

Oregon Investment Council
MINUTES
August 27, 2003

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

OIC Members Present: Jerry Bidwell, Gerard Drummond, Randall Edwards, Mark Gardiner, Diana Goldschmidt and James Voytko.

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

Consultants Present: John Ilkiw, Russell Investment Group
Bill Madden, Russell Investment Group
Tara Blackburn, Pacific Corporate Group
Eric Becker, Pacific Corporate Group
Allan Emkin, Pension Consulting Alliance
Nori Lietz, Pension Consulting Alliance
Randall Doser, Compass Advisors

Legal Counsel: Dee Carlson, Oregon Department of Justice

I. Review and Approval of Minutes - 7/30/2003

MOTION: Jerry Bidwell moved approval of the 7/30/2003 minutes. The motion was seconded by Randall Edwards and passed unanimously by the Council.

II. OPERF Domestic Equity Annual Review

Jay Fewel, Kevin Nordhill and Bill Madden presented the annual Domestic Equity review. Bill Madden presented the Russell Investment Group US Equity Review and outlined the US equity objective to achieve a portfolio return of 50 basis points or more above the Russell 3000 index over a market cycle of three to five years on a net-of-fees basis. He further outlined the following objectives:

- Target 43% active management, 43% passive investment and 14% enhanced index.
- Overweight small capitalization stocks by 40%. This tilt is based on the Investment Council's belief that, over the long-term, small capitalization stocks will provide greater returns than large capitalization stocks.
- Multiple specialist active managers with complementary investment processes are employed.

- Maximize exposure to security selection by maintaining neutralizing exposures to value and growth stocks, economic sectors and market capitalization, after adjusting for the strategic overweight to small cap.

Mr. Madden reviewed current portfolio characteristics and outlined changes in managers since the last annual review as follows:

- Aggregate structure is neutral to the benchmark and strategies. Small cap tilt is in line with target, and has added value over the past few years.
- For 3 years ended June 30, 2003, the net-of-fees excess return was +.43%, and the tracking error was lower than target, at 1.21%.
- The 5 year net-of-fees excess return and tracking error were +1.76% and 3.14%, respectively.

Mr. Madden presented a detailed review of individual managers and answered questions from the Council regarding the recommended changes.

Mr. Fewel and Mr. Nordhill presented the staff review of the portfolio and managers and commented on the following staff recommendations:

1. Terminate Oak Associates from their large cap growth mandate.
2. Nicholas Applegate: Terminate the Mid-cap product. Retain the Mini-cap and Emerging Company products. Assign Russell 2000 Growth Index as the benchmark.
3. Make the following changes to the manager target allocations:
Small Cap Growth:
 - Reduce Nicholas Applegate from 2.5% to 1.0%.
 - Add a new manager position. Allocate a target of 1.5% and authorize staff to initiate a search for a small/mid cap growth manager.Large Cap Growth:
 - Reduce Alliance Capital from 5.0% to 4.5%.
 - Increase vacancy created by Oak Associates' termination from 4.0% to 4.5% and authorize staff to initiate a search for a large cap growth manager(s) to complement Alliance Capital.
4. Approve OIC Policy 4.05.11 changes, which encompass the preceding recommendations.
5. Authorize staff to rebalance manager assets within the policy target ranges. Staff proposes to pare back Thompson Rubinstein, Wellington, and some of the passive overweights, and to reallocate the assets to certain managers underweight in their target midpoints.

SMID Cap products were discussed and whether or not they fit into the Small Cap policy mandates. Manager termination transition costs and process was reviewed. Mr. Fewel noted that staff maintains a shortlist of managers for consideration in the event of termination.

MOTION: Randall Edwards moved termination of Oak Associates from their large cap growth mandate. The motion was seconded by Jerry Bidwell and passed unanimously by the Council.

MOTION: Diana Goldschmidt moved termination of the Mid-cap Nicholas Applegate product. The motion was seconded by Mark Gardiner and passed unanimously by the Council.

MOTION: Mark Gardiner moved to make the following changes to the Small Cap Growth target allocations: 1) Reduce Nicholas Applegate from 2.5% to 1.0%, and 2) Add a new manager position. Allocate a target of 1.5% and authorize staff to initiate a search for a small/mid cap (SMID) growth manager. The motion was seconded by Randall Edwards and passed unanimously by the Council.

MOTION: Mark Gardiner moved to make the following changes to the Large Cap Growth target allocations: 1) Reduce Alliance Capital from 5.0% to 4.5%, and 2) Increase the vacancy created by Oak Associates' termination from 4.0% to 4.5% and authorize staff to initiate a search for a large cap growth manager or managers to complement Alliance Capital. The motion was seconded by Randall Edwards and passed unanimously by the Council.

MOTION: Mark Gardiner moved approval of proposed changes to OIC Policy 4.05.11. The motion was seconded by Randall Edwards and passed unanimously by the Council.

MOTION: Mark Gardiner moved to authorize staff to rebalance manager assets within the policy target ranges. The motion was seconded by Randall Edwards and passed unanimously by the Council.

Council complimented Staff and Russell for the depth and clarity of information presented in the review.

The status of Becker Capital Management was discussed. Mr. Fewel outlined Becker's current performance and process and noted that they continue to be closely scrutinized by Treasury staff.

III. Fixed Income - Portfolio and Manager Structure

Ron Schmitz, Perrin Lim and John Ilkiw addressed the Council regarding the issue of the pros and cons of core plus managers versus sector specialists. Mr. Schmitz noted that the OIC had been intermittently addressing the question of generalist vs specialist managers in the fixed income arena for several years and has not been fully satisfied with either the analysis or the conclusions. He further noted that the purpose of this presentation is to analyze alternative

fixed income structures from both a qualitative as well as a quantitative (risk/reward) perspective, in hopes of providing enough information to allow a decision to be made as to whether or not to keep the current core plus structure or to authorize a limited allocation to sector specialist strategies. He described the Russell presentation as a risk/reward analysis with quantitative comparisons of various alternative structures.

John Ilkiw noted that the current generalist structure remains the preference of both staff and Russell and that it is currently exceeding the expectations for risk and return established by the Council. He presented the Russell report, "Rewards and Risks of Three Fixed Income Manager Structures" and offered three different manager structures or scenarios for consideration by the Council.

**Structure comparison: Scenario I in detail; Scenarios II & III summarized using IRs
Relative to LB Aggregate, Longest History Available (Scenario I)**

	Current Benchmark	Option A (Current)	Option D (90/10)	Option E (40/40/10/10)
Excess Return (bps)				
Systematic	4	4	15	66
Active	-	80	86	96
Total	4	84	101	162
Tracking Error (bps)				
Systematic	69	69	129	257
Active	-	83	100	93
Total		108	163	274
Fees (bps)	-	12	15	23
Net Excess Return (bps)	-	72	86	139
Information Ratios				
Net of Fee IR	-	0.67	0.52	0.51
Return Leakage	-	0	Negative	More negative
Net of Fee IR (Adj'd)	-	0.67	<0.52	<<0.51
Scenario II IR	-	0.67	<0.59	<<0.65
Scenario III IR	-	0.67	<0.58	<<0.65

An in-depth discussion of High Yield (HY) and Emerging Market Debt (EMD) Fixed Income Specialist Managers ensued as the Russell scenarios were examined.

After the discussion, staff was directed to invite specialist EMD and HY managers to make presentations to the OIC to provide additional information. Staff was further directed to address the issue of implementation, assuming a 5%-10% allocation would be carved out of the Fixed Income portfolio for specialist managers.

Jay Fewel, Ron Schmitz, Tara Blackburn and Eric Becker were present to discuss the Pacific Corporate Group (PCG) and staff strategic review of the alternative equity portfolio's objectives and assumptions. Mr. Fewel noted that

during the May 2003 alternative equity annual review, the Council requested that staff and consultants analyze the issue of sub-sector classes and report back.

Ms. Blackburn noted that on a periodic basis, staff and PCG complete a strategic review of the private equity portfolio's objectives and assumptions in order to review strategic areas of interest and identify elements of the program that may need to be adjusted to account for market conditions, with a goal of optimizing risk and return. The strategic review is the basis of OPERF's long-term planning for the private equity program. The elements of the Strategic Review include portfolio optimization, investment pacing and relationship management. She further noted that this review would address portfolio optimization by sub-sector and include recommendations from a sub-sector analysis.

Proposed Sub-sector Allocations to be added to Policy 4.06.01:

<u>Investment Type</u>	<u>Target Allocation</u>
Corporate Finance	60-75%
Large Corporate Finance	45-60%
Small/Mid Corporate Finance	15-25%
Venture Capital	5-10%
Specialist Situations	10-20%
Distressed	5-10%
Mezzanine	0-5%
Secondaries	0-5%
Sector Focused	0-5%
Fund-of-Funds	0-5%
Co-Investments	0-5%

Jim Voytko commented on the sub-sector allocations from a liability viewpoint, with regards to the passage of HB 2003. He addressed issues of the recording and crediting of unrealized capital gains made from estimations and the subsequent obligations created. He stressed the necessity for conservative accounting while HB 2003 is up for judicial review. Mr. Voytko and Dee Carlson discussed legal accounting issues from a liability view.

MOTION: Randall Edwards moved adoption of changes to OIC Policy 4.06.01 addressing Sub-sector target allocations. The motion was seconded by Diana Goldschmidt and passed unanimously by the Council.

V. Asset Allocations & NAV Updates

Ron Schmitz reported that asset allocations are within policy targets. He noted that with some of the real estate managers off-loading some assets in this market environment, the Real Estate exposure has crept down slightly, but is still within range. Mr. Schmitz further noted that SAIF is near the point of

needing to be rebalanced and staff will be making adjustments to SAIF via the Froley-Revy account.

- a. Oregon Public Employees Retirement Fund
- b. SAIF Corporation
- c. Common School Fund

VI. Calendar - Future Agenda Items

Ron Schmitz commented on future meetings and an alternative meeting schedule for 2004; perhaps shortening or reducing the number of meetings while keeping the same content.

VII. Parking Real Estate Investment Fund

Steve Gruber and Nori Lietz addressed the Council with due diligence information regarding the Parking Real Estate Investment Fund (PREF) offered by The Gates Group. Mr. Gruber commented on recent liquidations in the OPERF real estate portfolio. Ms. Lietz discussed national vacancy rates and the market environment in general. Mr. Gruber noted that during the 2002 Annual Real Estate Review, PCA and Staff stated it was likely any acquisitions or strategies presented to the OIC would be for alternatives to traditional real estate property types, due to intense competition for performing, traditional assets.

Mr. Gruber introduced Mike DeWindt, Walter Stuelpe and Graham White of the Gates Group to discuss the Parking Real Estate Fund, which would fit into the opportunistic real estate portfolio. Mr. DeWindt outlined the Gates Group investment strategy and portfolio structure and gave background information regarding the firm's principals.

Mr. DeWindt, Mr. Stuelpe and Mr. White answered questions from the staff and Council.

Mark Gardiner declared a possible conflict of interest due to his involvement with an institution preparing to launch a search for a similar entity. He noted that he would abstain from voting on this prospective fund.

MOTION: Diana Goldschmidt moved to authorize a commitment to the Parking Real Estate Fund sponsored by the Gates Group in the amount of \$100 million in two tranches of \$50 million. Subsequent to the completion of the first \$40 million of investments, Staff will utilize the Real Estate Subcommittee and PCA to review initial transaction performance before approving for the second \$50 million tranche. This funding is subject to satisfactory negotiation of the requisite legal documents by legal counsel working with the OST Staff. The motion was seconded by Randall Edwards and passed by the Council. Mark Gardiner abstained from voting.

VIII. Rockpoint Investment Fund

Mr. Gruber introduced Bill Walton and Greg Hartman to discuss the Rockpoint Investment Fund (RIF). RIF is being formed to possibly acquire properties from the Westbrook Fund IV acquisition pipeline post closure of the Westbrook Fund IV acquisition period, and for other acquisitions that will close before the formation of the first Rockpoint sponsored real estate opportunity fund next year. Rockpoint is a successor company to the Westbrook Partners organization and has been formed by six of seven Westbrook Partners' managing partners, and nine of West brook's eleven investment professionals.

Mr. Walton and Mr. Hartman gave an overview of their fund and noted that the Rockpoint Investment Fund has a target size of \$100 million, \$75 million from OPERF and \$25 million from a university endowment. They discussed the Fund's management and operations team, summarized the goals of the newly created fund and outlined deal flow.

Ms. Lietz noted that PCA believes the Fund represents an attractive opportunity for OPERF to invest with a seasoned management team with a proven track record of success.

MOTION: Randall Edwards moved that the OIC authorize a commitment to Rockpoint Investment Fund, sponsored by the Rockpoint Group LLC, in the amount of \$75 million plus a 10% reserve. This funding is subject to satisfactory negotiation of the requisite legal documents by legal counsel working with OST Staff. The motion was seconded by Mark Gardiner and passed unanimously by the Council.

The Council commended Mr. Gruber for his creativity in the current market environment.

IX. Four-Level Performance Report – 2nd Quarter Working Document

As noted in previous meetings, a key component of the OIC's implementation of formal Board Governance policy involves improved monitoring tools. Mike Mueller, John Ilkiw and Lisa Massena (State Street Analytics) presented the first working draft of the new Four-Level Performance Report for OPERF.

Mr. Ilkiw illustrated the value of the report regarding precise manager information. Mr. Mueller and Ms. Massena reviewed the report and walked through, page-by-page, outlining definitions of terms and calculations.

X. Public Comment

Denack Murphy of the Service Employees International Union spoke regarding the Parking Real Estate Investment Fund. He also commented on the

Alternative Equity sub-allocations and expressed an opinion to implement a maximum allocation to any individual manager.

The meeting adjourned at 1:55pm.

Respectfully submitted,

Norma Harvey
Investment Coordinator