Oregon Investment Council
MINUTES
June 25, 2003

The Oregon Investment Council was called to order at 9:05 a.m. by Gerard Drummond.

OIC Members Present: Gerard Drummond, Mark Gardiner, Diana Goldschmidt and James Voytko.

OIC Member On-Line: Randall Edwards

OIC Member Absent: Jerry Bidwell

Staff Present: Jay Fewel, Cheryl Griffith, Steve Gruber, Linda Haglund, Curt Hartinger, Norma Harvey, Perrin Lim, Michael Mueller, Kevin Nordhill, Cesar Porte, and Ron Schmitz.

Consultants Present: John Ilkiw, Russell Investment Group
Bill Madden, Russell Investment Group
Neil Rue, Pension Consulting Alliance
Joe Meyer, Compass Advisors

Legal Counsel: Dee Carlson, Oregon Department of Justice

I. Review and Approval of Minutes – 5/28/2003

MOTION: Mark Gardiner moved approval of the 5/28/2003 minutes. The motion was seconded by Diana Goldschmidt and passed unanimously by the Council.

II. The Case for Global Investing – AllianceBernstein

Jay Fewel addressed the Council and noted that the OPERF domestic and international equities are separate and distinct asset classes. However, in recent years, some larger, integrated money managers have adopted a global approach. He further noted that the AllianceBernstein presentation does not entail a recommendation on the part of staff, but, in a proactive fashion, presents one of the prospective managers to discuss the case for global investing to see if there is any interest in further exploration.

Mr. Fewel introduced Andy Adelson, currently the AllianceBernstein international portfolio manager for OPERF. Mr. Adelson outlined his presentation to the Council entitled *Generating Alpha in a Global Environment.* He presented materials referencing correlations between US equities, the S&P 500 and EAFE. Included in the presentation were graphs and charts outlining the benefits of

diversification. Mr. Adelson noted that most money managers began foreign investing under the idea of diversification.

Discussion followed regarding the relative impact of country and industry factors on stock returns and factors that drive corporate profitability. Mr. Adelson noted that the same factors drive returns everywhere. The capital markets driving globalization are:

- Global interest-rate convergence.
- Alignment of regulations and corporate governance.
- Investment research and management.

The global auto industry was examined as an example of global investing, as well as the insurance industry.

Mr. Adelson answered questions from the Council regarding emerging markets.

Mr. Fewel noted that OPERF has both the US deep value and international products through AllianceBernstein. He pointed out that there are only a few firms that have global capabilities. He further noted that with regard to efficient markets, if a global approach were adopted, it would be most appropriate in the large cap stocks and not small cap or emerging markets arenas.

III. International Diversification - Ernie Ankrim, Russell Investment Group

Jay Fewel addressed the Council and noted that there has been some discussion and press recently on the merits of investing internationally. He introduced Ernie Ankrim, Chief Investment Strategist with the Russell Investment Group, to present his perspective and to discuss whether or not international investing is still worth the risk.

Mr. Ankrim outlined international equity diversification, with an emphasis on the low correlations between domestic and foreign markets and noted that investors everywhere can reduce the risk levels of their portfolios by buying foreign securities.

Discussion followed regarding whether or not US equities may outperform Non-US equities over the next three years. Also outlined was the management of risk through diversification, strategic diversification and tactical weighting (market timing).

Charts were presented outlining correlation and correlation trends in the last ten years, volatility, “return chasing” behavior and time horizons.

Conclusions:

- High correlations do not justify abandoning diversification.
- It’s not fair hiding a tactical call behind a diversification shield. Investors with short-horizon risk-management objectives should pay attention to

correlations (but they probably should have reduced allocations to equities anyway).

- Investors should avoid suggestions to leave behind the coldest asset class to start chasing the hottest, regardless of the recent correlation pattern.

Mr. Ankrim answered questions from the Council and Staff.

IV. International Equity – Annual Review

Jay Fewel and Kevin Nordhill addressed the Council and outlined the order of presentations by staff and Russell. Council policy provides for a target weighting to the International Equity asset class of 20% plus or minus 5% of the OPERF Regular Account balance. As of May 31, 2003, the International Equity Fund comprised 19.4% of the Regular Account. The diversification benefits of Non-US equities is a driving force behind the asset allocation decision of the International Equity asset class.

Mr. Fewel introduced Bill Madden of the Russell Investment Group.

Mr. Madden outlined the current Non-US benchmarks and the proposed new Non-US benchmarks as follows:

New Total Asset Class Benchmark	**In Place Of**
MSCI All Country World ex US (Free) (This is abbreviated ACWI Free ex US)	90% Citigroup BMI / 10% S&P IFC
New Style Indices	
MSCI ACWI Free ex US Growth	N/A
MSCI ACWI Free ex US Value	N/A
New Emerging Markets Benchmark	
MSCI Emerging Markets Free	S&P IFC Investable Emerging Markets Index

Comparative risk statistics were discussed as well as the impact of currency valuations on Non-US investment returns.

A review of Non-US equity managers followed with the following observations by Russell:

- Minimum number of managers (4 active) has lowest fee but highest tracking error. Not an acceptable structure.
- Adding enhanced index manager increases excess return slightly and has minimal impact on tracking error
- The existing (4/30/2003) manager structure has acceptable return/risk statistics (127/178=IR of 0.71) but is overly complex.
- Proposed structure reduces number of managers by two. This reduces complexity while producing a robust IR (0.71) identical to the existing structure.

The current portfolio status review followed with proposed allocations and a manager-specific allocation discussion. Charts were included with manager vs. benchmark statistics as well as value-added over benchmarks.

Specific discussions followed regarding Lazard Asset Management, Clay-Finlay, Montgomery/Wells and Schroders.

Mr. Fewel and Mr. Nordhill summarized staff recommendations and answered questions from the Council.

MOTION: Diana Goldschmidt moved the following staff recommendations: 1) Terminate Schroder Investment Management and 2) Terminate Clay Finlay. The motion was seconded by Mark Gardiner and passed unanimously by the Council.

MOTION: Mark Gardiner moved the following staff recommendations: 1) Create an Enhanced Index sub-category in addition to the Passive and Active sub-categories; 2) Hire BGI International Alpha Tilts strategy for the Enhanced Index sub-category; 3) Adopt the MSCI ACWI Free benchmark series. Identify value and growth managers and benchmark against MSCI ACWI Free Value and Growth benchmarks. Adopt the MSCI Emerging Markets index as the emerging markets benchmark; and 4) Approve OIC Policy 4.05.12 changes, which encompass the preceding recommendations. Authorize staff to rebalance manager assets within the policy target ranges. The motion was seconded by Randall Edwards and passed unanimously by the Council.

V. Rotating Internal Control & Operational Reviews

Linda Haglund and Curt Hartinger addressed the Council and presented the results of the rotating internal control and operational reviews performed in 2000, 2001, and 2002 and outlined suggested revisions to the OIC policy going forward. OIC Policy 4.01.12 requires that the Oregon State Treasury retain "a qualified accounting firm to perform an examination of the internal control structure over one of the major asset classes." In addition, the firm is to further provide "a procedural (operational) review of the investment portfolio and its practices as compared and contrasted to the investment portfolio practices of similarly managed investments in the private, and public sector."

Ms. Haglund and Mr. Hartinger reviewed reports from independent accountants and answered questions from the Council.

Recommended policy changes were discussed as Treasury has significantly bolstered its internal audit function since the inception of Policy 4.01.12. With this increased capacity, staff believes it will be more efficient and cost-effective to have Treasury's internal audit services perform the internal controls portion of the annual asset class audit. An external firm/consultant will still be retained to review the asset class operations in terms of best practices. Additional recommended changes were to permit the use of consultants for the operational

reviews due to the difficulty in finding sufficiently qualified accounting firms for some asset classes (real estate as an example). This will allow staff to secure the best resources to complete the operational reviews. It was further noted that Treasury is in the process of standardizing policy statements to reflect the statutory directive specifically rather than an interpretative version.

MOTION: Mark Gardiner moved to adopt changes to Oregon State Treasury Policies and Procedures Investment Manual 4.01.12. The motion was seconded by Diana Goldschmidt and passed unanimously by the Council.

VI. Consulting Contracts Review

Ron Schmitz noted that over the past couple of years, for various reasons, the OIC has modified otherwise expiring consulting contracts, through short-term extensions. He outlined the policy which states that contracts may only be extended twice in a seven year period. Mr. Schmitz outlined the proposal to extend existing contracts to a staggered series of dates while an efficient RFI process began.

There was Council consensus that the proposed dates presented in the agenda materials are too long and staff was asked for alternative extensions. Discussion followed regarding the most efficient work plan for staff and how many RFI's staff can expedite per year.

MOTION: Randall Edwards moved to extend consulting contracts for Russell Investment Group, Pension Consulting Alliance-Allan Emkin, Pension Consulting Alliance-Nori Lietz and Pacific Corporate Group as discussed. The motion was seconded by Mark Gardiner.

After further discussion, it was the consensus of the Council not to vote on extensions at this time. Staff was directed to proceed with a Request for Information for a General Consultant, the space currently occupied by Allan Emkin and Russell Investment Group, with staff recommendations before year-end. The real estate and private equity consultants would be dealt with in a like manner as soon as possible.

VII. House Bill 2003 Implementation

Ron Schmitz invited Jim Voytko to report on the implementation of House Bill 2003 from a PERS perspective. House Bill 2003 was signed into law on May 9, 2003, as it relates to investing the "Transition Account." Also, PERS is requesting confirmation of OIC investment structures for these accounts as it relates to the coordination of services between Treasury and PERS.

Jim Voytko reviewed the three different scenarios related to the new defined contribution responsibilities:

1. **Transition Accounts (HB 2003) during a period of judicial uncertainty**
   The bill requires assets be invested under OPERF. During this period, staff believes it most prudent to invest these funds on a commingled basis with the "Regular" account.
2. **Transition Accounts (HB 2003) following judicial review**
   Greater certainty will be had as to the long term status of these accounts which may result in the need to devise an investment structure different from the single "OPERF Regular" investment of funds.
3. **Individual Account Program (HB2020)**
   Current versions of the bill contain language for Program assets ranging from "9 investment options" (similar to the current 457 Deferred Compensation Plan) to "1" option (OPERF Regular Account). Final legislative outcome will define parameters of action required buy the OIC.

VIII. Asset Allocation

a. OPERF
b. SAIF Corporation
c. Common School Fund

Mr. Schmitz noted that all asset allocations are within policy ranges and no rebalancing is required at this time. He drew attention to the added NAV bar charts within the report, at the request of the Treasurer.

IX. Calendar – Future Agenda Items

Future agenda items were discussed and Mr. Schmitz noted that he would notify the Council with a list of prospective topics for the October OIC Workshop.

X. Public Comments

Bill Parish of Parish & Company addressed the Council regarding various items on the agenda as well as agenda items from previous OIC meetings.

The meeting adjourned at 12:12pm.

Respectfully submitted,

Norma Harvey
Investment Analyst