

**Oregon Investment Council
MINUTES
May 27, 2009**

Members Present: Ben Westlund, Paul Cleary, Harry Demorest, Katy Durant, Keith Larson, Dick Solomon

Staff Present: Josh Balloch, Brad Child, Natalya Cudahey, Michael Cutler, Stacey Dycus, Jay Fewel, Sam Green, John Hershey, Brooks Hogle, Julie Jackson, Perrin Lim, Tom Lofton, Ben Mahon, Mike Mueller, Kevin Nordhill, Jen Peet, Ron Schmitz, James Sinks, Michael Viteri, Judy Whaley-Fultz

Consultants Present: Allan Emkin and Mike Moy from PCA, Nori Lietz from Partners Group, John Meier and Mike Beasley from SIS, and David Fann from PCG

Legal Counsel Present: D. Kevin Carlson, Oregon Department of Justice
Ted Falk, Oregon Department of Justice
Deena Bothello, Oregon Department of Justice

The Oregon Investment Council was called to order at 9:04 a.m. by Katy Durant, Chair.

IA. 9:04 a.m.: Review and Approval of Minutes

MOTION: Ms. Durant brought approval of the April 17, April 29, and May 6, 2009 OIC minutes to the table. Mr. Solomon moved to approve the minutes. The motion was seconded by Mr. Demorest and passed by a vote of 4/0 (Treasurer Westlund had not yet arrived).

1B. Ratification of October 15, 2008 OIC Emergency Meeting Vote

MOTION: Ms. Durant brought the ratification of the October 15, 2008 OIC meeting vote to the table. Mr. Solomon moved approval. The ratification was seconded by Mr. Demorest and passed by a vote of 4/0 (Treasurer Westlund had not yet arrived).

II. 9:05 a.m.: Perspectives on the Current Market

Howard Marks, Chairman, from Oaktree Capital Management gave his perspective on the current market. Mr. Marks talked about the "era of increasing willingness" (willingness to accept new paradigms, to forgo liquidity, to relax due diligence and forget to question skeptically are a few examples) that carried markets to higher highs and set the stage for a major correction of attitudes and behavior. Consumers, Corporations, Homeowners, Governments, and Investors all increased the use of credit, which accomplished the goal of expanding activity, but not without negative consequences. Mr. Marks went on to talk about leverage and how it does not make something a better investment, it merely magnifies both gains and losses.

Mr. Marks also discussed how to "get out of this mess" and avoid negative consequences. The essential elements of recovery consist of delevering our economy at all levels, dealing with the related capital destruction, and restoring faith.

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

III. 9:54 a.m.: AQR Capital Management-OPERF Opportunity Portfolio

Staff and SIS recommended a commitment of \$150 million to AQR/CNH subject to the negotiation of the requisite legal documents with staff working in concert with the Department of Justice. Staff and SIS have reviewed the AQR/CNH convertible arbitrage strategy and believes that it presents an attractive investment alternative for the Opportunity Portfolio. Staff and SIS believe this is an appropriate opportunity for the following reasons:

- The strategy captures the arbitrage opportunity between the convertible bond price and the underlying fundamental values while hedging the credit and interest rate risk of the portfolio and offers a more attractive risk/reward scenario than a long only strategy.
- The team has a successful history of managing dedicated convertible arbitrage strategies.

- The firm has a long term relationship with the OIC and has an alignment of interest with clients through principal investments in their own funds.

John Hershey, Alternatives Investment Officer introduced Gregor Andrade and Michael Mendelson, with AQR Partners and Mark Mitchell with CHN. AQR/CHN offers four strategies that OPERF can choose from to best match its risk/return objectives to build a largely "buy and hold" portfolio. For all strategies, the expected time for the "cheapness factor" to return to "fair value" is approximately two years. Staff and SIS have focused primarily on the fully hedged/unlevered strategies that will remove some of the risks that are taken elsewhere in the portfolio.

Convertible bonds are a combination of a bond and an equity option. As such, their trading price can be compared to the "theoretical" value of the option and the bond combined. The difference between the trading value and the theoretical value is known as a "cheapness" factor which can be positive (attractive) or negative (unattractive). For example, the median cheapness factor was - 3% for much of 2002-2003 (indicating the bonds traded at levels higher than their theoretical value). Conversely, the cheapness factor has been as high as a + 3% in 1998 and in 2000, which indicated bonds were trading at values below their intrinsic value. Typically, bonds trade "cheap" when liquidity premiums are particularly high.

In 2007, the cheapness factor hovered around 0%. In 2008, after the Bear Stearns and Lehman Bros problems, the cheapness factor spiked to over 10%, higher than it's even been. This spike resulted in convertible bonds losing 35.7% in 2008 when many investors were forced to sell their positions. While the cheapness factor has receded some from its highs, it is still very high based on historical prices. Mr. Demorest questioned what would happen if the cheapness factor goes away; we would need to reevaluate the strategy.

There was a brief question and answer session following the presentation. Council asked Mr. Hershey to specifically tell them which strategy he is recommending for approval. Mr. Hershey recommended the fully hedged strategy where the best risk adjusted returns are apparent, with a modest amount of leverage (in the range of 1.0-1.5X).

MOTION: Mr. Larson moved approval of the staff recommendation. Treasurer Westlund seconded the motion. The motion was passed by a vote of 4/1 with Mr. Solomon voting no.

IV. 11:00 a.m.: Fischer Lynch Co-Investment Discussion/Negotiation of Investment Terms – Possible Executive Session

The meeting did not go in to Executive Session.

Staff and OIC Consultants discussed the current negotiation status with Fisher Lynch, vis-à-vis the recently adopted OIC Principles. There was discussion around fees and where specifically the disagreement was. Council did not vote on the staff recommendation-pending more information to come from Mike Beasley, SIS.

V. 11:47 a.m.: Oak Hill Advisors LP & Fixed Income Recommendations-OPERF Fixed Income

Staff recommended approval of: (1) a \$1 billion commitment to Oak Hill Advisors, subject to the satisfactory negotiation of the required legal documents, working in concert with the DOJ; (2) the termination of Pyramis Global Advisors as a Core Plus fixed income manager; and (3) the revision to the core plus investment guidelines constraining below investment grade securities to 15%.

Perrin Lim, Sr. Investment Officer gave some background on Oak Hill Advisors. Staff is extremely impressed with Oak Hill. They are a very experienced and deeply resourced investment manager of bank loans, high yield bonds and stressed/distressed investments with a close strategic relationship with Robert Bass, Oak Hill Capital Partners and other Oak Hill investment businesses. Oak Hill is one of OPERF's strongest private equity relationships. In addition to prior meetings in Portland and NYC in 2008, staff and SIS conducted a due diligence meeting with OHA investment professionals on January 22, 2009.

Mr. Lim introduced Glenn August, President and Senior Partner, and Bill Bohnsack, COO and Senior Partner from Oak Hill Advisors. The OHA investment process incorporates vigorous bottom-up, value oriented credit analysis, emphasizing careful consideration and understanding of relative value across industries and up and down company capital structures. As the current opportunities in the bank loan market are realized, staff foresees revisions to the investment guidelines to allow OHA to rotate additional exposure out of bank loans. Longer term,

the mandate may well evolve to include other areas where OHA sees relative value, such as stressed/distressed and structured investments, subject to prior approval by the OIC.

Mr. Lim and John Meier with SIS summarized each part of the staff recommendation and answered questions from the Council.

MOTION: Mr. Demorest moved approval of all staff recommendations. Mr. Solomon seconded the motion. The motion passed by a vote of 5/0.

VI. 12:24 p.m.: State Accident Insurance Fund Annual Update

Mike Mueller, Deputy CIO introduced SAIF representatives Brenda Rocklin, President and CEO, Theresa McHugh, Vice President of Financial Operations, and Jerry Dykes, CFO. An overview of their handouts showed that there was a decrease in policy holders, a decrease in premium dollars they take in equaling about 8.5% and a decrease in surplus. Most of these decreases directly relate to the slowing economy. Mr. Dykes highlighted investment performance, including investment income which has steadily increased in 2008. There were some significant realized losses-the majority of that was for impaired bonds. Ms. McHugh talked about claim counts, which have steadily gone down since 2007. There has also been a shift in types of claims entered, with the more serious claim numbers staying about the same and all other claims going down.

VII. 12:55 p.m.: External Public Equities Manager Recommendation

Kevin Nordhill, Senior Public Equities Investment Officer and John Meier of SIS gave some background on why the changes to the public equities managers are warranted. After a brief question and answer period and some discussion, Mr. Nordhill brought the following recommendations to the Council:

- Adopt OIC Policy 4.05.01, the red-line changes to OIC Policy 4.01.18 and the Investment Objectives and Policy Framework, and eliminate OIC Policies 4.05.11, 4.05.12, and 4.05.13. Re-number the existing OIC Policy 4.05.01 to 4.05.02.
- Terminate Goldman Sachs global equity mandate.
- Terminate Franklin Portfolio Associates domestic equity mandate.
- Terminate BGI U.S. and non-U.S. Alpha Tilts mandates (including the mandates for SAIF and the CSF which will be indexed in the products with the same benchmarks).
- Hire SSgA to manage a World ex-U.S. index fund.
- Extend Next Century's role to include a small cap growth allocation.
- Rebalance assets from terminated managers to passive strategies.

MOTION: Mr. Solomon moved approval of all staff recommendations. Mr. Demorest seconded the motion. The motion passed by a vote of 5/0.

VIII. 1:15 p.m.: Eudaimonia Asset Management

Mr. Nordhill introduced Travis Prentice, President and Chief Investment Officer of Eudaimonia Asset Management. US Micro Cap securities present an attractive opportunity to capture an inefficient segment of the market. The Oregon Investment Council includes a micro cap manager in their portfolio and has benefited from this portion of the manager structure. Eudaimonia Asset Management offers the OIC an option for increasing their exposure to micro cap with a familiar team. Staff performed a variety of undertakings in determining the appropriateness in recommending this manager for funding, including on-site due diligence and one-on-one meetings with all investment professionals and compliance officers. After complete due diligence, staff recommended hiring Eudaimonia Asset Management for a Microcap Growth mandate and fund them with \$50 million. Also, designate the Russell Microcap Growth index as the mandates benchmark and assign an excess return objective of 2.5 percent (net of fees).

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

IX. 1:30 p.m.: Shamrock Holdings-OPERF Opportunity Portfolio

The OIC approved a \$200 million commitment to the Shamrock Activist Value Fund, LP in April 2006 for the OPERF Opportunity Portfolio to pursue a concentrated, small cap public equity shareholder activist strategy. The original commitment (which began funding in August 2006), included a three year lock-up which expires in August

2009. During that time there have been some management changes at Shamrock, which have impacted the confidence staff has with Shamrock.

Staff believes there are other activist managers with a deeper team that might be worth considering. Given the change in portfolio manager, a lack of confidence in the current team, and the benefit of increased liquidity, staff recommends that the OIC authorize staff to begin an orderly redemption of its account as soon as the lock-up and terms of the contract allow. Staff recommended redeeming the Shamrock Activist Value Fund L.P. ("Shamrock").

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

X. 1:32 p.m.: OPERF First Quarter Review

Mike Beasley from Strategic Investment Solutions gave an update on the OPERF 1st quarter performance and the current market environment.

XI. 1:45 p.m.: Asset Allocation and NAV Updates

Mr. Schmitz reviewed the Asset Allocations and NAV's for the period ended April 30, 2009. OPERF and SAIF are basically right on target; Real Estate, CSF and HIED are also within range.

XII. 1:47 p.m.: Calendar – Future Agenda Items

Mr. Schmitz highlighted future agenda topics.

XIII. 1:50 p.m.: Other Business

There was no other business discussed.

1:51 p.m.: Public Comments

There were no public comments.

The meeting adjourned at 1:51 p.m.

Respectfully submitted,



Julie Jackson
Executive Support Specialist