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
June 18-19, 2009

Thursday, June 18, 2009

CALL TO ORDER

CHAIR GAIL SCHUBERT called the meeting of the Alaska Retirement Management Board (ARMB) to order at 9:03 a.m.

ROLL CALL

Eight ARMB trustees were present at roll call to form a quorum. Commissioner Galvin arrived at 9:25 a.m.

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

Investment Advisory Council Members Present
Dr. William Jennings
George Wilson

Consultants Present
Robert Johnson, outside legal counsel
Michael O'Leary, Callan Associates, Inc.

Department of Revenue Staff Present
Jerry Burnett, Deputy Commissioner
Gary M. Bader, Chief Investment Officer
Pamela Green, State Comptroller
Bob Mitchell, Senior Investment Officer
Zachary Hanna, State Investment Officer
Steve Sikes, 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 Financial Officer

Invited Participants and Others Present
David Slishinsky and Christopher Hulla, Buck Consultants, Inc.
Larry Semmens, former ARMB trustee
Alex Slivka, McKinley Capital Management
Leslie Thompson, Gabriel Roeder Smith & Company
Barry Nelson and Ed Johnson, Advent Capital Management, LLC
Kathy Kasper and David Stein, Eaton Vance Investment Managers
Tony Dote, James Donald and Ganesh Ramachandran, Lazard Asset Management

PUBLIC MEETING NOTICE

Judy Hall confirmed that public meeting notice requirements had been met.

APPROVAL OF AGENDA

<u>MS. HARBO moved to approve the agenda</u>. <u>MR. WILLIAMS seconded</u>.

The agenda was approved without objection.

PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES

There was no one present in Anchorage or listening by telephone who wished to speak.

RECOGNITION OF FORMER TRUSTEE LARRY SEMMENS

CHAIR SCHUBERT presented former ARMB trustee Larry Semmens with a plaque and read the following citation into the record:

> "The Alaska Retirement Management Board became effective October 1, 2005. Due to his active involvement with public employee pensions in Alaska, and because of his experience as a municipal finance officer, Larry Semmens was appointed by Governor Murkowski as one of the founding trustees of the Alaska Retirement Management Board. At the time of his appointment, Larry was the finance director of the City of Kenai, where he began his employment in 1996. Larry was past president of the Alaska Government Finance Officers Association and vice chair of the Alaska Public Entities Insurance Pool Board. From the outset, Larry established himself as a dedicated and active member of the board. One of his first projects was playing an active role in developing the report to the Legislature, as required in SB 141. Later, Larry worked on HB 375, which was a bill to provide funding to municipal and school district PERS and TRS employers to assist them in paying down their pension past-service liability. Although the bill did not pass the Legislature, some of the concepts did become law via subsequent legislation. Larry generously gave his time and service to this board. As chair of the real estate committee, Larry worked closely with staff and other trustees in the development of the annual real estate plans that were presented to the board. He was a member of the audit committee and, along with the chair and other committee members, he developed a high standard of review of the board's financial documents. When it came to actuarial reports, Larry could not help himself. His analytical mind and inquisitiveness demanded understanding. He asked probing questions, and in doing so, brought deeper understanding to staff and fellow board members. Larry has spent most of his time in public service in positions of increasing responsibility. He was recently appointed city manager of Soldotna. Acceptance of that position required him to resign his seat on the board. I know that I speak for all of the Alaska Retirement Management Board members and staff in saying that we miss his intellect, forthrightness and energy. Thank you very much for your service." [applause]

MR. SEMMENS stated that the time he spent on the board was the most outstanding time for him personally. He thanked everyone for the recognition and the plaque, and wished the trustees the very best in their future endeavors. He said he was pleased that Kris Erchinger took his spot on the board and that she would be an excellent addition.

APPROVAL OF MINUTES - April 23-24, 2009

MS. HARBO moved to approve the minutes of the April 23-24, 2009 meeting. MR. WILLIAMS seconded.

COMMISSIONER KREITZER said she had two items to discuss, but she did not know if they would rise to a correction or not.

> On page 5, Mr. Trivette had expressed concern that he had no idea from prior discussions that the intention was for Great-West to raise its recordkeeping fees for Supplemental Benefit System (SBS) and Deferred Compensation Plan (DCP) participants, as well as Defined Contribution Retirement Plan members. She said DRB presented information in an executive session in February 2008 and collected that information afterward, so trustees would not have a record to help them remember that. Whether that was a correction to the record or noted in the minutes of this meeting was fine with her.
>
> On page 7, Mr. Pihl had stated that the CAFRs are fine reports but that there were several errors that he wanted to go over with Mr. Worley at some point. She said she understood there was one minor error. The other issues that Mr. Pihl brought up were refinements that he would like to see in the CAFR reports, and not errors.

MR. PIHL said one error was that the target return for either PERS or TRS was 12.52% instead of 8.25%. COMMISSIONER KREITZER responded that that was a minor error in the CAFR that did not have an impact on any other numbers in the report. But there were not numerous errors, as the minutes seemed to reflect. MR. PIHL acknowledged that point.

The minutes were approved unanimously, 8-0.

REPORTS

1. Chair Report

CHAIR SCHUBERT briefly related the progress on plans for the tour at the New York Federal Reserve Bank as part of the education conference in October.

Chief Investment Officer GARY BADER advised letting Ms. Hall know who was planning to visit the Federal Reserve Bank as soon as possible so she could prepare people for any additional security checks.

CHAIR SCHUBERT reported that she was scheduled to be deposed in the Mercer litigation in July. She also mentioned a June 16, 2009 letter from Senator Bert Stedman that was just handed out, which she had not had a chance to read. COMMISSIONER KREITZER indicated that she had responded to Senator Stedman's staff last night to let him know that a discussion by Buck Consultants about how to address the time lag between completion of the actuarial valuation and the setting of employer contribution rates would be on today's agenda.

CHAIR SCHUBERT congratulated trustee Mike Williams, who was getting married in July.

2. Committee Reports

2(a). Audit Committee

Committee chair MARTIN PIHL reported on the June 17, 2009 meeting, where the main topic was reviewing the audit plan with KPMG and reviewing staff's efforts to facilitate the audit. Funding has been split into separate trusts in the last year, and the committee expects the FY09 audit process to be easier than the last one. There are no new significant audit or accounting standards to deal with this year. The committee received a legal report from Mr. Johnson with no notable issues. DRB gave a report on the employer audit program, which is still a challenging area, and the committee appreciates Mr. Shier's efforts to improve the process. The Treasury Division's report indicated that staffing is probably the best it has been for some time. Lastly, the committee performed a brief self-assessment and charter review, per the annual plan.

3. Retirement & Benefits Division Report

3(a). Buck Consultants Invoices

KEVIN WORLEY, Chief Financial Officer at the Division of Retirement and Benefits, drew attention to the summary of Buck Consultants, Inc. (state's actuary) billings by quarter, provided at each meeting at the board's request. The primary cost is through the actuarial valuations. Buck is also under contract to perform different analyses, either for the board or for DRB, and those costs were listed.

Responding to the Chair, MR. WORLEY stated that the cost of actuarial valuations are set under contract to be not more than a certain amount each year: the other items are typically add-ons to respond to board requests or other requests, and Buck charges for those based on the projects that they undertake.

MS. ERCHINGER asked how DRB budgets for the add-ons. PATRICK SHIER, Director of the Division of Retirement and Benefits, explained that, in addition to the budget for the actuarial valuation work, there are other funds in that line item for the unexpected that could be $40,000-$50,000. When DRB receives a request for some analysis, the Division would ask Buck how much it would cost, Buck would provide another "not-more-than" dollar amount, and DRB would spend up to that limit. If the cost of an analysis exceeded that amount, DRB would have to ask the commissioner and the Division of Finance for permission to move money between line items or, in an extraordinary case, ask for a supplemental.

MR. PIHL remarked that some of the analysis that is done for Legislative Budget and Audit, such as studying the impact of proposed legislation, should be paid by the entity making the request, rather than the retirement systems.

COMMISSIONER KREITZER responded that the Department of Administration attempted to get some general fund money into the budget to address requests related to legislation, but that did not happen. However, the department and DRB have to do some work as well to understand what the legislation would mean and to do a fiscal note. Because the costs so far have been relatively small and have not created an issue, she has not taken a firm stand in requesting some assistance. But she is very close to the threshold of needing the Legislature to provide some funding to do those kinds of reviews. She is cognizant of the situation and has been watching the costs throughout the legislative session.

Commissioner Galvin arrived at 9:25 a.m.

3(b). Membership Statistics

MR. WORLEY briefly reviewed the membership statistics for the Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS) for the quarter and the fiscal year through March 31, 2009. This was a report that the Board requested on a regular basis. He drew attention to the TRS defined contribution plan (Tier III) where 196 members opted back into managed accounts with Great-West. There was a similar number in the prior quarter for PERS.

3(c). Other

COMMISSIONER KREITZER referred back to the Audit Committee report and said the Department of Administration is finding more efficiencies in contracts, which is enabling them to move state personnel around and create more help in the audit area.

MR. PIHL mentioned that the auditors do not come until after the end of the fiscal year, while he is accustomed to interim audit work. Possibly some of the audit work could start a little earlier and address the concern about how long it takes to get the statements. He thought that was on the table for the Department of Administration and the Treasury Division to look at with the auditors in July.

MR. SHIER reported that Wells Fargo Insurance Services is the new third-party administrator for the AlaskaCare (retiree) Health Plans. The welcome kits and new identification cards are to be mailed out this week, and the switch to Wells Fargo begins July 1, 2009. The telephone lines will be operating starting June 22 as a test. The Division is aware that a transition always creates stress in the retiree and the active population, and they are trying to minimize that. The Division is excited about some new opportunities that come with the new third-party administrator.

4. Participant Fee Increase

JERRY BURNETT, Deputy Commissioner of the Department of Revenue, distributed a short written report on this item, which is on file at the ARMB offices. He said the report was a joint effort of the Departments of Administration and Revenue, as a result of the fee increase for member investments in the Supplemental Annuity Plan (SBS), the Deferred Compensation Plan and the Defined Contribution Retirement (DCR) plans. The report showed all the costs that are charged across the board to members and the costs that are charged on a per-fund basis.

MR. SHIER stated that the process of the recent fee increase revealed that there was no single place to describe all the fees that come out of the various plan investments. He said that Pam Green had the idea to state all the fees, even flat fees, as basis points for ease of comparison. Page 1 of the report showed the total annualized fees for each plan, which are a combination of the administrative fees that flow to both the Department of Administration and the Department of Revenue, and the fees that are captured out of the investment funds by the fund managers. For the Deferred Compensation Plan, the annual fees are 47.47 basis points; for SBS the fees are 41.45 basis points, and for the PERS/TRS defined contribution retirement plans the fees are 126.91 basis points. While the total annualized fees for the DCR plans are high, that number will become smaller and smaller as the balances in those accounts increase to the level of the SBS, when one could expect a like number in terms of the basis-point levy against the DCR accounts.

MR. SHIER next reviewed the fund-level fee table that contained the details behind the investment manager fees and the conversion to basis points.

Moving on to the administration fee analysis on page 3, MR. SHIER said the cost allocation plan re-examined and updated cost allocation between the two departments as necessary. He drew attention to a box entitled "sufficiency analysis" and said the purpose was to make sure that with the reallocation of funds what was being collected today would be sufficient to carry through into the future. Some reserves had built up in the SBS administrative accounts, and those are starting to be consumed. DRB will follow the progress of expenses over the next year to see if the fee schedule will have to be altered again or if the fees being charged will develop enough revenue to cover the costs as they stand.

MR. TRIVETTE asked about getting a break-down of fees to see who was getting what. MS. GREEN stated that the total fund management fee is a weighted average estimate of all fees that are booked or incurred at the manager level. Page 2 is a break-out of the investment fees by manager and fund. She regarded the last page as a "budget" or the expected monies coming in from all the fees being charged and the costs that will go against those fees on an ongoing basis. Referring to the sufficiency analysis, she said the SBS Plan by 6/30/2010 will have sufficient reserves to cover a couple of years' worth of costs. On the other hand, the remaining reserves balance for the Deferred Compensation Plan at 6/30/2010 indicates it is something to take a look at.

MR. BURNETT pointed out, for comparison, that the costs on the PERS/TRS defined benefit plans are approximately 27 to 30 basis points annually versus about 45 basis points for the DCR plans. The defined benefit plans are much larger funds and so the average costs are much lower.

COMMISSIONER GALVIN said the cost number for the DCR plans stands out, and he wondered if the analysis was a tool to compare, in terms of what similar plans are paying, to see if Alaska is paying a fair price in the market.

MR. SHIER replied that the Division could use the mature Deferred Compensation Plan and SBS Plan to benchmark against other plans. He would hesitate to use the DCR Plan's overhead at this point because the funds are relatively small. Those funds are expected to grow to where the numbers should be very similar among the various plans.

COMMISSIONER GALVIN inquired about the time frame for that leveling of fees across plans. MR. SHIER said it would depend on how fast the money accumulates in those funds. The employment under the DCR plans is growing faster than expected, and the general fund subsidy designed to initially carry those costs is running out this year. COMMISSIONER GALVIN said he would like to see a projection of when annualized fee equilibrium would be reached across the plans. MR. SHIER indicated that DRB could apply an expected growth rate to the net asset values to see what happens and provide that information to the board chair through the DOA commissioner.

MR. TRIVETTE asked when DRB expected the general fund appropriation that pays the DCR Plan costs to run out. MR. SHIER said the end of fiscal year 2010.

5. Treasury Division Report

MR. BURNETT stated that the Treasury Division currently has one hundred percent of its budgeted positions filled and is in good shape.

6. Actuarial Review

6(a). GRS Certification of Final FY08 Actuarial Valuation - PERS/TRS

LESLIE THOMPSON of Gabriel Roeder Smith & Company (GRS), the reviewing actuary firm hired by the ARMB to audit the 2008 PERS and TRS actuarial valuations, returned to go over the final report to the board. *[An extensive written report was included in the meeting packet and is on file at the ARMB offices.]*

MS. THOMPSON said the audit of the retiree health care plans that was not complete at her last report has been wrapped up. For PERS retiree health, she found the matching between GRS's and Buck Consultants' numbers for the present value of benefits to be amazingly close and representing a very clean audit. GRS audits the total present value of benefits because that tells them that all benefits are being valued, that the assumptions are consistently applied, and that basically everything is there. For TRS retiree health, the matching on one case was 0% and on the second case it was 0.4%.

MS. THOMPSON said the conclusion on the State of Alaska PERS and TRS audit for FY08 as submitted to the board is that everything looks reasonable and there is no significant finding in the audit.

6(b). GRS Review of JRS FY08 Valuation

MS. THOMPSON next spoke about the actuarial review of the Judicial Retirement System (JRS) pension and health plans. She said GRS recommended adding some wording to the actuarial valuation report just for clarification. GRS audited the total present value of benefits that Buck Consultants valued and came very close — 0.4% on one test case and 0.1% on the second test. That is considered a very good finding in actuarial terms. The conclusion on JRS is a clean audit.

Referring back to page 12 of the PERS and TRS audit report, MS. HARBO pointed out that GRS was using post-retirement pension adjustments (PRPA) and COLA interchangeably. PRPA is the annual increase based on the cost of living that each eligible retiree gets, while COLA is the extra 10% that each eligible retiree receives if they live in Alaska. She asked which GRS was referring to in the report.

MS. THOMPSON said she could not tell if the death benefit referred to both or either pension adjustments at this point, but she could clarify the language in the report.

MS. HARBO inquired why the PRPA or COLA would have anything to do with the spouse. MS. THOMPSON said it is about the survivor benefit, so to value it they have to use the survivor's age. GRS understands that that is not a system capability right now, which is the issue they were pointing out in the report. MS. HARBO suggested making the report clear that it means the survivor benefit when talking about the spouse. MS. THOMPSON agreed, saying the report was intended to be used by a wide audience, not just actuaries.

MR. TRIVETTE noted that the GRS report stated in a number of places that the system does not allow Buck to collect certain information. He asked if most of those situations were going to be corrected by the next audit. MS. THOMPSON replied that the largest area of concern for GRS, and to which that comment applied, was on the retiree medical. In the three years she has been working with Buck there have been great changes in being able to drill into the vendor data to get the data needed to value the underlying claims costs in the retiree medical plan. So the answer was yes.

MR. SHIER added that DRB has changed the underlying combined retirement system to accept more detailed information about what fund a particular retiree may be drawing from, and which ones should be primary and secondary in the case of multiple funds. They are constantly trying to improve the quality of the data for the day-to-day administration with the third-party administrator and claims payment, but those also roll to the valuation.

CHAIR SCHUBERT called a scheduled break from 9:50 a.m. until 10:05 a.m.

6(c). Final FY08 Actuarial Valuation by Buck Consultants
DAVID SLISHINSKY and CHRISTOPHER HULLA of Buck Consultants, Inc., the actuary firm hired by the state, attended the meeting and gave several reports on the fiscal year 2008 actuarial valuation results for the State of Alaska pension plans. *[Buck's slide presentation and other report materials are on file at the ARMB offices.]*

MR. SLISHINSKY stated that there were some issues with the data of the National Guard and Naval Militia Retirement System (NGNMRS) and, as a result, that valuation was not completed until the first part of May. GRS requested some additional time to review those results before they are presented to the board, so Buck did not have the results for this meeting.

6(d). FY08 Judicial Retirement System Actuarial Valuation Report
MR. SLISHINSKY reviewed the fiscal year 2008 valuation results for the Judicial Retirement System (JRS). There were no changes in the benefit provisions for the system and no changes in the asset valuation method. There were changes in the assumptions for health care benefit costs.

MR. HULLA said that, as with to the PERS and TRS valuations, Buck switched to the Society of Actuaries' newest long-term health care cost trend rate model. That was a much longer period of time to grade from the current level of health care cost increases experienced by a specific plan to 10, 20 or 30 years into the future. The longer outlook is a much more conservative approach and increases liabilities rather significantly. Secondly, the third-party administrator taking over management of retiree health starting July 1 has plans in place to identify members who have hospital bills that are not coordinated with Medicare Part A. So that will be another source where Buck can continue to refine their assumption regarding how many retirees in the system now and in the future will not qualify for Medicare Part A.

MR. HULLA stated that there were slight changes to the health care base annual costs per retiree that get projected into the future along with the trend rates he just described in the paragraph above. The modifications were similar to what Buck did for PERS and TRS: (1) refined the claim lag time by separating medical and prescription claims - prescription claims are much easier to process and have a much shorter lag time; and (2) grade in, to the extent they find it credible, Alaska-specific trend experience to develop the starting-point annual claim cost rates.

MS. HARBO asked Mr. Shier if DRB had discussed with Wells Fargo Insurance Services tightening up the claims lag time so that Buck could get the information quicker. MR. SHIER responded that up to this point the conversations have centered around making sure that the data is transferred to Wells Fargo to pay claims July 1. It will be part of the ongoing discussion, and one of the requirements of the contract is that Wells Fargo deliver data timely for the purposes of valuation and quarterly reviews.

MR. SLISHINSKY stated that one other change in the JRS valuation this year was a significant additional contribution of $49 million appropriated by the Legislature to pay off the unfunded liabilities.

Presenting the valuation results for JRS, MR. SLISHINSKY compared fiscal year 2008 and 2006 valuation data. The actuarial valuation is only done once every other year for JRS, and Buck does a roll-forward in the interim year. He highlighted the following:

- The active number of Judicial members increased from 66 to 73.
- There were a few more retirees, and the total number of members included in the valuation this year was 169 versus 159 two years ago.
- Annual compensation was up to almost $11,700,000.
- The plan assets increased dramatically, primarily because of the additional State of Alaska contribution of $49 million. Market value was up to almost $134 million. The actuarial value was up to $141 million.
- Buck set the actuarial value of assets to the market value as of July 1, 2006 and then began phasing in a five-year smoothing method such that they are recognizing the gains and losses over a five-year period. Currently, there are some delayed losses that have not yet been recognized in the actuarial value, which is why the actuarial value was almost 106% of market value.
- Annual benefit payments were close to $7 million, which represented 5.2% of the market value.

MS. HARBO asked how the $49 million appropriation to JRS was divided between pension and health care: she recalled from Buck's replication of JRS that the system had a huge unfunded liability in health care. MR. SLISHINSKY said it was based on the accrued liability, and the $49 million was intended to pay off that liability. MR. WORLEY said he did not know the exact percentages, but DRB and Buck knew what the unfunded liabilities were for pension and health care and that was what the allocation was based on.

MR. SLISHINSKY briefly reviewed the calculation for reaching the actuarial value of assets as of July 1, 2008. He also went through the actuarial valuation results broken out between pension and health care. The funded ratio for pension was 94% and for health care it was 101%. Overall, the funded ratio is now up to 95%. There were some liability losses on the pension side and some liability gains on the health care side, which accounts for the better funded ratio for health care than for pension. The calculated total annual contribution rate was 41.0% less the member contributions of 4.87% of pay to arrive at the employer contribution rate of 36.2% of pay. JRS members do not contribute to health care.

MR. SLISHINSKY showed a graph of the history of the employer contribution rates for the Judicial system since 1999. The rates increased from 2001 through 2009. With the contribution that paid off a large portion of the unfunded liability, that rate is down for 2011.

The next graph illustrated the historical actuarial accrued liability since 1996, split between pension and health care. Of note was the growth in those liabilities primarily since 2004. Another graph showed that pension was roughly 87% of the total accrued liability and health care was about 13%. The next graph depicted the history of the funding ratio going back to 1982. It showed a large drop in the funded ratio in 2006 and 2007, but it rose to around 95% with the additional contribution in 2008.

MR. SLISHINSKY stated that there were asset losses experienced as of June 30, 2008. On a market value basis, the loss was approximately 5%, or 13% below Buck's 8.25% long-term assumption for an investment return. Even though there were losses on the market value of assets, the amount of the losses are being smoothed over five years. There were losses on the actuarial side but not to the extent on the market side. Significant market losses are expected to be realized in the roll-forward valuation in 2009.

MR. SLISHINSKY said that since the losses are so significant, Buck was suggesting that the ARM Board discuss the current investment return assumption and its reasonableness in the current economic environment. The question is what kind of recovery will happen and what impact that will have long term on the funding of not only JRS but also PERS, TRS and NGNMRS.

MR. BADER inquired when Buck thought the board should hold a discussion about the reasonableness of the earnings assumption. MR. SLISHINSKY indicated the next board meeting. MR. BADER said that would be out of the cycle of the Board's usual review of actuarial assumptions. MR. SLISHINSKY said that typically there is a review and experience analysis of not only the demographic assumptions but the economic assumptions. He added that there has been such a significant impact on the markets and on the value of the pension assets since July 2008 that he thought it was a good exercise, because of recent events, for the Board to step back and look at the long-term investment return assumption that Buck is using in the valuations and to determine how comfortable trustees were with that, especially given the size of the losses that will be recognized and deferred in the next roll-forward valuation. The question is, what is the chance of a strong recovery that would be required to get the plans back to where they were before the steep drop in the markets.

MR. SLISHINSKY reviewed the changes in the unfunded liability that was $49 million in the 2007 roll-forward and ended up at $7.5 million by June 30, 2008. He also presented the calculation for the decreased employer contribution rate based on the 2008 valuation due to the state appropriation.

MR. TRIVETTE remarked that the $6.7 million loss in fund assets was the largest change in the unfunded liability and one over which the Board had no control. MR. SLISHINSKY said most of it was decremental losses on the pension side; there were actually decremental gains on the health care side, as there were for all the retirement plans.

MR. WORLEY mentioned that the transition to the Alaska Retiree Health Care Trust started last fiscal year. As planned, the State used the balance in the former Retiree Health Fund to pay health care claims for PERS, TRS and JRS for eight months of FY08, and the remaining four months of claims were paid out of the new Health Care Trust. That is part of the reason for the gains on the post-employment health care side for JRS: only four months' worth of claims were paid from the trust. The Board will see a full year's worth of health care claims paid out of the trust in FY09.

MS. ERCHINGER stated that it would be helpful to have the unfunded actuarial accrued liability history in a graph to see which portion of the unfunded is pension versus health care.

MR. PIHL mentioned that as the Board addresses the losses that have occurred, the return assumption, and Senator Stedman's letter, he would like to see a schedule that showed the change in retirement fund assets between June 2008 and May 31, 2009 and the resulting change in the unfunded liability. It would help the Board get its arms around the numbers it would be addressing.

COMMISSIONER KREITZER replied that she would check with people at a break and try to accommodate Mr. Pihl's request.

6(e). FY08 Actuarial Valuation Results: Defined Contribution Retirement

Plan's Other Benefits

MR. HULLA stated that the Defined Contribution Retirement (DCR) Plan established effective July 1, 2006 includes defined contribution components for the retirement income account and the health reimbursement account, and defined benefit components for occupational death and disability income and the retiree medical claims.

MR. HULLA reviewed the results of the valuation for the new DCR Plan as of June 30, 2008 compared to June 30, 2007. The number of actives grew to 5,052. With the deferred investment losses — very similar to PERS, TRS and JRS — the $4 million actuarial value of assets is higher than the roughly $3.7 million market value of assets because some losses have not yet been recognized. Right now, deferred losses result in market value that is 92% of actuarial value. No benefits have been paid out of the DCR Plan to date, although theoretically there could be under some of the death and disability provisions.

MR. HULLA presented the valuation results separately for the DCR defined benefit income pieces: the occupational death and disability benefits and the retiree medical. The occupational death and disability component is a relatively small liability, but it is highly variable in terms of when the actual benefits are paid. That is part of the reason there are a lot of assets compared to liability in the ramp-up period. The DCR occupational death and disability for PERS employees is overfunded by a million or so, and the retiree medical a bit less than that. The reason for retiree medical assets exceeding liabilities at this point is not so much the variability but just the deferral. The DCR Plan retiree medical is essentially a benefit that is paid after age 65, in terms of the State's contribution. For the most part, employees who retire and elect medical prior to that time will be paying premiums roughly equivalent to the cost. So assets will build up until such time as there are retirees in receipt of medical benefits at age 65 or after. Medically related occupational death and disability is a bit different and is essentially a deferral right now. The contribution for the occupational death and disability component of the DCR Plan for PERS is about 0.4% of pay, and retiree medical is about 0.55%, for a total contribution of 0.94% of pay.

MR. SLISHINSKY said that on the occupational death and disability valuation Buck has been assuming that 100% of the deaths and disabilities are occupational. They have done that to be very conservative in the valuation, to make sure that money is accumulating to pay for any benefits that would become payable. There is a lot of risk involved in providing benefits only for death and disability, more so than pension. So when Buck set those assumptions, they recommended being conservative for about a three-year period in order to seed the fund. That is why there is such a large unfunded liability for occupational death and disability.

MR. HULLA next reviewed the DCR results for the Teachers' System. The number of new hires, net of a few terminations, grew from 640 to about 1,200. Again, the actuarial value of assets is greater than the market value because the only deferral is losses. There are no current recipients of benefits. He briefly walked through the development of the actuarial value of assets for the Teachers DCR Plan.

MS. ERCHINGER asked for an estimate of how much of the deaths and disabilities would be occupational under normal circumstances. MR. HULLA replied that the incidence of occupational death and disability would be much higher in the public safety portion of PERS versus teachers, but Buck would say 50/50 for this small a group for the two systems combined at this time. In the first three years Buck is essentially saying double the liability until some assets are there and then start a longer-term approach.

MR. HULLA reviewed the retirement income benefits (occupational death and disability) versus retiree medical portions of the TRS defined contribution plan results, noting the results were very similar to the PERS plan. Because the plans are overfunded currently, there is an amortization component that decreases the recommended contribution. The resulting percentages of payroll are 0.28% for the death and disability income portion of benefits and 0.68% for retiree medical, for a total of 0.96%.

MR. HULLA presented a comparison across all the plans of the FY11 recommended employer contributions for pension and medical benefits (slide 24).

6(f). 2008 Demographic Gain/Loss Impact for PERS and TRS

MR. SLISHINSKY next described what was behind the change in employer contribution rates from last year to this year for both PERS and TRS. He also covered the sources of the gains and losses on the total accrued liability for both retirement systems. This information was included in Buck's draft report at the April meeting, but there had been some questions about the analysis.

Noting that Buck provided last year's employer contribution rate in the analysis of gain/loss for the PERS and TRS defined benefit plans, MR. PIHL said they did not provide it for the DCR plan. He wanted to know the prior contribution rates for the defined contribution retirement plan so he could see the change from this year. His concern was reducing those rates too quickly. MR. SHIER indicated that he could get those numbers by the afternoon.

6(g). Board Acceptance of FY08 Certifications and Valuations

MS. HARBO moved that the ARM Board accept the fiscal year 2008 certifications and valuations. MR. TRIVETTE seconded.

The motion carried unanimously, 8-0. [Commissioner Galvin was absent, having been excused by the chair just prior to the motion.]

6(h). Results of Roll-Forward Study for PERS and TRS

MR. SLISHINSKY said there is a time lag between the actuary's valuation that determines the employer contribution rates and the application of those rates to the fiscal year for budgeting purposes. Buck's valuation as of July 1, 2008 calculates the cost of the benefits that will be accruing from July 1, 2008 until June 30, 2009. That is the normal cost. That snapshot valuation also determines the value of the accrued liabilities and the actuarial valuation of assets on the valuation date of July 1, 2008 and then determines an amortization payment to be made through June 30, 2009. The calculated rates are used for the FY11 budget, or for contributions that actually get made beginning July 1, 2010 through June 30, 2011. That is the two-year lag that everyone talks about. Any time there is experience that occurs during that two-year period that is not included in that contribution, then there becomes a difference between that experience and the actual rate that is applied for determining the contributions for that fiscal year.

MR. SLISHINSKY said one method discussed for shortening that period is to do a roll-forward valuation. For example, that would be mathematically rolling forward the amounts calculated in the July 1, 2008 valuations to July 1, 2009, assuming that there were no demographic gains or losses (if mortality assumptions, retirement experience, termination experience, salary increases, etc. held as expected). Given all that, Buck could calculate what the expected accrued liability would be for the valuation as of July 1, 2009. They would assume that the normal cost rate that was determined in the previous valuation does not change — for example, the entry ages of the new group in 2009 is the same as the group in 2008. In a roll-forward, they take the actual asset performance experience as of June 30, 2009, when it becomes available, and recalculate the actuarial value of assets based on actual experience for the year. That includes investment gains or losses for the year and the contribution differences that actually are made for the year.

MR. SLISHINSKY stated that the advantages of the roll-forward approach to setting the employer contribution rates is that it reduces the lag time in recognizing investment experience and any contributions that are made from 24 months down to 12 months. If Buck got the asset numbers by August 31 and calculated the new employer contribution rates based on a roll-forward valuation, they would present the results at the September ARMB meeting. That would allow nine months to implement those rates for the next fiscal year. This process would reflect any major market changes one year earlier.

Putting this information into the current context, MR. SHIER said that it would mean getting the June 30, 2009 asset values to Buck Consultants by August, and by

September the State would have a valuation that could be used in budgeting for FY11. So instead of using FY08 audited numbers, the roll-forward method would be using FY09 numbers. And instead of setting employer contribution rates at a meeting in the middle of the summer, the Board would be pushing that off to a September meeting.

MR. SLISHINSKY said there would be a three-month delay in rate setting, but the Board gains a year because the calculation includes much more recent investment experience and contributions.

CHAIR SCHUBERT inquired if the assumption about no demographic gains or losses would be problematic in the long run. MR. SLISHINSKY said not really, because every time Buck did the roll-forward they would be updating the demographic experience based on the latest valuation, and that would adjust the rate. There is still the two-year lag in the rate for demographic experience because of how long it takes to gather the information and go through the process to calculate the rates.

MR. PIHL pointed out that there was normally no significant difference between unaudited and audited numbers. He said he has seen other actuarial reports where assumptions are used to set rates, and in the following year the actuary reports how much the assumptions were off and what the impact was on the contribution rate. MR. SLISHINSKY said the Board would still get that information when Buck did the valuation — it is still a measurement of the difference between the actual and expected experience from one valuation date to the next.

MS. ERCHINGER asked what impact pushing the rate setting from summertime until September would have on the state budget, if any. COMMISSIONER KREITZER said she did not expect any negative impact on the state budget: the executive branch would set the budget and the Legislature would discuss and act upon it. It does not impact the state's ability to meet its timelines.

MR. TRIVETTE voiced that it could be beneficial, because the Board would have tighter numbers available in the fall when the Administration was putting together budgets for the next fiscal year.

COMMISSIONER KREITZER indicated she did not disagree with him but added that budgets are always a matter of debate between the legislative branch and the executive branch. It would be helpful to the state to be able to have what is believed to be a tighter number by September when putting together the budget, realizing that it would be based on assumptions and a roll-forward of the previous year's valuation results. The caveat is how much debate it would generate that the contribution rate was based on some assumptions that the next year's valuation would show how far off those were. It opens things up to a certain amount of criticism.

MR. TRIVETTE acknowledged that the roll-forward approach would provide a more current number but also a potentially sloppier number.

MR. PIHL said he thought the differences between the contribution rates based on roll-forward assumptions and the rates based on actual valuation results would be very small.

MR. BURNETT noted that the defined benefit system is a closed system, and timeliness would become much more important as the system got closer and closer to its end date.

MR. SLISHINSKY listed the disadvantages of the roll-forward approach to setting the employer contribution rates:

- The normal cost rate delay is still 24 months. That is minor because the calculation is a relatively level normal cost rate.
- The assumption and plan changes would not be recognized unless study results exist. For most assumption changes Buck would have a study available that could be used for the roll-forward.
- Updated health care claims would not be recognized. That has to be done on a valuation basis.
- Updated asset information is only available on an unaudited basis. But there is typically not much difference between the audited and unaudited asset values.
- The condensed time frame may be difficult to achieve in some years. For instance, if the unaudited asset values are not available by August 31, then it may be difficult to get the calculation of the roll-forward contribution rate in time for the September board meeting.

MR. SHIER asked if the roll-forward approach would have the effect of increasing volatility in the employer contribution rate. MR. SLISHINSKY said he did not think the volatility was changed by using the roll-forward method, but any major changes are reflected more quickly in the contribution rate. For example, he expected there to be a significant change from 2008's to 2009's valuation due to the market losses and the impact that will have on the employer rates. Buck could reflect those asset losses in the FY11 rates by doing the roll-forward. Buck's calculations in the FY08 valuation that now will be used for setting the FY11 contribution rates do not have those asset losses.

MR. HULLA added that, in theory, the quicker the actual data gets into the contribution rate, the lower the volatility will be over time.

MR. JOHNSON inquired if using the roll-forward approach would impact Gabriel Roeder Smith's (GRS) ability to do a valuation of Buck Consultants' work, given the statutory mandate that they audit and certify the primary actuary's work before presentation to the Board. MR. SLISHINSKY replied that a lot of GRS's time is spent on going through test cases and making sure the calculations for a sampling of the members is accurate. That would already be done. In a roll-forward, GRS would just go through the same check of Buck's arithmetic of rolling forward those liabilities that have already been reviewed.

MR. SLISHINSKY next reviewed Buck's analysis of the roll-forward valuation versus the actual valuation for PERS employer contribution rates to be applied in FY09 and FY10. He did the same review of the results for the TRS system.

MR. TRIVETTE asked if other major public pension plans were using the roll-forward method. MR. SLISHINSKY replied that many systems use a one-year delay, not a two-year delay. An actuarial valuation will be presented maybe seven months prior to the start of a plan's fiscal year, and they use those rates for that fiscal year. He added that it is common for plans to use a roll-forward valuation when the valuations are not performed annually, much like Buck does with the Judicial and National Guard plans. The roll-forward method could be an application for the Alaska retirement systems because of the timing delay.

MR. HULLA stated that a lot of times one might not see a big difference using this process. That is typically because there is a net gain in asset values one year and a net loss the next and so on. As long as that alternates and is above and below the expected value year after year, then the lag is pretty much a wash. But if there are two or three years of asset losses in a row, and there is a lag of two years, that is when there is more variability.

MS. ERCHINGER requested an explanation of the relationship between the five-year smoothing versus the one-year attempt to make up for the time lag. She thought that the two elements had exact opposite goals.

MR. SLISHINSKY said the smoothing is done in both the roll-forward valuation and the actual valuation. The only change by cutting the lag time from two years to one year is in recognizing any contributions to the retirement plans.

6(i). Update to 30-Year Projections for PERS and TRS

MR. SLISHINSKY stated that the Board had a question for Buck at the April meeting on what contribution would be needed to make up for an investment loss, based on the modest recovery scenario that Buck presented. Using their model, Buck determined what dollar contribution would be needed for each year for five years from FY11 through FY15 in order to get the retirement systems back to paying off the unfunded liabilities by the year 2034. Buck used an expected loss for the fiscal year of -18.4%, based on actual losses through December 31, 2008 and the assumption that there would be no return for the next six-month period through June 30, 2009. Going forward, using the modest recovery scenario, the return for FY10 would be 16.0%, FY11 would be 12.0%, and then every year thereafter the return would be the assumed rate of 8.25%. So it is a combination of the significant loss that is expected to be experienced as of June 30, 2009 and then some gains due to a recovery. But that recovery is not expected to be enough to get the system asset values back to where they were, so there would have to be some additional contributions to get back to that point.

MR. SLISHINSKY asked if staff had any return numbers through April or May so he could see how those would stack up against Buck's projected -18.4% loss for the full fiscal year 2009.

MS. GREEN stated that the fiscal year-to-date return for PERS was about -22% through April, and May would see an uptick.

MR. SLISHINSKY estimated that with the May investment gain, and if June experienced another uptick, Buck's -18.4% loss for the full fiscal year would be realistic, based upon the most recent available return information.

MR. SLISHINSKY emphasized that these projections are estimates, and future results will differ based upon actual demographic and investment experience during the period. The additional contributions are assumed to be made over a five-year period to eliminate any additional underfunding caused by investment losses for the year ending June 30, 2009. Buck also assumes that the contributions would be made beginning in July 2010 and in July for each year thereafter through 2014 (FY15).

The result of Buck's projections is that the PERS system would need an additional state contribution of $322 million per year for five years, in order to get the funding back on a basis such that the employer contribution would be fully met through the year 2034.

MS. HARBO asked if Buck was using only the members in the defined benefit plan or if they were including the defined contribution retirement plan members where the state pays the difference between either the 12.56% and the 22% to the defined benefit funds. MR. SLISHINSKY replied that Buck was not making any distinction between whether this was contributed by the employers or the state: it is just what the total rate is.

MR. SLISHINSKY said for TRS the additional contribution needed is $144 million per year for five years to get back on track to where no additional employer contributions would be needed by the year 2034.

MR. SHIER pointed out that the Board takes a long-term view to come up with an 8.25% annual investment return and would expect it to be above and below 8.25% year to year but somehow average out over time. Given that 8.25% return over time, there is a 25-year amortization over the next 21 remaining years after which it falls off sharply. He asked if Buck was saying that the recent investment losses fell outside the normal expected variation around that 8.25% return assumption over 25 years. To get back on track in five years the systems would have to do some heavy lifting, but he wondered if it would get back to the projections over 20 years.

MR. SLISHINSKY said there is a statistical analysis that can be done to determine the probability of this result. The standard deviation for an 8.25% return assumption is about 13%. That means that the retirement plans have a 68% chance that the return rate in any one year will fall between 8.25% plus 13% and 8.25% minus 13%. Two standard deviations is a 96% chance that the return rate in any one year will fall between 8.25% plus 26% and 8.25% minus 26%. Looking at the down side and using two standard deviations (8.25% minus 26%), that is about the -18.4% return assumption that Buck used for FY09. Two standard deviations is a 2% chance or once every 50 years. It is not that the most recent investment return is outside the bounds of an expected return, because there is an element of risk in the tails of that distribution. The -18.4% return assumption that Buck used in their analysis hits the bottom tail.

MR. SHIER summarized his understanding that Buck had calculated that the price of admission back to the 8.25% trajectory for paying off the unfunded liability in 20 years or so was to get more money into the retirement plans, either by extraordinary earnings or by dumping $322 million into PERS plus $144 million into TRS annually for five years — above and beyond the unfunded liability contribution made by the state right now.

MR. SLISHINSKY said that was the real question — what returns would the retirement plans have going forward, and what kind of market recovery would there be. He stressed that Buck's projections were based on a modest recovery, not on 8.25% returns long term beginning July 1, 2009. It was assuming better investment returns over a short period of time because of a modest recovery. Is that the right assumption? Should it be a strong recovery? Will there be strong enough returns over a long period of time going forward that will eliminate the losses so that the investment return gets back to the mean? Those are the real big questions that the Board needs to consider, especially going back to the earlier discussion about whether or not the 8.25% return assumption is reasonable long-term given the recent losses.

MR. PIHL indicated he wanted an action resolution with regard to the roll-forward approach, as well as a resolution with respect to Buck's approach to trying to avoid a projected dramatic increase in the employer contribution rate.

CHAIR SCHUBERT stated that the Board took action to accept the fiscal year 2008 certifications and valuations but did not follow the two staff recommendations provided in the board packet, leaving the action somewhat confusing. She suggested bringing up the prior action to clarify what the Board intended.

<u>MR. TRIVETTE moved that the ARMB reconsider the prior action to accept the fiscal year 2008 certifications and valuations</u>. <u>MS. HARBO seconded</u>. The motion passed unanimously.

CHAIR SCHUBERT read aloud the staff recommendation from the board packet.

<u>COMMISSIONER KREITZER moved to amend the original motion to be clear that the ARMB is formally accepting the review and certification of actuarial reports by Gabriel Roeder Smith & Company, and that staff coordinate with the Division of Retirement & Benefits and Buck Consultants on the discussion and implementation of suggestions and recommendations of the reviewing actuary where the Board considered that appropriate</u>. <u>MR. WILLIAMS seconded</u>.

The vote on the amendment to the original motion carried unanimously, 8-0.

CHAIR SCHUBERT indicated the main motion was on the table and asked for any discussion. There was none.

The vote on the main motion passed unanimously, 8-0. [Commissioner Galvin was absent for the vote.]

<u>MR. TRIVETTE moved that the Alaska Retirement Management Board accept the actuarial reports prepared by Buck Consultants for the retirement systems in order to set retirement system employer rates</u>. <u>MS. HARBO seconded</u>.

MR. PIHL pointed out that the words "employer rates" were being used for the gross contribution rates. He suggested changing the wording to the "actuarially determined contribution rates," since the Legislature has set the employer rates at 22% for PERS and 12.56% for TRS. The employer rates are not the gross rates.

MR. TRIVETTE amended the motion to replace "retirement system employer rates" with "retirement system actuarially determined contribution rates."

MR. SLISHINSKY said the ARC would be more like an employer rate where there is assistance from the state. It excludes the member contributions. That is the typical calculation under GASB (General Accounting Standards Board), which is the amount of the required contribution to cover the actuarially required determination based on the actuarial methods that are used but excludes the employee or member portion of contributions. It is a rate that is contributed by employers and the state.

MR. TRIVETTE offered a second amendment to replace "retirement system employer rates" with "annual calculated contribution rates." He asked if that accurately got to the state's plus the employers' contributions.

MR. SLISHINSKY replied that it included the definition under GASB that does not include member contributions. That was the issue that he wanted the wording to be clear about.

CHAIR SCHUBERT asked Mr. Trivette to restate the entire motion.

<u>MR. TRIVETTE moved that the Alaska Retirement Management Board accept the actuarial reports prepared by Buck Consultants for the retirement systems in order to set retirement system annual calculated contribution rates</u>.

CHAIR SCHUBERT asked if there were any objections to the second on that.

COMMISSIONER KREITZER expressed concern that the motion was more confusing than the original wording. She was not certain it could be fixed on the fly and wondered if the Board could revisit this later.

CHAIR SCHUBERT asked for a motion to table until later during the meeting.

MR. TRIVETTE said he had no objection to tabling the motion.

MR. PIHL indicated that his same point about the use of the words "employer rates" applied to all the resolutions on the second day of the agenda.

MS. ERCHINGER noted that the resolutions on death and disability and retiree health excluded wording that was in the resolutions for PERS and TRS about what specific actuarial report the rates were based upon. She requested that those changes be included before the resolutions came before the Board.

LUNCH RECESS

CHAIR SCHUBERT called a lunch break at 11:53 a.m. When the meeting reconvened at

1:07 p.m., trustees Schubert, Trivette, Harbo, Pihl, Williams and Erchinger were present.

REPORTS (Continued)

7. Convertible Securities - Advent Capital Management, LLC

MR. BADER stated that staff arranged for an instructive presentation about convertible bonds and how their distribution of returns might benefit a portfolio.

F. BARRY NELSON, Senior Vice President of Advent Capital Management and Portfolio Manager, and ED JOHNSON, Chief Operating Officer, appeared before the Board with a slide presentation on enhancing portfolio returns by investing in convertible securities. *[A copy of the presentation is on file at the ARMB offices.]*

MR. JOHNSON offered introductory information about the firm: founded in 1995; $3.5 billion assets under management in three primary ways — long-only strategies, hedge funds, and closed-end mutual funds; and 49 employees with 20 of those on the investment team.

MR. JOHNSON said that convertibles are generally an overlooked asset class, and Advent spends a lot of time educating people about the attributes of the convertible market and the benefits of convertible securities. In 2008, there was a significant sell-off and down draft in valuations basically brought on by a credit crisis and the resulting belt-tightening. Many people had to sell securities, which became even more attractive than they typically are. Convertibles normally have positive asymmetry, which means that they have appreciation that resembles the stock market appreciation but with a buffering that occurs because of the bond value of a convertible when the stock market drops. There is more up side in a convertible at any given point in time than there is down side. The current environment has meant a significant number of new institutional investors coming into the convertible marketplace.

MR. JOHNSON stated that a convertible is first a bond that pays interest and principal and has an additional feature that allows the bondholder to convert that bond to common stock of the underlying company at any given point in time. A bondholder would want to do that when the stock market is appreciating, in order to capture the upside of the stock market. On the flip side, when the stock market is going down, a bondholder would have the protection of the actual bond value (the promise of the company underlying the obligation to pay back principal and interest).

MR. JOHNSON said that convertibles have characteristics of the equity market, but they will not capture 100% of the equity appreciation in a rising market. The benefits in return are typically higher than found in a bond but lower than seen in pure equities. On the risk side, the bond will protect as the stock market goes down — assuming that the convertible manager does the credit work right and the borrower can pay back the obligation at the bond's maturity.

MR. NELSON showed a graph comparing the performance of convertible bonds versus the S&P 500 Index from 1973 to 2009 to illustrate that over time convertibles do as well or better than common stocks, with much less risk. In most stock market up years convertibles did close to the S&P 500 (sometimes better), and in down years convertibles generally lost a lot less than the S&P. In 2008 convertibles suffered almost as much as the S&P, and that is the particular opportunity right now to get into an asset class that has a lot of recovery potential on top of its usual favorable characteristics.

Responding to MR. WILSON's question, MR. NELSON explained that year to date the convertible market has accelerated and is way ahead of equities because of the credit panic passing. Convertibles are in the mid to high teens, a typical rebound after a very big setback. Going forward, convertibles will probably be more sensitive to potential advancement in equities.

MR. NELSON said that convertibles can be classified as defensive equity or enhanced fixed income. Convertibles have been around since the 1830s, and Warren Buffett uses them to invest and occasionally to raise money as well. Convertibles have been in the news lately as a device to help with the capitalization of banks.

MR. NELSON stated that the U.S. convertible market is just under $200 billion right now, following a big setback last year. It is in a fast recovery, plus new issuance has returned. The liquidity of the convertible market is very similar to that of common stocks — much more liquid than corporate bonds because it is possible to hedge convertible positions using the underlying stocks. In the United States there are about 900 issues of convertibles and maybe 800 companies. It is an all-cap market, and those 900 issues are liquid, at least $75-$100 million minimum size. Individual issues go up to billions of dollars in size. Most of the convertible market is companies with an equity market capitalization of over $5 billion. Credit quality is all over the lot. Overall, the convertible market credit quality in the last year or two has been around BBB-, maybe moving down to BB+ now because of a smashing recovery in lower-rated securities this year. Companies that issue convertibles are typically growth companies that need capital: technology, healthcare, and drug companies are big issuers. Financials are big issuers because it is a way to improve their balance sheets, and a lot of financial companies need stronger balance sheets right now.

MR. O'LEARY asked if there are cyclical times in issuance where corporations are able to issue at minimal issuance cost. MR. NELSON said there was a period in 2004 when a lot of hedge funds were trading convertibles and making trading profits based on a highly volatile equity market. There was such demand from hedge funds that some convertibles were floated at the time that were called no-no's, that is, a thousand dollar bond with no interest coupon at all but you would get the thousand dollars back in five years or so. It was a bet by hedge funds on equity volatility, where the coupon return was irrelevant. These things have now become extinct due to the demise of the hedge funds. Oddities like this occur at very wide intervals.

MR. NELSON said it was okay with him if convertibles came on bad terms as well as good terms because Advent is under no obligation as investors to buy any new issue. Often it is a lot like buying new common stock issues: maybe they go up the first day but you are broke two or three years later. Some of the no-no convertibles dipped to very attractive discounts in the after market. Advent watches the market every day, and the after market often provides greater opportunities than the new issue market. The recent cycle in new issues has been cyclical companies that need to rebuild their capital. The different types of issuers come in fits and starts. The technology companies have been less active recently, but they will come back as they always have in the past.

MR. NELSON stated that new issues have been coming to market with more attractive terms, which means Advent will be buying some new issues. He referred to a Merrill Lynch Research chart that showed theoretical cheapness of convertibles since 1996 and a big peak in November 2008 at the height of the market panic. The Merrill Lynch All US Convertible Index return was -35.74% for 2008. Such an unprecedented setback in convertibles probably has not happened since the 1930. While there has been a big correction since then, convertibles still have room to recover and probably will do so this year.

MR. NELSON reviewed the opportunity in convertibles compared to high yield, saying that maturities in convertibles are shorter, which gives superior down-side protection. The average credit quality of the convertible market has been BBB- on average the last couple of years, and it is an all-quality market, unlike high yield.

At MR. BADER's request, MR. NELSON explained that convertibles often come with puts at par over an intermediate term: a new convertible may actually have a 20-year maturity but it will have a put in maybe three years. If something goes wrong (the stock collapses), the holder in the convertible has the right to put the bond back in only three years at par. This is a tremendous way to achieve excellent down-side protection. On the other hand, from the issuer's perspective, if their stock does do well, that bond could be outstanding for the whole 20 years. Put provisions were very frequent on a convertible bond two to five years ago but are less frequent now. More recently, maturities have been shortened. A few issues this year came with three-year maturities. Convertibles do not need puts if they mature even in five years. Obviously, there is excellent down-side protection in short-term bonds.

MR. NELSON stated that convertibles do as well as equities with less down side and lower volatility, and this has been tracked back to 1953 by Ibbotson.

MR. TRIVETTE asked about the index. MR. NELSON said Advent prefers to use the

Merrill Lynch convertible indices. Merrill Lynch has 20-30 sub-indices, which are very useful to Advent to figure out if they have been lucky or smart, or unlucky or stupid. Plus, Merrill Lynch has excellent transparency in revealing exactly how they construct the indices. Finally, convertibles correlate fairly well with the S&P 500 Index over a 10 to 20-year period.

MR. NELSON stated that, given the dramatic decline in the convertible market in 2008, there is no reason not to expect superb performance over the short term. The current year could be as good or better than 2003, when the indices were up 27%. The Merrill Lynch All US Convertibles Index was up almost 40% in 1999 because a lot of dot-com companies floated convertibles because they had no cash flow and no revenues and they needed capital and had great stories. The bonds went straight up. Advent did not buy them, and it was their worst year ever relative to the benchmark, but they got it all back the following year when these things collapsed. The convertible market is always changing.

MR. BADER asked what drove Advent away from the dot-com company convertibles in 1999. MR. NELSON replied that Advent Capital is credit driven, and how could they buy these bonds when the companies had no cash flow. Advent also looks at valuation because they want underlying stocks that look attractive. Advent bought railroad convertibles in 1999, and people were laughing at them. But three years later they had compounded maybe 20% a year while the dot-coms had gone straight up and straight down. At the time, it was possible to calculate that some new dot-coms that were only six months old and just dreams were trading at the equivalent of the Canadian National Railway.

MR. NELSON next discussed the outlook for the convertible market. The market is growing again with new issues and appreciation. Credit spreads remain wide, so the opportunity exists for spread tightening to enhance the down-side protection and raise the bond value. Hedge funds have gone out of business and their selling pressure has abated. Traditional buyers are coming into the market, not only institutional investors allocating to convertibles but money managers who run equity accounts and straight corporate bond accounts, in order to enhance their returns. This is stable investment money, unlike the leveraged hedge fund players who are mostly gone.

MR. JOHNSON reviewed four ways convertibles are attractive right now:

- The average put or maturity date in the convertible market that Advent manages in this strategy is about three years. It is buying a discounted bond security that will pay interest as it accretes to par and that is three years maximum outstanding. Advent has never had a loss due to a bankruptcy or default in the history of the firm, and that is because they do fundamental credit work. If Advent does its work right, the investor, in a worst case, has a positive rate of return in the 6% to 9% area right now.
- There is a credit component to a convertible because of its bond characteristics. So

if credit spreads tighten, investors will benefit.

- If the equity market rallies, investors will capture a significant part of the up side of equities.
- If there is volatility in the equity markets, it would increase the theoretical value of the conversion option. Investors can win by nothing else happening other than volatility spiking.

MR. O'LEARY mentioned that three years ago yields were in the 3%-6% range. MR. NELSON said yields could have been even lower than that. There was a credit euphoria through 2006 into 2007. One reason for the collapse of the hedge funds was that the only way to maintain double-digit returns was to leverage up lower returns, and ultimately that just backfired on the players who did this.

MR. JOHNSON examined what happens if the equity market crashes. Convertibles will do poorly but not follow the equity market down as far because of the bond value inherent in that convertible. If Advent does its credit work right, and the borrower can pay that obligation back, the investor will do relatively better than equities in a crash. If credit spreads blow out, the other credit instruments one could invest in will all be out. Convertibles will be out somewhat, but they won't be out as far because of the equity component — investors still own the ability to convert to an equity. And volatility often spikes up in times of economic strife: in that case, if nothing else happens, investors could expect to get an enhancement in the option valuation inherent in the convertible.

MR. NELSON made the observation that convertibles are at least complicated and at worst completely confusing. This is one reason why there often seem to be chronic opportunities in convertibles. The efficient market theories really do not accommodate the idea that one can invest in convertibles at much lower risk than equities and yet obtain equity like returns. But it really does happen, and this is Advent's specialty.

MR. NELSON spent a few minutes explaining two specific convertible bonds in Advent's portfolio — Transocean and Lucent Technologies — compared to the same companies' straight bonds.

Responding to a question from MR. RICHARDS about the coupon rate, MR. NELSON said that a new issue convertible comes at a lower yield than a straight bond because of the option to convert the convertible bond to equity. It is in the after market where Advent sees opportunities for hugely attractive yields by getting convertible bonds at a discount.

MR. NELSON briefly reviewed Advent's Phoenix Strategy that buys convertibles in the after market for less than par after something has gone wrong with the common stocks, but where Advent's credit and equity work indicates that the companies are all right. Advent had 11 consecutive years of positive returns with this strategy, but a perfect storm finally hit them last year and they lost 20% — yet the convertible market was down 35%. This strategy provides higher yields than convertibles, lower volatility than the convertible market as a whole, and less down side than the convertible market. He said he and the founder of Advent, Tracy Maitland, have run this strategy with the same discipline since October 1996.

MR. TRIVETTE thanked the gentlemen from Advent for their presentation.

[Commissioner Kreitzer rejoined the meeting at 1:52 p.m.]

8. Performance Measurement - 1st Quarter 2009

MR. MICHAEL O'LEARY, the Retirement Board's general consultant and Executive Vice President of Callan Associates, Inc., told people that a lot has happened in the markets subsequent to the March 31, 2009 quarter end and he would give an update on that, as well. *[Callan's slides and other materials for the March 31, 2009 total fund performance are on file at the ARMB offices.]*

MR. O'LEARY displayed a graph that illustrated that interest rates have begun to go up for Treasuries. The 10-year Treasury recently backed off the yield that had gotten up to 4%, but it is still in the 3.6%, 3.7%+ range. That is a big change and a reversal of the flight to quality. On a calendar year-to-date basis, a long Treasury could be down over 20%. That reflects how much of an aberration in value there was during the fourth quarter of 2008 when people wanted out of whatever they were invested in and into something that had no risk. So there was a mini bubble in Treasury yields that was most apparent at the long end of the curve, and that is changing. That is a tangible indication of health returning to the financial system. It is also, unfortunately, an indication of mounting concern with regard to the risk of future inflation.

A graph showing performance by asset class for the March quarter and the trailing 12 months indicated that it was generally ugly across the board. International equity and emerging market equity performed more poorly than other equity indices. A remarkable change began to occur in the first quarter: January and February were terrible for equities; March was very strong but not strong enough to offset the first two months of the quarter. Emerging markets actually had a positive return in the March quarter. High yield bonds had a positive return in the quarter, as well.

Callan had taken the performance of large, mid and small capitalization indices and divided them among value, broad sector, and growth styles over different periods. What was apparent is that over the last five years the small cap indices have underperformed the mid cap, and the mid cap has outperformed large cap. In the last quarter, the growth indices did better than the value indices across the board.

MR. O'LEARY stated that the dollar was a negative for international equity returns in the March quarter but subsequently has become a positive (dollar weakening).

The NCREIF Index for real estate was down 7.33% in the March quarter, and for the trailing year the index was down 14.68%. Further, the retirement fund's real estate portfolio significantly underperformed the NCREIF Index. MR. O'LEARY mentioned that at the last performance review for the Board he had touched briefly on the NCREIF Index and the challenges of valuation. The NCREIF is an unleveraged index that looks only at the property level performance and reports the numbers pre-fee.

MR. O'LEARY said real estate valuation involves making a projection of the future income that is expected from a property. That estimate is affected by an analysis of the structure of the leases that are in place on the property: What does the lease roll look like? Are the contractual leases on the property at, above or below market rates today? How occupied is the property? The other part of real estate valuation is to determine the rate to discount the future flow of income at. In general, depending on the property type and location, real estate is being valued at a 7%-8% discount right now. An increase in the discount rate results in a decline in the value to pay for the property. Just as the Board heard in the convertible bond presentation, the people who have been active in real estate have employed a lot of leverage in their strategies and now cannot either service the debt or refinance. That creates distressed sellers.

MR. O'LEARY said there are some anomalies, specifically in how frequently the income stream is re-appraised and how rigorous it is. In the NCREIF series there is a series that traces the capitalization rates on properties where there has been a transaction in a recent period. Those cap rates are significantly higher than the current value (appraisal) cap rates that are used in the appraisals. That suggests that there is still more value adjustment to come.

MR. O'LEARY mentioned that another factor is that accounting standards changed prior to the equity market decline, and Callan is seeing right now the effect of more market-like valuations of private equity investments. That was apparent in the December quarter. The Alaska retirement plan real estate returns, which Callan gets from the Townsend Group, are contemporaneous with the quarter for which Callan reports performance. Other plans lag the real estate returns by one quarter, so they may only now be seeing the calendar year-end returns imbedded in their total fund performance in the March quarter. The ARMB saw the December valuation adjustments in the December performance report and is now seeing the March numbers in the March report.

MR. O'LEARY stated that on the private equity side the partnerships are so slow in reporting that the norm in the industry and in the Alaska retirement fund's case is that the most recent valuation will be at least one quarter old adjusted for subsequent contributions and distributions. So with funds that have a very meaningful portion of their assets in private markets, the total fund rates of return may vary a lot from one to another. He did not think anyone would have a good handle on this through the end of the state's fiscal year in

June. He thought that the Alaska retirement fund was toward the more conservative end, given the performance reporting policies the Board has. The ARMB is not building in the lag to the extent that other funds have. The ARMB does not have a huge portion of the portfolio in private markets, but many endowments and foundations may have 30% or 40% of their assets invested in illiquid markets.

MR. O'LEARY talked about the period June 2008 to December 15, 2008, which was the period of maximum market stress. During that six months, investment grade corporate financials had a -22.6% return compared to duration-adjusted Treasuries. From December 15, 2008 through June 15, 2009, a period of recovery on balance, those same financials had a 10.9% excess return. High yield debt in the first period had a -45.2% excess return. Treasuries went down in yield and up in value; high yield debt went down just like stocks. The S&P 500 Index in the first six-month period was down just under 47%, and in the subsequent six months it came back up 14.6% — it is a very long way from being even. Amazingly, two-year AAA-rated auto paper and two-year credit card paper are basically back to where they were a year ago. The TALF (Term Asset-Backed Securities Loan Facility) Program has contributed importantly to that change. Non-financial investment-grade corporates have come down a lot from three months ago.

MR. O'LEARY drew attention to graphs showing that oil and other commodity indices have moved up in price as of the end of May. These are tangible signs that things economically seem to be getting better, despite the continuation of bleak news like a 9.4% unemployment rate.

MR. O'LEARY presented research by Fidelity that traced the historic composition of eight stock market recoveries that followed major market declines. The research showed the performance for each sector in the S&P 500 in the subsequent three months, six months, and 12 months, and the number of times a sector was a leading sector during one of the recoveries. Not surprisingly, consumer discretionary, which is highly cyclical, was at the top of the list. Financials tended to do well, as did small cap stocks. Many of the things that do the best in a recovery are the things that have done the worst in the decline. For example, Bank of America stock a couple of months ago was down near $3 a share: today, it is at $12-plus a share. But for most people their cost basis for Bank of America shares is $20-$30 as opposed to $3.

MR. O'LEARY stated that a majority of people believe that an economic recovery will begin late in 2009, and that is Callan's house view. Of late, talk has emerged that maybe things are feeling better but it will not stick because the feeling better right now is a result of the economic stimulus that happened last year and there won't be much of a bounce in a real economic sense. The detractors point to 30-year mortgage rates at more than 5.5%: when rates were below 5%, the level of refinancing activity was very high. People are questioning if there can be an economic recovery with housing prices continuing to decline.

COMMISSIONER KREITZER mentioned reading that some people think the economy is in for another hit from adjustable rate mortgages, maybe even worse than the subprime crisis. She asked for Mr. O'Leary's thoughts on that.

MR. O'LEARY replied that it is very disheartening that the mortgage delinquency rates and foreclosure rates in prime mortgages, including jumbos, have been rising. People, who almost by definition were less risky credits, are also suffering if they lost their jobs. That is a concern. Even people with jobs are unable to afford mortgage rates that adjusted higher.

COMMISSIONER KREITZER asked if Callan had factored in the potential implosion of adjustable rate mortgages and how that would impact the ability for the housing market to recover.

MR. O'LEARY said that when Callan debated internally the capital market people said that was why they thought it would be a slower recovery than trend. Normally if the economy drops off a cliff, when it begins to recover it ought it shoot back up. Housing starts for a protracted period have been below new household formation, auto production has been below auto scrappage rates, and inventories in many business are at very low levels. Things like residential construction have traditionally helped drive a recovery, but maybe this time it will have to be more the infrastructure construction to get people working, because there is a huge inventory of homes. More importantly, who can afford to buy the houses, even though the prices are low? Maybe after the summer shut-downs of the big auto producers there will be a discernable pick-up in production, just because they will have gotten rid of so much excess inventory. It is easy for there to be a measurable increase when going from no production to any production. It is not a foregone conclusion that we are off to the races. People genuinely seem to be becoming more concerned with how to afford all the things that are being put on the table.

Continuing with the "Where from Here" discussion, MR. O'LEARY said there is concern about the unintended consequences in the allocation of capital because of all the government programs. The contractual rights and the position of creditors are also a big concern because of a recent event. [A group of Indiana pension funds are opposed to the terms of Chrysler's sale of Fiat that put junior creditors ahead of the rights of senior lenders.] If the subordination of senior lenders becomes a pattern of action, it would affect future spreads.

MR. O'LEARY said the asset management business has been seriously hurt by huge asset losses. Staff reductions are common, products are being closed, and companies are combining businesses. He cited Barclays Global Investors (BGI) combining with BlackRock. BGI is a preeminent index fund manager but they also have active management strategies: What will become of them? Things may turn out to be wonderful, but Callan is seeing more of this type of unusual change. The good news is that it is a good time to negotiate fees with managers. Some investment areas have very high fees, and it makes sense to attempt re-negotiating terms.

MR. O'LEARY next reviewed actual asset allocation versus target allocation at March 31, using the PERS fund as the proxy. The fund was under allocated to equity and basically over allocated to the illiquid markets. In a relative sense, staff has done a good job of rebalancing. But unless the market tanks, in the June quarter the vast majority of funds will underperform their target indices because they will be under allocated to risk assets. Relative to other public funds, ARMB has a very small fixed income allocation, so that hurt in the March quarter.

The PERS total fund return was -7.53% for the March quarter, which was worse than target. For the trailing 12 months the PERS total fund had a -27.19% return. The biggest shortfall was in real assets, which had a 20.89% decline, against an index decline of 7.87%. The real estate component of the portfolio's real assets for the full year was down 27.68%. On the private equity side the 12-month return was -17.56%, while the target return that uses a blended index of public equity markets was down much more. That suggests that there is more bad news coming in the valuations in the private equity area to bring them more in keeping with the public equity markets over time. MR. O'LEARY said he was pleased to see that the total fund did better than the target index over the trailing 12 months and that the manager effect was positive, although he took with a grain of salt the positive 2.0% manager effect for private equity. A return range of -25% to -30% for the year was probably typical for funds that have reasonably current valuation procedures for their real estate and private market assets.

MR. O'LEARY said the cumulative total fund returns were fractionally below median for the year. He noted that Callan was reporting the numbers per the client's policy, so if a fund is lagging their real estate a quarter their return captures that. The total fund returns were above median and above target for the longer periods.

MR. O'LEARY next reviewed retirement fund performance by the major asset categories:

- Large cap equity did slightly better than the median manager in Callan's large cap style database for the quarter and fiscal year to date, and was at median for the trailing 12 months.
- Small cap equity was right at median for the year and fiscal year to date, and was below median for the quarter. The more growth orientation one had in the small cap portfolio in the quarter, the better the relative return.
- Total bond performance was strong for the March quarter relative to Callan's public fund domestic fixed income database and right at median for the trailing year.
- The in-house bond portfolio performance compared to Callan's core bond style group was very strong for the quarter and essentially at median for the trailing year.
- International equity had attractive performance relative to other public funds for all periods and was basically above benchmark with the exception of the most recent quarter.

- International equity minus emerging markets had a similar pattern but not as dramatic.
- The emerging markets equity pool was very strong for the quarter and fiscal year to date, thanks to Capital Guardian. The Board will be meeting with the other two emerging markets managers today, Eaton Vance and Lazard. Lazard's performance was very competitive, as well.
- The Lazard global equity portfolio had very strong relative performance.
- International bond manager Mondrian had very strong performance, as well.
- The composite of the fund's absolute return vehicles was way behind the target, but the relative performance was very strong. There are three absolute return managers: Cadogan, Mariner and Crestline. Cadogan and Mariner have both been doing very well. Crestline has been lagging a bit but is still not far from median. Both Cadogan and Mariner are on the ARMB manager watch list; Cadogan for asset growth and Mariner for performance. Now Mariner's performance is right at the top of the heap.
- The composite of the retirement fund's two high yield managers has done very well. Rogge (formerly ING) is on the manager watch list because of an ownership change. Because the managers did very well during the poor market, Callan expects them to lag in the recovery. But during the March quarter, the sum of the two managers had a positive return.

MR. O'LEARY presented performance and asset information for the Supplemental Benefit System (SBS). The performance on all the investment vehicles was very close to the benchmarks, and during the March quarter was a tad above target for most of the vehicles.

MR. O'LEARY reviewed performance specifically for the investment managers on the ARMB watch list:

- Rogge (formerly ING) high yield manager had attractive relative performance.
- Cadogan absolute return did not have a great quarter, but their performance has been relatively strong.
- Crestline absolute return was a bit of a laggard.
- Mariner absolute return had a very strong period of relative performance.
- Capital Guardian domestic large cap equity - their cumulative performance for many of the interim periods still warrants being on the watch list. Fortunately, they had a relatively decent quarter.
- Relational domestic large cap equity is on the watch list for performance reasons. They have eight stocks in the portfolio, and in the quarter those were the right eight stocks.
- At its April meeting the Board acted to terminate State Street Global Advisors international equity. While SSgA did not shoot the lights out in the March quarter, they did well subsequent to the end of the quarter.

MR. O'LEARY apologized for rushing through the last part of the performance material but he felt it was important to spend the time he did on the macro setting at the beginning of his presentation.

MR. PIHL inquired what impact the President's new consumer protection act would have. MR. O'LEARY replied that he did not know enough about it to have an informed opinion, but he promised to get an answer. He is in the camp of believing in capitalism and private markets. He reminded everyone of being together in September 2008 in the midst of the crisis and said that extraordinary times require extraordinary actions. He supported many of the actions that have been taken, but he worried about other actions that may flow from that and the effect on the economy and the outlook. He is happy with clients that have meaningful international exposure and emerging markets exposure.

CHAIR SCHUBERT called a scheduled break from 2:50 p.m. to 3:04 p.m.

9. Economic Roundtable Discussion with Emerging Markets Managers

MR. BADER, acting as moderator, introduced the panelists for the economic roundtable, who were representatives of ARMB emerging market equity managers: JAMES DONALD, portfolio manager in emerging market equity at Lazard Asset Management; GANESH RAMACHANDRAN, manager of emerging market currencies and debt at Lazard Asset Management; and DAVID STEIN, chief investment officer of Parametric Portfolio Associates, a subsidiary of Eaton Vance Investment Managers. MR. BADER explained that roundtables are an efficient way for the managers to talk about market conditions together instead of each individually in their scheduled presentations later in the meeting.

Moderator Question: *How do political risks or other potential for nationalization impact your portfolio management decisions?*

MR. RAMACHANDRAN: They do have a very important bearing as we analyze risk. The key point is that we are acutely aware that we are not political experts in this space. It is difficult to be a political expert on 40 to 50 different economies, so we look at politics from its impact on macro economic risks or as a reason to reduce exposure. So a nasty political outcome, a binary outcome — sort of God's gift to capitalism running against God's gift to communism — that kind of an election. Typically, there will not be a reason for us to add exposure. We do not bet on political outcomes. The other thing to keep in mind is nobody tightens policy in the run up to an election. That is not just in emerging markets; that is true of every country everywhere. So when there is an election coming up, you can typically expect looser monetary and fiscal conditions — looser fiscal most definitely, and looser monetary if the central bank is not independent of the politics. That is one of the key things I have to stress on from the impact of politics.

MR. DONALD: On the equity side, we are very lucky we have Ganesh and the team he works with right next to us. We also have another team that invests in portfolios that invest in closed-end funds and investment trusts, and they are very focused on macro economics and politics. But political issues in particular, we will look at the general issues politically, but we will discount company target prices effectively for certain macro economic and political factors that we think are very important. They tend to be very specific to the company itself. For instance, if it is an electrical utility in Brazil, where the most likely winner of the election is adamantly stating that he doesn't want tariffs to go up, that is a factor that we can use in terms of discounting the target price of a company directly. We've had cases in Russia recently where we've had to go in and try and estimate political risk on actual companies. So a company like Lukoil today, we do think the relationship between the Kremlin and Lukoil is pretty good, better than the relationship between the Kremlin and MTS (Mobile TeleSystems), and we actually have to discount for that factor directly.

MR. STEIN: I'd like to pick up on the theme that Gary mentioned directly — nationalization as a subtheme among political risks. I am paranoid about nationalization. I see it as basically stealing from investors. I am really concerned about investor protections, so we watch for that really very careful. Political risk more generally is a tricky subject, depending on what one means by political risk. I like to think of liking countries more if levels of economic freedom are stronger. And to the extent that political risk is corruption or other abusive type notions or dislike of capitalist economic systems, that causes some concern. For us, this is not something we think it is necessary to focus on in great depth in that it is usually quite clear when that is happening.

Moderator Question: *Are there any countries that are in the index now that you are avoiding because of fear of nationalization or some extreme governmental intervention?*

MR. STEIN: There are none in the index right now. There have been, in the past, times when there were some in the index. For example, Venezuela was in an index a couple of years ago, and we withdrew from Venezuela before the index basically kicked it out.

MR. DONALD: We also had the same situation with Venezuela. For us the issue was that the supreme court was filled by President Chavez's friends. Chavez had tried for several years; he finally did it by late 2005. So in January 2006 we made a decision that the rule of law did not exist in Venezuela. We considered seriously the possibility of Russia last year, in terms of the rule of law. The litmus test was probably TNK-BP, where BP was allowed to stay in Russia in that business. There were some things that irritated us about that from a political point of view, but the primary fight was not really between the government and BP, it was primarily between BP and its oligarch partners.

Question from Chair Schubert: *Do you think that emerging markets still provide a significant diversification benefit for funds like ours?*

MR. DONALD: I think that, as an index, diversification benefits are pretty low today. It is clear to us that correlations have increased. They have been pretty volatile. They have had a stabilization trend in the last couple of years, but they are reasonably high; they are above 80%. As an index, the correlations are pretty high. I think specific strategies can have significantly lower correlations and can have much greater benefits. We are going through an evolution from emerging markets equity being what people think about in emerging markets to a situation where down the road the next five years people will think about all sorts of different tailored strategies for different investment needs in emerging markets. Part of it will be things like local currency debt. But there will be all sorts of different uses for very well-defined strategies that will not be as highly correlated as the index.

MR. STEIN: I would take perhaps a slightly different point of view. I think it is a mistake to focus on short-term correlations. Correlations in emerging markets seem all over the place. There is a great deal of different kinds of things that are happening. Depending on the period, you are going to see different kinds of correlations. Just looking at the returns over the last three or four months, different markets have performed very, very differently. The story in Eastern Europe, for example, has been very different than the story in Brazil or in Taiwan. So I see emerging markets as providing diversifying benefits. And they do behave still very differently than developed markets. In a crisis, such as the awful crisis that we've been living through, things happen. There are times when the correlations go to one, where there is no place to hide. That does not mean to say that correlations will always be one or that one shouldn't invest with diversification in mind. Diversification is about doing different things and does not guarantee you a protection on the down side, as you separate between a reason for diversifying and a protection on the down side. Those are different things.

MR. RAMACHANDRAN: To expand upon that, I think it is absolutely true that recently you have seen correlations spike up to one and volatility go up. There has been no benefit for diversification. But if you look beyond that — and I'm speaking from a macro standpoint here — if you look at any which way from yield curve diversification, from the kind of economies that you get defined in emerging markets, you have commodity exporters. At the same time, you have commodity importers. You have very different economic structures. So there is tremendous call for diversification. That does not mean that there won't be the odd quarter or even two where that diversification benefit vanishes. But when I step back and see what it took for this diversification benefit to go away for a brief period, I think you saw a perfect storm, truly a confluence of very horrible events. I think structurally that diversification benefit is well in place.

Moderator Question: *Are we in the midst of a bear market rally or a global recovery?*

MR. STEIN: I don't know, that's the quick answer. My own view is just sit in there and hang on. It is a mistake — and I hope I'm not offending anyone — to try to time too quickly decisions like this, and in the long haul it is not going to even matter whether it is one or the other.

MR. DONALD: Nothing is for certain, but I have a strong degree of confidence that we have seen the worst in emerging markets. I felt this view since at least October of last year. The reason for it is that if I look at what has been going on I think politicians around the world were very alerted to the dangers of deflation and depression, and have basically acted in a way whereby they would almost do anything in order to make sure that a depression did not happen or a very severe deflation did not happen. I think they have done that. If you look at monetary policy and fiscal policy in most parts of the world recently, particularly in the developed world, they have pulled out almost all the stops. I'm not saying there is a nil chance of it occurring. I still think there is a possibility of some sort of political error that could result in a very negative set of circumstances occurring. So protectionist legislation, for instance, would be seen as very negative in this type of environment and could have major risks. But, in my opinion, I think we've got an 85% chance that we're in a recovery much like the 1970s, a period of relatively robust, relatively more volatile growth, and in fact rising inflation over time.

Moderator Question: *Do so-called frontier markets have any place in your investment strategy?*

MR. STEIN: Yes. I see frontier markets as providing great diversifying benefits, as well as great long-term growth opportunities. They are a significant part of our strategy.

Moderator Question: *Can you give us an idea of what countries you might include in that category?*

MR. STEIN: We have frontier countries all around the world. A number of the Eastern European countries are in our portfolio, a number of African countries — Botswana, Ghana. A number of Asian countries — Vietnam, for example. There is a whole list I'd be happy to disclose to you as we go through out presentation later.

MR. RAMACHANDRAN: Yes, frontier markets have played a very important role in our portfolio, as well. It peaked at around a third of our portfolio in 2007. We picked them for both offense and defense reasons. What we like about them is their very low correlation, plus the fact that the stories are sometimes a little bit obscure. A lot more effort goes into doing the research and analysis, but once that is done, it gives us an advantage in that the market in these countries is driven by country specific issues. It does not matter that there is a subprime crisis in the U.S. for, say, the Ugandan tea market. We do find frontier opportunities, we've been investing in them for over ten years now. They range from Uganda and Ghana and Tanzania in Africa to Costa Rica and Vietnam. So anything that is not G-7 we will look at.

Moderator Question: *Setting aside emerging markets, we always like to ask panelists what their favorite investment would be tomorrow if they could not go into emerging markets.*

MR. STEIN: I was at an emerging markets conference in January when things were looking a lot more bleak than they are now, and a similar question was asked, which is your favorite currency, rather than which is your favorite market. The one that I liked the best was let's buy futures on Bordeaux wine. Switching to asset classes, I have to admit I'm relatively passive and don't like to even hazard such a notion. But since you are forcing me to, I'll say commodities have some up side. I think they were beaten down very hard.

MR. DONALD: I'd like to be the contrarian here and say that large cap global equities seem to be an area, at least in the next year or two, that could have some significant recovery potential.

MR. RAMACHANDRAN: This is not my area of expertise here, and I'll throw in all the usual disclaimers. But there has to be some value in credit, but I do realize what the market has done in April and May, so I'm going to have to rethink that.

Moderator Question: *Do you have a view on the dollar?*

MR. DONALD: Against emerging market currencies I think the dollar will fall over the next three or four years. I would expect it to be a reasonably gentle decline against most emerging market currencies because I think a lot of these countries do not want their currencies to rise dramatically against the dollar. I don't think there will be an enormous movement between the dollar and the euro. The yen I think is the wild card. A lot of things really are based on what happens in Japan in the course of the next couple of years. The yen could be either very strong or could be sideways.

MR. RAMACHANDRAN: I agree with James about the view versus emerging markets, but I do think there will be a distinction. Some emerging markets, Eastern Europe for example, there are some parts that are still broken. I also expect the dollar to weaken because I think that is the path of least resistance. It is the play book from the 1990s when you have accumulated as much leverage as we have. One of the least painful solutions, the relatively painless way to do it, is to inflate. And if you have to think about what to do to attract an investor into the bond market, there are two ways, especially if the investor is a foreigner. You either offer a cheaper dollar or higher rates. I don't think we can afford higher rates now. We are quantitatively easing. So the cheaper dollar has got to be a very obvious outlet. I think there is definitely strengthening in emerging markets simply because even though this crisis has been as huge and all-encompassing as it has been, we don't have a structural breakdown in the banking sector in many of the emerging markets. It is more cyclical. Not to the extent that the Western European and the U.S. banking systems have seen a hit. So I think for various reasons you will see emerging market currencies strengthen quite strongly versus the dollar.

Question to Mr. Ramachandran: *You run an emerging market debt portfolio with your* *colleague. What countries are you overweight?*

MR. RAMACHANDRAN: If I had to draw a theme it would be countries such as Brazil, India, Indonesia. One common factor is we are looking for large relatively closed economies that are not being driven by trade and trade alone. We spoke about protectionism earlier, so we are trying to avoid, if we can help it, having to form an idea about things like that. We are also trying to avoid countries that depend on growth on trade and especially trade with the western consumer. So countries that can drive their growth, that have the ability and the willingness to drive their growth because of their reserve cushion. So essentially building railroads and things like that to keep growth going. In the long run, it will have its own impact, but in the short term it is pretty essential for growth. So we tend to favor countries like that.

MR. STEIN: I can't complete disagree with my co-panelists [view on the dollar]. I certainly am really worried about the potential for inflation in the United States, as well. I'm a little comforted by the fact that through the economic crisis, in the depths of the crisis, the United States dollars, which has gotten so much flack for so many years, strengthened remarkably. It was interesting how much money fled to the dollar. So it is still the currency of choice.

Question from Chair Schubert to Mr. Ramachandran: *You said you were overweight in three countries, and China was not one of them. Is that because its economy is fueled by trade, or what is the reason for that? I had actually read or heard something that China is expected to emerge from this crisis as a global powerhouse.*

MR. RAMACHANDRAN: I should have made that clear. I was speaking specifically from a local currency and debt standpoint. Now for China, I do believe they have the ability to grow, to the extent that you can trust their growth statistics. I don't think it will dip below 7%, just because they won't say if it will. We have some exposure to the Chinese [unintelligible] through the offshore forward market. The reason why we are not more aggressively overweight is because of the valuation. The currency already reflects a very strong appreciation trend. If it does sell off to the extent where maybe some weakening is factored into the forward market, we will take that chance to add. We still think that inflation in the very near term, I think you will find policy makers worried more about deflation and falling prices than about rising prices. These currencies don't have to strengthen because of inflationary fears in the very near term. I think they will have to strengthen simply because they've already seen why it is useful to have piles of dollars when things go wrong. It also does hurt when you have a quantitatively easing currency making up most of your $2 trillion pile of reserves.

Question from Mr. Richards: *No excuses are necessary about spotting or recognizing the recent collapse of the market, but do emerging markets lead or follow things like this, and did you learn something about emerging markets as being a harbinger of this global* *problem? Did they set the pace? Did things start happening in emerging markets first, last, or flow right along with the group? And how are they going to fare in the future for your groups to recognize that something is going to happen around the world?*

MR. DONALD: In the last 20 years when there have been problems around the world, usually they have been in emerging markets, so usually the attention has all been on us. So this case was a bit of an exception because really the problems have been here in the U.S. and Western Europe, and they have been caused by issues in the financial services industry and are the direct result of higher credit costs. Again, it is not usual for us to look elsewhere for problems, but this has been very much a case of that. Usually they happen with us first, so we get to see them, whether it is the Mexican peso devaluation in 1994 or whether it's the Thai bat devaluating leading to the Asian crisis and six currencies devaluating very quickly. Or even the Russian devaluation and default in 1998, which was basically coincidental with the LTCM (Long Term Capital Management hedge fund) crisis. I'm not sure if I've learned anything. Perhaps what I've learned is problems don't just have to happen in emerging markets: they can happen elsewhere. And when you have very, very long periods when there aren't problems, when the problems come they can be enormous. If you look back five or six years and you described what we've lived through in the last 12 months, I don't think a majority of U.S. or European investment professionals would have been able to believe what has happened. But it really has been enormous. We used to have recessions every five or six years. We really didn't have a major recession for about 19 years, and we appear to have paid an enormous price for it.

Question from Mr. Pihl: *How much does the richness or abundance of natural resources play in your selection of countries?*

MR. STEIN: From our point of view, it does not play a major role. We certainly do look at natural resources, in terms of our diversifying, but the choice of the country does not depend on natural resources for us per se.

I'd like to go back to the previous question on emerging markets and what we learned from this crisis. This crisis started in the United States and developed countries. But the recession is a global recession. To some extent, many of those countries will get hurt a great deal more than the developed countries because of the nature of what they are doing. I think each crisis is different. I don't know that it's possible to anticipate how to behave or what to do in a crisis. I think that is what a crisis is, it is something that you haven't really seen before and you are sort of lost. From my point of view, I don't know that there was a great deal I learned that I didn't know intellectually could happen. We know there are things that could happen. We know wars can happen, there are major terrorist activities, we know that there can be major natural disasters. These things can happen and will happen at some point everywhere. But what I learned was this feeling in the depth of the gut as you live through it and feel it differently, that was something new.

MR. RAMACHANDRAN: One of the key things that was striking for me was how quickly the term moral hazard disappeared. Remember, in the run up to the crisis you couldn't read a sentence without tripping over it. When I sit down to analyze policymakers and their behavior I will learn to give that word its proper rating. In other words, if things have got to be done, they have got to be done. I actually think policymakers have done as well as they could have without all the information that we now possess. Moral hazard does not mean much when things are really going down. In terms of the natural resources, we do not in aggregate in the portfolio try to express a view. Of course, the key reason when you look at a Venezuela or an Argentina, you have to acknowledge that they make most of their money selling commodities. So we tend to incorporate a country's position on commodities. Venezuela exports oil and Korea buys pretty much every barrel of oil it consumes. So that does get factored in. But the whole portfolio will have both oil exporters and oil importers, for example, and it will not be used as a simple way to express a view on commodities.

MR. BADER thanked the panelists for their participation and said he looked forward to hearing their presentations on their specific funds.

10. Eaton Vance Investment Managers - Emerging Markets Equity

KATHARINE KASPER, senior relationship manager with Eaton Vance, and DAVID STEIN, chief investment officer of Parametric Portfolio Advisors, made a presentation on the Eaton Vance Structured Emerging Markets Mutual Fund in which the Alaska retirement plan is invested. *[The Eaton Vance presentation slides and supporting materials are on file at the ARMB offices.]*

MS. KASPER first talked about the Eaton Vance firm. They had $119 billion in assets under management as of March 31, down slightly from $125 billion at the end of 2008. The decline is mostly attributable to the challenging markets, but they have been fortunate to have positive net inflows in each of the last several quarters. Eaton Vance has a diversified business, which helps in markets like this. Twenty percent of the assets are institutional. The ARMB is invested in an institutional mutual fund, which would fall under the retail assets.

MR. STEIN stated that Parametric Portfolio Associates, a subsidiary of Eaton Vance, has been in business since 1987. They manage about $22 billion, of which $3.5 billion is in the emerging markets strategy that began in 1995. Almost everything they do at Parametric is relatively quantitative, meaning they focus on the mathematics and the computational aspects of the portfolio design. They are relatively passive and do not do individual stock selection, nor are they doing macro economic analysis on the countries. The answers he gave during the roundtable are not necessarily what he is involved with day to day at Parametric.

MR. STEIN gave a brief overview of the investment philosophy of the Eaton Vance Structured Emerging Markets Fund. He said the lowering of risk is a key part of the strategy, and they achieve that primarily through the country weightings. They have a great deal of respect for the cap-weighted indexes: the prices that are set in the indexes are sort of the consensus wisdom of a large number of really intelligent people. That does not mean that consensus is always right, but it is very tough to beat. In most markets Parametric basically indexes, but they do not index in emerging markets. The reason is that three or four countries constitute well over 50% of the MSCI Emerging Markets Index, and eight countries constitute well over 75%-80% of the index. These countries are volatile and behave like companies would in more developed markets. If focusing on political risk, for example, or the idiosyncratic risk of the countries, Parametric can lower that risk by diversifying more. That means underweighting the largest countries and overweighting the smallest countries.

MR. STEIN explained that they have a four-tier structure: the largest countries are underweighted and all get a target of an equal weight (about 6% right now); the second-tier countries get half of that; third-tier countries get a quarter of that; and the frontier countries, which are not even part of the index, get an eighth of that. They rebalance down when a country grows to beyond 50% of its target value. Some of the tier 4 countries are not really frontier countries. They are countries that, for whatever reason, are not part of the standard emerging markets indexes. Parametric likes those countries because they encourage different kinds of assets to come into the portfolio.

MR. STEIN said the philosophy underneath the investment process is that if you structure a portfolio in a more diversified way than a cap-weighted index and achieve a lower total volatility, which comes about because you are more diversified and not building up concentration in the portfolio, then the rebalancing to a target and the lower volatility actually give you compounded wealth over the long haul and a higher rate of return. They are looking for a mathematical point that says let's diversify more than the cap-weighted index, and they do it in a relatively simple way. They have a way within the countries of diversifying the economic sectors and the stocks.

MR. O'LEARY said an important part of that success is determining what the rebalancing rules are. He asked how Parametric selected growth beyond 50% of a target value as the trigger to rebalance and why it wouldn't be 20% or 70%.

MR. STEIN replied that they are moving away from the 50%, which is a number they have used for many years as being a relatively high bound to overcome transaction costs. If they rebalance too frequently by setting the rebalance bound too low, they would rebalance too often and create more turnover in the portfolio. Turnover is very expensive in emerging markets. It is an analytical tradeoff between how much a turnover will cost the portfolio in trading versus how much extra growth they would give up. Parametric is evolving the strategy so each country has a bound for rebalancing. Relatively high transaction cost countries and higher volatility countries will have a higher bound, about 50% beyond the target value. Lower transaction cost countries can have a lower bound. Parametric has done extensive work to determine where the bounds should be.

MR. STEIN stated that Parametric is very worried about investor protections: Is there an appropriate legal system to support foreign investors? Can they trade? Are the markets appropriately liquid? Will the custodian in the U.S. have a subcustodian in the local country whom they trust? For many years the number of such countries was relatively small. As soon as Parametric can become comfortable in countries they will start to explore investing in them. There are certain countries not even on the list which they are starting to explore. They want to have as many countries as possible, but they are really worried about investor protections, trading costs, liquidity, and whether it is possible to put money to work. They are not focused as much on valuations. The first time they go into a country they won't invest if the valuations are too high, but once they are invested they are not going to remove or change the weighting based on valuation. Venezuela is an example of when Chavez started making loud noises about nationalizing in early 2007 it set off some triggers, and Parametric disinvested from Venezuela. Russia is a concern that perhaps investors are not fully protected, but right now the country is in the portfolio.

Looking at recent changes to the investment model, MR. STEIN said that Argentina moved from tier 3 to tier 4, triggered when one of the largest companies, Tenaris, was delisted from the exchange and started trading in Europe. So the amount of money Parametric could put to work in Argentina was substantially less. They have added Slovenia, an Eastern European country, as a small tier 4 country.

MR. BADER said he noticed a big underweight to China and wondered if that reflected anything other than an economic assessment. MR. STEIN said it is not an economic assessment, it is Parametric's structure that says they would invest the same amount in all the large countries. The underweight to China is getting larger and larger. Parametric's strategy is evolving and may evolve still to have another tier, of which China would be a good candidate to move up. Right now, a large amount of Parametric's tracking error risk comes from the China weight, and that is an increasing concern to him. He added that South Korea is less of a concern because it is more correlated with the developed countries, and there is a great deal of talk that South Korea be classified as a developed market.

MR. STEIN stated that the ARMB has been invested in the Eaton Vance Structured Emerging Markets Fund about a year, and there has been a change to the vehicle in which the money was invested during that time. The one-year return as of April 30, 2009 was -44.15% compared to the MSCI Emerging Markets Index return of -42.90%. Their underperformance has happened through the recovery period in 2009.

CHAIR SCHUBERT questioned the footnote about the contractual expense limitation that continues through February 28, 2010, after which it may be changed, and that without the expense limitation the performance would have been lower.

MS. KASPER explained that the expense ratio is driven off the assets of the fund, so as the size of the fund gets lower (sic) the expense ratio will come down. The fund started in 2006, and since its inception Eaton Vance has subsidized some of the operating expenses. The 11 basis points difference between the annual gross operating expenses and the net operating expenses that Eaton Vance is picking up will be revisited in February 2010.

MS. KASPER mentioned performance has improved dramatically so the fund is up 30.5% year to date through June 17. MR. STEIN added that in the last few months the performance of the fund varied huge amounts each day depending on the returns of the individual countries. Not only does the fund performance vary a great deal, but the relative performance to the target benchmark varies a great deal, sometimes by hundreds of basis points in a day. It really talks to the fact that there are so many different things going on in the marketplace. So any numbers reflect what is happening at that point in time.

MR. STEIN presented a detailed breakdown of the performance attributable to decisions that Parametric has been making. The fund's performance year to date through April 30 was 13%. The MSCI EM Index performance was 17.73% for that period, so the fund has been underperforming for the year by 4.73%. The country allocation decisions have been the cause of most of that underperformance, and they have gained a little bit from the stock selection within the countries. China underperformed the target index during this period, but the fund was underweighted China so that added about 60 basis points of return. What hurt the fund the most was a substantial underweight to Brazil, which had outstanding performance. They have also been hurt by extra weight to Taiwan, Hungary and some Eastern European countries that have been hammered through the economic crisis. Having said that, they take a long-term view because they have been through periods like this before.

MR. TRIVETTE inquired how much of the performance was attributable to the effect of currencies. MR. STEIN replied that they do not pull that out separately, but he could do an analysis if the Board wanted him to. He added that some countries are linked to the U.S. dollar, so it is not so much of an issue. Certain countries are not, but it is not an issue that Parametric focuses on. The fund is not hedged and is incurring the currency risks of the countries.

MR. TRIVETTE asked if Mr. Stein was concerned that the Pacific Rim was almost one-third of the portfolio, given issues with South Korea. MR. STEIN said the Pacific Rim is such a large part of the portfolio and it did not cause concern. China is a big country that is developing very rapidly, and there is huge opportunity there. China and South Korea alone constitute over 35% of the MSCI Emerging Markets Index.

11. Lazard Asset Management - Emerging Markets Equity and Emerging Markets Income

TONY DOTE in client relations, JAMES DONALD, portfolio manager in emerging market equity, and GANESH RAMACHANDRAN, manager of emerging market currencies and debt, attended the meeting to present reports on two investment portfolios that Lazard Asset Management manages for the ARMB. *[A copy of the Lazard slide presentation and other information is on file at the ARMB offices.]*

MR. DOTE stated that Lazard now has four emerging markets strategies with 19 people working in this area, which gives them a unique perspective in covering the emerging equity markets and the debt markets. The combination of the information that is gathered helps make better portfolio decisions. The equity side is a bottom-up strategy to put together a portfolio of what Lazard believes are the best 70 to 90 stock names in the emerging markets. Country allocation and sector allocation are a residual of stock selection.

MR. DOTE explained that Lazard's investment process it to look for stocks that have good strong returns on the business and low valuations. They conduct accounting validation on the balance sheet and cash flow, with strong emphasis on accounting treatment and strong emphasis on a company's source and use of cash and the legitimacy of return on equity. They do the traditional Graham & Dodd analysis and then portfolio construction.

MR. DONALD reviewed the portfolio construction steps, the last step in the investment process. Lazard discounts for every company, if necessary, based on four distinct risks: macro economic, political, corporate governance, and portfolio risk. All these risks relate to the company itself. With macro economic risk, for instance, they look at the major macro economic effects. They utilize the emerging income group quite extensively for this. They look at the effects of currency movements, interest rates, inflation, and growth, and determine what that is likely to do to the profitability of the company they are looking at and apply a risk that they think expresses that. Political risk was discussed earlier. Portfolio risk looks at trying to increase diversification as much as possible across the emerging markets universe. Corporate governance is the largest weighted risk because they believe it is the largest manageable risk they have: that looks at various historical factors, as well as forward-looking factors, particularly alignment of interests. So Lazard takes all these into account and gets to final price targets. The up sides to those final price targets will determine in large part the type of position in the portfolio.

MR. DOTE displayed a graph of the MSCI Emerging Markets Index from January 2006 to March 2009 and said higher levels of volatility have clearly affected all equity markets. Lazard has taken advantage of that volatility in the emerging markets strategy. The ARMB portfolio started in early 2008 when the market was relatively flat and then declined. Lazard was defensively positioned going into that decline mid-summer of 2008 through the end of the year, and they had many stocks in defensive sectors in countries like South Africa. As markets declined into the fourth quarter, they began to sell the more defensive names and use the proceeds to buy commodity stocks, cyclical stocks, and companies in Russia and

Brazil. Those stocks were dollar bills selling at 10 or 20 cents. Markets have rallied significantly in 2009, and Russia and Brazil are amongst the better performing sectors. Lazard is now trimming those positions and again rotating back to a more defensive position.

MR. DOTE stated that valuations of emerging markets have crept up so that there is almost parity with developed markets. But the one thing that has not changed is the return on equity: these are much more profitable companies than you will find in the developed markets. The return on equity in Lazard's portfolio is even higher than that of the index. It is a very high quality portfolio with strong returns from competitive companies that are well managed with good balance sheets.

MR. DOTE reviewed the ARMB emerging markets equity portfolio performance. He said it is very difficult for a value manager to keep up in a sharply rising market, but Lazard kept up because of the rotation in the portfolio, going from defensive to more cyclical and commodity related names. Year to date through the end of May 2009, the portfolio (33.9%) is lagging the index (37.9%), but that is typical in a rising market. The market is down in the month of June, and the portfolio is down less, as the rotation back to defensive names is helping. Since inception of the ARMB account, the portfolio return is at -22.3% against the index performance of -25.3%.

MR. DONALD referred to a list of the top ten holdings in the emerging markets equity portfolio, saying that every stock in the portfolio has price targets for the next one, two and three years, and has positions based upon the up sides to those price targets. He said the portfolio has a lot of money in the top ten holdings, which are relatively inexpensive and very profitable. Unlike ten years ago, these companies have built out their infrastructure and do not have high capital expenditure expectations going forward.

MR. DONALD stated that geographically the portfolio has more in Latin America exposures than the index does. They also have more in Europe, Africa and the Middle East than the index mainly because for the first time in this strategy's life they have more in Russia than the index. The reason for that is entirely because of valuation. Lazard realizes it is a risky market and there are risky holdings there, but valuation attracted them. They have less than the index in Asia, primarily because they do not have much in China. China is unequivocally the locomotive of growth in the world economy for the next at least ten years. However, a lot of the valuations in that stock market are, in Lazard's opinion, already discounted. Secondly, very few public companies in China have very high margins or levels of profitability. That does not help for adding positions in China in the portfolio.

MR. BADER asked what type of a discount rate Lazard would use in China versus Brazil. MR. DONALD said they don't actually look at cost of capital that way because they believe a lot of that is already bound within their database screening. So they typically look at valuations across each sector and compare them on that basis instead of a discount rate.

For the China market as a whole, Lazard is typically getting low to mid-teen returns on equity, and they are getting valuations that are more expensive than the index. Today they are getting a lot of mid-teens to 20 times earnings, as one valuation measure. For a lot of other companies they look at across emerging markets they are getting seven to 11 times earnings, often with returns on equity of almost 20% or more. Sector by sector it is very important. Banks in China are the most expensive banks in the world, in many cases, typically well over two times book value, and returns on equity typically 10% to 15%. Oil companies are very expensive in China today versus other oil companies across emerging markets.

MR. DONALD next reviewed holdings by country and by sector. He said a relatively large amount of the portfolio is in the more defensive sectors today — consumer sectors and telecom services. They have been reducing some of the holdings in energy and materials, based upon the very strong recoveries that stocks in those sectors have had. He also briefly mentioned the portfolio characteristics: discounted valuations, much higher returns on equity, much higher dividend yields, and typically much higher free cash flow than the index. For instance, at the end of March, the free cash flow yield was 255% of that of the index.

MR. RICHARDS asked if a profitable company like Redecard would be ripe for a country to nationalize. MR. DONALD said he did not think Redecard would be nationalized. Redecard, and another credit card payment processor, Visanet, are controlled by banks. He doubted that the government wants to get into the credit card processing business, but the banks might want to take over them. Right now the banks say they don't want to because it highlights the value in that company. But Mr. Richards' point is important because there is political risk to these companies. When companies are so profitable, politicians start to talk about windfall profits, so that is definitely a major risk for these. The perfect scenario is if credit grows but it doesn't grow too aggressively.

In terms of the outlook, MR. DONALD stated that valuations have come up in the last two months in terms of emerging markets. They are not as high today as developed markets, but certainly they are not as cheap as they were two or three months ago. There has been a tremendous period of performance in this asset class. But the fundamentals are excellent in emerging markets; this is a period not unlike the 1970s, which overall for the world was quite a tough period but for most emerging markets it was a pretty good period. With China being the locomotive of growth, Lazard believes that will demand a significant amount of basic manufactured goods and commodities. That is going to mean that economic growth in emerging markets is going to be relatively robust, particularly against the U.S. and countries in Western Europe. It is interesting that emerging market countries are providing capital to countries like the U.S. and the European countries today.

MR. DONALD said that emerging markets equities have consistently higher levels of profitability — 28 consecutive quarters of higher profitability and a better earnings-per-share growth profile as well. Lazard is expecting that to continue. They are also expecting some offset to the massive effects of unwinding the carry trade last year, so expecting something of a rally in emerging market currencies.

MR. DONALD said they expect the market to be choppy and volatile, but they are optimistic about emerging markets right now, particularly for the long term. It is a good period to be invested in this asset class.

MR. TRIVETTE asked if Lazard believed that other countries would be selling commodities to China. MR. DONALD said yes. He added that China has to first throw out the Asian mercantileless model of the last 50 years. That is because the industrial revolution in China is so big, and with the transfer of so many people across the country, they cannot rely on the world economy anymore to provide the growth to employ the people who need employment. That will mean that they need to have massive infrastructure programs put in place in the next ten years. That will be a major reason why commodities will be demanded very heavily, in Lazard's opinion. China will also be looking for basic manufactured goods for that infrastructure program. Most of those are made in emerging markets, but Australia and Canada will be beneficiaries of this as well. More medium term, China has been talking about enticing their inhabitants to part with their money more readily. The savings rate in China is abnormally high; recently it has been around 50% apparently. The reason for that is very simple — there is such a transient population and huge issues about employment, so people are very concerned about being made unemployed quickly. If the Chinese government introduces unemployment insurance and welfare programs, as they are talking about, that would give people a lot more comfort to spend some of their money and help the economy over the course of the next ten years.

MR. TRIVETTE inquired if Lazard found it easier to get good data on the companies when doing due diligence before purchasing stocks than it was five years ago. MR. DONALD replied that it has probably not changed dramatically versus five years ago, but versus 15 or 20 years ago it is dramatically better. That is due to the positive effects that can occur from crises. Companies, when they need to recapitalize their balance sheets at inopportune times, do everything they can to make sure that they don't stack things against them. A lot of companies improved their accounting very significantly for this type of situation. On the whole, it has improved.

MR. DOTE moved on to talk about Lazard emerging income, a top-down currency and local debt strategy where they spend a lot of time looking at governmental policy and monetary policy that come into play in constructing the portfolio. It is an absolute return strategy, the benchmark is LIBOR, and the target is 4%-5% over LIBOR with low levels of risk in the portfolio. There are two sources of returns: one is high yield and the other is currency. The portfolio is managed to take advantage of opportunistic currency transactions and changes. The universe is an evolving group of 50 lowly correlated emerging market countries, and Lazard will put money into some frontier markets. At the peak before the crash last year the portfolio had roughly 30% in frontier markets. These markets provide yield pick-up and diversification within the portfolio. It is an actively managed portfolio, and things have been quite active over the last year as the market environment has changed. The maturity exposure of the portfolio is usually very low, one year or less. There is little if any credit exposure. The risk/return characteristics are very attractive. Lazard has managed this strategy over the last 14 years. So while last year's market experience was a three or four standard deviation event, they have managed through other crises in the past.

[Commissioner Galvin rejoined the meeting at 4:30 p.m.]

MR. DOTE said the ARMB portfolio was fully invested in April 2008. With the crash and the collapse of Lehman Brothers in August and September, markets basically stopped functioning, correlations spiked, risks spiked, and Lazard moved to a very defensive portfolio position. Over the inception-to-date period LIBOR has been up about 2.2%, and the portfolio is down 4.9% (net of all fees). Markets were still not functioning into the first quarter of 2009, investors were risk averse, LIBOR was up 0.3%, and the portfolio was down 0.8%. April, May and moving into June, markets are beginning to open up, and Lazard is investing some of the cash they had moved to a roughly 45% cash position last fall to protect capital. Markets are starting to respond. LIBOR year to date is up 0.4%, and the portfolio is up 2.3%.

MR. O'LEARY inquired if beating LIBOR was the target for the Lazard Emerging Income Fund. MR. RAMACHANDRAN replied that, to the extent that it is an absolute return strategy, the aim is to make money, regardless of what the stock market does or other bond markets do. That is where LIBOR comes in. MR. DOTE added that the target is LIBOR plus 4% or 5%. So looking at the history of the strategy, Lazard has compounded at 9% over time. That is more than 5% over LIBOR.

MR. O'LEARY said he recognized that the historic performance has been very attractive, but he was trying to get a forward-looking statement from Lazard. MR. DOTE said they were getting to that. His comments were basically to frame the difficulty of the environment that they were in and the necessary shifts within the portfolio. The two objectives for the ARMB are to get a return of 4%-5% over LIBOR and to make money every year. Of the 14 years for this product, last year was the only year that Lazard lost money, and they were -6%.

MR. O'LEARY said that to put that in context the ARMB has a bunch of absolute return money that has a long-term goal of LIBOR plus 5%. That is not an easily achieved objective.

MR. RAMACHANDRAN said the other equally important part of the story is that they want to do that in a volatility space that is roughly bond-like, so 4%-5% volatility. Lazard is doing something in emerging markets, and to end up with risk that is somewhere around the Barclays Aggregate does not sound really intuitive, but that is what they are trying to do.

MR. O'LEARY inquired if there was a comparative group that the Board should be comparing Lazard's emerging income strategy to. MR. DOTE replied that in a very broad sense it would be other emerging market debt strategies. But within that group, Lazard's is a very defensive, consistent-return strategy. When markets are rising very rapidly in emerging market debt, Lazard will not be up 25%. When those other strategies correct and are down 25% or 30%, Lazard will be down 6%, like they were last year. So the range of return historically has been between roughly 16% and -6%, and -6% is really the outlier. The volatility spread for other managers within this space would be considerably larger.

MR. RAMACHANDRAN stated that Lazard invests in debt of emerging markets that is denominated in emerging market currencies. He could not think of anyone who has been doing pure local currency debt for as long as Lazard has. Typically, people think of emerging market debt as the old Brady debt, dollar-denominated debt. The volatility is typically around two times what Lazard manages with. No surprise, but based on what happened in the fourth quarter of last year, Lazard is definitely outperforming even most emerging market debt managers. But looking at return on a per-unit-of-risk basis, he would say the risk was a bit more stark, because they are managing to a very different goal.

Noting that the dollar strength in the face of a severe crisis was touched upon in the panel discussion, MR. RAMACHANDRAN said he wanted to take a couple of minutes to talk about what happened, to put into context what Lazard did. There was a global meltdown in the fourth quarter of 2008, and people did not have access to credit. There was a recession on top of that, and there still is a recession. It is important to make that distinction because dollar behavior is very different in both these environments. In a credit crunch there was no access to credit, and people could not get their hands on dollars when they wanted to. Therefore, the dollar did strengthen. It was the flight-to-quality asset. The fact that prime brokers like Lehman Brothers went down further exaggerated the demand for dollars. Lazard recognized that in this environment — when U.S. institutions were the epicenter of the crisis and the U.S. currency was being sought after — it was not really business as usual. So their first job was to get the risk under control, which they did by cutting their directional exposure quite dramatically. Their cash level went up. Since correlations were going up and diversification benefits were temporarily affected, they reduced the number of countries as well, especially countries that were not adding the diversification benefits.

MR. RAMACHANDRAN stated that any crisis itself brings with it opportunities, and Lazard took advantage of that. An example was the offshore forward market in Argentina, yields went up from 6%, 7% — where it did not look all that interesting to Lazard — to 150%. That is to accept pure currency risk, and then they found it interesting. It is not as though Lazard spent the fourth quarter completely on the sidelines: they did see opportunity, and they participated whenever those came up. But the fourth quarter of 2008 going into the first quarter of 2009, it was all about preservation of capital, essentially recognizing that things were not normal. Even within the parameters of Lazard's philosophy, approach and process, they have the room to recognize that when the correlation is not working as it should, one should reduce that exposure, that the thesis is not valid for investing in a particular country.

MR. RAMACHANDRAN said that as this year has progressed, Lazard has seen the credit crunch itself slowly dissipate and the world move more toward a pure recession. It does not mean that things are going to be great from here on. It just means that they do not have a credit crunch to deal with. Now, if a borrower is creditworthy and needs access to dollars, they will get access to dollars. The Federal Reserve has set up lines with the central banks in various countries like Brazil, Mexico, Singapore and Korea to get dollars to these countries. This was not happening before, and these countries were being penalized for just being these countries. Now it is more of a pure recession. Emerging markets have the habit of going through recessions (the 1990s saw more than their fair share), so in a pure recession, given that Lazard has 50-plus countries in their universe, there are plenty of places to hide and a variety of different economic structures.

MR. RAMACHANDRAN stated that the breakdown in the banking system is a little bit more structural in developed markets than it is in emerging markets. So Lazard has, over the last two months, continued to put capital to work. They had extended duration as panic ensued and people just fled emerging markets. More recently, some of those assets have performed extremely well and yield curves have flattened — in other words, some of these bonds have gone up quite sharply in price — and Lazard has taken profits. But for the most part, the cash position has come down quite dramatically, and the number of countries in the portfolio has also gone up. Cash today is around 14% of the portfolio, still at a defensive level, and that is because Lazard has not completely seen the correlation spike work its way out. The second reason is that to assume that things will grow at a rapid pace from here on is a very dangerous assumption to make.

MR. RAMACHANDRAN reviewed a graph of the monthly return pattern for the emerging markets income portfolio since 1995, pointing out the magnitude of October 2008 that was their worst month ever. In spite of this being an emerging market strategy, Lazard typically does not lose a lot of money — they have lost 1% in a month on ten occasions out of the last 14-plus years. Three of those losing months were in the last quarter of 2008. Typically yields in the income space go up dramatically in a violent period. The average maturity in the income portfolio is quite low, so when yields go up Lazard gets the chance to jump in, as they did with the Argentina case. After the initial sell-off and spike in correlation, yields are higher than they were going into the crisis, and subsequently the currencies return to their fundamental levels.

Looking forward, MR. RAMACHANDRAN expressed his positive outlook for emerging market local currency debt. LIBOR is practically zero now - roughly 50 basis points, but yields are significantly higher - close to double digits. Lazard can get these yields without taking undue credit exposure. Where they own bonds, they own sovereign bonds, bonds that countries issue in their own currency. So countries do not typically default on their own coin because they can print money and pay back. So it is a very sound footing from a credit standpoint. At the same time, they are able to get in at these levels, where currencies have been punished for absolutely no fundamental reason. For example, it made no sense that Brazil sold off the same amount that Iceland did: one of these two countries still has a banking system. Protectionism is the same story: there has to be a distinction made between a Malaysia, where trade is more than 200% of GDP, and an India, where trade is 30% of GDP. But there was none. So this kind of panic selling has its benefits, which makes the future return look more attractive. That is the reason for his positive outlook.

MR. O'LEARY asked, if he told Mr. Ramachandran that LIBOR was going to be average (2.5%) over six or seven years, what he would say the likely return on the emerging income strategy would be. MR. RAMACHANDRAN replied that over six or seven years he was very confident of beating LIBOR plus 500 basis points, which means he would expect returns to be in the 8% to 10% range. There is no reason to believe that volatility will be anything besides the long-term 4% to 5%.

CHAIR SCHUBERT inquired if Lazard was doing any down sizing and if it was impacting the firm's ability to manage the accounts.

MR. DOTE said that in over 25 years that he has been with Lazard they had never had a layoff of any kind in the asset management department until January 2009. Roughly 55% of their clients are in North America and the rest are offshore. Even though they have built a diversified business by client type and by strategy, about 80%-85% of assets are in equities. So when markets went down as much as they did globally, Lazard's revenues were down 40% by the first of 2009, and they were compelled to lay off 10% of the staff. They did not want to trim investment personnel because they did not want to impact the implementation and management of any of the strategies they manage for clients. There have been no layoffs since January, and they don't anticipate any more. Obviously, markets have rebounded. The other portion of this is that with regard to all their equity strategies they are relative value and tend to be defensive. Markets were down a lot last year but Lazard protected as they should, so their client base is relatively happy with the performance provided. The potential flight of clients has been minimized. Lazard has been fortunate to have raised about $4 billion last year in new money, and the prospects of raising more capital from prospective clients in 2009 is also very strong. So the business is stable, but they had to right-size the staff to some degree. It was a difficult decision that senior management had to make.

MR. DONALD stated that Lazard has had a net increase of eight people in emerging markets strategies in the last 18 months. Four analysts were added in the Developing Markets Equity, a growth-oriented strategy. No people were made redundant in the emerging market group during this period.

RECESS FOR THE DAY

After thanking the Lazard group for their presentation, CHAIR SCHUBERT recessed the meeting for the day at 4:54 p.m.

Friday, June 19, 2009

CALL BACK TO ORDER

CHAIR SCHUBERT reconvened the meeting at 9:00 a.m. Eight trustees were present to start, and Commissioner Kreitzer arrived several minutes later.

REPORTS (Continued)

12. Chief Investment Officer Report

MR. BADER notified the Board that staff increased the domestic fixed income allocation by $55 million by selling from the Russell 200 Index Fund, starting to move toward a larger asset allocation to fixed income in the coming fiscal year.

The meeting packet contained notification from TCW Group that Marc Stern was appointed the interim chief executive officer, replacing the retiring Robert Beyer. MR. BADER said that staff did not think the change at the top of the organization would result in any significant changes in the management of the TCW energy fund or warrant putting the fund on the manager watch list. Staff will continue to monitor the energy fund.

MR. BADER stated that the Board has adopted asset allocations for fiscal year 2010 that are essentially the same for all the major funds the ARMB invests in. Now that the investment trusts and subaccounts are finally in place, it should make it a lot easier for the portfolio management staff and accounting staff to do their jobs more efficiently.

MR. BADER reported receipt of notification that the head of research at Mondrian Investment Partners Limited has resigned. The ARMB has an international fixed income allocation with Mondrian. Staff believes the person's absence at Mondrian leaves a vacuum that they would like to see how it is going to be filled. For that reason, staff recommended placing Mondrian on the watch list.

<u>MS. HARBO moved that the ARMB place Mondrian Investment Partners Limited on the manager watch list [for personnel changes]</u>. <u>MR. TRIVETTE seconded</u>.

The motion carried unanimously, 8-0.

MR. BADER reported that Barclays Global Investors (BGI) was being purchased by BlackRock, one of the largest investment firms in the world. BGI manages several investment options (index funds) in the defined contribution retirement plan. The purchase would be a blending of cultures of two firms. He did not think that BlackRock had an index function, so staff did not anticipate any impact on the indexing function at BGI. However, the joining of the two firms probably warranted the Board putting BGI on the watch list.

<u>MS. HARBO moved that the ARMB place Barclays Global Investors on the manager watch list [for ownership change]</u>. <u>MR. PIHL seconded</u>.

The motion passed unanimously, 8-0.

13. Fund Financial Presentation

PAMELA GREEN, Comptroller in the Treasury Division of the Alaska Department of Revenue, reviewed the financial report for April 2009. *[The Board was provided with the financial statements in the meeting packet, and a copy is on file at the ARMB offices.]*

Total assets at the beginning of the fiscal year on July 1, 2008 were $18.3 billion. At April 30, 2009, total assets were at $14.5 billion. That was a decrease of $3.8 billion over ten months of the fiscal year, which equated to roughly 21%. Losses for the various retirement systems ranged around 22% for the Public Employees' Retirement System (PERS), the Teachers' Retirement System (TRS), and the Judicial Retirement System (JRS). The Military Retirement Plan lost 9.3%.

For the month of April, PERS had investment income of $400 million, which equated to a 5% increase in the invested assets. The TRS had a 4.4% gain in invested assets. Both funds experienced withdrawals in the defined benefit plans and contributions in the smaller dollar plans. The JRS had investment income of 6.3% in April. The Military System had an increase of 3.9%. The Supplement Benefit System saw an increase of 4.9%. The Deferred Compensation Plan had a gain of 5.0%. All the funds totaled had a net increase in the invested asset balance of 4.9%, or $673 million. The preliminary financial numbers for May indicate an uptick for the defined benefit plans of about 3.9%.

MS. GREEN reviewed graphs of the PERS defined benefit plan data for April 30 and the same set of information for the PERS retiree health care trust fund. With the smaller dollar value funds going out of their current investments and into the investment pools, the asset allocation for the health care trust fund will change as of May.

MS. GREEN reviewed graphs of the TRS defined benefit plan April and fiscal year-to-date information, followed by the graphs for the TRS retiree health care trust fund. On the JRS defined benefit plan graphs she mentioned that the allocation to private equity had not yet been invested but it should happen in May. The health care trust fund for JRS was a similar story to the other funds. The Military Retirement Trust Fund graphs showed that the actual asset allocation was tracking well with the targets.

MS. GREEN next reviewed how the investment managers for the various defined benefit retirement funds fared for the month of April. Of interest was that cash experienced a lot of contributions, and there were a lot of withdrawals from the different managers. That was due primarily to the defined benefit plans moving out of some of the pool investments, which is what this report does. She said that in May the Board will be able to see the re-movement of all the assets, and this report will include both the defined benefit plans and all the other plans.

MR. O'LEARY asked if the movements were in effect bookkeeping movements. MS. GREEN said they were, and Mr. Worley's report would show that the net transfers are zero. The Schedule of Investment Income and Changes to Invested Assets did not reflect an complete picture because it showed only the defined benefit plan portion and not the movement into the other assets.

KEVIN WORLEY, Chief Financial Officer in the Division of Retirement & Benefits, referred to the supplemental financial report for the ten months ending April 30, 2009. Looking first at PERS, he said most of the employer and employee contributions came from the participating employers on the defined benefit plan, along with the State of Alaska contribution. He mentioned that Trustee Harbo had asked yesterday about allocation of the State monies provided through general fund appropriation. Staff has separated out the dollar amounts based on consultation with Buck Consultants: $79 million went to the PERS pension plan and $162 million went to the retiree health care trust. The biggest costs for the PERS and TRS retirement systems are pension benefits and health care costs. He reviewed the TRS numbers as well. The State of Alaska made a $206 million contribution to the TRS in July 2008. Again, in consultation with Buck Consultants, DRB staff allocated $104 million to the defined benefit plan and $102 million to the health care trust.

Regarding transfers in and out on the ten-month supplemental report, MR. WORLEY explained that these are true-ups at the end of last fiscal year. Because of the way they had to process the Premera health clams for the retiree health care trust, staff had to allocate things for a couple of months until they could true-up after the fiscal year end. The transfer, while recorded on the books as a receivable/payable between those two funds, did not actually occur until fiscal year 2009.

MR. TRIVETTE inquired if the new third party administrator for the AlaskaCare (retiree) Health Plans would cause accounting staff any grief. MR. WORLEY replied that staff has been working with Wells Fargo Insurance Services quite a bit in the last month in order to get the data transfer much faster. Staff has also requested that when a member's data gets transferred to the Division the primary and secondary funds that are paying for claims will be identified so staff can properly post to the correct retirement systems. The new third party administrator has indicated that should not be a problem. Staff has done a mock-up of what they expect on a data transfer, and so far there have been no issues with it. He expects the transition will go smoothly.

MR. WORLEY also reviewed the Judicial system, saying its activity was very similar to the PERS and TRS. In closing, he noted that at the end of April there were no transfers, as Ms. Green had pointed out earlier.

MS. ERCHINGER inquired if the allocation of the additional State contribution to pension and health care was based on the ratio of the unfunded liability of each of those components. MR. WORLEY replied that when staff discussed with Buck Consultants how the allocation determination was made, it was made more on the issue of the underfunding of each of those plans at the time the transaction was done. In the case of TRS, it was more of a 50/50 split of underfunding the pension and health plans. For PERS, it was more like a one-to-two split between pension and health. The division did not necessarily equate to the same ratio of the unfunded liabilities. The funding is based on how the systems received contributions during the fiscal year. In the case of PERS, if the rate is 30%, and employers are paying the 22%, the 8% is made up by the additional state contribution. The way the past-service cost came up for PERS, it was more the one-to-two ratio. So going back to Trustee Erchinger's original question, the answer would be yes.

CHAIR SCHUBERT returned to unfinished business from the prior day, under Actuarial Review, when the Board tabled a motion to accept the FY08 actuarial valuations.

The Board had split the original motion into two parts and accepted the review and certification of actuarial reports by Gabriel Roeder Smith & Company, and directed that staff coordinate with the Division of Retirement & Benefits and Buck Consultants in the discussion and implementation of suggestions and recommendations of the reviewing actuary where the Board considered that appropriate. What remained on the table was dealing with the FY08 actuarial valuations by Buck Consultants.

6. Actuarial Review (Continued)

6(g). Board Acceptance of Actuarial Reports for PERS, TRS & JRS (Continued)

MR. SHIER stated that Mr. Pihl had brought up an observation yesterday about the language of staff's recommendation. He read into the record the amended language of the recommendation, as follows:

> "That the Alaska Retirement Management Board accept the actuarial reports prepared by Buck Consultants for the Public Employees',

Teachers', and Judicial Retirement Systems in order to set the actuarially determined contribution rates attributable to employers."

COMMISSIONER KREITZER moved adoption of that language change to the action item with the subject line "Acceptance of Actuarial Reports - PERS, TRS & JRS." MR. WILLIAMS seconded.

MR. TRIVETTE said he thought Mr. Pihl's issue yesterday was that the employer rate is set by statute, and so what staff was talking about was the contribution rate that the State has to kick in to make up to the rate that is in the [actuarial] report.

COMMISSIONER KREITZER related that she and staff consulted with Mr. Pihl and with the Department of Law to accommodate Mr. Pihl's concern.

MR. PIHL stated that the wording that Mr. Shier read aloud satisfied his concern. The motion was not identifying the gross rate as the employer rate, it was identifying the gross rate as the actuarially determined contribution rate attributable to employers.

MR. SHIER made it clear that the proposed action was simply the acceptance of the actuarial reports. The resolutions for rate setting are more specific and more detailed.

On an outcry vote, the motion passed unanimously, 9-0.

14. Contribution Rates for FY2011

MR. SHIER requested some additional time for staff to re-examine and amend the language of Resolution 2009-13 regarding the PERS FY2011 contribution rate.

CHAIR SCHUBERT granted the request and called an at-ease at 9:27 a.m. At 9:40 a.m., she re-ordered the agenda to take up Investment Actions next, while people continued to work on the contribution rate resolutions.

15. Investment Actions

15(a). Action on Convertible Bond Securities

MR. BADER stated that there was no action memo in the meeting packet to accompany yesterday's presentation to the Board about convertible bond securities. Staff had wanted to hear Advent's presentation and gauge the Board's reaction to the strategy before making a recommendation. Advent showed net-of-fees returns of 6.56% since inception of their fund versus the S&P 500 Index return of 3.46% for the same period. They had positive returns 11 out of the 12 years, and even though 2008 was their first negative year, it was nowhere near the loss on the S&P 500

Index. Advent's portfolio manager is well seasoned. Staff likes the fund on the basis of its merit but also believes this would be a opportunistic time to go into the convertible bond asset class. For that reason, staff was asking the Board for a motion to authorize a due diligence review of Advent for suitability in the ARMB portfolio.

MR. RICHARDS moved that the Alaska Retirement Management Board authorize Callan Associates, Inc. to do a due diligence review of Advent Capital Management, LLC for suitability in the retirement fund portfolio. MR. WILLIAMS seconded.

The motion passed without objection, 8-0. [Mr. Trivette was briefly out of the room for this action.]

15(b). Selection of Index Funds for Terminated SSgA Proceeds

At the April 23-24, 2009 meeting the Board terminated State Street Global Advisors as an international equity fund manager and authorized staff to conduct a manager search for potential suitable replacements to present to the Board. MR. BADER said he had intended to come to the Board with a recommendation at this meeting. He reminded everyone that earlier in the year he had made a presentation about staff's wishes to gradually move the retirement fund more toward indexing than it currently is. Staff believes this is a good time to deploy the SSgA international equity fund money into indexing strategies. There was no written recommendation in the packet because staff wanted to investigate the opportunity in other index managers for diversification. It turned out that when staff reviewed one of the other providers that the fee schedule would be nowhere near as attractive as the ARMB has with its current index manager, SSgA. Therefore, staff was asking the Board to authorize the staff, with the concurrence of the general consultant, to select appropriate index funds to take the place of the SSgA international equity fund.

MS. HARBO moved that the Alaska Retirement Management Board authorize staff, with the concurrence of the consultant, Callan Associates, Inc., to select appropriate index funds to take the place of the State Street Global Advisors international equity fund. MR. PIHL seconded.

The motion carried, 8-0. [Mr. Trivette was out of the room for this action.]

15(c). Amended Equity Investment Guidelines

MR. BADER explained that investment in publicly traded partnerships are not currently allowed in the investment guidelines for public equities. There were 97 publicly traded partnerships listed on the New York Stock Exchange, AMEX, and NASDAQ exchanges, and some of them have significant size and volume. Most of these partnerships are public master limited partnerships and are in the energy or natural resource-related sector. Staff was recommending that publicly traded partnerships be included in the equity guidelines for possible investment by the ARMB managers.

MR. WILLIAMS moved that the Alaska Retirement Management Board adopt Resolution 2009-20 approving the revised Investment Guidelines for Domestic and International Equities to include publicly traded partnerships. MS. HARBO seconded.

MR. JOHNSON advised the Board that the term "publicly traded partnerships" is a term of art and means limited partnerships or limited liability companies that trade on security exchanges.

The motion passed unanimously, 9-0.

15(d). Revised Asset Allocation Resolutions

MR. BADER stated that the Board at its April 2009 meeting approved asset allocations for fiscal year 2010. There were amendments to the resolutions before the Board at that time, mostly related to the bands around the target allocations. He said that when staff reviewed the resolutions that the Board had approved following the April meeting they thought it would be better to return to the Board with the resolutions in cleaned-up form for the record, rather than rely on the narrative of the changes in the April meeting minutes. For that reason, staff was requesting approval of the revised resolutions listed in the staff report — Resolutions 2009-21, 2009-22, and 2009-23 — that would repeal and replace the previous resolutions. He noted that the resolutions contained no substantial changes from the intent of the Board at the April meeting.

MS. HARBO moved that the Alaska Retirement Management Board adopt the following resolutions approving the revised asset allocations for the retirement plans for fiscal year 2010, effective July 1, 2009:

Resolution 2009-21 - relating to the PERS, TRS and JRS retirement systems, the PERS, TRS and JRS retirement health trust funds, the retiree major medical health insurance fund, the health reimbursement arrangement funds, and the PERS peace officers/firefighters occupational death & disability fund

Resolution 2009-22 - relating to the Military Retirement System

Resolution 2009-23 - relating to the PERS and TRS holding accounts.

MR. TRIVETTE seconded.

The motion carried unanimously, 9-0.

15(e). Absolute Return Manager Search

MR. BADER reported that, prior to the recommendation for asset allocation, staff, the Investment Advisory Council (IAC), and Mr. O'Leary of Callan held much discussion on absolute return. They talked about whether to keep absolute return as part of the asset allocation for the retirement systems, one concern being the potential for headline risk associated with the funds. Microsoft could lose $50 million in one day without stirring any public interest, but if one small hedge fund blows up, staff gets calls from the local media. Another concern is that the funds are called absolute return, yet the one time when the retirement system wanted absolute return it was not delivered. Nevertheless, comparing absolute return to the portfolio as a whole, the managers did provide diversification and they had better returns in fiscal year 2008.

MR. BADER stated that after the discussions staff agreed to recommend continuing the absolute return program in the 2010 asset allocation. He did want to prevent the magnitude of loss that might be experienced should something go in the wrong direction. Staff believes it is in the interest of the retirement fund to be more diversified in the absolute return area than currently. So merely adding assets to the existing managers would not likely provide that additional diversification. Therefore, staff was asking the Board to authorize a search for one or more absolute return managers.

<u>MR. PIHL moved that the Alaska Retirement Management Board authorize Callan Associates to conduct a manager search for one or more additional absolute return managers to be brought before the Board for possible engagement</u>. <u>MR. TRIVETTE seconded</u>.

COMMISSIONER GALVIN asked if staff intended to carry on evaluating whether to recommend continuing with the absolute return program, while the manager search was going on.

MR. BADER replied that the Board has made the decision to continue absolute return, so staff was making a recommendation on how to best implement that decision going forward. He believed the best way to do that was to add one or more absolute return managers to the three existing investment managers.

COMMISSIONER GALVIN asked if Mr. Bader believed that the Board in the process of an absolute return manager search should re-evaluate the commitment to the absolute return strategy prior to actual engagement with the potential managers.

MR. BADER said no, that he had tilted in that direction at the beginning of the discussions, but input from the IAC members — particularly Mr. Mitchell, Mr.

O'Leary, and Mr. Hanna of the investment management staff led them to the conclusion that the Board's original decision should be continued. So staff was not recommending revisiting that decision, however, they could if the Board was interested in doing so.

Discussion on the motion was concluded, and the vote was 9-0 in favor.

15(f). Additional Target Date Funds for DCR Plan and SBS

MR. BADER said that, per the Board's action, the aged-based target funds managed by T. Rowe Price would become the default options for defined contribution plan retirement accounts and the SBS accounts effective July 1, 2009. He referred to correspondence from T. Rowe Price in the packet that supported staff's recommendation to add some target date funds to the default options. If a 20-year-old person were to come into the Alaska Target Retirement Funds right now they would be placed in the 2040 Trust, and the asset allocation would be appropriate for them. The asset allocations are primarily equities until a person gets well along in their investment cycle when the glide path changes to more fixed income investments. Staff believes that it would be more appropriate to put a younger person into farther out funds as they enter the system, hence the recommendation to add 2045, 2050, and 2055 target date trusts to the mix of age-based default options.

MR. BADER stated that people are entering the retirement systems for the first time who are older than 65, and they do not fit the profile of what was anticipated as new employees in the defined contribution retirement plan. Therefore, staff recommended that the Alaska Balanced Trust was the most appropriate for employees born in 1942 or before. The Alaska Balanced Trust can be identified as a targeted risk fund and is one of the permissible funds under ERISA for a default option. [ARMB is not subject to ERISA, the Employee Retirement Income Security Act.]

<u>MS. HARBO moved that the Alaska Retirement Management Board adopt the recommended age-based mapping to target date funds and direct staff to add additional 2045, 2050, and 2055 target date funds</u>. <u>MR. WILLIAMS seconded</u>.

MR. TRIVETTE said he assumed that staff had discussed this recommendation with Mr. O'Leary and the IAC members and received their support. MR. BADER replied that they discussed target date funds but did not identify the funds specifically. He suggested getting their opinion now.

MR. O'LEARY indicated he was quite comfortable with staff's recommendation. DR. JENNINGS and MR. WILSON both voiced their support.

MR. TRIVETTE asked if the 2045, 2050, and 2055 target date funds would be much like the 2040 Alaska Target Retirement 2040 Trust. MR. BADER said they would initially.

The motion passed unanimously, 9-0.

UNFINISHED BUSINESS

1. Meeting Calendar

JUDY HALL, ARMB Liaison Officer, pointed out the proposed 2010 meeting calendar in the packet, saying that it basically followed the same dates as 2009 that seemed to work for everyone. She asked for Board approval.

MS. HARBO moved to adopt the 2010 ARMB meeting calendar. MS. ERCHINGER seconded. The motion passed unanimously, 9-0.

2. Disclosure Report

MS. HALL stated that the financial disclosures since the last meeting were included in the packet. There were not reports of significance.

3. Legal Report

The Board's outside legal counsel ROB JOHNSON made a recommendation that the Board consider hearing a presentation on due diligence at its December meeting or thereabouts. The presentation should include input from Ms. Green, Mr. Hanna, and himself on what the Department of Revenue undertakes. It would work along the theme of what public pensions have been doing in the wake of the Madoff circumstances and so on. It should not only be worthwhile but probably interesting.

CHAIR SCHUBERT responded that she supported the idea.

COMMISSIONER KREITZER inquired if the Board could get an update on the Mercer case in executive session for the next meeting. CHAIR SCHUBERT said the Board had a scheduled executive session on the agenda. MR. JOHNSON stated that he had no new information that would change anything from the last report the Board received. All that transpired was that several deposition requests have gone out.

REPORTS (Continued)

16. Executive Session - Litigation Matters

CHAIR SCHUBERT requested a motion for an executive session.

MR. TRIVETTE moved that the Alaska Retirement Management Board meet in executive session for the purpose of receiving information from staff regarding litigation. MS. HARBO seconded. The motion carried without objection, 9-0.

MR. BADER requested that staff, the IAC members and the consultant be permitted to remain in the executive session. Those whose presence was not requested left the room, and the teleconference connection was terminated.

The executive session started at 10:00 a.m., and the meeting returned to regular session at 10:35 a.m.

MR. TRIVETTE moved that the ARMB move forward as discussed in executive session. MS. HARBO seconded.
The motion passed unanimously.

CHAIR SCHUBERT indicated the Board would return and take up report #14 on the agenda.

14. Contribution Rates for FY2011

MR. SHIER first reviewed Resolution 2009-13 relating to the FY11 PERS employer contribution rate for Tiers 1-III. He pointed out that staff's recommendation was revised to address a Board concern earlier, now stating "...PERS actuarially determined contribution rates attributable to employers consistent with its fiduciary duty..." The original resolution that was in the packet was accordingly changed to explicitly state that the State has established a statutory rate of 22% for employers in PERS. Mr. Worley, in consultation with Mike Barnhill, prepared the language changes and included two additional whereas clauses to split out the normal rate for pension and the past service for pension, as well as the post-employment health care benefits rate for normal cost and past service. The second page of the resolution was changed to make the "Now therefore be it resolved..." statement clearer.

MR. TRIVETTE moved that the Alaska Retirement Management Board adopt Resolution 2009-13 that sets the fiscal year 2011 Public Employees' Retirement System actuarially determined contribution rates attributable to employers, consistent with its fiduciary duty. COMMISSIONER KREITZER seconded.
On a roll call vote, the motion passed unanimously, 9-0.

MR. SHIER drew attention to the resolutions in the packet pertaining to the PERS Defined Contribution Retirement Plan Retiree Major Medical Insurance rate for FY11, and the PERS Defined Contribution Retirement Plan Occupational Death & Disability Benefit rate for FY11.

COMMISSIONER KREITZER moved that the Alaska Retirement Management Board adopt Resolution 2009-14 and Resolution 2009-15 that set the PERS Defined Contribution

Retirement Plan Retiree Major Medical Insurance and Occupational Death & Disability Benefit rates for fiscal year 2011. MS. HARBO seconded.

Per Mr. Pihl's request the day before, staff distributed a spreadsheet showing the DCR Plans retiree major medical insurance rate and occupational death & disability rate for the prior years for both PERS and TRS.

MR. WORLEY pointed out that the last "whereas" clauses in both resolutions were changed, per Ms. Erchinger's request the day before, to identify that the rate is being established on the June 30, 2008 PERS data, so that the resolutions are consistent with the rate adoption of the defined benefit plan for PERS.

The roll was called, and the motion carried unanimously, 9-0.

MR. SHIER briefly reviewed the revised memo handed out for the FY11 Teachers' Retirement System employer contribution rate, indicating that the memo and attached resolution incorporated the same language changes as he presented for the PERS employer rate.

COMMISSIONER KREITZER made it clear that the change to staff's recommendation was inclusion of the words "actuarially determined contribution rates attributable to employers."

MR. TRIVETTE moved that the Alaska Retirement Management Board adopt Resolution 2009-16 which set the fiscal year 2011 TRS actuarially determined contribution rate attributable to employers, consistent with its fiduciary duty. COMMISSIONER KREITZER seconded.

The roll was called, and the motion passed unanimously, 9-0.

MR. SHIER next presented the resolutions in the packet pertaining to the TRS Defined Contribution Retirement Plans Retiree Major Medical Insurance rate for FY11, and the TRS Defined Contribution Retirement Plan Occupational Death & Disability Benefit rate for FY11.

MR. WORLEY stated that per Ms. Erchinger's request yesterday staff had inserted the date of the information along with the calculation of those rates in the last "whereas" on page one of both resolutions.

MR. PIHL moved that the Alaska Retirement Management Board adopt Resolution 2009-17 and Resolution 2009-18 that set the TRS Defined Contribution Retirement Plan Retiree Major Medical Insurance and Occupational Death & Disability Benefit rates for fiscal year 2011. COMMISSIONER KREITZER seconded.

The motion carried unanimously, 9-0, on a roll call vote.

MR. SHIER stated that the contribution rate for the Judicial Retirement System is set by the commissioner of the Department of Administration. He distributed for the Board's information a memorandum from the commissioner setting that rate according to the Buck Consultants actuarial report.

COMMISSIONER KREITZER mentioned that the Department of Administration viewed as an oversight the JRS contribution rate being set by the commissioner of Administration instead of the ARMB. She said the department would not introduce separate legislation to make that change in the statute but they were looking for an opportunity to arise to amend it.

NEW BUSINESS

Follow-up to Roll-Forward Study from Buck Consultants

MR. PIHL said he was hoping the Board would deal with the roll-forward analysis that Buck presented, as well as their projections on additional contributions and amortizing the disastrous 2008 investment losses over five years. He recommended that the Board go on record as supporting the roll-forward approach to setting the employer contribution rates and take action to encourage the Department of Administration to look into it and move towards it. He inquired if that type of action required a motion.

MR. RICHARDS stated that at first blush he was not in favor of going to the roll-forward method of setting the employer contribution rates. He understood that it had advantages, one being to take some of the highs and lows out of the calculation, but what the State has done for many years has worked well. He felt there was a reaction to what could be called a modern-day depression. It seemed the Board would be paying Buck to not only do what they normally do but then additional money to simply make a quick roll-forward valuation that would have to be adjusted the following year. He was not convinced one way or the other yet about the roll-forward approach as presented so far and thought it warranted some further looking into.

MR. PIHL rejoined that the roll-forward was one approach to address a long-standing concern about reducing the two or more year delay between the valuation data and when employer contribution rates go into effect and had nothing to do with the disastrous markets in 2008. He did not think a roll-forward valuation and a true-up the following year would be expensive to have done. It is very commonly used.

CHAIR SCHUBERT suggested adding the roll-forward discussion as a future agenda item.

COMMISSIONER KREITZER said that in the meantime the Division of Retirement & Benefits would try to identify costs and timelines, without incurring too much effort. It would also give her time to speak with the Office of Management & Budget and glean more about the impacts on the State itself. She expected the Legislature to send someone to weigh in from their perspective as well, given the correspondence from Senator Stedman about his concerns.

CHAIR SCHUBERT asked if the next meeting (October 1-2) would be enough time. COMMISSIONER KREITZER said maybe not. CHAIR SCHUBERT set the discussion for the December meeting instead.

MR. TRIVETTE stated that he liked the roll-forward concept, but he supported looking at the pros and cons. He did not think the Board would get the information early enough to make as much difference as he wanted it to. He also wanted input from the IAC and Mr. O'Leary.

MR. PIHL said his second point was to try and address Senator Stedman's letter about the additional underfunding in the retirement systems caused by investment losses in FY08. As trustees of the pension funds, the Board has a real concern about the funding ratio. He wanted the Board to encourage the Legislature, within its available means, to seriously look at additional funding for the retirement systems, as outlined in the Buck projection results for a modest recovery scenario they described yesterday.

MR. TRIVETTE commented that there might be another option that has not been discussed yet, so he was not ready for a motion today. But he wanted on the agenda of the October meeting at least a conceptual motion to the effect that the Board supports the five-year increase in additional contributions to the retirement systems for the reasons that Buck outlined. He was not wedded to Buck's presentation, and if there was a better idea, he wanted to hear about that, too. But the Board ought to support something, because if they did not start doing something now it would cost a lot more down the line.

MS. ERCHINGER said she supported both recommendations but thought the Board should put them in the form of a resolution of support. She added that the average person thinks that if the Board does not set the rates, for example, to incorporate a roll-forward then the Board does not necessarily support that. She felt, as a trustee, that the Board sending that message to the Legislature in as strong a form as possible was really important. It is a distinctly different issue than setting the rates, but the average person does not think it is a different issue.

MR. BADER suggested that a letter from the Board chair to Senator Stedman acknowledging his letter would be appropriate. Where it would go from there might require assistance from Mr. Shier. CHAIR SCHUBERT requested staff to draft a response in writing.

COMMISSIONER KREITZER stated that she had e-mailed Senator Stedman's staff to let them know the Board would be discussing the Buck roll-over study, and his staff was on line yesterday. She added that she was not ready to commit on behalf of the Department of Administration supporting a resolution because that requires a lot of discussion with the executive branch.

Follow-up to Buck's Recommendation to Revisit Earnings Assumption

MR. BADER stated that Mr. Slishinsky of Buck Consultants had suggested that the Board should revisit the 8.25% earnings assumption. At the same time, Callan Associates is working on an asset-liability study for the ARMB. Mr. Slishinsky had further suggested reviewing the earnings assumption as early as the next meeting. However, it did not sound like any roll-forward would be available, and the Board would not have the Callan asset-liability study by the October meeting. It was staff's suggestion to put the earnings rate discussion on the December meeting agenda instead of October.

MR. TRIVETTE said it would be appropriate to deal with the earnings rate when looking at all the assumptions, rather than pulling out one to talk about singly because they all interact. The December meeting is the Board's regular time for dealing with the assumptions.

COMMISSIONER KREITZER stated that if the Board were going to consider using a roll-forward method the earnings assumption would have a bearing on that. She proposed at least having a presentation in October not to actually set the earnings rate but to consider it in preparation for a decision in December.

CHAIR SCHUBERT checked with the trustees, who had no objection to doing that. MR. BADER indicated that staff could arrange it.

OTHER MATTERS TO PROPERLY COME BEFORE THE BOARD - None.

PUBLIC/MEMBER COMMENTS - None.

INVESTMENT ADVISORY COUNCIL COMMENTS

DR. JENNINGS stated that at the April meeting he talked about some of the other investment committees on which he sits and related what he saw as ARMB best practices. He wanted to flip that around this time and bring a few lessons that he has learned from some of the other investment committees. These were not necessarily best practices but things the committees have worked through.

The first is the importance of due diligence. He supported legal counsel bringing that up for an educational session at the next meeting. In investments a sin of commission is much worse than a sin of omission, that is, a lot of the marketing is oriented toward "here is a wonderful opportunity." It is far better to be prudent and go through a thorough due diligence process, both with Callan from an investment point of view and with the lawyers.

It reminded him of former trustee Pat Wellington jabbing his finger in the air at the investment managers and challenging them about anything they might be hiding and probing for what else the board needed to know. The committees he has been on would have been well served by having that kind of personality among their memberships.

A second lesson is the important of rebalancing. At some committees this ends up being a board discussion function. At ARMB it has been appropriately passed down to a staff function. The staff has appropriately brought that back to the board when there were issues with the private market valuations or similar situations. That is something where the ARMB practices would have been helpful.

DR. JENNINGS next listed the importance of thinking about liquidity. Some foundations and endowments are further out on the illiquidity spectrum. He thought that illiquidity gets rewarded, in general. He was not trying to say that the ARMB is too far out on that spectrum. The ARMB could have more illiquid investments and could benefit from that. But it is a good thing to keep in mind because events can happen, and those illiquid investments end up being quite large and you end up having to wrap the rest of the portfolio around that.

The fourth and fifth points are related: a healthy emphasis on cost, and indexing. If the Board is not comfortable that active management is going to add value, indexing is a cheap and good alternative. Former trustee Semmens could always be counted upon to ask cost questions, and a continued focus on cost would be a good way to preserve his legacy.

MR. WILSON mentioned Mr. O'Leary's set up the day before on real estate as being particularly insightful. The graph of transactions in the real estate business just falling of a cliff was probably not too dissimilar to what is going on in the residential real estate markets, as well as the private equity markets. It is sobering after an almost a 15-year bull market run in the commercial real estate market that there are now essentially no transactions going on, with buyers wanting to pay a lot lower prices than the sellers are willing to sell at. He mentioned a keynote transaction that occurred in Boston over the last 60 days: the John Hancock Building sold in 2004 for $700 million and got flipped two years later for $1.3 billion, and it just went for foreclosure at less than it sold for in 2004. The only reason that transaction happened was because the debt came due, and the owner of the building had no way to deal with it. One can look to the debt markets and see that a lot of debts are coming due over the next couple of years. So it was a heck of a party and it is a heck of hangover, and it is going to take a while to clean it up, unfortunately.

MR. WILSON said that Commissioner Galvin's point last meeting is particularly important because these real estate cycles do happen every ten or 15 years. There was one in the early 80s and another one in the early 90s. So it is important for the ARMB to institutionalize these memories and mistakes to try to avoid them when the cycles hit again. And they will hit again, probably in our lifetimes. He favors the direction that staff and the

Board is headed, which is separate accounts and control — controlling the decisions as well as the leverage. One of his favorite lines is, "History doesn't repeat itself, but it sure does rhyme." We are seeing the rhyming in the workouts of the real estate business again.

TRUSTEE COMMENTS

COMMISSIONER KREITZER announced that the IRS (Internal Revenue Service) had provided a long-awaited letter stating that the State had brought its plan provisions into compliance, particularly with the 115 trust and the transfers of the appropriate amounts of money between the trusts that have been created. This has been a long-standing issue. She thanked the Department of Law's Mike Barnhill for his assistance.

MR. TRIVETTE requested a copy of the IRS letter.

CHAIR SCHUBERT commented that Eaton Vance, as part of their marketing to the ARMB, said they would outperform whether the market is going up or down. But their performance was in the 97th percentile last quarter and the 84th percentile in their first year for the Alaska retirement plan. She asked staff at what point the Board would just say that a manager was not delivering what they said they would deliver, and then cut them off.

MR. BADER quoted former CIO Bob Storer as saying that managers who were top quartile were good until funded. That frequently becomes the case because investors select managers based on their history and are in there just in time for performance to revert to the mean. In Eaton Vance's case, because of the exercise in pooling that happened with the retirement plan assets, the ARMB had to get out of the Eaton Vance commingled fund format that was not allowed to have investments that were related to health trusts and into the mutual fund format. Eaton Vance could not just transfer securities and had to sell securities and buy back, and that probably had an impact on returns.

MR. BADER said that every board and every person individually debates when it is time to say a manager is not cutting it. Some people say one market cycle; Brian Andrews used to say three years, and he and Brian would talk about that. Certainly, the only cycle that Eaton Vance has been in with the ARMB is a bear market. The Board's reasons for hiring Eaton Vance were longer term, and he did not think that one year was enough time to make a decision about them.

MR. O'LEARY explained that part of Eaton Vance's strategy, and one of the things that they brought to the table in terms of ARMB's emerging markets exposure, was a willingness to invest a meaningful portion of the portfolio in the so-called frontier markets, which are not in the emerging markets index. In a highly illiquid market environment, he thought that was a major contributor to Eaton Vance's underperformance in this period. From his perspective, he would be very quick to pull the trigger if the average stock (as opposed to the index) in the emerging markets universe did well and Eaton Vance underperformed. Given the volatility in emerging markets, there was a statement made yesterday that was potentially overstated but was true that the impact of Brazil in relative performance of one manager to another was incredibly important of late. Eaton Vance's strategy that caps the exposure to the major emerging markets will result in short-term differences in performance, both good and bad. If he had been told in advance what the market environment was going to be like, he would have said that in that type of market environment Eaton Vance would underperform. It is consistent with expectations, given the market environment, and it is much too soon to consider terminating them. In a different market environment, even if Eaton Vance outperformed, they might be outperforming by an insufficient amount to be consistent with their stated approach. That is the type of thing to focus on in making the quick termination decision.

CHAIR SCHUBERT said she recognized that the ARMB could not have a custom index for all the different funds, but an asterisk or some notation next to Eaton Vance's performance indicating that the index against which they are being measured is not entirely appropriate would be helpful. For example, in Eaton Vance's case, the emerging markets index does not include the frontier markets. That could apply to any of the other managers who have specific circumstances, so that someone who is not immersed in the investment world every day could look at the Callan performance reports and see that a target index does not exactly fit a manager's strategy.

MR. O'LEARY agreed, saying that in Eaton Vance's case Callan could add a frontier markets index. However, he did not want to give managers an easy out. For example, Eaton Vance's mission is to provide superior emerging markets exposure and beat the emerging markets index. Their philosophy and approach says that one of the things they will use to do that is frontier markets — so they better be right.

MR. TRIVETTE said he wished there was a bit less selling during the manager presentations and more time for questions at the end. It makes it difficult to get to some of the issues on trustees' minds. He said he dealt with this in previous jobs by giving presenters an outline, such as to put the firm structure in writing so people can read it on their own time. Managers do not need to go over these things when most trustees have heard them several times.

MR. PIHL commented that the Advent presenters indicated that Mr. Bader gave them exact instructions about giving an educational presentation without selling their product.

COMMISSIONER KREITZER remarked that the message to managers probably warranted repeating.

FUTURE AGENDA ITEMS

Items were discussed and requested throughout the meeting.

ADJOURNMENT

There being no objection and no further business to come before the board, the meeting was adjourned at 11:15 a.m. on June 19 2009, on a motion made by Ms. Harbo and seconded by Mr. Williams.

For the record, CHAIR SCHUBERT stated that the Board would be touring the McKinley Capital Management headquarters in Anchorage at 1:30 p.m.

Chair of the Board of Trustees
Alaska Retirement Management Board

ATTEST:

Gayle W. Harbo

Corporate Secretary

Note: An outside contractor tape-recorded the meeting and prepared the summary minutes. 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
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