s recessions, 2001/2008 bear markets
- Final PCA/Staff structure reflects implementation preferences, minimizes exposure to hedge fund segment; lowest overall volatility
- Conclusion: utilize PCA/Staff structural model to analyze potential impact on Total portfolio

Source: SIS, PCA

Appendix III – PCA Presentation

Modeling a Diversifying Betas Class

FINDINGS

- PCA found that a Diversifying Betas class could provide material benefits to the OIC Total portfolio
- PCA assumed underlying segments could successfully diversify against one another
- Modeling uncertainty exists with several of the underlying segments
- SIS' assumptions for the same segments resulted in an aggregate portfolio with much higher volatility than the PCA-modeled class
- Key drivers of SIS assumptions: modeling uncertainty, expected illiquidity risks

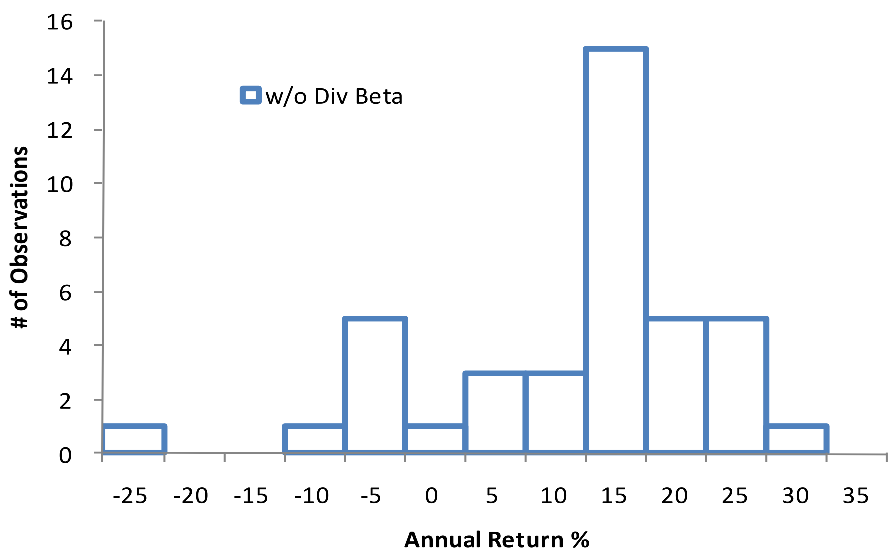
Appendix III – PCA Presentation

Appendix

Appendix - Proposed Diversifying Betas Class

IMPACT on TOTAL PORTFOLIO– DESCRIPTION OF EXPECTED OPERF **CURRENT POLICY** RETURNS

Modeled Return Distribution of OPERF W/O Diversifying Betas



Portfolio Stats	w/o
Min	-26.3
Max	26.5
10th %	-7.6
Periodic Median	12.5
Periodic Avg	9.4
Compound Avg	8.8
Std Dev	11.7
Kurtosis	1.0
Skewness	-1.0

Crisis Type	w/o
73-74	(11.0)
90-92	0.9
00-02	(7.6)
07-08	(9.5)
Avg All Crises	(6.8)

- Forward looking with the distribution of the last 40 years
- Distribution is non-normal; evidence of fat tails (i.e. heavily influenced by major events)
- Current policy tilted toward equity risk

Source: PCA

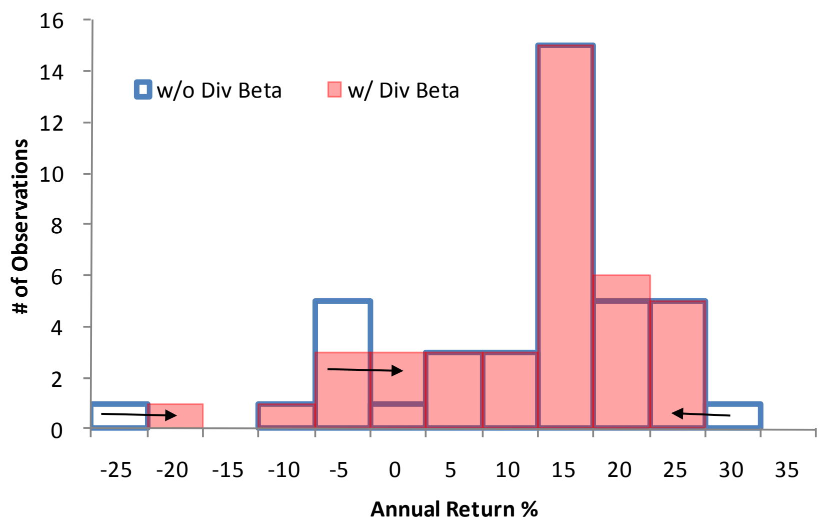
9

Appendix III – PCA Presentation

Appendix - Proposed Diversifying Betas Class

IMPACT on TOTAL PORTFOLIO – OVERLAY of DIVERSIFYING BETAS RETURNS with EXPECTED OPERF POLICY RETURNS

Modeled Return Distribution of OPERF with Diversifying Betas (in Pink)



Portfolio Stats	w/o	with
Min	-26.3	-24.9
Max	26.5	24.5
10th %	-7.6	-5.3
Periodic Median	12.5	12.5
Periodic Avg	9.4	9.3
Compound Avg	8.8	8.8
Std Dev	11.7	10.7
Kurtosis	1.0	1.5
Skewness	-1.0	-1.2

Dramatic 30% reduction in 10% worst outcomes

More tightly bunched around the average return

Crisis Type	w/o	with
73-74	(11.0)	(8.2)
90-92	0.9	1.3
00-02	(7.6)	(6.5)
07-08	(9.5)	(8.6)
Avg All Crises	(6.8)	(5.5)

Potential of 20% reduction in losses during a crisis

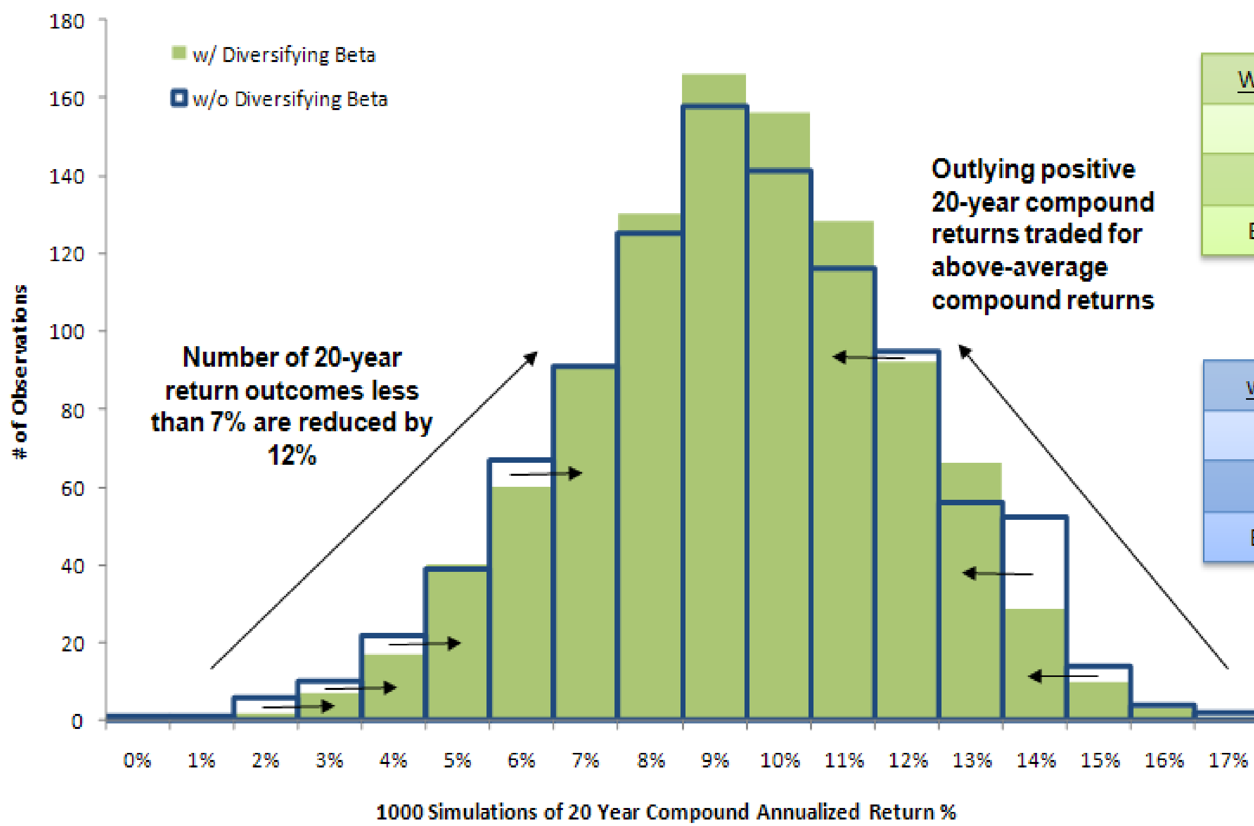
- Addition of Diversifying Beta Class Moves in the Outliers
- Improves the worst outcomes significantly
- Estimated ballpark savings during a crisis period could amount to $600 million per year

Source: PCA

Appendix III – PCA Presentation

IMPACT on TOTAL PORTFOLIO – COMPARISON of EXPECTED LONG-TERM GROWTH TRENDS

OPERF Policy Portfolio Distribution with a Diversifying Beta Class – Simulated



With Diversifying Beta	
Top Decile	12.1%
Median	8.9%
Bottom Decile	5.6%

w/o Diversifying Beta	
Top Decile	12.4%
Median	8.8%
Bottom Decile	5.3%

- Simulated compound return rises; potential for long-term wealth improvement

Appendix IV

Attached Draft Policy Statement

FUNCTION: **Alternative Investments**
ACTIVITY: **Portfolio Standards & Procedures within OPERF**

POLICY:

I. BACKGROUND

The Oregon Public Employees' Retirement Fund ("OPERF") has established the Alternative Investments Program (the "Program") to participate in attractive long-term investment opportunities and to provide diversification to the overall OPERF investment portfolio. To date, investments in this category have included participation in diversified strategies including: infrastructure limited partnerships, oil and gas limited partnerships, hedge fund partnerships, and other special situation partnerships. The allocation to the Program will be in the range of 3-5% of OPERF's total asset value. OPERF should be selective and invest such assets, as are allocated to this Program prudently, as opportunities become available.

II. GENERAL POLICY

Alternative Investments provide an appropriate addition to OPERF's investment portfolio, and are compatible with the general objectives of the Fund, which include:

1. Providing a means to pay benefits to the Fund's participants and their beneficiaries.

2. Investing to produce a return on investment that is based on levels of liquidity and investment risk that are prudent and reasonable.

3. Attaining an adequate real return over the expected rate of inflation.

4. Complying with all applicable laws and regulations concerning the investment of pension assets.

Alternative Investments possess a low correlation relative to other investment classes and should therefore contribute to reduction of risk and the enhancement of returns, on a total portfolio basis, as well as providing portfolio diversification.

III. OBJECTIVES

A. PORTFOLIO INVESTMENT PERFORMANCE OBJECTIVE

The performance objective for Program investments is significant long-term net returns to OPERF (e.g., after management fees and general partner's carried interest) above a benchmark reflecting the CPI plus an appropriate premium to compensate for illiquidity, risk and expense. The performance objective should exceed the CPI plus 400 basis points, and may vary by the type of investment, for example, infrastructure or timberland. The performance objective, benchmark and premium will be periodically evaluated by Staff.

B. DIVERSIFICATION

Diversification reduces risk in the Program's investments and the following types of diversification should be considered, including, but not limited to:

1. Strategy - Diversify investments through exposure to a variety of alternative investment strategies, including infrastructure, natural resources (including commodities), and absolute return or hedge fund strategies. The targeted exposure ranges for various types of investments are:

Investment Type	**Target Allocation**
Infrastructure	**25-35%**
Natural Resources	**40-50%**
Hedge Funds	**15-25%**
Other	**0-10%**

2. Industry Sectors - Investments will be diversified among industry groupings.

3. Size of Investments - Investments will be diversified among a range of partnerships of varying sizes, generally with a minimum investment size of $25 million, and may be as much as 25% of a particular co-mingled partnership when appropriate. Deviations from these guidelines will be documented and communicated to the Council.

4. Geographical - OPERF should consider geographical diversification in investment selection; and investments, to the extent appropriate, may be considered which benefit the overall economic health of Oregon, so long as and only if such investments would otherwise meet the investment criteria and quality of the Program.

5. Time - OPERF will endeavor to invest in a consistent manner over time, unless market conditions appear unfavorable.

C. TOTAL PORTFOLIO DIVERSIFICATION

Correlation of the Program's investment return to other asset classes is not high, and the inclusion of Alternative Investments, therefore, provides an added measure of diversification to the Fund.

PROCEDURES:

I. PROCEDURES AND STANDARDS

A. DEFINITION OF INVESTMENT UNIVERSE

Oregon State Treasury (OST) staff and the advisor shall furnish the OIC an annual statement of the sector and strategy plan for the Program, and a list of potential managers that includes sector information and strategy. The list is to be updated periodically and shall define the population from which Alternative investments may be made.

B. GENERAL PROCEDURES

1. Staff, and the advisor selected specifically for Alternative Investments, will screen available investments and identify those which meet the Program's general strategy, selection criteria and performance goals. Staff will coordinate the available investments received by Staff, the Council, and the advisor. Staff may reject such proposals if they do not meet the Program's investment strategy or criteria.

2. The advisor, working in conjunction with staff, will review the documents pertinent to an investment opportunity, including the offering memorandum, and identify possible issues. The advisor and Staff may meet with the general partners, sponsors, or investment managers to discuss the investment.

3. The advisor will identify to Staff those investments determined to best meet the Program's investment strategy and criteria for consideration for further detailed review.

4. Staff will select investment opportunities for the advisor to conduct full due diligence on. Upon completion of its due diligence, the advisor will provide a written report containing a summary of the proposed investment including: a description of the general partner's background, historical performance, and organization; the proposed investment strategy; the proposed terms of the investment; the expected rate of return; the merits of the investment; issues and concerns surrounding the investment and how they might be resolved; and issues and provisions that should be subject to negotiation.

5. The advisor and Staff will discuss the investment opportunity and whether an investment is likely, under the circumstances. Presentations and meetings between Staff and the general partners or sponsors will be arranged as necessary to address issues or questions. Unfavorable opportunities will not be considered further.

6. Appropriate legal counsel (generally the Oregon Attorney General's office) will be furnished partnership documents for those investments selected by Staff and approved by the Council. Legal counsel will identify any legal issues and discuss these with Staff.

C. OST STAFF AUTHORITY

The Chief Investment Officer, under recommendation from the Alternatives Investment Officer and with a favorable recommendation from the Program advisor, shall have the authority for the following Alternatives investment transactions:

1. Approval of administrative activities and guideline exceptions if a plan is established to conform the exception [project/investment/fund] to guidelines within a reasonable period of time.

2. Approval of purchase or sale of fund interests, if delegated by the OIC; review and approve other activity as necessary to further the interests of OPERF's Alternative Investments Program, consistent with the overall risk management and performance objectives.

3. Approve up to an additional $15 million to an existing fund for the following purposes: (1) to recapitalize the fund with additional equity, (2) to acquire all or part of another LP's position in an existing fund or (3) to co-invest with the fund in a new investment. Such additional commitment shall be on terms equal to or better than the existing fund terms previously approved by the OIC.

Any of the foregoing activity exercised by Staff shall be reported to the OIC at an upcoming meeting.

E. SELECTION CRITERIA

1. The OIC will generally invest with experienced organizations that have managed prior investments or partnerships. Primary emphasis will be on the quality and experience of the investment sponsor or manager.

2. Additional criteria to be considered will include:

   a) A well-developed investment focus that meets the Program's objectives and a favorable assessment of the proposed investment's strategy and market conditions;

   b) Relevant investment experience of partners and key staff, individually and as a team, as well as their stability;

   c) Organizational depth and significant time commitment to the partnership's or project's interests;

   d) Well-structured decision-making and transaction execution processes, including:

      - deal flow and initial analysis of portfolio investments,
      - pricing, selection and negotiation of portfolio investments,
      - financial structuring of portfolio investments,
      - management or oversight of portfolio companies,
      - development of exit strategies;

   e) Consideration of relevant issues, such as conflicts of interest and alignment of interests, among others;

f) Experience in, and a demonstrated record of, successful prior investments;

g) Appropriate proposed terms and structure for the investment.

F. STANDARDS

1. Types of Allowable Investments

Any appropriate investment opportunity which has the potential for returns superior to traditional investment opportunities and which is not otherwise prohibited by OPERF investment policies or by law.

2. Prudent Investor Standard

The applicable prudence standards and fiduciary duties will guide the selection of Program investments under Oregon law and regulations.

3. Negotiated Terms

Terms, such as preferred returns, lower fee structures, and profit splits, should be negotiated where prudent.

II. IMPLEMENTATION

A. ADVISOR AND OPERF REQUIREMENTS

OST and the OIC have elected to manage the Program under a lean-staff/outsourced model. An appropriate number of Staff will be assigned as the workload necessitates, and will manage portfolio planning and construction, the investment decision-making schedule and process, and the advisory contract. A qualified, independent advisor will be retained by the OIC to facilitate Program investing, and will be delegated substantial duties for: performing due diligence on investment opportunities, monitoring of Program investments, Program analytics, valuation analyses, and performance reporting. Staff retains the primary responsibility to ensure Program investments receive appropriate due diligence, monitoring, and valuation analyses. While some of these duties will be delegated to the advisor, Staff will conduct and document sufficient reviews and tests of the advisor’s work to conclude these delegated duties are being consistently performed.

B. LEGAL COUNSEL

Relevant legal advice will be obtained from the Office of the Oregon Attorney General. However, due to the complex nature of the Program's investments, the necessity for expert outside legal counsel shall be recommended to the Attorney General when deemed necessary by Staff and the Council.

C. CONTRACT EXECUTION

1. General Partners or investment managers will be informed of the Council's approved commitment, in writing, immediately following the Council meeting.

2. The Program advisor will receive OIC meeting agenda materials which shall include the written minutes of the Council's most recent meeting.

3. Legal counsel will receive written verification of the committed amount in conjunction with the partnership documentation.

4. The Council's authorized signatory, the Chief Investment Officer (or designee in accordance with OST policy), will ensure legal sufficiency has been provided by the DOJ, prior to the execution of the agreement.

D. PARTNERSHIP FUNDING

1. For all existing and future partnership relationships, each general partner shall submit a complete listing of the bank account(s) to which OST may wire funds on behalf of the investment manager; this list may be included as an exhibit to the investment management agreement. OST shall not deviate from these pre-established instructions unless the general partner, or investment management firm, authorizes such a change in writing.

2. All requests for funding (e.g., capital calls) must be made in writing and shall include an authorized signature. Facsimiles or e-mails may be accepted, if they include an authorized signature and account information previously authorized per D.1. above.

3. OST staff shall regularly monitor, through the OIC's advisor, that fundings do not exceed the maximum amount authorized by the OIC, except as otherwise allowed by partnership recycling and temporary bridge financing provisions.

4. OST staff shall verify that an authorized signer signs the written request by matching the signature to specimen signatures maintained at OST.

III. MONITORING

A. REPORTS

Reports prepared by the independent outside advisor will be furnished at least quarterly on Program activity and performance, and annually in an expanded format.

B. ADHERENCE TO STRATEGY

The actual strategy employed by general partners or investment managers will be judged relative to stated objectives and strategies. The advisor will interact with general partners or investment managers periodically as necessary.

IV. REVIEW AND MODIFICATION OF INVESTMENT POLICY STATEMENT

The Council may review this policy statement and procedures from time to time to determine if modifications are necessary or desirable.

SAMPLE FORMS, DOCUMENTS, OR REPORTS

A. Appendix A – Private Partnership Investment Principles
B. Appendix B – Alternative Investments Valuation Policy

TAB 4 – OPERF Core Real Estate Review

MATERIALS TO BE SENT UNDER SEPARATE COVER

TAB 5 – Annual Placement Agent Summary

Annual Disclosure of Placement Agents

January 26, 2011

Purpose

In accordance with OST Policy 5.03.01, Conflict of Interest and Code of Conduct: Staff shall present to the OIC an annual summary of any Placement Agent used by an investment firms, recommended to the OIC for approval.

Summary for Calendar Year 2010

Partnership	OPERF Commitment	Placement Agent
Baring Asia Private Equity Fund V L.P.	$100 million	UBS Private Funds Group
Blackstone Capital Partners VI L.P.	$200 million	Park Hill Group LLC
Centerbridge Capital Partners II L.P.	$100 million	Park Hill Group LLC
GSO Capital Opportunities Fund II L.P.	$100 million	Park Hill Group LLC
KSL Capital Partners III L.P.	$100 million	Probitas Partners
The Veritas Capital Fund IV L.P.	$100 million	UBS Private Funds Group
Vornado Capital Partners	$100 million	Mercury Capital Advisors
Waterton Residential Property Venture XI	$100 million	Park Madison Partners

Note that placement agents are retained by the general partner of the fund, and OPERF does not rely on such firms for access or analysis.

TAB 6 – Asset Allocations & NAV Updates

Asset Allocations at December 31, 2010

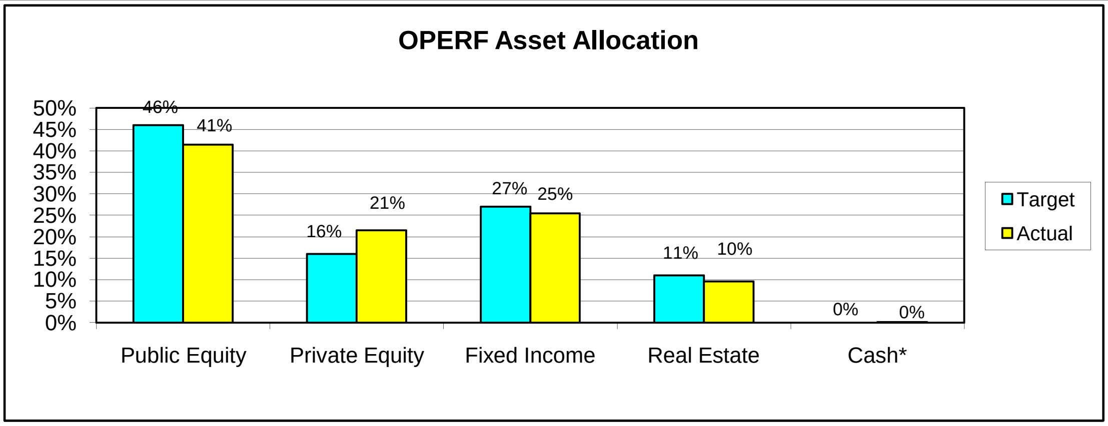
OPERF	Policy	Target	Regular Account: $ Thousands	Pre-Overlay	Overlay	Net Position	Actual	Variable Fund: $ Thousands	Total Fund: $ Thousands
Public Equity	41-51%	46%	23,116,037	41.5%	(37,912)	23,078,125	41.4%	977,344	24,055,469
Private Equity	12-20%	16%	11,973,204	21.5%		11,973,204	21.5%		11,973,204
Total Equity	**57-67%**	**62%**	**35,089,241**	**63.0%**	**(37,912)**	**35,051,329**	**62.9%**		**36,028,673**
Opportunity Portfolio			1,053,075	1.9%		1,053,075	1.9%		1,053,075
Fixed Income	**22-32%**	**27%**	**13,377,378**	24.0%	**813,613**	**14,190,991**	25.5%		**14,190,991**
Real Estate	**8-14%**	**11%**	**5,329,935**	9.6%	**(2,500)**	**5,327,435**	9.6%		**5,327,435**
Cash*	**0-3%**	**0%**	**847,284**	1.5%	**(773,201)**	**74,083**	0.1%	7,047	**81,130**
TOTAL OPERF		**100%**	**$ 55,696,913**	**100.0%**	**$ -**	**$ 55,696,913**	**100.0%**	**$ 984,391**	**$ 56,681,304**

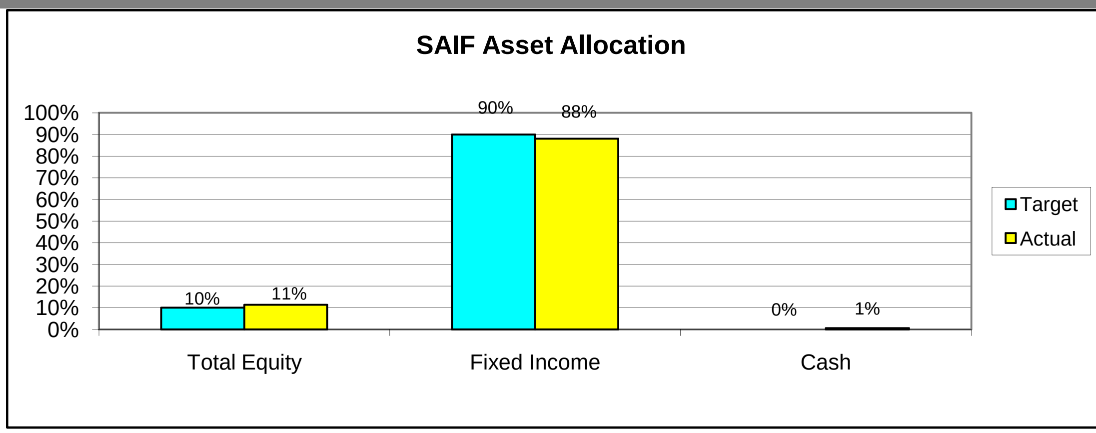
*Includes cash held in the policy implementation overlay program.

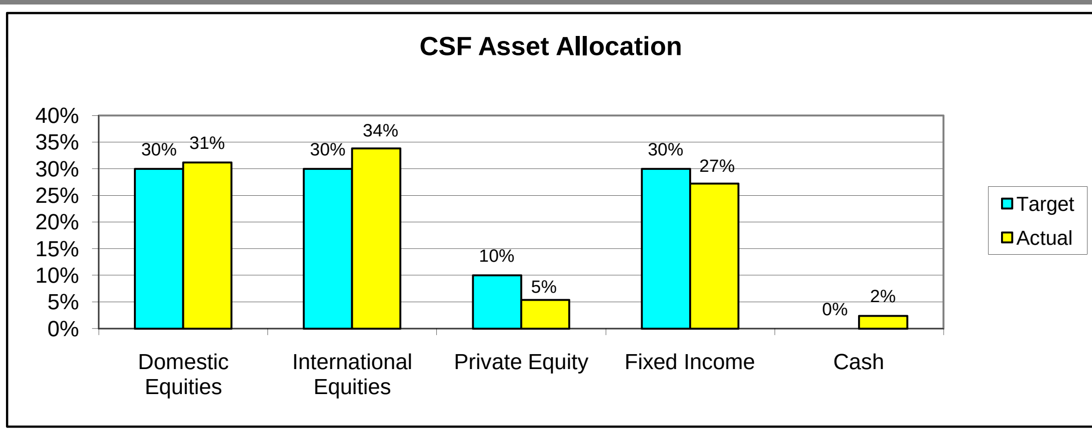
SAIF	Policy	Target	$ Thousands	Actual
Total Equity	**7-13%**	**10.0%**	**468,191**	**11.4%**
Fixed Income	**87-93%**	**90.0%**	**3,629,094**	**88.1%**
Cash	**0-3%**	**0%**	**23,829**	**0.6%**
TOTAL SAIF		**100%**	**$4,121,114**	**100.0%**

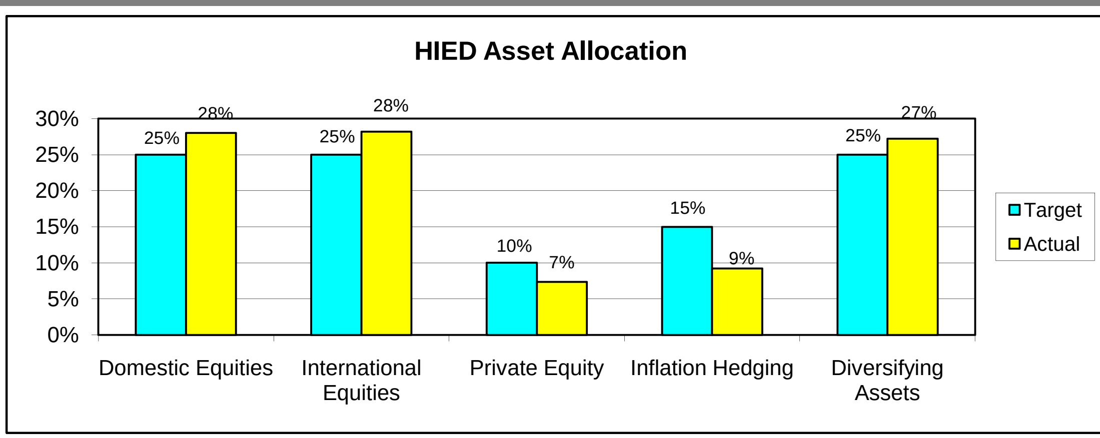
CSF	Policy	Target	$ Thousands	Actual
Domestic Equities	25-35%	30%	$345,349	31.2%
International Equities	25-35%	30%	374,552	33.8%
Private Equity	0-12%	10%	59,502	5.4%
Total Equity	**65-75%**	**70%**	**779,403**	**70.4%**
Fixed Income	**25-35%**	**30%**	**301,593**	**27.2%**
Cash	**0-3%**	**0%**	**26,860**	**2.4%**
TOTAL CSF			**$1,107,856**	**100.0%**

HIED	Policy	Target	$ Thousands	Actual
Domestic Equities	20-30%	25%	$17,809	28.0%
International Equities	20-30%	25%	17,901	28.2%
Private Equity	0-15%	10%	4,687	7.4%
Growth Assets	**50-75%**	**60%**	**40,397**	**63.6%**
Real Estate	0-10%	7.5%	1,498	2.4%
TIPS	0-10%	7.5%	4,360	6.9%
Inflation Hedging	**7-20%**	**15%**	**5,858**	**9.2%**
Fixed Income	20-30%	25%	16,316	25.7%
Cash	0-3%	0%	988	1.6%
Diversifying Assets	**20-30`%**	**25%**	**17,304**	**27.2%**
TOTAL HIED			**$63,559**	**100.0%**

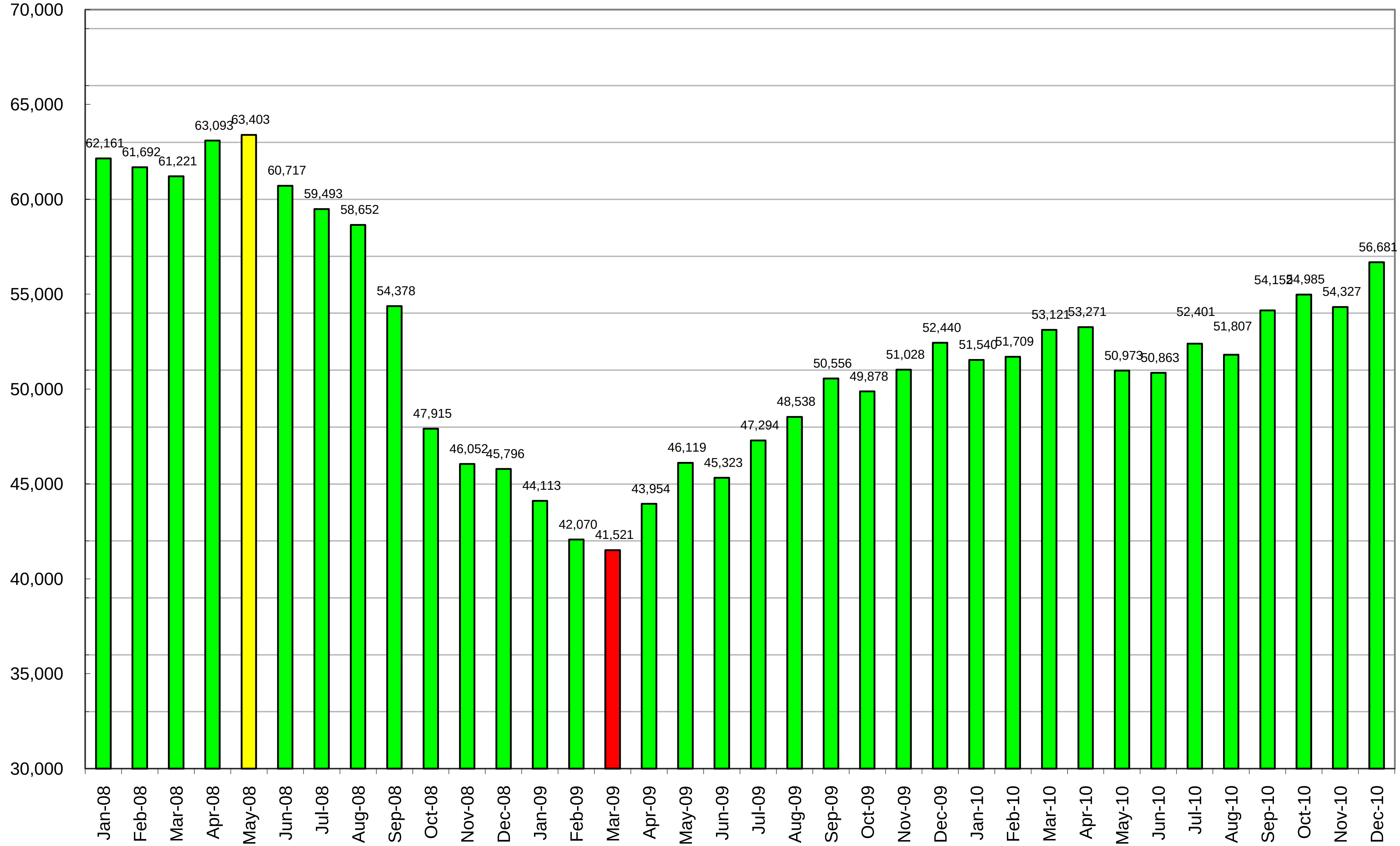

OPERF Asset Allocation
50%
45%
40%
35%
30%
25%
20%
15%
10%
5%
0%
46%
41%
16%
21%
27%
25%
11%
10%
0%
0%
Public Equity
Private Equity
Fixed Income
Real Estate
Cash*
Target
Actual


SAIF Asset Allocation
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
10%
11%
90%
88%
0%
1%
Total Equity
Fixed Income
Cash
Target
Actual

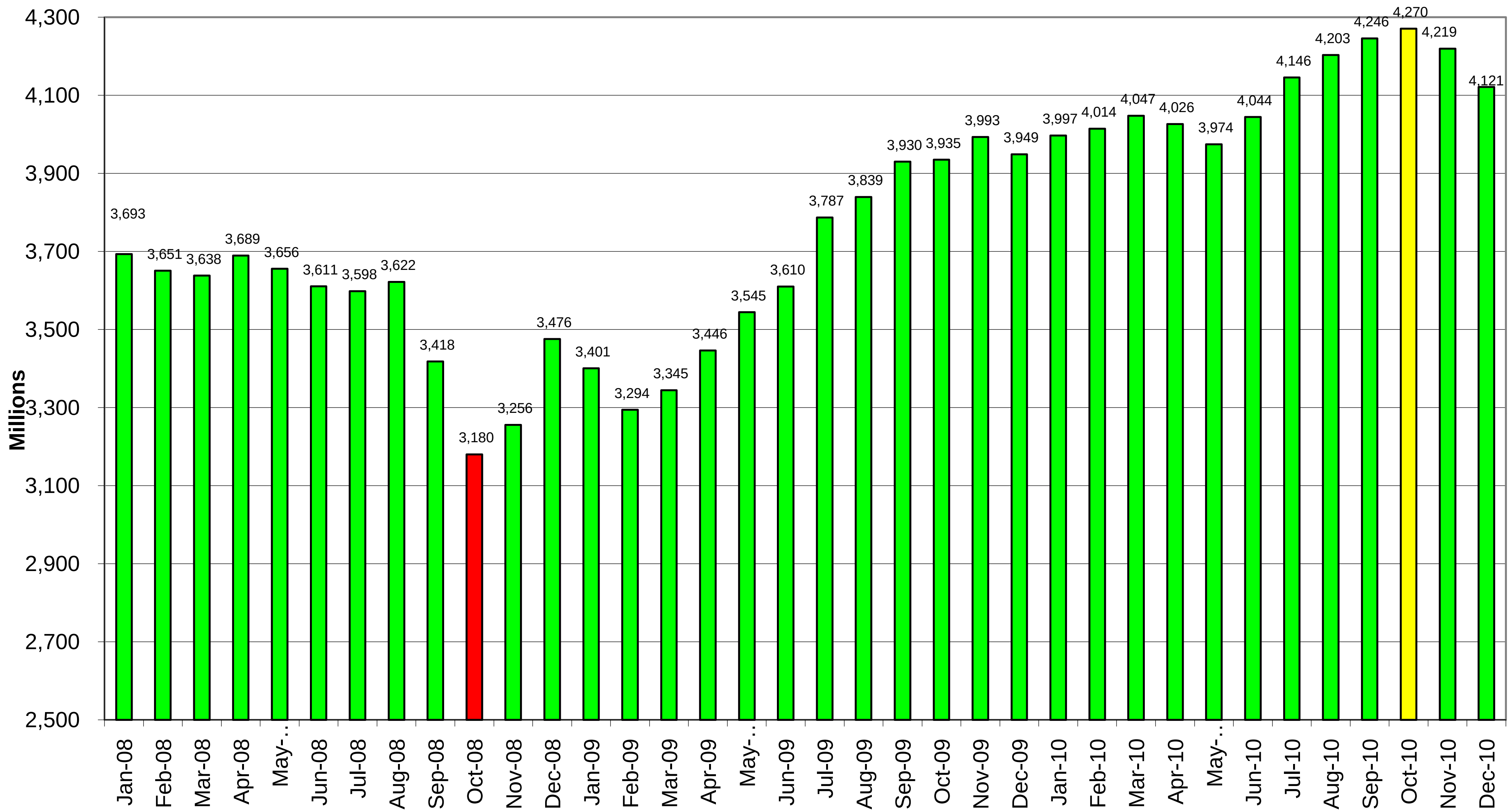

CSF Asset Allocation
40%
35%
30%
25%
20%
15%
10%
5%
0%
30%
31%
30%
34%
10%
5%
30%
27%
0%
2%
Domestic Equities
International Equities
Private Equity
Fixed Income
Cash
Target
Actual

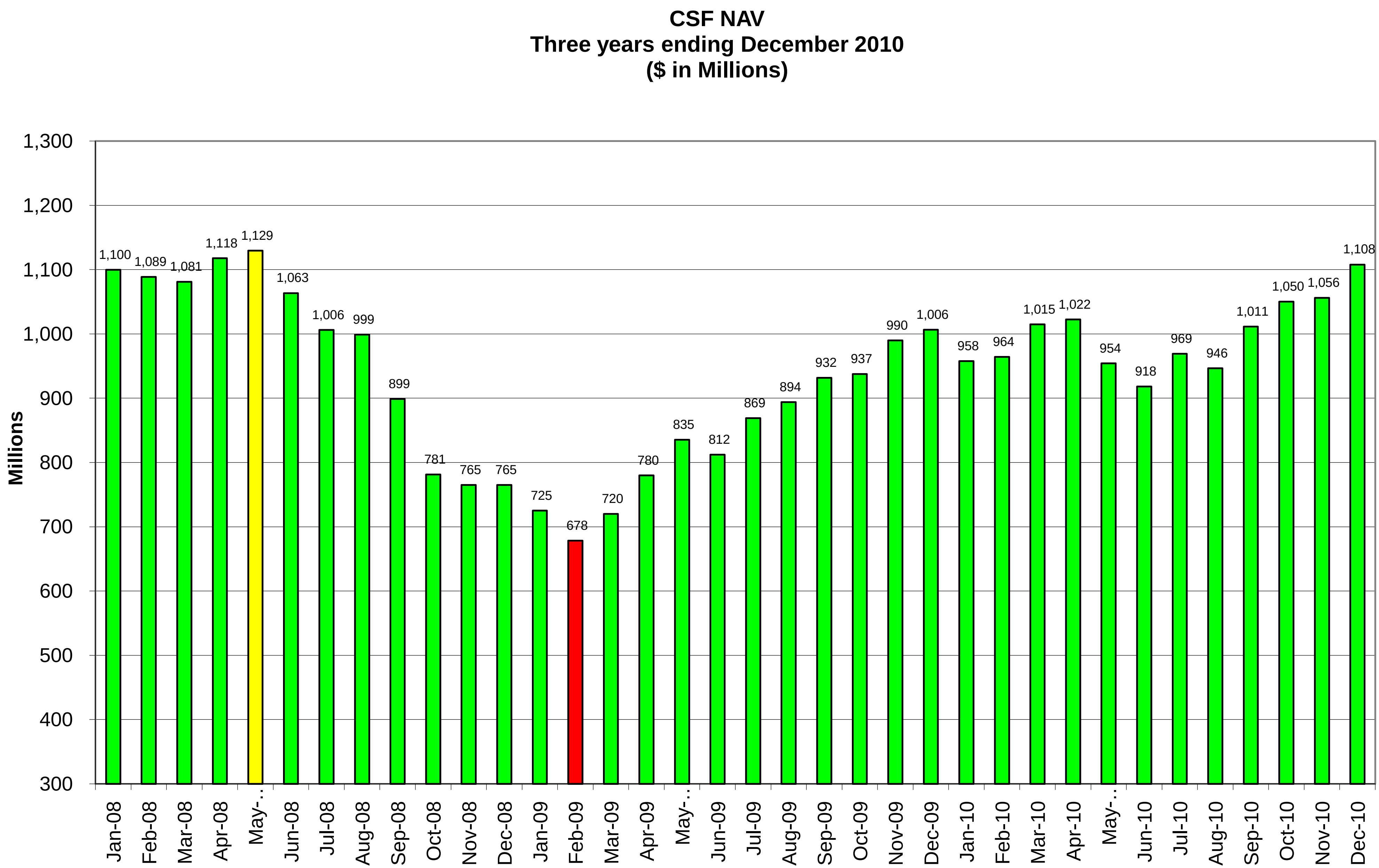

HIED Asset Allocation
30%
25%
20%
15%
10%
5%
0%
25%
28%
25%
28%
10%
7%
15%
9%
25%
27%
Domestic Equities
International Equities
Private Equity
Inflation Hedging
Diversifying Assets
Target
Actual

OPERF NAV
Three years ending December 2010
($ in Millions)



SAIF NAV
Three years ending December 2010
($ in Millions)




CSF NAV
Three years ending December 2010
($ in Millions)
Millions
1,300
1,200
1,100
1,000
900
800
700
600
500
400
300
1,100
1,089
1,081
1,118
1,129
1,063
1,006
999
899
781
765
765
725
678
720
780
835
812
869
894
932
937
990
1,006
958
964
1,015
1,022
954
918
969
946
1,011
1,050
1,056
1,108
Jan-08
Feb-08
Mar-08
Apr-08
May-…
Jun-08
Jul-08
Aug-08
Sep-08
Oct-08
Nov-08
Dec-08
Jan-09
Feb-09
Mar-09
Apr-09
May-…
Jun-09
Jul-09
Aug-09
Sep-09
Oct-09
Nov-09
Dec-09
Jan-10
Feb-10
Mar-10
Apr-10
May-…
Jun-10
Jul-10
Aug-10
Sep-10
Oct-10
Nov-10
Dec-10

TAB 7 – Calendar – Future Agenda Items

2011 OIC Forward Agenda Topics

February 23:	OSGP Review OIF Portfolio Update OPERF Proxy Voting Agent OPERF Private Equity Annual Plan OPERF 4th Quarter Performance Review
April 27:	Public Equity Annual Review OSTF Annual Review DOJ Litigation Update Securities Lending Review Annual Policy Updates
June 1:	SAIF Annual Review OPERF 1st Quarter Performance Review
July 27:	OPERF Real Estate Annual Review Annual Audit Update
September 28:	CSF Annual Review
November 2:	CEM Benchmarking Annual Review
December 7:	OPERF 3rd Quarter Performance Review OPERF Opportunity Portfolio Review HIED Annual Review