NOTE: These minutes were approved and executed at the July 20, 2012 Investment Committee meeting.

Independent Investment Committee
June 22, 2012

Public Minutes

New Hampshire Retirement System
54 Regional Drive
Concord, NH 03301

Committee Members: Harold Janeway, *Chair;* David Jensen; Patrick O'Donnell; and Hersh Sosnoff. Catherine Provencher, *absent.*

NHRS Trustees: Dick Gustafson, Ph.D. and Kate McGovern, Ph.D. *(delayed arrival).*

Staff: Larry Johansen, *Director of Investments*; Jack Dianis, *Director of Finance*; John Browne, *Internal Auditor*; Jeff Gendron, *Investment Officer*; Scott Needham, *Investment Analyst*; and Greg Richard, *Investment Analyst.*

NEPC, LLC: Kevin Leonard, *Partner and Senior Consultant*; and Sean Gill, *Partner.*

Mr. Janeway called the meeting to order at 9:03 a.m. He surveyed the Committee for comments on the draft public and non-public minutes of the May 18, 2012 Investment Committee meeting and the draft public minutes of the June 5, 2012 Investment Committee special meeting. As there were none, a motion to approve the public and non-public minutes of the May 18, 2012 Investment Committee meeting and the public minutes of the June 5, 2012 Investment Committee special meeting was made by Mr. O'Donnell and seconded by Mr. Jensen. The motion carried unanimously.

Mr. Johansen referenced the Work Plan dated May 22nd, indicating that the Asset Liability Study/Asset Allocation Review process would continue at today's meeting with a discussion of potential asset class mixes. He acknowledged the special meeting held by the Committee on June 5th and mentioned that it was a very productive meeting devoted to the continued discussion of the Asset Liability Study/Asset Allocation Review process and potential asset class mixes. Mr. Johansen noted that it is a full meeting today which will include presentations by Boston Trust; CS McKee; and The Townsend Group. He made the Committee aware of a change in presenters for Boston Trust as Mr. Kenneth Scott is unable to attend the meeting due to a personal issue. Mr. Johansen noted that NEPC would be making a presentation on hedge fund implementation and would provide an overview of private debt later in the meeting. Mr. Johansen updated the Committee on the "go anywhere" investment manager search, indicating that Staff has met with two firms and that these managers would be available to present to the Committee at a future meeting. He added that Staff and NEPC continue to work on the calendar year 2012 Private Equity Work Plan and that three private equity managers are currently in the pipeline to present to the Committee. He explained the three different strategies employed by these managers: a global secondaries fund; a small debt fund; and a venture lending fund. Mr. Johansen noted that he will participate in an onsite meeting with the small debt fund next week and has already participated in onsite meetings with the other two managers.

Mr. Johansen referred to the Legislative Update dated June 8, 2012. He indicated that the legislative session is complete and that two technical correction bills, Senate Bills 230 and 244 were signed by the Governor. He noted that House Bill 1483, which repeals the retirement system special account and also repeals special assessments on employers for salaries that exceed parameters paid by employers in the retirement system, was also signed by the Governor. In response to a Committee member question, Mr. Johansen confirmed that these Bills do not have implications to the Investment Committee.

Mr. Johansen provided a brief update of the performance of the System's Marketable Assets component, which represents approximately 90% of the Total Fund. He noted the revised format which is generated from NEPC's new performance reporting system. Through May 31st, the Marketable Assets component returned -4.8% for the 3-month period; -3.0% for the fiscal year-to-date period; and 11.0% for the 3-year period. The Marketable Assets component lagged its benchmark by 30 and 90 basis points for the 3-month and fiscal year-to-date periods, respectively; and outperformed by 20 basis points for the 3-year period.

Mr. Janeway entertained a motion to convene into non-public session under RSA 91-A:3, II(c) to discuss matters which, if discussed in public, would likely adversely affect the reputation of a person, other than a member of the public body itself. A motion was made by Mr. O'Donnell and seconded by Mr. Jensen to enter into non-public session, in accordance with the aforementioned provision.

Roll call vote:

Aye: Mr. Janeway, Mr. Jensen, Mr. O'Donnell, and Mr. Sosnoff.
Nay: None

Motion carried.

The Committee discussed the Investment Consulting Services RFP.

A motion was made by Mr. Jensen and seconded by Mr. Sosnoff to conclude non-public session.

Roll call vote:

Aye: Mr. Janeway, Mr. Jensen, Mr. O'Donnell, and Mr. Sosnoff.
Nay: None

Motion carried.

The Committee agreed to hear finalist presentations from two investment consultants, Callan Associates, Inc. and NEPC, LLC, at its July meeting.

Mr. Johansen informed the Committee that the investment management agreement between NHRS and BlackRock is due for renewal. He noted that at its July 2010 meeting, the Committee requested that NEPC provide a recommendation with regard to such manager agreement renewals when they come due. He referenced memos provided to the Committee from L. Johansen and from NEPC, which recommend that the agreement between the System and BlackRock be renewed. In response to a Committee member question, Mr. Johansen stated the fees paid to BlackRock. A motion was made by Mr. Jensen and seconded by Mr. Sosnoff to renew the investment management relationship with BlackRock through July 2014. The motion carried unanimously.

Mr. Leonard provided a brief overview of Boston Trust & Investment Management Company (Boston Trust) which included strategy and firm overviews and performance history.

Mr. Stephen Amyouny, Senior Vice President and Portfolio Manager; Mr. Stephen Franco, Vice President and Portfolio Manager; and Mr. Russell Gentry, Portfolio Manager, of Boston Trust presented an overview of their firm and a review of the Small Cap Domestic Equity portfolio that the firm manages on behalf of the System. They referred to the "New Hampshire Retirement System" presentation, dated June 22, 2012.

In response to Committee member questions, Mr. Amyouny indicated that the Small Cap strategy may be closed in the near future due to capacity limitations. Mr. Franco explained that as market cap climbs to $3.5 billion, portfolio positions will be sold and replaced with smaller cap companies. He noted that the portfolio is generally sector neutral, usually plus or minus 2% of the benchmark. Mr. Franco mentioned that the firm uses a 10.5% discount rate which is consistently used across all sectors. He confirmed that the firm is concerned that the overall market is set up for earnings disappointment as earnings per share have outpaced sales per share in the Russell 2000 benchmark. Mr. Franco noted this contrasts with the Boston Trust portfolio which holds higher quality stocks and have reported sales per share slightly ahead of earnings per share. Mr. Franco indicated that the portfolio will underperform when the market rallies and becomes disconnected to fundamentals as higher quality stocks will suffer relative to lower quality stocks in this environment. Mr. Amyouny noted that the portfolio team is compensated based on the success of the firm and that compensation is not tied directly to individual stock selection. He concluded by stating that the firm has lost very few clients over the last several years.

Mr. Leonard provided a brief overview of CS McKee, LP (CS McKee) which included strategy and firm overviews and performance history.

Mr. Michael Donnelly, Senior Vice President and Portfolio Manager; Mr. Eugene Natali Jr., Senior Vice President; and Mr. Eric Fencil, Securities Analyst, of CS McKee presented an overview of their firm and a review of the Small Cap Domestic Equity portfolio that the firm manages on behalf of the System. They referred to the “CS McKee Investment Managers” presentation.

In response to Committee member questions, Mr. Donnelly confirmed that since his arrival at the firm about six months ago, no significant changes have been made to the strategy. Mr. Fencil explained some of the recent trades within the portfolio and distributed a report that summarized portfolio attribution since inception through June 20, 2012. He noted that this report highlighted the healthcare and information technology sectors, along with individual securities, which hurt the portfolio the most. He mentioned that about 20% of the portfolio will be trimmed with the proceeds used to purchase securities that CS McKee expects to outperform. Mr. Donnelly noted that the portfolio has been through rough periods in the past and has bounced back from last quartile to first quartile returns over the long term. He noted that he believes that, given time, the same bounce back can occur and that the firm estimates that by calendar year-end, the portfolio is expected to perform better. In response to additional Committee member questions, Mr. Fencil outlined the strategy that the firm uses to select securities stating that the approach is roughly 50% quantitative and 50% qualitative. Mr. Donnelly confirmed that he was not hired by CS McKee due to recent investment underperformance but had been in discussions with the firm for several years.

The Committee discussed the CS McKee presentation including the strategy and the model used to select the firm's sectors and securities. The Committee agreed that CS McKee will be closely monitored to determine if future action is needed. Mr. Johansen and Mr. Leonard confirmed this approach.

Mr. Anthony Frammartino, Partner; Ms. Terri Herubin, Principal and Portfolio Manager; and Mr. Tony Pietro, Assistant Portfolio Manager, of The Townsend Group provided an overview of their firm, provided an update on the Fiscal Year 2012 Investment Plan and presented the Fiscal Year 2013 Investment Plan for consideration by the Committee. They referred to the "New Hampshire Retirement System Real Estate Fiscal Year 2013 Investment Plan" presentation, dated June 22, 2012.

In response to Committee member questions, Ms. Herubin explained that certain real estate investments are recycling capital into new investments. Mr. Frammartino and Mr. Pietro confirmed that the investment plan is flexible in order to allow Townsend to take advantage of opportunities in the market place as they arise and that the direct property sales generally track with the market values that these properties have been carried at. Ms. Herubin concluded by providing detail on the investment process utilized to select investments.

A motion was made by Mr. Jensen and seconded by Mr. O'Donnell to approve The Townsend Group's Fiscal Year 2013 Investment Plan. The motion carried unanimously.

As requested by the Committee at its May meeting, Mr. Gill presented an example of how a hedge fund program could be implemented at the System. He referred to the "Hedge Fund Discussion" presentation dated June 22, 2012.

In response to Committee member questions, Mr. Gill explained the pro-forma structure using a core-satellite portfolio assuming a 60% fund-of-funds, 40% direct approach to investing in hedge funds along with the various strategies available in the market. He detailed the strategy breakdown within the hedge fund industry and provided background on how funds are allocated to each. Mr. Gill distributed a handout titled "NEPC Hedge Fund Industry Update – Q1 2012" and discussed the historical change in assets under management. He acknowledged the theory that as AUM increases, alpha opportunities decrease but explained that this theory assumes that all managers have the same skill level. Mr. Gill noted that if it is assumed that there are fewer skilled managers in the market, then the alpha opportunities could actually increase along with increasing AUM. He stated that although there have been numerous academic studies, whether or not there is performance persistence is inconclusive. Mr. Gill confirmed that the vast majority of hedge funds continue to be compensated on an annual basis although post-2008 there has been some shift towards a 3 or 5-year compensation period which better aligns the interests of General Partners with Limited Partners. Mr. Gill confirmed that NEPC maintains a preferred list of hedge fund managers.

In response to a Committee member question, Mr. Johansen noted that Staff does not currently have the capacity to build out a hedge fund program while concurrently building out a private equity program. He mentioned that the overriding decision is how hedge funds would function as part of an asset allocation policy. Mr. Gill responded to concerns regarding survivorship bias in performance returns. The Committee agreed to continue to investigate hedge funds as potential investment opportunities that will take into account both investment and operational considerations.

Mr. Leonard referred to the "Asset Allocation Review" presentation dated June 22, 2012. He noted that staff and NEPC had met and discussed various potential asset allocation mixes, which were included in the meeting materials, for Committee discussion. The Committee had a discussion about the various allocation mixes and the level of alternative investments that would be prudent.

Mr. Leonard provided a brief overview on private debt opportunities in the market place and referenced a memo titled "Private Debt Overview" dated June 22, 2012. Mr. Johansen noted that private debt takes different forms and acknowledged that some of the recent commitments made to private equity are focused in this area and that the Committee will be hearing from two additional firms that specialize in private debt at upcoming Committee meetings.

Mr. Johansen noted that at the July meeting, the Committee will hear presentations from two private equity firms and the two finalist investment consultant firms.

In response to a Committee member question, Mr. Johansen summarized the Thornburg Investment Management report in the Informational Items section and noted that it was incorporated to address concerns regarding the capitalization size of the companies in which Thornburg invests.

On a motion by Mr. Jensen, seconded by Mr. Sosnoff, the meeting adjourned at 1:12 p.m.