State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
MEETING

Location of Meeting
Juneau-Haines Room, Anchorage Marriott Hotel
820 W. 7th Avenue, Anchorage, Alaska

MINUTES OF
November 28-29, 2007

Thursday, November 28, 2007

CALL TO ORDER

Chair GAIL SCHUBERT called the meeting of the Alaska Retirement Management Board (ARMB) to order at 9:04 a.m.

ROLL CALL

Eight ARMB trustees were present at roll call to form a quorum.

ARMB Board Members Present
Gail Schubert, *Chair*
Sam Trivette, *Vice Chair*
Gayle Harbo, *Secretary*
Commissioner Annette Kreitzer
Martin Pihl
Tom Richards
Larry Semmens
Mike Williams

ARMB Board Member Absent
Commissioner Patrick Galvin (present on November 29)

Investment Advisory Council Members Present
Dr. William Jennings
George Wilson

Consultants Present
Robert Johnson, outside legal counsel
Mike Barnhill, AK Department of Law legal counsel

Michael O'Leary, Callan Associates, Inc.

Department of Revenue Staff Present
Brian Andrews, Deputy Commissioner
Gary M. Bader, Chief Investment Officer
Pamela Green, State Comptroller
Bob Mitchell, Senior Investment Officer
Zachary Hanna, State Investment Officer
Scott Jones, Assistant State Comptroller
Judy Hall, Liaison Officer

Department of Administration Staff Present
Rachael Petro, Deputy Commissioner
Patrick Shier, Director, Division of Retirement and Benefits
Kevin Worley, Chief Finance Officer

Invited Participants and Others Present
Jack Kreinheder, State Office of Management and Budget
Jim Rohlinger, Great-West
Evan Rose, Alaska Permanent Capital Management (Anchorage)
Jason Swiatek and Daniel Nichols, Jennison Associates LLC
Stacy Allen and Michael Smith, Lord Abbett & Co.
Steve Purvis and Mark Johnson, Luther King Capital Management
Tom DiBella and John Finnegan, Turner Investment Partners, Inc.
Judy Bockmon, AK Department of Law
Gary Robertson, Callan Associates
Peter Henkel, Coventry Real Estate
Juan Benito and Karen Gilbert, Brandes Investment Partners
Tony Dote and Ardra Belitz, Lazard Asset Management
Kathy Porterfield, KPMG

PUBLIC MEETING NOTICE

Judy Hall confirmed that proper public notice of the meeting had been published.

APPROVAL OF AGENDA

MS. HARBO moved to approve the agenda. MR. TRIVETTE seconded.

COMMISSIONER KREITZER moved to table item #8 Defined Contribution Plan Default Option Recommendation Action until the next meeting or the meeting after to allow time for the Department of Administration to work with Great-West on some issues that they have raised regarding their contract. MR. WILLIAMS seconded.

The roll was called on the motion to table, and the motion carried 7-1, with Mr. Trivette casting the lone dissenting vote.

Staff requested that items #17 and #18 be taken up in reverse order and that items #22 and #23 also be switched.

The agenda was approved as amended.

PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES

EVAN ROSE, the CEO of Alaska Permanent Capital Management in Anchorage, stated that the firm has a long track record of fixed income management and would like some business from the ARM Board. He said some of the issues that happened with State Street Global Advisors this summer would not be as big a problem with Alaska Permanent Capital Management. Their market is Alaska, and if they were to make a mistake like that it would be the end of their franchise. Alaska Permanent Capital may not have the numbers to shoot the lights out of all the databases, but they manage about $2 billion for Alaskan companies and employ Alaskans.

APPROVAL OF MINUTES

MS. HARBO moved that the Board approve the minutes of the September 26-27, 2007 and November 6, 2007 meetings. MR. RICHARDS seconded.

The motion passed unanimously.

ELECTION OF OFFICERS

MS. HARBO nominated Gail Schubert for the office of board chair. MR. PIHL seconded.

MR. TRIVETTE moved that nominations be closed. MR. RICHARDS seconded.

The motion passed without objection.

MS. HARBO nominated Sam Trivette for the office of board vice chair.

There were no other nominations.

MR. TRIVETTE nominated Gayle Harbo for the office of board secretary.

There were no other nominations.

Ms. Schubert, Mr. Trivette and Ms. Harbo were present and accepted the offices to which they had been elected.

REPORTS

1. Chair Report - no report.

2. Committee Reports

a. Audit Committee

Committee chair MARTIN PIHL reported that the committee met November 27 to hear the final fiscal year 2007 audit results from KPMG and to review the financial statements. There will be no changes and the final results will be clean opinions. KPMG reported full cooperation from staff and no disputes or issues. KPMG's management letter had one observation and recommendation to consider additional staff in the Division of Retirement and Benefits because of the increased number and complexity of plans involved. The Audit Committee supports this recommendation, as well as the Division's exploration of technology and smarter ways to get things done to free up people. The update on the actuarial valuation work indicates that the results should be available to the board at the April meeting on time for setting contribution rates. The committee received both Treasury Division and Retirement and Benefits Division compliance updates. The committee feels the Retirement and Benefits employer audits warrant a lot of continued attention to address the audit findings. Lastly, the committee set its meeting schedule.

b. Defined Contribution Plan Committee

Committee chair SAM TRIVETTE said this committee's task was to develop a recommendation for a default investment option for the defined contribution retirement accounts and Supplemental Benefit Plan and to present a plan to the board no later than the November 2007 meeting. The board took action to table that discussion a few minutes earlier. At its October 31 meeting, the committee voted to recommend to the full board to set age-based target funds as the default investment option effective July 1, 2009.

MR. SEMMENS asked if the board's action to table this item would delay the implementation plan the committee established. COMMISSIONER KREITZER said it was not intended to and she did not believe that it would.

CHAIR SCHUBERT indicated that the committee would be meeting again to iron out the details.

Board legal counsel ROB JOHNSON suggested that the board meet in executive session if trustees wanted to hear a quick overview of the contractual issues that the Commissioner mentioned earlier.

MS. HARBO moved that the board go into executive session to discuss matters the immediate effect of which could impact the ARM Board. MR. TRIVETTE seconded. The motion passed unanimously.

The board met in executive session from 9:20 a.m. until 9:37 a.m. When the meeting reconvened in regular session, they did not report having taken any action in executive session.

c. Health Care Cost Containment Committee

Committee chair MIKE WILLIAMS reported that the committee met November 27 with the Division of Retirement and Benefits and Buck Consultants, the state's actuary. The meeting was a continuation of ongoing discussions about various health improvement and cost containment initiatives that can be made within the retiree health care plan. The committee heard about colon cancer screening coverage and about leveraging purchasing power for immunizations by working with the Division of Public Health, coalitions of municipal governments, and labor organizations. The committee did not have a recommendation to the board at this meeting.

3. Retirement & Benefits Director Report

COMMISSIONER KREITZER reported that there is a management plan to do some restructuring in the Division of Retirement and Benefits to see how much that helps. Referring to Mr. Pihl's Audit Committee report, she said it would probably be fiscal year 2010 before the Division knew whether the restructuring was working and whether adding staff was warranted.

COMMISSIONER KREITZER said she met with some legislators during special session and felt there was some strong sentiment about a cash infusion into the retirement plans to pay down the unfunded liability. The ARM Board may be in the same situation of reacting to the Legislature setting an employer contribution rate as lawmakers attempt to get the state back on track with rates. Or there could be a cash infusion and then the board would be asked to respond to that in setting the rates.

MS. HARBO asked about Senate Bill 125. COMMISSIONER KREITZER replied that she inquired among the Finance Committee members and House and Senate leadership and did not hear any issues with that bill. The Department of Administration is working with the Department of Law on the bill's language.

MS. HARBO inquired about Buck Consultants' findings about the funding ratios of the pension trust and the health trust for both the Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS). PAT SHIER, Director of the Division of Retirement and Benefits, stated that Buck identified that if separate contributions been made to pensions and health and had separate expenses been tracked, today the

pensions would be essentially fully funded, and the health care portion of both PERS and TRS would be severely underfunded. That information has not been published widely yet, but he could provide trustees with a copy of Buck's report.

MR. SHIER drew attention to the quarterly FY 2008 membership statistics and audit details that the division provided for the board's information.

4. Revenue Deputy Commissioner Report

Deputy Commissioner BRIAN ANDREWS reported the following items:

- The Treasury Division is in the process of evaluating Balance Score Card, a performance management system used for measuring whether the activities of an organization are meeting its objectives.
- There are no known actual expenditures at this point that would adversely affect the ARMB operating budget.
- Office of Management and Budget has approved the two new investment officer positions in the FY09 budget, and that will be in the Governor's transmittal to the Legislature.
- Beth Larson was hired to fill the senior compliance officer position in the accounting section.
- Two investment officer position vacancies have been filled.
- State Comptroller Pamela Green and Assistant Comptroller Scott Jones traveled to New York to do some private equity training with the Bank of New York and then to Boston to meet with State Street Bank. Ms. Green and Mr. Andrews are compiling a schedule for training for the next year.
- The Legislature is expected to continue discussions about pension obligation bonds in the next legislative session.
- Given the state of modern financial markets and limitations of the classic static portfolio models, the traditional approach to portfolio construction is starting to incorporate true diversification through the use of leverage to achieve a targeted risk/return objective, offsetting or doing away with the constraints of a long-only approach, moving away from capitalization weighting and incorporating current and forward-looking data, implementing multi-factor strategies, and employing rules-based rebalancing techniques. It is important that these and other advanced portfolio concepts are implemented through active risk management systems designed to help achieve desired investment results.

CHAIR SCHUBERT asked if the ARM Board would be better off or worse off now if it had moved forward with pension obligation bonds when it first considered them. MR. BADER replied that given the pension funds' 18.9% returns last year the board would have had a hard time not being better off. But looking at the last three months, it might be a different story. POBs are a long-term play. MR. ANDREWS added that analysis shows that over a

16-year period there were only two years where the ARMB would have been playing catch-up.

MR. PIHL asked for an update on the state's global salary review. He noted that at one time a commissioner was paid the same as a superior court judge, and that is way out of whack now. He said the state's recruitment and retention problems start at the top with not paying commissioners enough.

COMMISSIONER KREITZER responded that the commissioners' salary increase done by the previous administration has provided leeway for the administration to raise salaries for everyone under commissioners. She noted that the administration has been able to put the best labor contracts on the table that the unions have seen in 15 years. The Governor's working group is continuing to work on several aspects, including employees not covered by union contracts, people on salary override, and state corporations that already pay higher salaries. She said she could send an email to fellow trustees once the Governor's budget is released.

5. Chief Investment Officer Report

Chief Investment Officer GARY BADER reported on the following items:

- The cash securitization program that the board approved in February 2006 and that staff implemented in July 2006 has netted an additional $8.1 million for the pension fund as of October 31, 2007. He stressed that a cash overlay program can underperform during certain equity market conditions.

MR. SEMMENS commended Mr. Bader and his staff and recalled that Mr. Bader's initial estimate of returns for the cash securitization program was more conservative than the actual results.

- Citizens Advisors, which manages the socially responsible equity fund that is an investment option in the SBS program and Deferred Compensation Plan, has agreed to be acquired by Sentinel Investments. Citizens is already on the ARMB watch list for underperformance, and Mr. Bader views this acquisitive as a positive development.
- Capital Guardian disclosed to the board in writing that it buys services from Callan Associates, Inc., an annual disclosure.
- A routine disclosure by Ron Peyton of Callan Associates, Inc. of anticipated litigation.
- Staff increased the investment authorization to Hancock Agricultural Investment Group by an additional $25 million.
- There is a farmland investment opportunity that the board authorized staff to pursue, pending the outcome of favorable negotiations through the investment advisor. It

appears the potential seller may sell the properties piecemeal. MR. BADER asked the board for authorization to increase the allocations to UBS and Hancock to possibly acquire these properties.

MS. HARBO moved that the Alaska Retirement Management Board authorize increasing the allocation to UBS Agrivest LLC and Hancock Agricultural Investment Group, as needed, to facilitate acquisition of farmland properties. MR. TRIVETTE seconded.

On a roll call vote, the motion passed unanimously, 8-0.

MR. BADER continued with the items in his CIO report:

- Notification of investing defined contribution funds with various managers as the contributions come in each month.
- Notification of two investments totaling $150 million for the Retirement Health Trust into vehicles other than cash. Staff is moving almost $400 million out of the cash account and into other investments in a way that does not adversely affect the fixed income portfolio. There have been subsequent transactions since the board packet material was put together.
- Staff reallocated $100 million from value to growth. The intent is to balance the portfolio and get returns similar to the S&P 500 Index.
- Notification of funding Lazard Emerging Markets mandate for $100 million that the board approved at the September 2007 meeting. The board previously terminated J.P. Morgan's emerging market mandate. Another $100 million will be invested with Eaton Vance Management pending contractual negotiations.
- Two state investment officers left the Treasury Division and two new entry-level people have been hired and should start by mid December. Losing two people is viewed as negative because it represents four to five years of training that has gone to other opportunities, and the training will have to start over again.
- The Department of Law (DOL) issued a press release about a $19 million settlement with Quest Communications. To date, DOL, with the help of outside legal counsel, has recovered a total of $78 million net of fees for various state investment funds.

6. Fund Financial Presentation

State Comptroller PAM GREEN briefly reviewed the financial report included in the meeting packet. The total invested assets at September 30, 2007 were $19.2 billion, up 2.9% for the quarter, with most of that increase happening in September.

Department of Administration's Chief Finance Officer KEVIN WORLEY drew attention to a handout of information that Mr. Pihl had requested at the September meeting. Mr. Pihl's concern was that the state is paying out pension benefits that are exceeding the

contributions from employees and employers. These spreadsheets show actual cash inflows and outflows to retirement system accounts and not just the net numbers.

CHAIR SCHUBERT called a scheduled break from 10:27 to 10:40 a.m.

7a. External Manager Review / FY09 Asset Classes

MR. BADER stated that he meets annually with Mr. O'Leary and the Investment Advisory Council (IAC) members to review the ARMB's entire investment manager line-up. Staff also sends a questionnaire to each manager and the results are discussed. He briefed the board on the key points from that manager review meeting:

- All three absolute return advisors have not reached their benchmark of Treasury bill plus 5%, although they are above T-bill plus 4% and some a few basis points away from 5%.
- Farmland investment returns are generally satisfactory. The growth of assets under management has been slower than was anticipated when the board added this asset class, but they believe the ARMB's patience will be rewarded ultimately.
- The two high yield managers are in the middle of the pack return-wise. There is a slight underallocation to high yield right now, but there was no distress about that.
- International fixed income - Mondrian is the sole investment manager and just below the benchmark return last year. Over three years and long term, Mondrian is doing fine.
- International equity - Brandes' performance in the defined benefit plan has been outstanding but not as stellar in the defined contribution plan. Brandes will be presenting their defined contribution plan program to the board later in this meeting. Mr. O'Leary thought that the new blend of Lazard and Eaton Vance and Capital Guardian would be good in the emerging markets equity space. McKinley Capital has a growth mandate and is doing very well in the international space as well.
- Large cap equity - Callan is impressed with QMA, a value manager. The value style has not been in vogue lately, so QMA and Barrow Hanley have not had really stellar returns in a period when growth has been in style. Relational Investors did very well last year and contributed to the pension fund's great fiscal year return. However, they have been a drag on the portfolio lately. Relational has a very concentrated portfolio of about 12 stocks. They take a big position in a company and attempt to persuade it to follow good governance and focus on shareholder equity. Dr. Mitchell pointed out that if the board is going to have highly concentrated portfolios, it has to take the bad along with the good — right now the board is seeing some of the bad.
- There was no particular concerns about small cap equity managers.
- For real estate, Mr. Wilson noted that the end of 20% returns is at hand. The ARMB's returns in real estate remain good. Mr. O'Leary mentioned that the level of debt is a concern in real estate. Lowe Investment Advisors, which has a hotel focus, did not respond to the questionnaire sent to them. Staff has been concerned about

Lowe - this is their third portfolio manager in two years. But their investment returns continue to be satisfactory.

- TCW Energy has been a good performer.
- State Street Bank's questionnaire response mentioned the use of derivatives. Staff has asked State Street for clarification on that. It is not unreasonable that they would be using some derivative products until they can get the money placed where they want to, however, staff wants to find out if State Street is doing something not expected. Zach Hanna is working closely with them.

MR. BADER said the manager review group also talked about asset allocation and asset classes, and his comments to the board were about the defined benefit plan selections. He said the ARMB and its predecessor, the Alaska State Pension Investment Board, have been busy creating a more diversified asset allocation by adding TIPS (Treasury inflation protected securities), high yield bonds, farmland, absolute return, value-added real estate, a cash overlay program, and an enhanced cash program.

MR. BADER reported that the manager review group discussed how the pension fund's performance has gradually improved relative to other public pension funds to become top quartile, according to Callan's most recent report. While the board can be very pleased with those returns, it should look at funds that are best in class to see if there is anything to learn from them. MR. BADER reviewed a spreadsheet showing the returns and asset allocations for other large public funds as of 6/30/07: Mass PRIM, Pennsylvania Teachers, CalStrs, and CalPers. He noted that these funds all outperformed the PERS fund for the last year. All had a high allocation to international equity. PERS is most like Mass PRIM in diversification, which reduces risk but also provides the opportunity to be right in more areas. Over ten years, Mass PRIM's diversified portfolio has returned 10.13% and is a fund the ARM Board might consider borrowing ideas from.

MR. BADER stated that the Harvard endowment returned 23% last year, and the Yale endowment made 28%. Endowments have different investment goals and predictable cash flows, but the ARM Board can learn something from them. These endowments are using six asset classes: domestic equity, foreign equity, fixed income, real assets, private equity, and absolute return. The ARMB has multiple asset classes, and this way of looking at the investment world drives the asset allocation process. The process introduces a degree of granularity that does not necessarily benefit the portfolio. For example, how much different is farmland from core real estate?

MR. BADER presented a chart showing the ARMB asset classes grouped into the six broader asset classes that the endowments use to look at the world. He said he, Mr. O'Leary and the IAC members discussed this approach at length at the manager review meeting. They agreed to recommend that the board at its next asset allocation review use the six broad asset classes as opposed to the multiple asset classes currently used.

DR. JENNINGS commented that this was his fourth and least eventful manager review. The IAC members were comfortable with the discussions, and he had no specific concerns about individual investment managers or the overall manager structure. He supported Mr. Bader's comment that the board has made substantial progress on asset allocation over the years. And he strongly endorsed the board looking at its asset allocation in six broad asset classes. He stressed that it is a new lens through which to look at portfolio structure and not a change in the asset mix. Some of the nonprofits he is associated with use the six-way approach, and it is a simpler and probably better framework.

MR. WILSON stated that the most important decision the board makes is asset allocation. He said Mr. Bader's slides highlight that the public funds that had the best performance over the last five to ten years had the lowest allocation to bonds and probably the highest allocation to international investing. With the 10-year Treasury heading south of 4%, public fund investors cannot get the higher rates of return they need. He urged trustees to continue thinking about how much they want in bonds and international equity. He noted that during his 18 months on the IAC he has heard the advisors say that where they see the biggest opportunity is in emerging markets. A committee he serves on voted last week to have a double weight to emerging markets relative to indices.

MR. O'LEARY said he echoed the comments already made. He drew attention to the huge absolute return allocation for both Harvard and Yale, much higher than at Mass PRIM and for the Alaska pension fund. He has observed that with the funds that have gone into more esoteric implementation strategies, as their exposure to that style of management has increased, in many cases they collapse it back into the major equity categories. In the endowment world it is very common to see extensive use of hedge funds, not the hedge fund of funds types that the ARMB participates in that are more bond substitutes. To get up to the 17% to 25% levels in hedge funds means a significant reduction in the major traditional equity asset categories but still provides equity-oriented exposures. When there is a strategy as opposed to an asset category (absolute return is a management approach), it can create a lot of confusion and uncertainty. Callan will not be advocating a 17% or 25% allocation to absolute return, but he wanted to explain that in advance.

MR. BADER indicated there was an action memorandum in the packet asking the board to direct Callan Associates to use the six asset classes in preparing the FY09 asset allocation.

MR. PIHL moved that the Alaska Retirement Management Board direct Callan Associates, Inc. to use six asset classes — domestic equity, foreign equity, fixed income, real assets, private equity, and absolute return — when preparing the FY09 asset allocation. MS. HARBO seconded.

Responding to MR. RICHARDS, MR. O'LEARY stated that to develop the return, risk and correlation estimates for the six proposed asset classes Callan would be looking

underneath at the subsets within each asset class, but massaging them to come up with a single aggregate real return that would include real estate, timber, etc. Callan will show the board the underlying assumptions so trustees can get comfortable that the assumptions are reasonable.

MR. RICHARDS said he trusted staff and Callan and the research that has been done to make this recommendation to the board. But he has observed very experienced trustees who ask good detailed questions, and staff's proposal is moving away from that level of review. He said at first blush he had reservations about changing the asset allocation process as described.

MR. BADER explained that Callan would use the six major asset classes in the modeling. Then the asset allocator is not as sensitive to the numerous variables. Staff would not have carte blanche but would take direction from the board on how to operate within the six bigger buckets.

MR. RICHARDS said he still did not see the advantage of staff's recommendation other than Callan's mathematical model would be improved. MR. BADER said that a more focused look at the investment world would be better than trying to look at 15 asset classes.

MR. O'LEARY remarked that in asset allocation discussions there is a tendency to presume a degree of accuracy in the inputs that is totally unwarranted. Some asset categories do not have a good history of correlation, but Callan has to pick a number to put in the model, and the model spits out to several decimal points what the allocation should be. Callan always cautions people about that, but nonetheless people are looking at numbers that seem to have great precision. That is why Callan does reverse engineering on the assumptions, because a 10-basis-point change in correlation can result in a 15% or 20% change in suggested allocation.

MR. JOHNSON asked if changing to six major asset classes would result in different benchmarks being applied to the existing subcategories. He also wondered if the benchmarks would match up with the benchmarks that, for example, Harvard or Yale or Mass PRIM use.

MR. O'LEARY said he did not know the answer for the latter question. The beginning point is to use the current benchmarks for the major asset classes.

DR. JENNINGS pointed out that dealing with 15 asset classes results in 135 correlation elements, whereas six asset classes means about 27 correlations. The board can still ask the right questions about the subclasses, but six major asset classes is a good approach.

<u>Roll call vote</u>

Ayes: Williams, Trivette, Harbo, Pihl, Semmens, Schubert
Nays: Richards

The motion passed, 6-1. Commissioner Kreitzer had stepped out of the room two minutes before the vote and was gone about ten minutes.

7b. Performance Measurement - 3rd Quarter of 2007

MR. O'LEARY used a slide presentation in his report on investment performance for the periods ending September 30, 2007. *[A copy of the presentation material is on file at the ARMB office.]* He made the following key points about the market and the SBS investment options:

- The quarter was incredibly challenging in the bond market, but across the entire style spectrum the median manager had positive returns. Interestingly, the core-plus strategy had lower returns than the core strategy. That makes sense when the median high yield manager was up less than a percent. The median long bond manager made more in the September quarter than they did in the full year. The biggest decline in interest rates during the September quarter was at the short end of the curve. So intermediate and defensive portfolios tended to do well, particularly if they had high government bond exposure.
- The bond market actually did better than the stock market during the quarter.
- For the one-year period international equity earned 25% and domestic stocks returned 16.5%. Currency accounted for more than 10% of the international return, an extraordinary number and not expected to continue. Over the long term, the difference in returns in local currency terms and dollar terms tends to be within a percent or two. And generally those differences are attributable to differences in secular inflation rates.
- Large cap domestic stocks were up 2.0% for the quarter while small cap stocks were down 3.1%. Over the 12-month period, large cap had a 16.4% return versus 12.3% for small cap. That number is deceptive because 5% of that difference came in the September quarter. Over five and seven years, small cap is still way ahead.
- There was poor timing in implementing the large cap value managers, but that money would have been in large cap value stocks anyway in an index fund context. Value did very poorly in the quarter. The big driver was that the financial sector is the biggest single economic sector in the value index, and financial stocks went down the tubes. It is not uncommon for value managers to have more than a third of their portfolio in financial stocks, and that sector continued downward subsequent to quarter end. Growth has now outperformed value significantly for the quarter, calendar year to date, and the last year. Value still holds the lead over longer periods.
- Real estate - Callan believes the income component will likely continue to trail down and the market will not see the appreciation of recent years.

- Supplemental Benefit Plan:
  - Commitments to the target maturity funds have not grown as much as expected. The target maturity funds are right on top of their objectives when looking at the one-year returns.
  - Brandes international fund returned 18.66% for the year net of fees. The separate account that Brandes manages for the ARMB had a pre-fee return of 22.85%, a significant difference between the two portfolios. The fact that the MSCI EAFE Index was close to 25% for the year compared to Brandes at 18.66% is not a surprise because Brandes has a pronounced value orientation, and value did not do well anywhere. Brandes' investment style is extremely insensitive to the index.
  - The Capital Guardian Global Balanced Fund looks good across all the time frames relative to their target.
  - The Citizens Core Growth Fund has had a severe performance problem, in addition to management changes, but has benefited in 2007 from the large cap growth style doing well.
  - T. Rowe Price Small Cap Trust went down in the quarter less than the Russell 2000 Index went down. It was very close to the index for the year and beat the index over three and five years.
  - The T. Rowe Price Stable Value Fund seems to be doing reasonably well.
  - It could be beneficial in the future if SBS participants could use the T. Rowe Price component or "building block" funds to do their own silo construction.

MR. O'LEARY next reviewed the major asset classes for the defined benefit programs, as follows:

- The total fixed income pool returned 4.97% for the year versus the median public fund in Callan's database at 5.16%.
- The internally managed core portfolio was behind the Lehman Aggregate Index for the quarter, and because of that, the one-year return is slightly below the index. That is consistent with the in-house investment approach, which has a little emphasis on spread product — credit did worse than government securities. The three-year return of 4.23% versus the custom index at 3.86% is outstanding, and all the longer-term numbers are above the benchmark.
- High yield bond manager ING had a negative return in the quarter while their target had a 33-basis-point positive return. For the trailing year ING earned 8.02%. So even though high yield bonds had a weak quarter, the full year results show that it still made sense to have high yield exposure because they returned more than investment-grade bonds, and ING in that period was above the benchmark.
- High yield bond manager MacKay Shields had positive results in the quarter and returned 8.03% for the trailing 12 months.
- Mondrian, the international bond manager, made 8.0% in the quarter. This is a reflection of how bad the dollar did in the quarter. A government bond index

produced more than twice the return of the Lehman Aggregate Index, which is what diversification is all about.

- Absolute return portfolios - Mariner, Cadogan and Crestline. While more volatile than investment-grade bonds, the returns are also higher. So even Mariner, the weakest of the three absolute return managers, added value relative to leaving the money in bonds. Cadogan returned 14.25% for the year and Crestline earned 12.65%.

CHAIR SCHUBERT asked if the pension board's bond managers are buying any subprime mortgage debt. MR. O'LEARY confirmed with Bob Mitchell that the in-house bond portfolio is not buying any subprime paper. He added that there are many asset-backed securities and some mortgage-related securities that are still investment-grade rated, even after all the trauma and downgrades. MR. MITCHELL noted that the ARMB's high yield managers have some exposure to companies that were affected by defaults. MR. O'LEARY said he has seen a tremendous interest in buying below-investment-grade paper associated with the problems, but that has typically been done in opportunistic, distressed-debt types of funds. He expected to see some of that in the hedge fund of funds, as well.

MR. WILSON stated that some private equity people are buying debt because they think the returns are in excess of what they could earn in buying companies right now.

MR. O'LEARY continued with the performance report:

- Callan looked at the underlying international equity holdings to see if there was a significant bias in terms of capitalization or growth versus value styles. In aggregate, the numbers do not suggest a significant bias.
- Emerging markets pool was JP Morgan and Capital Guardian during the September quarter. The board terminated JP Morgan's emerging market mandate but maintained the relationship and account while searching for a replacement manager. JP Morgan did well in the most recent period and the pension fund benefited from that — so it was a good decision not to close the account immediately and place the money in an index fund or in cash.
- Lazard global equity has been underperforming over an extended period and is a potential candidate for the watch list. Callan's research indicates that the global portfolio does not have a pronounced style tilt.
- The large cap domestic equity pool did better than the S&P 500 benchmark over the trailing 12 months and was a few basis points below the Russell 1000 Index. A style analysis of the pool shows 33.5% in value-oriented stocks, 30.8% in core, and 35.7% in growth. There is a slight growth tilt that is the result of the managers' actions.
- The small cap equity pool has done fine in the last year relative to the index, so the changes were worth it.
- The picture for the internal REIT (real estate investment trust) portfolio has not been

pretty in a relative sense.

Turning to the asset allocation for PERS, MR. O'LEARY stated that nothing of substance changed during the quarter. However, if a period happens where financial markets generally are doing poorly, the fact that there is meaningful exposure to alternatives and real estate compared to other public funds may well result in the pension fund's relative performance looking better. Conversely, if there were a strong rebound in the public markets, that would hurt the pension fund's relative performance. If stocks continue to tank and bonds do well, the ARMB bond allocation is comparatively low, so the relative performance would deteriorate. Those are major bets that are embedded in the asset allocation and that will affect the pension fund's relative performance — for good over the long term, but it could be different on a quarter-to-quarter or year-to-year basis.

MR. O'LEARY reported that the PERS and TRS retirement funds outperformed the target index for the quarter. All the outperformance came from either asset allocation or from private equity doing better than the target. The one-year returns were great, both in absolute terms and in a relative sense. Performance has been very good over the past three years. The long-term return was 9.53% over 16 years versus 9.31% for the target, and there have not been huge variances from the target.

LUNCH RECESS

CHAIR SCHUBERT called a lunch break at 12:00 p.m. When the meeting reconvened at 1:25 p.m., trustees Schubert, Trivette, Harbo, Semmens, Pihl, Williams and Richards were present. Commissioner Kreitzer was absent for the afternoon.

REPORTS (Continued)

The agenda was reordered to take up an item from Thursday's agenda.

8. Fixed Income Presentation

Senior Investment Officer BOB MITCHELL reviewed the investment mandate for the domestic fixed income portfolio managed in-house:

- Market value $3.0 billion at October 31, 2007, or 17.5% of the ARMB portfolio
- Index is Lehman Aggregate, which is representative of investment-grade, dollar-denominated bonds
- Core fixed income portfolio, meaning that it is:
    - All U.S. dollar denominated debt
    - Investment-grade debt
    - Constraints in the investment guidelines that duration is +/-20% of the index
    - Limitations on corporate bond holdings

- Treasury Inflation Protected Securities (TIPS) and enhanced cash mandates were added in July and June
- In addition to investing fixed income, the portfolio fits into the other components of the ARMB asset allocation, primarily serving as a buffer for cash flows in and out (pension payments, employer and employee contributions, liquidations in real estate, and private equity and other asset classes).

MR. MITCHELL stated that in addition to the chief investment officer and himself, there are four other investment officers on the fixed income investment team: Casey Colton, Philip Bartlett, Victor Djajalie, and Andy Wink (starting December 10). He reviewed the investment philosophy to outperform the Lehman Aggregate Index over a reasonable period of time by seeking yield in shorter-dated maturity bonds and by trying to find individual bonds that will outperform a similar component of the index. He explained the investment process, saying that they make the major decisions for how to structure the portfolio at a monthly meeting and tend not to make major changes to the approach. They review what is happening with the economy and in the markets, they check feedback from performance attribution reports to determine the sources of return in the recent past, and they discuss what the duration, yield curve exposures, and sector allocations should be. They also meet weekly to revisit positioning and the thought process behind that, and if there have been significant market developments they may make changes to the approach. Also weekly, each investment officer is assigned research from a Wall Street firm, which they read and summarize for distribution to the team. On a daily basis, they have ad hoc discussions. The team is situated in proximity to each other so they can easily communicate.

MR. MITCHELL stated that the fixed income investment team tends not to take a position that deviates materially from the duration of the index, and they tend not to have curve positionings that are significantly different from the index either. But to the extent that they choose to make duration or curve positions, that would happen at the monthly meeting. Risk management centers around keeping principal because they believe over time that will be a significant source of outperformance. The most recent manifestation of that was in 2005 when they chose to exit the auto manufacturers prior to what turned out to be a very vicious downgrade cycle that placed a lot of stress on corporate bonds of Ford, General Motors and auto suppliers. That action has been a significant source of the fixed income portfolio's performance. On the buy side, they prefer bonds that have collateral — asset-backed securities, commercial mortgage-backed securities, and to some extent, mortgage-backed securities. Regarding corporate bonds, they have risk management processes in place that limit the amount of a corporate bond issuer the portfolio can own relative to its positioning in the index and its rating.

MR. MITCHELL reviewed characteristics of the ARMB fixed income portfolio compared to the Lehman Aggregate Index. Principally, the in-house portfolio has a higher yield, the quality is similar to that of the index, the duration and convexity are similar to the index, and

there is an overweight to spread duration. Looking at a graph of sector allocation, he said that the portfolio is underweight government securities and overweight the other asset classes, which is consistent with the team's approach to try to out-yield the index. He also pointed out that home equity (part of the asset-backed securities) comprises 0.2% of the entire index, and a subset of that would be subprime mortgages. So subprime mortgages are a very tiny part of the index.

MR. WILSON asked if, and how, the ARMB's fixed income sector exposure changes from year to year. MR. MITCHELL said it does change, and in hindsight, if they had increased the government exposure in April and May that would have helped performance in the last quarter. Generally, the exposure has been to underweight Treasuries and agencies versus other products, and to do that primarily in shorter maturities.

MR. WILSON observed that about 60% of the portfolio was in mortgage-type-related things, and that looking out over the next year there was a lot of stress in the marketplace. He wondered how staff planned to deal with that.

MR. MITCHELL stated that staff feels comfortable with the securities in the portfolio, but they are vigilant in monitoring them. If they lose faith in a security, they will sell it. A lot of the exposure that the portfolio has been gaining recently has been in commercial mortgage-backed securities. These tend to be older bonds that have more price appreciation embedded in them and lots of credit enhancement. In many cases, loans that were originally part of these trusts, particularly in 2003 when rates dropped there was a desire to refinance the commercial mortgage-backed securities, but there are penalties associated with that, and one of the solutions is to replace a loan with a Treasury security that has the same cash flows as that loan. In some cases, the ARMB portfolio has short bonds that are up to 100% defeased by Treasuries. As recently as last week, staff was finding two-year bonds that had more than 20% defeasance at 200 basis points over Treasuries. Those are the types of securities that staff likes. In collateralized mortgage obligation (CMO) space, staff has emphasized looking for secured agency debt rather than unsecured agency debt. They have purchased what are effectively collateralized bonds with a guarantee on the timing of all the cash flows in the trust. It looks like an agency debenture and will perform like an agency debenture, with the added benefit of actual property that secures it. Because it is less liquid than agency debt, staff has garnered it at higher yield. Staff feels very comfortable with those secured types of bonds. Where they are seeing weakness is the portfolio has been overweight banks, which has hurt performance. If things get much worse, that overweight will result in underperforming the index.

MR. MITCHELL stated that the latest data suggests that home prices are down about 5% year over year. Over the past five years prices have gone up about 70% nationally. So if a portfolio owns bonds that have some seasoning to them, they still have an embedded cushion in home prices: if those borrowers were forced to sell today, they would still have

positive equity. Staff takes comfort in that characteristic when looking at the debt.

Continuing with his prepared presentation, MR. MITCHELL showed a graph of the fixed income portfolio broken down by duration components: 0-2 years, 2-4, 4-7, 7-9, and 9+. He noted that the portfolio's exposure is roughly the same as the index from a yield curve perspective. The portfolio is underweight government debt in the shorter maturities but not in the longer maturities, consistent with the in-house fixed income approach.

MR. MITCHELL next gave an overview of the investment-grade bond market:

- The markets are very stressed and risk premiums have increased dramatically. Year-end for half the street is the end of November and year-end for the other half is the end of December. Liquidity was already constrained, and it is becoming even more constrained. Market participants are concerned that the Fed is not easing rates fast enough. The Fed has been cutting rates in the last couple of months but saying that they are concerned about inflation and taking a bit of wait-and-see attitude. The two-year Treasury was approaching 5% in June and is almost 200 basis points lower now. These are all signs that the market is stressed.
- The past five years have been characterized by easy credit, lots of liquidity, and Wall Street creating and packaging financially engineered bonds that it sold to a wide variety of participants. The most damaging of those bonds, known as collateralized debt obligations (CDOs), have wreaked a lot of damage to portfolios. These are complicated, opaque instruments that most investors do not have the resources to delve into, so they rely on rating agencies. And those ratings are very sensitive to the models that the rating agencies are using (the probability of loss turns out to be a lot higher than modeled). These CDOs started to get downgraded and lose value. The ARMB portfolio does not own CDOs.
- Asset-backed securities, as represented by derivative contracts at the AAA level, were at par in the spring, in the high 90s in the summer, and last week were in the 60s, implying that investors will lose 40% of their principal at a AAA level. That is not what AAA bonds are supposed to do. A lot of buyers of the debt thought they owned a AAA security: some have been forced to sell and others are holding it.
- The increase in volatility has hurt levered investors, hedge funds, off-balance-sheet trusts that financial entities created, and others.
- Liquidity has dried up, one reason being that banks have come under pressure because they are stuck with levered debt that nobody wants to buy. Any subprime exposure that banks might have had in their portfolios has had to stay there. And there may be off-balance-sheet trusts that banks have contingent liabilities for. So banks do not have the ability to provide liquidity like they did six months ago.

In closing, MR. MITCHELL stated that the ARMB fixed income portfolio underperformed by about 30 basis points in the September 2007 quarter, and it is bringing down the one-year return number. So far in October and November the performance is down roughly another

30 basis points. There has been a dramatic increase in spreads, especially in November. Staff believes that spreads will tighten over time. They continue to monitor the bonds in the portfolio and are positioning for a reversion to the mean in spread product. If that does not happen, or takes some time, it may be a while before things turn around. One of the pillars of the in-house fixed income strategy is to underweight short-term Treasuries and buy short-buy alternatives, so the worst case scenario is to sit on a two-year bond and let it mature to get that return.

MR. O'LEARY stated that in the previous market environment spreads were so narrow that he and staff wrestled with the notion of whether the ARMB should have any high yield bonds. It is in environments like this where the yield advantage for the credit products begins to look pretty compelling. As long as the spreads do not continue to widen, the portfolio is getting a tremendous yield advantage, which over time produces the excess return. In the high yield sector, the ARMB has been underallocated relative to the target. Staff, in the next six to nine months, may be recommending a movement toward the target.

MR. TRIVETTE asked Mr. Mitchell to comment on the outlook for 2008. MR. MITCHELL said it will be challenging for two reasons: the housing market has been severely impacted, and existing home sales suggest almost 11 months of inventory on the market; and there are quite a few borrowers with adjustable rate mortgages that will reset over the next year. That will affect consumer demand, which is 65-70% of the economic activity for the country. The problems are not easily fixed and it will take a while to turn things around.

9. Small Cap Economic Roundtable Discussion

Panelists: TOM DIBELLA, Turner Investment Partners, Inc.
JASON SWIATEK, Jennison Associates LLC
STEVE PURVIS, Luther King Capital Management
MICHAEL SMITH, Lord Abbett & Co.

Moderator: GARY M. BADER

MR. BADER: Have we seen the peak of the subprime impact on the market or is there more to come?

MR. SMITH: I don't believe we have seen the peak in the subprime market. I think there is definitely more to come. You have seen two very important events in the last week. Freddie Mac, which is one of the two lenders of last resort, having significant problems and announcing that they may cut their fourth quarter dividend in half to raise capital. We recently saw the Dubai government invest $7.5 billion in Citigroup in an 11.5% convertible preferred, which is a very expensive piece of capital. So that gives me an indication of the depth of the problems. I think we've got quite a ways to go, especially as the resets come into play in a big way in the first half of 2008 and throughout the whole year.

MR. PURVIS: I agree with Mike. Our research shows that the peak in resets will happen kind of late first quarter, early second quarter in 2008. We view that as still having a problem. But everyone is starting to understand the problem, and we're really in that confession stage. Like Mike mentioned, we've got a couple of big banks out talking about their problems. We think that's a very healthy situation, but we don't believe we're through with that. So we still expect many more banks and financial organizations to step forward and say they've got a problem and they're going to write some things down. So we still think it's going to be choppy.

MR. SWIATEK: I agree. The subprime issue has some time to go. The resets are really coming up in front of us. Interestingly, it seems to be broadening beyond subprime. Just last night, Wells Fargo, for example, announced over a billion dollar charge in their home equity area. So the issues in the housing market I do not believe are contained solely to subprime. Home equity has been an area that we've been watching very closely because a lot of that does not currently show up on balance sheets — that is, if somebody has a line of credit they can simply tomorrow write a check for $25,000 or $50,000 if they are in distress, and it is only at that time that it shows up in the bank balance sheets. So we think there is further stress to come in the financial system from the mortgage issue.

MR. SEMMENS: How does this impact your world of small cap companies?

MR. DIBELLA: When you go to buy something nowadays you have to ask yourself some additional questions: How is this going to affect the company that we're going to buy? Do they have any direct relationship to what's going on? Do they have any indirect relationship to what's going on? So it probably takes the process a little bit longer and you're probably a little bit more careful, in terms of how you look at the world nowadays. I agree with what all these gentlemen have said. I don't think you unwind the sins of probably the greatest housing boom in the last forty or fifty years in six to nine months. Also, I would question what is going to happen at the end of the year when the auditors have to write off these assets that they say they have. I think they have been looking at the write-offs so far, but they are really going to have to sign off at the end of the year. So I wouldn't be surprised to see the auditors take an additional haircut to some of these valuations that we see in play.

MR. SEMMENS: I can understand how that impacts financials, but I don't get how it impacts so much of the broader market. I'd like someone to explain a specific for-instance that you know about.

MR. SMITH: The real concern that we have is the damage to the confidence of the consumer psych. So any kind of big ticket consumer purchase, especially something that is easily deferrable, we're seeing that deferment take place. Also, the consumer at the median household income or below, those folks are getting hit very hard as a result of taxes and high energy costs. One of our larger holdings is a company called Select

Comfort. The stock has had a very tough year. They sell premium mattresses. It's a big ticket consumer purchase, and the company has had a tough time getting customers to pull the trigger and convert to an actual purchase. We think the business is still a good business with a good product, but the consumer has not bought. So that would be one example of where we're seeing an impact.

MR. BADER: Do you try to make predictions of Federal Reserve policy, or does it influence investment decisions you are making?

MR. DIBELLA: We don't spend a lot of time predicting what the Fed is going to do. Our process is very much bottom-up. We tend to look for companies that are improving internally. We try not to predict oil prices or interest rates or the economy. Certainly, though, we are paying attention to what's going on; it's the environment in which we live in. But if we're basically trying to recommend a stock simply because we think the Fed is going to increase rates or decrease rates, that gets really away from our process and our philosophy.

MR. SWIATEK: That's actually a very similar philosophy that we have at Jennison. We try to add value by building up portfolios on a bottom-up basis, but of course what the Fed is going to do is implicit to some extent in our thinking. We try to take advantage of the volatility that some of the speculation causes. For example, a couple of days ago people were unsure whether the Fed was going to cut in December, and then vice chairman Cohen came out and said the credit markets really seem to be seizing up, and the market read that to mean that the Fed was going to cut in December, and it sparked a very large rally. So you've had a lot of volatility due to speculation of what the Fed is doing. And what we try to do is have discipline and entry points into our investments and take advantage of that volatility to buy the companies that we wish to hold.

MR. PURVIS: The impact that the Fed policy has on our portfolios is it really helps us understand where we're at in the economic cycle. The Fed has historically been a lagging indicator — it follows the market, follows the economic scenario — so with the Fed cutting, we're clearly in a slowing economic environment, and that may have some impact on our portfolio.

MR. O'LEARY: Small cap stocks have had a tremendous run, outperformed large cap stocks. But in the last year they have pretty substantially underperformed, although much of that was because of the September quarter. Nonetheless, valuation differences don't seem to make a compelling case for small cap. So are we in for a three- or four-year period where small cap underperforms large cap? Does global growth help or hurt small cap stocks? All those types of issues.

MR. DIBELLA: We've been saying for over five years now that we thought that the small cap stocks were attractive relative to large cap stocks. We have had an outperformance for

quite a bit of time, so certainly they could have a resting period. But one of the reasons that we always thought that small cap stocks were more attractive than the large cap stocks was that we were in a very low inflationary environment. And if we continue in that environment, it is really tough for the large cap companies to grow their top line. If you have a company that you think can grow at 15%, then by definition if you have 2% inflation, you need a 13% unit growth. That is pretty hard to do for some of these large cap companies. For example, if people can think that GE can grow between 10% and 12%, they would have to kick out a company the size of Anheuser-Busch or Dow Chemical every year to grow at that rate. Now that is a simplistic analogy there, but it's to give you a feel for the magnitude of the growth that people assume. So unless inflation picks up, I think some of these large cap companies, to grow their top line, are going to have to resort to acquisitions and then they're going to be targeting the small and mid cap companies.

MR. PURVIS: The risk profile that investors have taken on over the last year to year and a half has been pulled back. Clearly that's a function of where we're at in the economic cycle — slowing earnings growth, rising interest rates — and the result of that has been small caps underperforming. I think if you fast forward another six to 12 months, we'll probably see additional Fed interest rate cuts. We'll get to a level where confidence comes back into the system, and you'll see the small caps with their higher earnings growth begin to outperform again.

MR. SWIATEK: If you take a historical perspective, there has been a pretty steady relationship in valuations between small cap and large cap. What you saw in the late 1990s was a huge level of outperformance of large caps, particularly the mega caps within large caps. What I believe we've seen over the last five or six years is an unwinding of that. So actually if you look at relative multiples between small caps and large caps, they are pretty much in line with where they have been historically. I would agree that with large caps struggling for earnings growth I still think we're in a decent merger and acquisition environment. And of course private equity is on the sidelines for now, but they have raised a lot of money over the last several years that at some point will be put to work. So I think that due to superior earnings growth and then the M&A bid underneath a lot of these stocks that it should be a relatively decent environment for small caps.

MR. SMITH: One other point. It has been a very strong small cap cycle and a historical valuation metrics. You could argue that small caps have had their day. But right now I think valuations probably look as compelling as I've seen since probably early 2003 to late 2003. I'm finding some extremely compelling ideas out there which get me very encouraged for the first time in a few years.

MR. BADER: Can any of you think of any significant risks that we haven't talked about today or that the market is neglecting right now?

MR. DIBELLA: The one risk I don't think anybody is ready for, and I'm not sure it's going to

happen, is pretty much the world believes that China is okay through the Olympics or China is okay for the next four or five years just because of the significant growth that they've shown and significant growth that they probably will have. I'm a believer in the long-term growth rate of that country. Any huge country like that that goes from a farming economy to an industrialized economy will continue on. No country in the history of mankind has gone backwards, so they will continue on. But I think people just assume it's going to be straight line. It may be, but I don't think the world is ready if they have a hiccough or something.

MR. SWIATEK: A follow-up on the China point. China has been a tremendous source of deflationary pressure over the last several years. You are starting to see some import inflation from China. So the common thinking seems to be now that with the economy slowing down that inflation pressures will be contained and will slacken. That is likely true. But there is this risk that money supply has been growing very quickly, China has switched from a source of deflation to potentially inflation, and we might be underestimating the impact of inflation going forward.

MR. PURVIS: I think we have some political risk that is not fully discounted. Within 12 months we'll have already elected the next president, the leader for the next four years. And I think that there may be a risk of a change in trade policy and a change in tax policy. Both could have a negative impact on the micro level, as far as our economy and our stock market. Right now I don't think that there's a lot of talk or discounting of that potential risk.

MR. SMITH: Yes, I would say exactly what Steve said. That is a huge issue that is getting a lot of press. The views of the candidates are a lot different than we've seen in the past election cycles, and I think they're going to have a huge impact.

MR. BADER: Tell us what you think the economy is going to do over the next five years; if you have any views on the U.S. gross domestic product growth, positive or negative; job growth; inflation, and so on.

MR. SWIATEK: We believe a small to moderate growth environment. So unemployment will probably drift a little bit upwards from where we are today. But we're in sort of the slow growth camp with moderate inflation going forward.

MR. SMITH: To the previous point of political risk, that's going to have a huge impact on how that plays out. I think nominal GDP will most likely be fine. It depends on some of our policies. Job growth, that's a wild card. You may see a lot more jobs move offshore more aggressively if the regulatory environment increases.

MR. BADER: What are the long-term economic implications for the U.S. on the growing economies — we have talked some about China, but China and India, and how has the emergence of those two countries affected U.S. small cap investments?

MR. PURVIS: We think it is going to be a huge positive. Basically, the world is going through a massive global Marshal Plan, similar to how we rebuilt Europe. There is a tremendous amount of infrastructure growth all around the world. We don't think that that stops. The rate of growth may change, but that is going to be a positive. We have a lot of small companies that participate globally that will also participate in that global growth.

MR. SWIATEK: I agree with that. We've historically been very concerned watching China, in terms of how the emergence of China will impact our companies from the supply side. If you think of industrial companies, we've always had to be very concerned about the commoditization of the products that they're making, that they'll lose a competitive advantage. But what we're starting to see is a shift to end market plays in terms of China. One portfolio holding called UCBH, which is a bank that is based on the West Coast that was just recently approved to buy a bank in China. So this is a small cap U.S. company that now has access to this very large China market. So we're starting to see the emergence of middle class plays and market plays, and we're keeping our eyes open for those opportunities.

MR. BADER: Any demographic trends that any of you are looking at over the next five years that could have a significant impact on small cap stocks?

MR. SMITH: The biggest demographic trend is the aging of the U.S. consumer. That's going to create more health care opportunities, and that's going to continue to be one of the higher growth areas in the marketplace, especially as that becomes a bigger and bigger piece of the overall economy. We try to see the government try to drive efficiencies in that part of the marketplace. We think there's going to be a tremendous amount of opportunities there going forward.

MR. PURVIS: We've talked about the aging of the Baby Boomers for a long time, but when you think about it, the historical view was that when the Baby Boomers reached retirement they would take their money out of the stock market and put it into bonds. At the time that thinking came about interest rates were very high, double digit, you could get a 12%, 15% coupon. And if you look at where we're at today, I think that you're going to see the Baby Boomers keep their money in the stock market because of lack of alternative investments in the fixed income market. I think that's going to be a big positive. I also see them continuing to invest to support a very robust lifestyle.

MR. DIBELLA: In terms of the Baby Boomers, I think that this generation is going to inherit way more money than their parents ever inherited, so there is a lot more money to sustain that lifestyle. They may cut back a little bit, but generally speaking, it will be full steam ahead. That's pretty much what they've known. The other thing, I think as people get older they really don't want to live in tough environments, tough climates, so you're going to continue seeing movements to the west, probably in the Nevada and Arizona area and

probably even more in California.

MR. BADER: What industries do you believe have the highest growth potential over the next five years?

MR. SWIATEK: We believe we're still relatively early in this hard asset cycle. If you look back to 1980, energy stocks were almost 30% of the S&P 500, materials were 15%, and financials were about 5%. If you fast forward to today, financials are over 20% of the S&P 500, energy is down from 29% to 9%, and materials are down from 15% to 2-3%. So what you had was a very long period of 25 years where financial assets substantially outperformed hard assets. And while certainly commodities and other hard assets have had a great run over the last couple of years, we believe we're still relatively in the early innings of that reversal to move toward hard assets.

MR. BADER: I'm hoping for another dot-com boom. Do any of you see a dot-com boom coming?

MR. DIBELLA: No.

MR. BADER: Looking back over the last 12 months, based on your expectations, what has surprised you the most?

MR. DIBELLA: What surprises me is with the dollar falling so much, over 15% in the last 15 months, is that we haven't seen more foreign buyers come in and buy some corporations here in the U.S. I think they would probably concentrate on commodities, non-residential real estate (hotels and things like that), and brand-name type companies. We've seen a little of it but not as much as I thought we'd see. But maybe we'll see it in the future.

MR. SMITH: I was very surprised how long it took the market to recognize the credit issues out there. The new housing market peaked over two years ago, and a lot of those stocks hung in there pretty good through the first quarter of this year. Now you're seeing a market correction in those stocks, but I still think we have a long way to go.

MR. O'LEARY: I think we all learned a lot in July and August about how some changes in the structure of the market and how managers manage money can cause distortions. Would you comment on that as it pertains to small cap? What I'm referring to is so many people using quantitative investment tools and techniques, and all of them seemingly finding attraction in the same thing. Then if they have a need to raise money, they're all selling the same thing. What seemed like great liquidity turned out not to be so great liquidity. The structure of the market in small cap and investment strategies, approaches that are used in your space, including the influence of hedge funds.

MR. DIBELLA: I would agree, that certainly is the risk in small cap stocks. They are not as

liquid and they get thrown around a little bit. It is always tough when you see a stock going down significantly and you don't know the reason for it, and you basically have to decide is this really a short-term thing and is the company okay or is it time to reduce or exit the position. That is still a problem going forward and will probably be with us for a while.

MR. SMITH: The hedge funds are extremely active in small and mid cap, and that has really increased a lot in the last five to seven years because it is historically one of the most inefficient markets out there. And the quantitative funds have gotten much more active. We look at the shareholder base very closely in any position before we get into it to get a sense of how stable or volatile the shareholder base is and the likelihood of them potentially exiting or sticking around if there is some bad news in the stock. So that's one of the strategies that we utilize when we may want to get into a stock.

MR. PURVIS: It's interesting that the volatility began to pick up in the market, not just small caps but overall. And it happened about the same time that they removed the up tick rule on shorting stocks. Where before you had to wait for a stock to move higher before you could put on a short position, now the hedge funds can short and short and short and really drive stocks. Ironically, that's about the same time the volatility increased. They love our space. It's important to have a good fundamental knowledge and understanding of the companies so you know when it is time to add to those positions and when it's time to say maybe it's time to move on. I think that's a big difference that the hedge funds have brought on.

MR. SWIATEK: In addition to your observation on the quantitative funds, another phenomenon has been the very large growth of ETFs (exchange traded funds). We saw this particularly last year, where I believe 80% of active managers underperformed the Russell 2000, because what you had was a lot of either hedge funds or international investors that wanted quick small cap exposure, and the fastest way to do that is to buy an ETF. What the ETF has to do is go out there and indiscriminately buy all 2,000 stocks in the index. So you saw a lot of low-quality, illiquid stocks that performed very well in that type of environment. I think what you saw this summer was an unwinding of that, where now instead of indiscriminate buying you see indiscriminate selling of those stocks. It has been an important driver in the market.

MR. BADER: You are all small cap managers, but what asset class do you think over the next 12 months is the asset class that you would expect to have the highest rate of return?

MR. SWIATEK: I mentioned earlier that I believe that we're still early in this commodities and hard assets cycle, so I think that could be a source. Perhaps looking just a little bit beyond 12 months, a really interesting area to start looking into is international real estate. As we know, there is very low global bond yields. The dollar has been declining. For a U.S.-based investor, that makes international assets very attractive, obviously. And we are in the early stages of what I would call monetization of that asset class. What I mean by

that is in Europe and Asia you don't have the REIT funds like you do here in the U.S. The vast majority of international real estate is still held in private hands. I think we're in the early phase of that monetization. Why I say a little bit longer term is in a credit cycle that impacts real estate and people's ability to finance real estate. But once this credit clears up a little bit, that could be a very interesting area to start looking at.

MR. BADER: Would you be looking at privately held real estate or looking for a REIT fund that is active in that space?

MR. SWIATEK: I think the REIT funds are just sort of coming onto the horizon, so I think both could be ways to benefit from that trend.

MR. SMITH: I agree with Jason on the commodity cycle. It is a very long cycle, and we're still fairly early on. You will probably get a hiccough after the Olympics next year in Beijing. I would also say agricultural farmland. Commodity prices are very strong, and agricultural farmland will be a big beneficiary of that over time.

MR. O'LEARY: Following up on the comments about real estate securities, it is my impression that many small cap managers really don't think much about REITs, although REITs are an important part of the small cap market. So if we could just run down the panel and get a sense of do you use REITs, do you not use REITs — ever or just now or whatever.

MR. DIBELLA: Yes, we use REITs. I think they are about 7-8% of the Russell 2000, so you really can't ignore them. Currently, we're underweight by probably 300 basis points or so, maybe more. We were overweight all of 2005 and most of 2006. We started cutting back last year in November-December. They just haven't been performing well with the whole real estate thing.

MR. SWIATEK: We've similarly owned REITs in the past. We scaled back our exposure last year. Entering the credit issues of the summer, the only REIT we owned was a company called Analee Mortgage, which actually somewhat benefits from a difficult credit environment. So we've been pretty much persistently underweight the REITs, but we have had an exposure in the past.

MR. PURVIS: We're typically underweight REITs. In fact, when we think about our investment strategy as focusing on high-quality companies that generate high returns and that can reinvest back into their business and grow over time, taking a longer-term approach, when you think about the REIT structure where, by law, they have to pay out the majority of their cash flow, that just limits their ability to reinvest. So almost by definition of our strategy we're going to be underweight REITs. Every now and then we might find a REIT where we feel like it's trading at a significant discount to its asset value, but just to clip the coupon, we'd rather find companies that can take that cash flow and reinvest it

internally in their business.

MR. SMITH: We've historically had very little REIT exposure. We don't think the valuations have been compelling on a risk-adjusted basis. We bought our first REIT in the second quarter of this year.

MR. O'LEARY: Earlier there were comments regarding the demographic shift, the aging of the Baby Boomers, etc. Another very powerful trend has been the increase in minority representation in the population. There seem to be some businesses that have really benefited from that. Is that a type of secular trend that you would attempt to exploit, or is it just another potential advantage on a company-by-company basis that you'd consider?

MR. PURVIS: I agreed that that's a big trend. Coming from Texas, we're seeing that Hispanic population grow significantly. Unfortunately, I haven't been able to find very many stocks that cater to the Hispanic community that have been worthy of investment. There have been several media companies that focus on the Hispanic market, and those have been terrible investments, and I'm glad we weren't invested in those. But I'd be interested if anybody has any good ideas.

MR. BADER: I think we heard that real estate was an asset class and farmland, but we haven't heard from two other panelists in terms of projecting outperforming asset classes over the next year or so. Anybody have any other ideas?

MR. PURVIS: For the record, I was the one who said small caps last year, so take that however you like. I am going to go out on a limb here a little bit. I think there's going to be a big opportunity over the next 12 to 18 months in distressed debt. What we're seeing in the credit markets today is a real melt-down. There is some real bad paper out there, but I also think there is probably some decent paper that is getting thrown out with the garbage. Someone who is very good in the distressed debt area may have the opportunity to buy some things in this time of crisis and actually have a nice return over that time frame.

MR. DIBELLA: That's a tough one, because I would say commodities basically upfront. But some of these consumer discretionary stocks. We're underweight in the group now, and it's been really hard to make a lot of money in the group. It seems like the market is saying that no one will ever eat out at a restaurant again or buy clothing or anything like that. But some of the restaurant companies own a lot of their own real estate, and there is some real estate value in them. One that we own right now is Bob Evans. They probably have $24-$25 a share worth of real estate on the balance sheet, and that doesn't put any valuation on their sausage business. They also own another restaurant concept. The stock is around $30 now, so I don't think you're paying that much for the business, although I still think it's going to be tough sledding while the market decides that it doesn't like these consumer discretionary stocks.

MR. TRIVETTE: What effect does the devaluation of the dollar have on small cap stocks in the next couple of years, if any?

MR. SMITH: A lot of the small cap companies historically are very domestically focused. The internet is allowing them to market themselves and their products internationally, but they're generally in the very early stages of that. As the dollar becomes sloppier and sloppier, their products become more competitive from a pricing standpoint. So I think it expands their opportunity set.

MR. BADER: Are high commodity prices here to stay, yes or no?

MR. DIBELLA: Yes, I think they probably are, particularly on the energy side. Unless we get a decent national energy policy, I think we're going to face higher rather than lower prices in energy.

MR. SWIATEK: Yes. We've had years of under investment in the asset class. Also, to tie back to the decline in the dollar, obviously, commodities are priced in dollars so that lends further support.

MR. PURVIS: I would agree with that. I think a lot of it has to do on the supply side. The management teams of these companies are so geared towards achieving return on invested capital and are not spending their money foolishly and are actually holding back capital, under spending. And until we start to see the supply increase, we're going to continue to see high commodity prices.

MR. SMITH: Yes.

That concluded the roundtable discussion, and MR. BADER thanked the panelists for their input.

CHAIR SCHUBERT called a scheduled break from 2:45 p.m. until 3:05 p.m.

10. Jennison Associates LLC - Small Cap Equity Review

JASON SWIATEK, Portfolio Manager, and DANIEL NICHOLS, Vice President - Client Relationship Management, spoke to the board about the small cap equity portfolio that Jennison has managed for the pension fund since May 2005. *[Please refer to Jennison's slides on file at the ARMB office for charts and graphs used in the presentation.]*

MR. SWIATEK first reviewed the small cap team, then discussed the portfolio characteristics. The portfolio's projected earnings growth is lower than the Russell 2000 benchmark, and he explained that Jennison believes the 15% earnings estimates for the index in 2007 and 19% for 2008 are wildly optimistic, given the economy. Jennison is

confident that two years from now their portfolio will have delivered higher earnings growth than the benchmark. The portfolio has an equal to slightly lower P/E ratio than the benchmark. Historically, the beta has been very close to the benchmark. But entering the summer the beta drifted down to 0.85, and he and fellow portfolio manager John Mullman noticed that the market was not paying enough attention to risk. They were paring the more risky assets and replacing them with more steady growing companies, which has served them well.

MR. SWIATEK stated that about 80% of Jennison's outperformance comes from bottom-up stock selection, but the other 20% has been from industry overweights and underweights. They tend to be overweight in industrials and telecom services, while being underweight in banks and consumer discretionary over the last several years. He briefly reviewed the 20 largest holdings in the portfolio, saying that they look for companies they believe will grow 10-20% on a sustainable basis. REITs have not normally fallen within that growth rate.

MR. SWIATEK drew attention to the 13.4% return through October of 2007 compared to 6.1% for the Russell 2000 Index. While they did well in strong growth markets in the first and second quarter of 2007, they also preserved capital in the third quarter, a value market that was difficult for small cap stocks. He said Jennison strives for about 3% annual excess return over the index on a rolling three-year basis, and they have managed to do better than that. He also explained a graph showing the small cap portfolio's performance in different market conditions over nine years.

At MR. O'LEARY's request, MR. SWIATEK spent a couple of minutes describing other products that the Jennison investment team manages.

MR. WILSON inquired about the investment edge that Jennison believes they have to deliver the performance. MR. SWIATEK said the universe of small cap stocks is about 2,000 to 2,500 companies. They spend a lot of time getting to know what they believe are above-average businesses without being too concerned about the stock price up front. Each team member covers 70 to 80 companies or 500 companies in aggregate. They pride themselves on knowing these businesses as good or better than anybody else on Wall Street, and it may be years before they invest one penny in them. So when a hiccough happens in a small cap company or the group seems to be out of favor, Jennison is in a strong position to act quickly because they know the companies well.

11. Lord Abbett - Small Cap Equity Review

MICHAEL SMITH, Portfolio Manager, and STACEY ALLEN, Client Portfolio Manager, appeared before the board to give an update on the small cap core equity portfolio Lord Abbett has been managing for the pension fund since May 2005. *[The presentation included a series of slides, which are on file at the ARMB office.]*

MS. ALLEN talked about the corporation, their formal succession planning, and assets under management.

At MR. O'LEARY's request, MS. ALLEN also briefly mentioned their small/mid cap value and small cap growth products.

MR. SMITH reviewed the small cap core investment team that is dedicated to this one product. In terms of allocating capacity of ideas among teams at Lord Abbett, if one of the analysts on the small cap core team finds a compelling idea, they go ahead and buy as aggressively as they can. If there is no poison pill in place, they will generally buy up to a 15% position in a company. However, there are very few names where they are above 10%, and 5%-10% is the sweet spot of position size. The small cap core portfolio has low turnover, and they generally hold positions on average two years. At October 31 there were 91 stocks in the small cap core portfolio, and probably nine names were in common with the Lord Abbett small cap value portfolio and five or six names in common with small cap growth. The small cap universe has about 2,500 names, so it is not that common to bump into the other products.

MR. SMITH described the small cap core investment philosophy and investment process.

MS. ALLEN reviewed performance, pointing out that 2007 has been a good year for the ARMB small cap portfolio after a difficult 2006. Since inception, the returns lag the Russell 2000 Index a tad. Year to date up to October 31, the portfolio has returned 15.4% compared to the index return at 6.1%.

Looking at a slide of attribution analysis over the trailing 12 months, MR. SMITH stated that a significant underweight to financial services was one of the strongest contributors to the portfolio's outperformance. They also have very little exposure to REITs, something that hurt the portfolio quite a bit in 2005 and 2006, but it has been a benefit this year. The financial services stocks they did own performed very well, such as Ohio Casualty Corp. and Investors Financial. Performance was helped by an above-market exposure to the health care sector, which is not generally an economically sensitive business as the economy decelerates. The biggest negative contributors were the technology area and materials and processing.

MR. SMITH reviewed the portfolio characteristics: larger average capitalization than the index, focused on quality as measured by return on equity that is higher than the index, free cash flow that allows companies to make acquisitions or repay debt, and the long-term growth profile is more compelling than the index. He discussed the 12 largest holdings, which comprise approximately 20% of the portfolio.

MR. TRIVETTE asked what Lord Abbett expected for a return in the next few years. MR.

SMITH replied that there has been a strong small cap cycle. It depends on investors' risk appetite: high yield spreads have expanded quite a bit since June, which gives a sense that investors are not willing to embrace risk as much as they were. It is probably an environment where people are very skittish as long as the headlines are ugly in the financial sector, so it will probably be a tough small cap equity market. After that, Lord Abbett sees compelling opportunities and the mergers and acquisition market picking up quite a bit for small cap companies. Returns will probably be in line with long-term averages, but he did not expect anything above that.

MR. SEMMENS asked about portfolio turnover. MR. SMITH said Lord Abbett establishes upside and downside price targets for every name in the portfolio, and they change those at least once a quarter based on a company's earnings or industry factors. When a stock will reach a price target is driven by market volatility, but he could easily see most of the current list turned over in two years' time. The long-term average portfolio turnover has been about 50% a year.

MR. O'LEARY inquired about Robert Gerber being the chief investment officer. MS. ALLEN explained that when Daria Foster became managing partner her first order of business was to appoint a new CIO, who was Robert Gerber. He has been a partner with the firm for 11 years. MR. SMITH added that the CIO at Lord Abbett functions more in a chairman's role in that he ensures that portfolio managers have the resources necessary to execute their job. Mr. Gerber understands the culture of the organization, where the owners are active in the privately owned business on a day-to-day basis, and is looking to continue what is already in place.

12. Luther King Capital Management - Small Cap Equity Review

STEVE PURVIS, Co-Manager of the small cap core strategy, and MARK JOHNSON presented an update on their firm and the portfolio Luther King Capital has managed for the ARMB since May 2005. *[A copy of the background material and slides is on file at the ARMB office.]*

MR. PURVIS reviewed the small cap investment strategy, which has a research-intensive, bottom-up approach that is supported by 15 analysts. Portfolio turnover is 50-60% a year. He also described the portfolio characteristics: high alpha predominantly from stock selection as well as some sector allocation decisions; lower beta than the benchmark because they like companies that have already proven themselves; and they capture 80% of the up market but only participate in about 65% of the down market. Being able to protect the portfolio in down markets has really positioned them well over time.

MR. PURVIS explained two graphs showing composite three-year rolling returns since 1994, highlighting that Luther King has consistently added value versus the Russell 2000 benchmark and has generated good returns on an absolute basis as well. The ARMB's portfolio is ahead of the benchmark for the year as of October 31. He said the small cap

market has been very volatile, but they continue to try and add value in the volatility. Since inception in 2005, the ARMB portfolio has outperformed the Russell 2000 Index. He reviewed the sector weights and performance attribution for the ARMB portfolio. They have been underweight the financial area quite a bit, which has been a positive. A couple of themes they talked about last year have continued to play well — the aerospace and defense, and the industrial sector, especially the marine transportation area. They have increased the health care weighting over the last quarter because the consistency and predictability of the health care earnings stream will become more valuable in a decelerating earnings environment. Larger companies are outperforming smaller companies, so that means taking the weighted average capitalization up above the Russell 2000 a bit. Also, growth stocks are outperforming value stocks after a tremendously long period of underperformance. As a core manager, Luther King will tilt the portfolio to the growth side a little bit where they see the most and best investment opportunities. They have always been a quality manager, but those stocks have done better in this environment, and they continue checking the portfolio to make sure they have the highest quality names in what is a more volatile and trickier market environment.

MR. PURVIS drew attention to a list of the 15 largest equity holdings and pointed out characteristics of these stocks. He said there have been a lot of price changes in small cap stocks lately, so many names Luther King has been watching but never could get comfortable with the valuations are starting to come back into a more attractive price range.

Prompted by questions from MR. O'LEARY and MR. RICHARDS about Tempur Pedic International in the 15 largest holdings list when the company appeared to have high debt, very little equity, and no return on shareholders' equity, MR. PURVIS explained that they dig deep into the fundamentals of the company to figure out what is truly the capital structure and the company's ability to fund their interest payments. When it was a private company, Tempur Pedic did not have an incentive to show profits because they did not want to pay taxes. The company went public three years ago, is very profitable, and now reinvests back into the business. Their operating margins are in the 25% range, which is quite high, and they just built a new facility that will generate very high return on invested capital. Sometimes the reported numbers can be deceiving, but the stock is generating high returns and reinvesting that back in their business.

MR. PURVIS stressed that all the stocks on the top 15 list got there because they performed well at a starting position of 1% to 1.2% weighting. He also manages the risk by trimming the stocks back after they get above 2%, no matter how much he likes a company and feels good about the long-term prospects. He wants to avoid the risk of a large holding falling 20-30%, which can happen.

Responding to MR. PIHL, MR. PURVIS stated that over the last two to three years the valuations for the smaller banks has been significantly higher than the valuations for the

large banks. In the sell off, a lot of small banks have come down to a valuation level that is slightly higher but is becoming more attractive. Luther King looks at the deposit premium that the stock is trading at. They currently own five regional banks, and all of them have deposit premiums that are close to zero. Typically, acquisitions take place at about a 20% premium to the deposit base, so Luther King believes there will be some consolidation once the uncertainty passes about what banks own and are invested in.

MR. O'LEARY asked for a reminder about Luther King's capacity in its small cap product. MR. PURVIS said they have $1.7 billion in assets now and, while it is hard to say what the right number is for a small cap manager to manage, they look at the $2 billion mark as the upper end for Luther King. Even then, they expect to have enough flexibility for existing clients.

13. Turner Investment Partners, Inc. - Small Cap Equity Review

TOM DIBELLA and JOHN FINNEGAN addressed the board about the small cap core equity portfolio that Turner Investment Partners has managed for the pension fund since February 2004. *[A copy of Turner's presentation booklet is on file at the ARMB office.]*

MR. FINNEGAN gave an organization update, stating that the firm has taken steps to offer a minority interest of shares to the public for the first time. Ten senior employees of Turner will continue to own two-thirds of the firm.

MR. DIBELLA reviewed the investment approach and process. Turner looks for one of two things in a stock, either a company that is showing significant earnings improvement and selling at a reasonable price, or they use their value screens to identify hidden or unrecognized intrinsic value that the market is not recognizing. Their process tries to separate the assets from the underlying company to figure out what they are paying for each part. He mentioned the risk controls and stressed that Turner has a very disciplined sell strategy — once a stock is down 25% or up 50% from where they bought it the stock has to be reviewed and repitched in order to stay in the portfolio.

MR. DIBELLA discussed the five stocks that helped portfolio performance and the five stocks that hurt. He said 2006 was Turner's worst year, and only about 20% of the small cap managers outperformed the index that year. But Turner has had three quarters in 2007 in which they outperformed the market, and they have been positive so far in the fourth quarter. The market has been very earnings sensitive. Turner has had strong stock selection and also has avoided some major problem areas. They have owned very little banks, been really underweight in REITs, and avoided the classic consumer stocks like restaurants and retailers. They owned eight stocks that were taken over this year. A new screen in their investment process is looking for unrecognized land on the balance sheet of a company that is not reflected in the stock price, so even when a company is not doing well it creates a floor for the stock. He described the example of Bob Evans restaurants.

Turner tends not to do well in a market that takes off for a short period of time, and there were two mini "jackrabbit" markets this year, both in the third quarter when the Fed cut the discount rate. In four days the portfolio gave back 240 basis points of return to the market. Turner believes that when the market is taking off portfolio managers are looking for places to invest their money in stocks, and usually they don't throw money at complicated stories where you have to understand the pieces.

MR. O'LEARY stated that Tom DiBella was the portfolio manager for a very successful small cap mutual fund for a lot of years before he joined Turner. He was also very successful right after joining Turner, and Alaska benefited from that strong performance. When the board hired Turner there was no worry about assets because DiBella had built a record at his prior mutual fund with a large asset base, and he seemed to be very quick to close the product at Turner. However, the performance has been under the target for a couple of years by enough that the benefit of the really good returns at the beginning has been lost. There have been people changes at Turner and product additions. He asked Mr. DiBella how the team for the small cap core product has changed and if some of those changes were because he thought he could improve on the people side of things.

MR. DIBELLA said that Turner has hired three professionals this year, one of whom worked with him at ING, which brings the team up to eight. He said the underperformance is not due to the team or the amount of assets under management. Turner has outperformed the market 11 out of 14 years, and two or three years they underperformed by only 90-100 basis points. The real clinker to the performance was 2006. He said he was not happy about 2006, and Turner has since made some adjustments. It was the year that the only place to get earnings momentum or pricing leverage was in commodities, transportation and machinery related to commodities, and energy. They found that by 2006 there were a lot of growth players in what are normally thought of as value stocks, and it was hard adjusting to that. When a company misses its earnings a value or core manager's reaction is to cut back a little and figure out the new value of the stock. But growth managers sell the whole thing immediately when a company misses its earnings estimate. In 2006 there were very few restructurings going on, and Turner tends to key on restructuring because they like businesses that are trying to improve internally, and there were not a lot of those companies around. Last year Turner had five stocks that were taken over in five weeks. Turner's style of handling these companies in the past was to move out when they found stocks to replace them, and there was no hurry to get out. Unfortunately, these five stocks that totaled 5-7% of the portfolio now acted like cash when the market took off. It hurt performance, and Turner has changed their policy to get out of takeover stocks a lot quicker. Hiring two more people on the team late this year will give Turner more analytical power.

MR. FINNEGAN reviewed the long-term performance of the small cap core equity product.

14. Investment Actions

MR. SHIER passed on to the chair Commissioner Kreitzer's apology that she had been detained on state budget matters and would not be present for the next two action items.

14(a). Townsend Real Estate Consultant Contract Renewal

MR. BADER reviewed the staff report in the meeting packet, which covered the background of the real estate consultant contracts. He said the current contract with The Townsend Group expires March 31, 2008. Staff's recommendation was to execute the remaining one-year extension option on the contract based on several reasons: (1) the significant savings achieved in the 2006 contract negotiations; (2) the value of continuing a consultant relationship when staff, the board and the real estate committee have been satisfied with Townsend's work; and (3) and the depth of real estate resources available to ARMB and staff through Townsend.

MR. SEMMENS moved that the Alaska Retirement Management Board exercise its option to extend the Townsend contract for real estate consulting services by one year to expire on March 31, 2009.
MR. TRIVETTE seconded.

On a roll call vote, the motion passed unanimously, 7-0.

14(b). Consultant Review of Investment Managers

MR. BADER reviewed the staff report in the meeting packet. He said at its last meeting the board briefly discussed giving the chief investment officer ongoing authority to engage Callan Associates or the Townsend Group to conduct due diligence of prospective investment advisors to bring to the board. It is important to be nimble in today's markets because some manager opportunities open and close fairly quickly. Currently, staff must wait until the next board meeting to request the board's authority to engage a consultant to review an investment advisor.

MR. PIHL moved that the Alaska Retirement Management Board authorize the chief investment officer to engage the services of consultants to conduct due diligence of investment advisors /managers.
MS. HARBO seconded.

MR. SEMMENS asked if the contractual services are at a set agreed-up fee or negotiated at each request. MR. BADER replied that Callan's manager search fee is set by contract, between $20,000 and $30,000 per search. The same is true for Townsend's fee.

MR. O'LEARY clarified that there is no intention to circumvent the traditional manager

search process. He said staff is seeking the authority to deal with special purpose investment funds or a large private equity fund, etc., where there is a fundraising cycle, and investors need to act quickly. Staff needs to evaluate whether to participate, and the board needs that information before having to make a choice. As an illustration, Pimco put together a distressed debt fund and started talking to clients about it in August. The fund closed at the end of October. Potential investors had to be organized so that they could make the conceptual evaluation and then move ahead to a decision in short order.

MR. TRIVETTE commented that the ARMB only meets about five times a year, and he recalled the Alaska State Pension Investment Board talking several years ago about the need to become more nimble. He thought there was even more of a need today in order to participate in some investment opportunities.

The motion carried unanimously (7-0) on a roll call vote.

RECESS FOR THE DAY

CHAIR SCHUBERT recessed the meeting for the day at 4:48 p.m.

Thursday, November 29, 2007

CALL BACK TO ORDER

When CHAIR SCHUBERT called the meeting back to order at 9:00 a.m. on Thursday, fellow trustees Sam Trivette, Gayle Harbo, Larry Semmens, Michael Williams, Martin Pihl, Commissioner Annette Kreitzer and Tom Richards were present. Commissioner Patrick Galvin arrived at 9:31 a.m.

REPORTS (Continued)

15. Executive Ethics Act Review

JUDY BOCKMON, Assistant Attorney General at the Alaska Department of Law, informed the board that she serves as the state's ethics attorney and was invited to give a presentation on Alaska's Executive Branch Ethics Act. *[Ms. Bockmon provided a copy of the training manual and various disclosure forms, which are on file at the ARMB office.]* Her 90-minute presentation was comprehensive, and she answered many questions from trustees, staff, and the board's legal counsel throughout. The following is a summary of Ms. Bockmon's comments, and anyone wishing more detail should refer to the tape recording of the presentation kept on file at the ARMB office.

MS. BOCKMON said Governor Palin has made ethics one of the themes of her administration, and the Legislature passed a new ethics bill that went into effect July 2007. Changes were made to the financial disclosure filings of state officers, and anyone with questions should contact the Alaska Public Offices Commission, which has been implementing the changes. The Department of Law's web site has an ethics web page that contains a variety of guides and training materials, including an interactive PowerPoint presentation that covers some of the issues.

MS. BOCKMON noted that the ARM Board has its own conflict of interest statute that requires trustees to disclose interests in entities in which investment assets are under a trustee's control.

MS. BOCKMON stated that each person has a responsibility to understand and comply with the Executive Branch Ethics Act, and the focus of the act is individual violations and preventing potential violations from happening. The designated ethics supervisor is the chair of every board, by statute, and in some cases that responsibility is delegated. Judy Hall is serving as the ARM Board ethics supervisor. The ethics supervisor for the chair of the board is Linda Perez (administrative director of the Office of the Governor), by delegation from the Governor. The state attorney general first serves as advisor to all the ethics supervisors and also administers and enforces the act through the complaint process when complaints of Ethics Act violations are received.

MS. BOCKMON reviewed why to have an ethics standard, and said the Ethics Act takes a balanced approach to dealing with conflict situations. The Legislature wisely recognized that although Alaska is large in territory it is small in population, and people come to state service with lots of interests from many backgrounds. Invariably, some of those interests are going to relate to state business. There are guidelines for evaluating when a conflict or an interest may be insignificant or an officer's ability to affect that interest may be purely conjectural. It is important that state officers bring to their service experience and background from outside and that they be permitted to do their job when there is no substantial conflict preventing it. Under the Ethics Act judgment is not on appearances but on the actual circumstances. There are not many bright lines, and changes in the facts can frequently change the outcome when looking at whether there is a potential violation or actual violation.

MS. BOCKMON said the ARMB statute sets the criteria for who the board members should be, and people serve in many instances because of their particular job. The Ethics Act, in that situation, wants to permit trustees to represent those interests — because clearly the Legislature intended that those interests be represented — but also try to help trustees decide when that interest flows in a particular case into a conflict. When trying to apply two statutes, such as the Ethics Act, which applies generally, and the ARMB's specific statutory conflict of interest requirement, the Department of Law looks at the specific statute and

melds it with the more general to address situations in an appropriate manner.

MS. BOCKMON talked about attitudes about ethics and common rationalizations. She encouraged everyone to think about the appearance of conflict in a situation because frequently that is what causes the uproar or problem to start with. That is why board members are allowed to choose to refrain from participating or taking action if they think there is an ethical conflict. If the individual is uncertain about a conflict, it must be disclosed, and the board chair makes a determination. If someone on the board objects, then the entire board will vote, and that will control whether the person can participate. If the procedures are followed, the individual is protected if for some reason a later reviewer believes there is a bigger problem that has to be addressed for the future.

MS. BOCKMON went over the basic rules and important definitions. People have to think about whether they are going to take official action — any action, not just a final vote as a member of a board — that would benefit themselves or their interests or provide an unwarranted benefit to another. MS. BOCKMON talked in detail about misuse of official position and described a list of circumstances which are prohibited, or if a person perceives a problem they must refrain from action relating to the interest involved.

MR. SEMMENS told Ms. Bockmon that he works for the City of Kenai and he has work-related and maybe some personal information on a computer that belongs to the ARMB. He accesses non-ARMB-related files in the evening that he needs to do work that he cannot do during the day while serving as a trustee on the board. He asked if he was violating the Ethics Act by doing these things with the state's computer.

MS. BOCKMON said no, that incidental use of computers when a person is not on state time, and there is no cost to the state for using it, is generally okay. She added that if the state is providing Mr. Semmens with a computer to facilitate his service on the board, she assumed the state did so in recognition that he has to be in communication with his employer, given there is no cost to the state to use the computer. That would be looked at as an insignificant use and okay. But if he were making long-distance phone calls to do the City of Kenai's business and charging it to a state account, that would be improper, unless it was approved ahead of time.

MR. SEMMENS stated that he is here on behalf of the ARM Board, and if he has to call his employer long distance because of some work he has to do during the work day or at any time he thought the state was responsible for that, not him or his employer. He added that his employer was paying his wages while he was attending the board meeting. He said he did not think his employer should be responsible for paying long-distance charges while he was on state business.

COMMISSIONER KREITZER said that the key to that is getting approval ahead of time and having that arrangement understood and settled with the state.

MS. BOCKMON related that she often hears from board members that they are volunteers and feel the Ethics Act is putting burdens on them. It is important that the Ethics Act apply to board members, but it is not to put an undue burden on them. What to avoid is a huge phone bill coming to light and nobody knowing who the board member is calling or why. The board administration and the ethics supervisor can decide ahead of time that long-distance calls are appropriate to a trustee's position and their need to have the trustee present at a meeting, and/or insignificant in the context of the Ethics Act. She said she assumed that would be the judgment, but the state does not like surprises, and these kinds of things need to be addressed in advance.

MS. BOCKMON finished reviewing the different aspects of misuse of official position before moving on to an explanation of improper gifts. The general rule is that a public official may not solicit or accept a gift if it could reasonably be inferred that the gift is intended to influence their action or judgment. This is the one exception to the "we don't judge on appearances" rule. Here, the state ethics attorney is looking objectively at what a reasonable person would see in a situation involving the receipt of gifts. The general rule applies regardless of value. If the circumstances suggest an intent to influence, you should not accept the gift. If you do accept the gift and it is reported, the state ethics attorney would probably tell you to pay for it or return it. There is a regulation that says that gifts of less than $50 are presumed to not be intended to influence. So the occasional lunch or drink after a meeting, or a box of candy, or a small bouquet of flowers that somebody might get because of their position is generally okay. If it were to happen on a regular basis and rise to the level of totaling something significant, in the context of some action that might be taken with respect to the person, the state ethics attorney would have a concern — even though the individual gifts are small. [The Legislature's $15 rule is part of the legislative code of conduct and not part of the Executive Branch Ethics Act requirements.]

MS. BOCKMON stated that the Legislature amended this section to add that all gifts from lobbyists are presumed to be improper, regardless of value, unless the giver is an immediate family member of the person receiving the gifts. The state has a small population, and people have relationships with lobbyists outside of their state service. If gifts are exchanged among friends and relatives that include a lobbyist and a history of that relationship, it is best to disclose a gift to the ethics supervisor so that it is on the record and get some guidance as to what is a purely social gift and acceptable because of a past relationship and whether it has any connection to your job. In most instances, there is absolutely no connection to the job at all, and the gift is not improper.

MR. BADER explained that both during his term as a trustee and in his current position as an employee gifts arrive at the office during the holiday season that have significant value. His practice has been to distribute the gift baskets of fruit and candy, or flowers, etc. to all the employees in the office because it is impractical or impossible to return the gift. He asked if that is an appropriate way to deal with these types of gifts.

MS. BOCKMON replied that under the Ethics Act the state ethics attorney is concerned with gifts intended to influence individual action. If a gift is sent to an office and not to someone personally, and the gift is distributed, the caution is to think about who sent the gift and the relationship that person has to the office. She said distributing the gift to others in the office is an appropriate solution, and the state ethics attorney is not going to penalize the individual trustee or employee. The rule applies to gifts given to a state official as a result of their state position. However, lobbyists should not be distributing those kinds of gifts to individual state officials where they have action pending and want to get something from them.

COMMISSIONER KREITZER commented that the Department of Administration has lots of computer vendors, one of which, for example, sent prepackaged T-shirts to the Enterprise Technology Services section, and car dealerships that brought in cases of fruit to the Division of Motor Vehicles. These people are currying favor, which is appropriate in the private sector, but people representing the state have to be very careful and recognize the gifts are because of their state position. People have to do all they can to not allow the appearance of granting favors. DOA cannot return the T-shirts to the vendor and has distributed them.

MS. BOCKMON said the other area that the gift provisions have generated is the idea of gifts to the state. The Ethics Act is focused on gifts to the individual who can take action, and it does not really address things that could be described as gifts to the state. The box of T-shirts from a computer vendor more than likely was not sent to Commissioner Kreitzer for her personal use; it was sent to the division and does present the appearance of a problem. It is up to the individual officers to address that. The solution to distribute a gift and have the employees have the benefit of it is a good solution. Gifts to the state are not improper, as such. The Ethics Act recognizes that state officers should be building relationships with those outside state service that they need to work with. The state ethics attorney permits, under certain circumstances, gifts of transportation or lodging to the state that are construed not to be gifts to the individual employee when the employee has been sent on state business and perhaps the most efficient way to get to the field is by private transportation. Some people think the state should not accept anything of this nature at all, and there are others that address it practically. There are different views about whether that gets over the appearance hurdle. But it is important to think about how it looks.

MR. BARNHILL remarked that gifts from vendors are unquestionably for an improper purpose, and the way to deal with that is to dilute the impact by letting employees, who cannot take or withhold official action with respect to that vendor, consume it.

MS. BOCKMON said the situations where gifts are most often found improper would be when there is an immediately pending action before the board. She gave an example of a investment company giving a trustee tickets to the Alaska Shootout basketball game

around the time the board was making a decision on whether to hire that firm. However, running into someone from a company that occasionally has business before the board, and this person has an extra $10 ticket to a game that he offers to a trustee, that would not be viewed as improper. It depends on the circumstances.

MR. PIHL described the board's previous practice of attending dinners where several investment firms in town for a board meeting would split the bill equally among them. Trustees got to talk to these managers in an informal setting and got a feel for their commitment to the pension fund, etc. The per diem for the trustees attending these dinners was reduced accordingly. Some on the current board were uncomfortable with the practice and it has been discontinued. However, he did not think trustees were doing anything illegal under the Ethics Act, and he thought the board had lost valuable contact with investment managers.

MS. BOCKMON said she did not think those circumstances represented an improper gift to individual board members. One reason would be that the value of the dinner would not be really significant, although it could rise above $50. The gift is not given to individuals but to the group, and it is provided as a benefit to the state because the per diem is reduced. Also, because it is a group of investment managers providing the benefit to the board, there is not the intention of an individual directing a gift to an individual officer. The circumstances described generally do not sound like an improper intent to influence. While the board at some point took action to hire these managers to start with, it did not sound like there was any immediate board action related to these managers. She said that was a good example of the kinds of things that state officers do to maintain relationships and to be educated or get an understanding of the group's perspective on things. She did not see a problem in those circumstances.

COMMISSIONER KREITZER said she had a different view, that she thought it was currying favor and currying a relationship. There was nothing necessarily wrong with having dinner, but she would pay for her own dinner with the state's per diem and talk with managers to maintain a relationship. There might be a time down the road when the board would have to vote to put a management firm on the watch list. While she was not implying that trustees might be swayed by one meal, she was uncomfortable with the appearance of familiarity with investment people over time.

MS. BOCKMON remarked that people have different views on some of these things. She reminded everyone that violations of the Ethics Act are looking particularly at an individual officer. There are many situations where the circumstances are not focused that narrowly, and this is one of them.

MR. TRIVETTE requested a copy of the actual ethics law and any regulations so he could read them for himself. MS. BOCKMON indicated that both the updated statute and the regulations were on the DOL ethics web site, but she would also forward a copy to Judy

Hall for distribution.

MS. BOCKMON stated that any gift worth more than $150 to a board member must be reported within 30 days. The gift value of $150 is a reporting bright line, not a line between proper and improper gifts.

MR. JOHNSON observed that a $50 gift is deemed as insignificant, and $150 is the bright line for reporting. In the real world, the area between $50 and $150 might be where a lot of gifts occur, and he wondered about that.

MS. BOCKMON said the general rule is that a board member should not accept any gift that could be reasonably construed as intended to influence his or her actions. State officials have an obligation to report any time a potential violation of the Ethics Act could occur or has occurred. If a board member receives a gift in the gray area of value between $50 and $150 that they are uncomfortable about, they could disclose it and have it reviewed by the ethics supervisor. The Legislature raised the limit of reporting probably to suggest that the lower limit gifts are not as much a concern in terms of regular reporting. The presumption is that something less than $50 is not meant to influence a state official, but presumptions can be overcome by the facts of a situation.

Both CHAIR SCHUBERT and MS. HARBO spoke about how they found attending dinners at the invitation of investment managers in the past to be beneficial.

MS. BOCKMON said it is beneficial for state officials to meet and talk casually with those they have to work with. When the Legislature raised the disclosure limit there was intent not to inhibit these kinds of interactions because they are important. At the same time, the Ethics Act provides for addressing situations that could get out of hand.

MS. BOCKMON next reviewed the provision barring improper use or disclosure of information acquired through official state duties, unless the information has already been publicly disseminated. The ARMB has a statute that permits it to designate some materials as confidential.

MS. BOCKMON also reviewed improper influence in state grants, contracts, leases or loans. The Legislature has adopted a separate conflict of interest provision for the ARMB that recognizes that board members can have interests in businesses. In these circumstances, the state ethics attorney looks at both statutes and works them together. Other boards have the same situation and have determined that the absolute bar that is normally applied under this Ethics Act provision does not apply. But it does not mean that a board member does not have a problem; they would have to refrain from acting, but their interest does not bar them from sitting on the board.

MS. BOCKMON briefly discussed improper representation, restrictions on employment

after leaving state service, and the prohibition against assisting others to violate the Ethics Act.

MS. BOCKMON stated that if there is a circumstance that presents a conflict for a board member, once the state ethics attorney makes that judgment, they can apply the standards to determine whether or not the board member can participate without violating the Ethics Act. The ARMB would be judged a bit differently than others because there is a statutory basis for the reason most members are on the board and the Legislature wants input from certain organizations and interests.

MS. BOCKMON next reviewed the disclosure procedures. Every time a board member perceives that there is a conflict or a potential violation of the Ethics Act with respect to themselves they are required to disclose it on the public record and in writing to the designated ethics supervisor. If meetings are recorded, an oral disclosure constitutes the written requirement. The idea is to state the conflict and get a decision from the ethics supervisor as to whether or not the conflict is so substantial that the board member should refrain from participation. [There was a procedures guide for boards in the handout materials.] MS. BOCKMON also reviewed the procedures for complaints, hearings and enforcement (remedies and penalties).

In closing, MS. BOCKMON urged board members to ask questions if they are unsure about something and to err on the side of reporting.

CHAIR SCHUBERT called a scheduled break from 10:29 to 10:42 a.m.

16. Private Equity Review and Performance Analysis

[A copy of the Callan Associates slides that accompanied this presentation are on file at the ARMB office.]

MR. O'LEARY introduced GARY ROBERTSON, Senior Vice President at Callan Associates and head of the private equity section. He said Mr. Robertson was involved many years ago when the Alaska State Pension Investment Board first entered the private equity arena, and he assisted in developing of the private equity investment policy. He assisted in the manager searches that resulted in the board hiring two oversight managers. He currently works directly with ARMB staff on analysis of individual private equity types of investments. Annually, Callan conducts a comprehensive analysis of the ARMB private equity program and reviews it with the board.

MR. ROBERTSON gave a brief history of the private equity program that started in 1998 with a 3% allocation and the hiring of Abbott Capital as a gatekeeper manager. The board hired Pathway Capital in 2001, and the two managers have 19 investments in common, which represent about 27% of the capital that ARMB is deploying. The board expanded the

program in 2005 by hiring Blum Capital. The Blum investment was put in the private equity portfolio but it is actually public small cap with a private equity overlay to it. In 2006 the board increased the private equity allocation to 7% of total pension fund assets. This year staff initiated an in-house private equity portfolio, making the first investment in the third quarter.

MR. ROBERTSON stated that the ARM Board is pursuing a broad market portfolio that invests across all the major strategies: venture capital, buyouts and special situations, subordinated debt, and distressed debt. He noted that the private equity portfolio is close to fully funded at $1.1 billion. Abbott has about 53% of the assets, Pathway roughly 36%, and Blum has about 11%. There is approximately $712 million in uncalled capital commitments, so there is a good backlog of commitments that will be paid in over time. Because the portfolio is almost fully funded, private equity might go above the 7% target but stay within the range allowed around that target. The funded status going forward will be tied to what is happening in the other 93% of the pension fund assets that are largely invested in public markets.

MR. ROBERTSON spent a few minutes on a flow chart to illustrate how capital flows through private equity. He said it takes about three years for partnerships to begin to distribute back from early sales of companies they bought. Gradually the distributions build into a bell-curve pattern, and then things tail off as partnerships expire after ten years. Every year new investments have to be made into private equity because down the road partnerships are going to start expiring and paying out.

DR. JENNINGS asked if Mr. Robertson was seeing the timeline stretch out or if Callan was forecasting changes in their models as things slow down in the leveraged buyout sectors, etc. MR. ROBERTSON replied that he and state investment officer Zach Hanna review models periodically and make slight adjustments for sensitivities in the market, but they tend to focus on normalized markets in making the projections.

MR. O'LEARY stated that during the dot-com frenzy of 1998-1999 money was being returned in this new private equity program much sooner than anticipated. Then in the bust, new partnerships basically dried up, so it was very difficult to even make commitments. But that tends to average out over time.

MR. ROBERTSON presented data from Venture Economics Database about the flow of investors' money into private equity from 1995 through 2007. He said the private equity market can expect less liquidity and more uncertainty in the future, and he covered the economic indicators behind that sentiment. These included:

- Tighter credit markets;
- Less debt is expected to be available;
- Prices of companies are expected to decline;
- Sellers are going to take some time to adjust their expectations for pricing;

- Public stock prices are holding up fairly well meaning the buyout funds cannot point to lower prices as a reason that sellers of companies should take less; and
- Strategic buyers doing stock deals will be able to outbid private equity funds to buy companies for sale, which is a reversal of this last boom.

MR. ROBERTSON next discussed how the market outlook could impact the limited partnerships and the ARMB private equity program:

- Distributions are expected to slow because of fewer company exits.
- Fundraising should be strong for the next year to 18 months, and general partners will stop returning as often to the market for capital, as a backlog of unspent capital builds up.
- Valuations - the accounting industry is requiring that private equity use more of a GAAP mark-to-market methodology in valuing portfolio companies. To the degree that companies get written down, there will be more scrutiny and controversy, and the press might pick up on it to sensationalize some of the declines in portfolios a little bit. As a limited partner, the ARM Board should anticipate and be aware that there could be some markdowns in the portfolio if the economy slows.
- There will be more illiquidity, and people are looking at more conservative, recessionary strategies like distressed debt.
- Globalization should continue. If partnerships cannot get loans in the U.S., they may focus more on Asia where they use less debt in companies.

CHAIR SCHUBERT recalled that when the Alaska State Pension Investment Board was getting into private equity almost ten years ago some trustees questioned whether the pension fund was getting in too late. She asked if any large public funds have exited the private equity area.

MR. ROBERTSON stated that people mostly understand that private equity is equity so it will go in bear and bull cycles. Returns have been very good, and investors that are not fully funded have the pedal to the metal trying to get there. So the supply/demand imbalance has changed, and no one is really backing off. Some of the very large endowments have scaled back, but that is going from 35% private equity to 20%, so they still have a massive allocation.

MR. WILSON said that over the last 12 to 18 months large buyout funds that used to raise $3-$5 billion are now in the market to raise $15 billion. These funds are doing things like buying Chrysler and not building small companies anymore. This changes the return characteristics a bit because there is so much money out there.

MR. ROBERTSON said the industry returns have been very good, generally double-digit. Both Pathway's and Abbott's five- and ten-year numbers are beating the industry composites. He then reviewed activity in the ARMB private equity portfolio for the 12 months ended June 30, 2007, as follows:

- Three managers, totaling 166 partnerships.
- Commitments increased by 15% during the year, or $273 million. $283 million was paid into partnerships.
- Cash distributions back totaled $300 million, representing a 35% cash yield.
- On top of the cash yield, there was 26% unrealized appreciation.
- In fiscal year 2007, for every dollar paid in, the ARMB got 60 cents distributed back. Looking at the net asset value, there is about 77 cents left in the portfolio from that dollar. So combining the distributed and the residual value, the portfolio has generated about 37 cents of profit for every dollar paid in so far.
- The portfolio is still building and maturing. When truly mature, it should run at about 1.5 times total value, combining immature partnerships and mature partnerships. The mature partnerships will be returning probably $1.60 to $2.00 for every dollar paid in.
- The portfolio is 66% paid-in, so it is maturing. Abbott is 72% paid-in, and Pathway is 53% paid-in.

MR. ROBERTSON presented details about the Abbott Capital portfolio that was started in early 1998. Abbott was a top quartile performer six of those years, a second quartile manager in two years, and never fell below the median manager in the peer group.

MR. ROBERTSON also reviewed the particulars of the Pathway Capital portfolio that was initiated in mid-2002. From a peer group standpoint, Pathway has had top quartile performance every year.

Using pie chart illustrations, MR. ROBERTSON talked about strategy diversification in the private equity portfolio. He said most of the venture capital is coming from Abbott; venture capital is a scarce asset, so it is very valuable that Abbott can get ARMB top-quality venture capital exposure in size. Pathway has more of a buyout tilt, 16% more than Abbott. Both managers have similar special situation exposures. Abbott likes mezzanine but does not like distressed debt, and Pathway is the reverse, so the two managers are complementing each other in these areas.

Turning to the corporate governance portfolio, MR. ROBERTSON reported that the board made its first investment with Blum in May 2005. This is not private equity but primarily small and some mid cap publicly traded companies. There are two partnerships: one is an open-end hedge fund type that is a long-only strategy where ARMB can put capital in or take capital out annually; and the second is a 10-year private equity partnership that is primarily public stocks, but they can do some buyouts. Blum's strategy is to take positions in underperforming companies and work with management to get them to improve operations. It is still too early to evaluate the portfolio meaningfully, although performance is positive for both investments.

MR. ROBERTSON stated that the ARMB private equity portfolio is developing well and

overcoming the challenges of the initial timing in 1998. Even though venture capital has not done well, when it comes into cycle again, Abbott's large position in venture capital will stand them in very good stead. The portfolio is stabilizing, and Callan does not expect to see a big change in what is an attractive strategy mix. Callan will be reporting on the in-house private equity portfolio when it has more than one investment in it.

MR. BADER asked Mr. Robertson to comment on the pros and cons of being in a secondary fund. MR. ROBERTSON said there are managers that buy used partnerships, and historically secondaries have been very attractive because they have gone off at a discount. As more and more capital has been raised in the secondary market and there has been very good visibility on the exits, secondaries have traded at premiums recently. So they have not been as attractive as they have been in the past. Secondary funds provide faster cash flow, and there tends to be a lower multiple but maybe a 15%-20% internal rate of return because the profit comes back quicker. It is a cyclical business. After the 2002 recession, there was a period of time when investors could get fantastic discounts on secondary funds, and it was a good time to jump in. Although not as attractive now, it is appropriate to do secondaries when the time is right or if an investor wants to deploy more capital at a bit lower rate of return.

MR. O'LEARY stated that he has always preached that the only justification for investing in private equity is if an investor believes they can identify and partner with the people whose funds are going to be top quartile. So the most appropriate frame of reference in evaluating performance is whether the oversight managers are getting into those funds. He said his sense for ARMB is that both Abbott and Pathway have basically done that. He asked for Mr. Robertson's comments.

MR. ROBERTSON said Abbott and Pathway are in the cream of the crop groups that all the newer investors to the market are trying to get into and struggling. It is more difficult now to enter the private equity market with people who know what they are doing and have good track records than it has been historically.

17. Litigation Update - Executive Session

MR. WILLIAMS moved that the ARM Board meet in executive session for purposes of receiving privileged information from legal counsel. MS. HARBO seconded.

The board met in executive session from 11:27 a.m. until 12:22 p.m.

18. Investment Contingency Plan

MR. TRIVETTE moved that the Alaska Retirement Management Board set up a committee to develop an investment contingency plan and that that committee work with the staffs of the Departments of Revenue and Administration and legal counsel at the Department of

Law and attempt to get a draft to the full board by the April 2008 meeting. MS. HARBO seconded.

MR. JOHNSON clarified that the process in mind is to formalize a contingency plan because there has been plenty in place already that would constitute an informal contingency plan.

MR. TRIVETTE said it was his intent that the board work toward adopting a formal contingency plan that would put into writing the things the ARMB is already doing.

The motion passed unanimously, 9-0.

LUNCH RECESS

CHAIR SCHUBERT recessed the meeting for lunch at 12:25 p.m. When she called the meeting back to order at 1:27 p.m., trustees Trivette, Harbo, Semmens, Pihl, Williams, Richards and Schubert were present. Commissioner Galvin came back at 1:47 p.m., and Commissioner Kreitzer returned at 2:35 p.m. during the Lazard presentation.

REPORTS (Continued)

19. Coventry Real Estate Advisors Review

PETER HENKEL, President and CEO of Coventry, a firm that specializes in retail properties, appeared to update the board on the Coventry Fund II that the pension fund is invested in. *[A copy of Coventry's presentation booklet is on file at the ARMB office.]* He said Coventry invests only in retail and mixed use projects in the U.S. It is a value-added, opportunistic strategy, where they buy well-located retail assets that are in need of some repositioning, re-leasing, or redevelopment. The objective is to grow the net operating income (NOI), improve the credit quality of the tenants, and then sell the properties to make money for the investors. Mixed use is a project that includes retail as well as other commercial asset classes, such as apartments or office property built on top of retail. But from Coventry's perspective, retail is the core of that asset. Coventry's target return on the retail strategy is 18% on a gross IRR (internal rate of return) basis.

MR. HENKEL gave a brief review of the firm, his background, and the experienced team, followed by a description of the investment strategy. He said Coventry Fund I is fully realized and achieved about a 42% IRR. They just finished committing all the capital in Coventry Fund II, which the ARMB is invested in, and are now beginning the process of selling assets and getting capital back to investors. Besides buying existing but under-utilized retail properties and redeveloping them into formats that retailers and shoppers are looking for today, Coventry also does new ground-up development with joint venture partners, and they also buy portfolios of stores from retailers. Asset redevelopment

comprises 47% of Coventry Fund II, joint venture development is 38%, and portfolio acquisition is 15%. Coventry has a network of key relationships with property owners, developers, and REITs across the country that gives them access to a variety of retail opportunities.

MR. HENKEL went into detail about Coventry's acquisition strategy and development strategy. He reported that ARMB committed $55 million of the total $400 million equity committed to Fund II. That $400 million acquired about $1.4 billion of projects valued at cost. Three assets are targeted for sale in the near term. They expect the IRRs on these projects to be in the 25% to 30% range, well in excess of the 18% target return.

MR. HENKEL spent a few minutes giving an overview of the retail market. He stated that retail sales in this country never go down: the combination of a growing population and increasing incomes will always mean that retail sales go up every year. The talk in the market right now is about the *rate of growth* in retail sales, which changes from year to year, but it is always positive.

MR. HENKEL mentioned that there are even more opportunities in weak economic environments for Coventry to create value in retail properties. The last economic down turn was following the technology surge in the late 1990s. Of all the equity capital that Coventry invested between 2000 and 2002, the actual IRR on those deals in that time frame was about 55%. They are able to take advantage of dislocations in weak economic environments. He said Coventry Fund III is in the market, and they would like to keep working for the ARMB in that fund as well.

20. Brandes Investment Partners - International Equity Review

[A copy of the Brandes presentation booklet is kept at the ARMB office and contains slides and detailed information.]

MR. BADER introduced JUAN BENITO, Portfolio Manager, and KAREN GILBERT, Relationship Manager. He said Brandes has two mandates with the ARMB: they run an international equity portfolio in the defined benefit plan, and they manage an equity mutual fund option in the defined contribution plan. MR. BENITO stated that Brandes manages the non-U.S. portfolios with the same philosophy, the same analysis, and the same model. The small differences in performance are because of the cash flows: for withdrawals Brandes has to sell securities, and when contributions come in they buy securities that have the most potential at the time. The defined benefit plan separate account has been reduced by withdrawals from close to $1.0 billion to $670 million. The defined contribution plan portfolio, on the other hand, has been experiencing deposits. Alaska's pension fund opened the separate account for the defined benefit plan in 1997, and the 10-year performance is 15.22% annualized. The mutual fund over that same time period returned 14.79%. The pension fund did not invest in the institutional mutual fund until 2001 and has captured a higher proportion of the underperforming period. But over the long term, the

returns for the separate account and the mutual fund are really the same.

MR. BENITO briefly talked about the firm's independence to make the right investment decisions, the main elements of Brandes' absolute value philosophy that focuses entirely on how much companies are worth, and the portfolio management team's "committee" style of decision-making.

MR. SEMMENS asked about the annual portfolio turnover rate. MR. BENITO said typically 20% to 40%, so fairly low. Over the last 12 months it was closer to 25%. MR. SEMMENS inquired how long it would typically take for Brandes' strategy to pay off. MR. BENITO said a full market cycle, which is normally three to five years. However, the last market cycle has been very long and is still in the "up" phase.

MR. BENITO also mentioned the research methods and Brandes' equity sell discipline. He said he had appeared before the board not long ago to talk about the separate account portfolio, and today's review would focus on the mutual fund.

MS. GILBERT stated that since the pension fund invested in the Brandes institutional international equity mutual fund in September 2001 the six-year annualized return of 16.97% has outperformed the EAFE Index at 15.97%. The entire mutual fund has $1.1 billion in assets, and the three ARMB accounts within that fund total $223.5 million. Over three years, the fund has produced good absolute returns but it has actually underperformed the index. Because of it's value approach, this fund (and any Brandes portfolio) can and will be considerably different — in terms of its allocations to industry, country and sectors — from the index. That means the fund will underperform at times. Brandes will generally buy companies when they are out of favor and be less likely to buy companies when their performance is strong and they are bid up. Another point is that the EAFE Index is a general international equity index and not a value index, and it does not include emerging markets, which Brandes does invest in.

MS. GILBERT spent a few minutes reviewing the sector exposure, industry exposure, and country exposure in the institutional international equity fund. Energy, industrials and materials collectively account for 29.5% of the EAFE Index and have been strong performers over the past three years, and the fund currently has 3% of these sectors. The fund has had meaningful exposure to energy, industrials and materials in the past but sold down or completely out on the strong market performance. When Brandes finds good value in the future they will start increasing the exposure to those sectors.

MR. BENITO commented that there are 60-plus industries in the classification of the EAFE Index. Some industries, like metals and mining, and oil and gas, are actually quite large in the index, but Brandes does not have any weighting in those in the fund. MS. GILBERT added that those industries have also outperformed, and Brandes does not feel that the value of those companies and their earnings can be sustained over the long run.

CHAIR SCHUBERT asked if the outperformance of the sectors that the Brandes fund is underweight in account for the fund's underperformance generally. MS. GILBERT said yes, that was why she highlighted that information. MR. BENITO stated that normally they talk about what they have in a fund, but Brandes is out of 50% of the industries in the market. A value manager like Brandes normally loves industries that are cyclical. Cyclicals are industries that have a very big fixed cost, therefore, if the market is very hot, the prices are high, and when the market cools down, the prices are low. But in this long market cycle, the cyclicals have gone from neutral to hot to hotter to hyper hotter. As Brandes has been out of those traditional hunting grounds for value managers because the stocks are closer to their peak than the bottom, they have underperformed on a relative basis. Brandes plays between cheap and fair, not between high and very high, and they stay faithful to their philosophy.

MS. GILBERT stated that their highest country weighting is Japan at 26.5% versus the index at 20.7%. The second highest is the United Kingdom at 15.8%, and the third is France at 14%. Japan has been the number one underperforming country, and that is where Brandes currently is finding great value in commercial banks and consumer finance companies. Brandes has been finding more value in emerging markets and has increased the allocation over the last 12 months to 10.4% of the fund. South Korea and Brazil are the two emerging market countries that Brandes has the larger number of companies in, and they have done quite well.

MS. GILBERT mentioned that there will be a big drop in net asset value when Brandes adds in the distributions at the end of the year. She said State of Alaska participants are welcome to call Brandes if they have questions about the distributions.

MR. O'LEARY said that the size of Brandes' investment in Countrywide surprised people. He inquired about their position in going over the magic 5% level and taking on the SEC reporting, etc. MR. BENITO responded that they normally do not like to hold much more than 5% of a company because of the reporting requirements. As long as Brandes is not considered an insider by the local regulations in a country, they are happy to go higher than 5%. But it has to be a great opportunity, very cheap, and have a lot of potential. Liquidity is not a problem when they want to get out of a company because there is lots of interest in a stock that is doing really well.

21. Lazard Emerging Market Short Duration Fund - Presentation

TONY DOTE and ARDRA BELITZ made a presentation on Lazard's emerging income strategy. *[Please refer to Lazard's presentation booklet for charts, graphs, and other details, kept on file at the ARMB office.]*

MR. DOTE stated that Lazard has 15 people who concentrate only on emerging market

investments, and they manage about $18 billion in a combination of emerging market equity and debt. He said there are few firms that have so many resources working in emerging markets. Prospectively, emerging markets are a source of alpha in most client portfolios. Lazard has about $1.0 billion in emerging market debt, which is a capacity controlled product — $2.5 billion is probably the upper limit.

MR. DOTE said that Lazard's emerging currency and local debt strategy is investing in money market instruments in emerging market countries, and the objective is to produce a consistent absolute rate of return at very low risk. The strategy has been in place for about 13 years. The worst annual return was zero, and the best year was 15.7%. The target is between 9%-10%. The sources of return are twofold: high yield on the investment and currency. Currency can be a drag on performance at times, but right now currency is helping the return. Lazard has an evolving list of 50 emerging markets to invest in, some of which would be considered frontier markets. Diversification is very important to provide consistent returns, and the strategy is invested in about 25 markets today. The duration of the portfolio is always less than one year, and today the duration is about six months. There is very little credit exposures.

MR. DOTE noted that Lazard also offers an emerging income plus strategy or leveraged strategy, which they were not presenting today. They have public fund clients who use the emerging income product as a cash enhancement, or as an absolute return strategy, or as a way to enhance their fixed income portfolio.

MS. BELITZ, one of the two lead portfolio managers on the emerging income strategies, stated that fundamentals in emerging markets have evolved considerably since Lazard started this strategy. One attribute of the strategy is that it has delivered a consistently positive return with very low levels of volatility. It has done that irrespective of whether the fundamentals in emerging countries are sound or quite poor. She said the fundamental improvement in emerging countries at this juncture is best expressed in a risk-adjusted way via the emerging market local currency short duration exposure. The global imbalances are such that the emerging market countries and the petro dollar country economies, such as Russia and the Gulf, are generating surpluses externally which are financing the U.S. deficit. It is the emerging country currencies that are undervalued broadly relative to the dollar. These currencies have tremendous scope to appreciate in the years to come, particularly as emerging market central banks are in the midst of tightening monetary policy, and stronger currencies are a critical component of their monetary tightening policy efforts.

MS. BELITZ reviewed the correlations with other asset classes and the betas to show why the emerging local currency debt strategy is a compelling diversifier for client portfolios.

MR. DOTE stated that the benchmark is three-month LIBOR, but some clients use the Lehman Aggregate as a benchmark. He noted that Lazard's performance numbers are net

of all fees and expenses. The three-year return was 10.7%, the five-year was 10.5%, and the one-year was 15.2%.

MR. SEMMENS asked how much of the returns quoted were from currency. MR. DOTE referred to a graph (pg. 9) showing the returns broken out by yield and by currency movements since 1999. MS. BELITZ explained that eight to ten years ago emerging markets were running large external deficits. So the policy interest rate at the central banks needed to be high enough to attract foreign capital to finance the deficits. In the early years of Lazard's emerging income strategy the interest rates were in the mid-teens and currencies tended to depreciate relative to the U.S. dollar. So high yields more than compensated for the magnitude of currency decline. As the external deficits in general have swung into surplus in more recent years, some emerging markets don't need to attract the foreign capital, and there has been a notable decline in the level of local market interest rates. In the last five years, Lazard has earned the yield available in the local markets, which is about 8.5% to 9.0%, but emerging market currencies in aggregate have contributed to the strategy over and above the earned yield. This is what Lazard expects in the years to come.

MR. O'LEARY inquired about political risks and how Lazard tries to mitigate them in this strategy; also, how they mitigate the risks of contracts with counter-parties. MS. BELITZ stated that the stability of a government has ramifications for a reform agenda and the ability to implement reform. The real question for political risk is how it impacts currency direction and how it impacts the central bank's response to fundamental balance of payment pressures. That is where Lazard goes country by country and differentiates between those countries that have unstable political regimes and whether those regimes will impact investment inflows and currency direction, and how the central bank — whether independent or not — will respond to those fundamental economic pressures. Repatriation risk is one that Lazard considers among many risks. They can decide to invest onshore in a country by buying domestic debt, or they can decide instead to keep the money offshore. They do that by using nondeliverable forwards, which have no convertibility risk and no risk that Lazard cannot get the money out of the country.

Answering the second part of Mr. O'Leary's question, MS. BELITZ said they mitigate counter-party risk by transacting in the forwards only with the highest quality international banks and only with the parent company, not the local branch of a bank. So nonpayment on those contracts would be viewed as a default by the parent bank. Another important way to mitigate that risk is by diversifying across a number of different counter-party banks. Lazard has trading lines with 11 to 12 highest quality international banks at the moment.

Regarding liquidity, MR. DOTE stated that if all Lazard's clients in this strategy said they wanted to get out of their investments tomorrow it would take ten business days under normal market conditions to liquidate the entire $1.15 billion of exposure. These are low-risk, very liquid investments.

MS. BELITZ said that illiquid countries are limited as a percentage of the fund. Within the relatively thinly traded markets, Lazard staggers the maturities on the balance sheet. So no one day's trading will exceed the capacity of the local interbank market.

Referring to a graph of performance, MS. BELITZ noted that when there is period of monthly stress, the rebound tends to be sharp and immediate because central banks in each country have the ability and willingness to stabilize the markets. That natural market stabilizer does not exist in other emerging market asset classes.

MS. BELITZ reviewed the Lazard emerging income portfolio exposure by country, saying they are exposed to at least 20 countries at any point in time but have no regional targets. It is a long-only strategy, and the maximum exposure to any one currency will not exceed 8%. She said Lazard does not own any exposure to the Chinese currency or the Chinese local market, primarily because changes in the currency market are not transparent. Also, the forward market, which is how one would take exposure to the idea of Chinese currency revaluation, at the present time already prices a 9% revaluation over the next 12 months. Lazard has found much better value over the last few years in being long Asian currencies that reflect the revaluation theme and have much more transparent central bank policies and more flexible currency regimes.

MS. BELITZ stated that Lazard makes a change in the emerging income portfolio when a position hits multi-month price targets. Over the last couple of years the most notable change has been the decline in Central European weightings from about 35% to less than 10% today. That is a function of the poor diversification benefits they add to the portfolio and the relatively low level of domestic interest rates in the converging European economies.

Responding to MR. O'LEARY, MS. BELITZ said she has been on the management team of the portfolio since March 1998, having joined Lazard in 1996.

MR. DOTE stated that the management fee is 1%, and the participation fee is 10% on gains once Lazard attains the performance hurdle. The investment vehicle is a limited partnership, the valuation frequency is monthly, and 60-day notice is required to withdraw.

21(a). Lazard Emerging Market Debt Fund - Action

MR. BADER stated that the board at its September meeting gave staff authority to engage Callan Associates to review two investment managers for a short-term emerging market debt strategy. As a result of Bob Mitchell, Deputy Commissioner Andrews and himself visiting Lazard and Lehman Brothers, those two managers were selected for review. Callan subsequently did a performance review, and the findings are included in the packet. Staff settled on Lazard because they believe it is the right manager for this time, and it is

consistent with the strategic asset allocation the board passed that has 3% allocated to high yield bonds. Staff would include the emerging market debt mandate in the high yield allocation. Currently, there is about 1.7% of pension fund assets in high yield bonds, and a $100 million allocation to emerging market debt would leave the high yield category a bit short of the target allocation. He said staff recommended hiring Lazard to manage $100 million in the mandate they just presented to the board.

MR. TRIVETTE moved that the Alaska Retirement Management Board authorize staff to invest $100 million with Lazard Asset Management in the Lazard Emerging Income strategy, subject to acceptable negotiation of management fees. MS. HARBO seconded.

MR. WILLIAMS asked about the benchmark for an emerging market debt mandate and why it was different than the benchmark for the ARMB high yield managers. MR. BADER replied that LIBOR is an appropriate benchmark at the current time, although it is a bit of a disconnect in terms of the rest of the high yield benchmark. Staff will be looking at having different allocations within the fixed income asset class and believes LIBOR as a benchmark will be more consistent in the future.

MR. O'LEARY stated that a reasonable target expectation would be 7% net of fees, and that he thought of emerging market debt as an absolute return type of strategy that is focused on fixed income performance from riskier markets. If the board at some point invested in longer-dated emerging market debt, then an appropriate market index would be some premium to the non-dollar-denominated emerging market debt index. The duration of the Lazard emerging income portfolio is short, so thinking of LIBOR as the starting point for return expectations is appropriate. However, LIBOR is certainly much less risky than the product. So the board has to really believe ARMB can get at least a meaningful return premium to LIBOR to justify the investment.

Roll call vote
Ayes: Galvin, Harbo, Kreitzer, Pihl, Richards, Semmens, Trivette, Williams, Schubert
Nays: None

The motion passed unanimously, 9-0.

CHAIR SCHUBERT called a short break from 3:12 to 3:20 p.m.

22. Audit Report - KPMG

KATHY PORTERFIELD of KPMG appeared to give the annual independent audit report to the ARM Board. She said she reviewed the results of the audit in great detail with the Audit Committee on Tuesday, November 27. KPMG will be issuing unqualified opinions for the financial statements of all the various funds.

MS. PORTERFIELD drew attention to KPMG's letter to the Audit Committee, dated November 20, 2007, that covered the audit process in more detail and described the findings. She stated that with regard to the pension plans, excluding Military, there was a required change in some disclosures. The financial statements have a lot more information about post-employment benefits in the footnotes. She mentioned that KPMG reviewed the estimates of fair value in the investment portfolio that are reported in the financial statements and believes they are reasonable. The alternative investments are more complex, and she has talked with the Audit Committee about those in the past. KPMG is satisfied that the Treasury Division has very good controls and policies and procedures in place for their own review of the managers' valuations for alternative investments. Another estimate in the financial statements is claims liabilities in the health funds, and KPMG is satisfied with the estimate of claims that have been incurred but not reported yet to the plans. The biggest estimate of all in the pension set of financial statements is actuarial obligations. The actuarial liabilities are not part of the basic financial statements but are supplemental to the financial statements and are not required to be audited. KPMG did not audit them but did review them at a very high level, for example, to make sure the actuary is using accurate census data.

MS. PORTERFIELD said that KPMG will find some differences between the audit results and what is actually recorded in the financial statements or the underlying books and records. KPMG will propose audit adjustments that are either reflected or not reflected in the financial statements, depending on how material they are. There was an adjustment of approximately $700,000 in the Retiree Health Fund to accrue additional benefits expense. There were also several adjustments that were not included in the financial statements. There are 12 months of income recorded for the alternative investments, but it is the 12 months ended March 30, as opposed to the 12 months ended June 30 when the state closes its books. There is a significant lag in managers reporting to the Treasury Division so it is not possible to know the fourth quarter's activity for those investments. For PERS the difference is about $50 million of additional income that would have been recorded in FY07 if the 12 months was ended June 30. She said she told the Audit Committee that if the differences continue to grow KPMG believes the Treasury Division will have to consider actually reflecting the adjustments in the financial statements in the future.

MS. PORTERFIELD reported that KPMG had full cooperation with all Treasury Division and Retirement and Benefits Division staffs and absolutely no issues or difficulties in getting the audit completed.

Looking at the management letter to the board, MS. PORTERFIELD stated that KPMG is not issuing an opinion on internal control but they have observations as a result of their testing. KPMG did not discover any material weaknesses or even significant deficiencies in internal control. The one suggestion is that the Treasury Division review all the activities that are under audit and decide if there is a better way to combine some entities to make more sense for the board and other readers of the financial statements. There were

several new funds and plans that were created in 2007, and that created a couple of issues. When established, there wasn't a lot of thought about how the financial statements related to those entities should be put together. The Treasury Division has committed to taking a look at a different format for next year.

MS. PORTERFIELD commented that the addition of new funds and plans creates a strain on resources. The resources are good in terms of quality but not so great in terms of quantity. KPMG has recommended to the Division of Retirement and Benefits that they review positions and workloads to see how best to use the resources to meet the increased requirements. The Division Director wants to find some technology solutions before adding personnel, and KPMG considers that responsive to the management letter recommendation.

MS. PORTERFIELD reported that there was no process in place to reconcile claims data from the third party providers to the underlying accounting records for the Group Health and Retiree Health Funds, and this resulted in the audit adjustment she mentioned earlier. KPMG has recommended that the Division of Retirement and Benefits put that process in place.

MR. TRIVETTE asked if the Long Term Care Program, the Dental/Audio/Visual Program, and the Life Insurance Program are audited as well. MS. PORTERFIELD said yes.

UNFINISHED BUSINESS

1. Meeting Calendar

CHAIR SCHUBERT requested that the February meeting be moved from the 12-13th to the 14-15th, if it did not inconvenience other trustees.

There was no objection to the requested change of date.

MS. HALL indicated that the Audit Committee set out its 2008 meeting dates, so the master calendar would be updated.

2. Disclosure Reports

The disclosure memo was included in the meeting packet.

3. Legal Report

MR. JOHNSON reported an issue having to do with generating emails to groups among boards and commissions. When more than three persons are gathered, public notice is required for a public meeting. There have been situations, at least coming out of the State of Washington, where — probably without intending to create a public meeting issue — people have generated emails to groups, and then replies and exchanges of communication have been done on a group-wide basis. The result is that a decision has

been reached or is close to being reached by virtue of emails being generated in that fashion. He cautioned trustees not to get into an unwitting public meeting situation. Emailed information from Ms. Hall and others to all the board members is appropriate. But to avoid the appearance of decisions being made without the public notice comment, trustees should keep that in mind and reply to one person rather than to the group. The issue has not specifically come up in the State of Alaska, although there were some issues raised at the Superior Court level on email exchanges with the apportionment board in some of their decision-making.

NEW BUSINESS - None.

OTHER MATTERS TO PROPERLY COME BEFORE THE BOARD - None.

PUBLIC/MEMBER COMMENTS - None.

INVESTMENT ADVISORY COUNCIL COMMENTS

DR. JENNINGS said he endorsed further index funds in the defined contribution plan space, but fewer investment choices is probably better. Participants can be overwhelmed by having too many choices. The way the choices are framed is important: categorize things rather than adding items to a very long list. He said he gave examples of how that might be done at the September Defined Contribution Plan Committee meeting. He also recommended that the three plans be more harmonized in their investment options so that funds are not offered in two plans and not in the third plan. The federal defined contribution plan, which is very well regarded, uses index funds exclusively and is a good model to look at. Over time, the federal plan has added an equivalent to the ARMB's S&P 500 fund, a Lehman Aggregate bond fund, an extended market portfolio, and international. That is probably the order in which to add index funds that would benefit the participants.

TRUSTEE COMMENTS

MR. TRIVETTE said that Mr. Wilson had indicated to him in an earlier conversation that he supported more index funds for the Supplemental Benefit System Annuity Plan.

MR. WILLIAMS stated that as a member of the Defined Contribution Plan Committee he supported the board looking at the fund array of investment options between the Defined Contribution Plan, Deferred Compensation, and the SBS plan, and harmonizing that. He agreed with Dr. Jennings about looking at the individual investment choices to become more index-like because some of the current options have stylistic characteristics and there is no other option.

MR. TRIVETTE commended Commissioner Galvin and his staff for their efforts on behalf of the state's citizens during the special legislative session. The new tax structure on oil

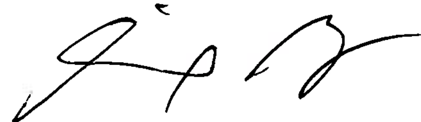
and gas could result in some additional monies being available for the retirement systems' unfunded liability.

CHAIR SCHUBERT congratulated the board's legal counsel, Rob Johnson and Mike Barnhill. She said that in all her years on the ASPIB and ARM Board she felt the board has the highest caliber of legal counsel and assistance now that it has ever had.

FUTURE AGENDA ITEMS - None.

ADJOURNMENT

THERE BEING NO OBJECTION AND NO FURTHER BUSINESS TO COME BEFORE THE BOARD, THE MEETING WAS ADJOURNED AT 3:40 P.M. ON NOVEMBER 29, 2007, ON A MOTION MADE BY MR. TRIVETTE AND SECONDED BY MR. WILLIAMS.



Chair of the Board of Trustees
Alaska Retirement Management Board

ATTEST:

Corporate Secretary

Note: The summary minutes are extracted from a tape recording of the meeting and are prepared by an outside contractor. For in-depth discussion and more presentation details, please refer to tapes of the meeting and presentation materials on file at the ARMB office.

Confidential Office Services
Karen Pearce Brown
Juneau, Alaska