State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
MEETING

Location:
Mariott Anchorage
Kenai-Denali Room
820 West Seventh Avenue
Anchorage, Alaska

MINUTES OF
June 26-27, 2014

Thursday, June 26, 2014

CALL TO ORDER

CHAIR GAIL SCHUBERT called the meeting of the Alaska Retirement Management Board (ARMB) to order at 9:02 a.m.

ROLL CALL

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

Board Members Present
Gail Schubert, *Chair*
Sam Trivette, *Vice Chair*
Gayle Harbo, *Secretary*
Kristin Erchinger (Telephonic)
Commissioner Angela Rodell
Tom Brice
Sandi Ryan
Martin Pihl
Commissioner Curtis Thayer

Investment Advisory Council Members Present
Dr. William Jennings
Dr. Jerrold Mitchell
Robert Shaw

Department of Revenue Staff Present
Gary M. Bader, Chief Investment Officer
Scott Jones, State Comptroller
Zachary Hanna, State Investment Officer
Pamela Leary, Director, Treasury Division
Judy Hall, Board Liaison

Department of Administration Staff Present
Jim Puckett, Chief Operating Officer, Division of Retirement & Benefits
Kevin Worley, Chief Financial Officer, Division of Retirement & Benefits

Consultants, Invited Participants, and Others Present
Tim Maloney, Abbott Capital Management
Jonathan Roth, Abbot Capital Management
Robert Johnson, ARMB Legal Counsel
David Slishinsky, Buck Consulting
Dana Brown, Callan Associates, Inc.
Paul Erlendson, Callan Associates, Inc.
Chris Poag, Department of Law
T.J. Duncan, Frontier Capital
Leslie Thompson, Gabriel Roeder Smith
Dana Woolfrey, Gabriel Roeder Smith
Jeff McCarthy, Jennison Associates
Peter Reinemann, Jennison Associates
Tom O'Halloran, Lord Abbett
Frank Paone, Lord Abbett
Steve Purvis, Luther King
Jim Chambliss, Pathway Capital Management
Canyon Lew, Pathway Capital Management
Trey Chenier, Alaska Permanent Fund Intern
Jeff Pantages, Alaska Permanent Capital Management

PUBLIC MEETING NOTICE

JUDY HALL confirmed that public meeting notice requirements had been met.

APPROVAL OF AGENDA

MS. RYAN moved to approve the agenda. MS. HARBO seconded the motion.

The agenda was approved.

PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS, AND APPEARANCES

JEFF PANTAGES, CIO of Alaska Permanent Capital Management, introduced the Alaska Permanent Fund summer intern, TREY CHENIER, and noted he will be present during the ARM Board meeting to learn.

APPROVAL OF MINUTES: April 24-25, 2014

MS. HARBO moved to approve the minutes of the April 24-25, 2014 meeting. MS. RYAN seconded the motion.

The minutes were approved.

REPORTS

1. CHAIR REPORT

CHAIR SCHUBERT expressed her appreciation and congratulated the Governor for signing the legislation transferring the three billion dollars into the retirement funds. She expressed her appreciation to the Trustees, staff and all who were involved in that effort.

2. COMMITTEE REPORTS

A. Audit Committee

MR. PIHL reported the Audit Committee met June 25, and members included Trustee PIHL, Trustee ERCHINGER and Trustee HARBO. Extensive discussion occurred regarding audit and disclosure requirements of GASB 67 and 68. MR. PIHL noted Buck will provide an explanation today regarding the lowered contributions for 2016 that were revised since the last ARMB meeting. The difference is of particular concern when coupled with the back-loading of contributions under percent of pay. MR. PIHL stated the Audit Committee believes the review should include long-range financial projections, rate sensitivity and risk analysis.

MR. PIHL reported that legal counsel, Robert Johnson, had no issues to report to the Audit Committee. The Department of Revenue staffing for the Board is full and in good shape. The Audit Committee is very pleased with the top financial positions in both Department of Revenue and Department of Administration. MR. PIHL recommended that the Board to review the provided Blue Ribbon Panel Report on retirement.

B. Evaluation Committee - General Consultant RFP

Chief Investment Officer GARY BADER reported the Committee met with the two consultant applicants in Juneau. The report on findings and recommendations to the Board will come as an action item later in the agenda.

3. RETIREMENT & BENEFITS DIVISION REPORT

A. Buck Consulting Invoices (informational)

JIM PUCKETT, Chief Operating Officer, referenced the Buck Invoice handout provided to the Board and noted the expenses with Buck for the first nine months of this fiscal year are a little higher than they were last year. This is due to the Board requesting more assignments from Buck. MR. PUCKETT noted there is nothing unusual with the Buck invoices.

MR. TRIVETTE asked when the contract with Buck expires. MR. PUCKETT requested Kevin Worley, CFO of the Division of Retirement and Benefits, answer that question during his report.

B. Membership Statistics

MR. PUCKETT reported the number of retirees and beneficiaries has increased 9% from last year. However, the number of retiree applications the Division has handled so far this year is unexpectedly lower than last year.

C. DRB Update

MR. PUCKETT stated the workload for the Division has calmed down and they are not receiving as many phone calls regarding the health plan transition. Both the Processing Team and the Survivor Team are meeting their turn-arounds.

MR. TRIVETTE asked what percentage of the new DC members are using managed accounts, since the time managed accounts were removed as the default. MR. TRIVETTE requested Mr. Puckett provide an answer to the Board at the next meeting.

4. TREASURY DIVISION REPORT

MS. LEARY stated she has no report to give and MR. BADER will cover most of the topics in his report.

5. CIO REPORT

MR. BADER referred to his report and noted the first few items relate to the number of times the pension funds were rebalanced since the last meeting. MR. BADER conveyed the recommendation to remove Brandes Partners from the performance watch list. For the six years ending March 31, the EAFE benchmark returned 1.97% and Brandes returned 4.04%.

<u>MS. HARBO moved to remove Brandes Partners from the performance watch list. MR. TRIVETTE seconded the motion.</u>

<u>The motion passed unanimously.</u>

MR. BADER conveyed the recommendation to remove RCM Allianz Large Cap from the watch list. For the six years ending March 31, the Russell Index was up 8.71% and RCM was up 9.59%.

<u>MS. HARBO moved to remove RCM Allianz Large Cap from the performance watch list. MS. RYAN seconded the motion.</u>

The motion passed unanimously.

MR. BADER conveyed the recommendation to remove Relational Investors from the watch list. For the six years ending March 31, the Russell 1000 Value Index was up 7.47% and Relational was up 9.9%.

MS. HARBO moved to remove Relational Investors from the performance watch list. MR. TRIVETTE seconded the motion.

The motion passed unanimously.

MR. BADER informed that Board staff has been in contact with MacKay Shields regarding their changes in portfolio manager. No recommendation will be made to place them on the watch list. MR. BADER noted Mr. Erlendson will comment more on this topic later in the agenda.

MR. BADER advised Item Five reports a 30 million-dollar commitment to the Resolute Fund Number Three of the Jordan Company, which operates in mid-market private equity investments. Their managers average 27 years' of experience and have returned an average IRR of over 25% in their last three mature funds.

MR. BADER reported a redemption of $10 million from the Crestline Blue Glacier Fund due to the Board-approved change in the investment mandate. Other items are related to this same Board-approved investment mandate change. Another transaction was to remove $150 million from Lazard Global Fund and invest $50 million with Advent Capital, the convertible bond manager, and $100 million with Analytic Investors Buy-Write.

MR. BADER continued to review his report noting that fixed income assets totalling $100 million were sold to fund the investment with Frontier Markets with Everest Capital. The total asset allocation was rebalanced on May 23 by selling $200 million of the Russell 1000 Value Index and $100 million of the Russell 1000 Growth. Fixed income was bought with the proceeds.

MR. BADER reported $1.9 million from cash was transferred to Blue Glacier Class B Fund on May 30, and an amendment was made to the Partnership Agreement. The signed Letter of Agreement is included in the Board's packet, worked on by legal counsel Mr. JOHNSON and Zachary Hanna, State Investment Officer. The commitment to the Blue Glacier Class B Fund increased from $264.7 million to $320 million. There was $50 million of the SSgA Russell 200 sold and put into cash to fund the J.P. Morgan infrastructure capital call.

MR. BADER noted the Board awarded a real estate consulting contract to the Townsend Group at the April meeting. When preparing the contract, Townsend informed staff they were uncomfortable with the requirement that performance be calculated in accordance with Global Investment Performance Standards (GIPS) standards. Townsend stated that the SEC advised them there should be no references to GIPS, unless Townsend is claiming to be compliant with GIPS, which is a designation reserved for investment managers. The contract has been modified to remove the reference to GIPS and instead, use language that defines GIPS. The performance calculations will be provided as requested and the substance of the contract is the same. MR. BADER noted staff intends to move forward with this contract, if there are no objections from the Board. CHAIR SCHUBERT reported there were no objections from the Board.

6. FUND FINANCIAL REPORT

State Comptroller SCOTT JONES and MR. WORLEY presented the Fund Financial Report. MR. JONES reviewed the financial statements for the month ending April 2014. The PERS system ended with $14.9 billion, the TRS system with $6.1 billion, the JRS with $161 million, the National Guard and Naval Militia with $37 million, SBS with $3.2 billion, and Deferred Comp with $763 million, for a total of $25.2 billion.

MR. JONES stated that since April, the nonparticipant-directed plans increased roughly 3% from $20.6 billion to $21.2 billion. All asset allocations were within the bands.

MR. WORLEY answered MR. TRIVETTE's previous question and advised Buck's contract will be ending next week. There were three firms who submitted bids for the actuary RFP and Buck was selected again to be the actuary. The audit RFP selection process also occurred and KPMG was awarded a new contract.

MR. WORLEY discussed the Division's cash flow supplement and the rebates for prescriptions under the Other category. The benefit payments for PERS was $51.8 million, PERS Health Care Trust was $33.7 million, Teachers Defined Benefit was $32.7 million and Teachers Health Care Trust was $10.5 million. Paid out refunds included $1.3 million for the PERS Defined Benefit, $95,000 for TRS Defined Benefit, $2.5 million for PERS Defined Contribution, and $215,000 for TRS Defined Contribution. The benefit payments for SBS was $13.6 million, of which $11.3 million was as a result of separation of service and $695,000 was related to retirements. The QDRO benefit payments for separation was $570,000. The Deferred Compensation Plan distributed $3.4 million.
MR. WORLEY noted staff is still working on the age distribution for the separations of service requested by Ms. Harbo at the prior meeting.

7. ABBOTT CAPITAL MANAGEMENT

TIM MALONEY and JONATHAN ROTH of Abbott Capital Management provided a review of the private equity markets, an update on the firm, and the performance of the ARMB Private Equity Portfolio. MR. ROTH stated the equity markets of 2013 provided great opportunity for the private equity sponsors to take their companies public. This is continuing into 2014. The venture capital conditions last year had a steady pace of investment and the IPO market is wide open. Mergers and acquisition exits was on the decline.

MR. ROTH believes the current market pricing is being driven by a strong equity market and by the current Fed policy of keeping interest rates low and forcing investors to find higher tracking rates of returns. This is considered to be a challenging time to be a buyer in the most developed private equity markets of North America and Europe. MR. ROTH discussed nontraditional investors in the changed landscape are beginning to get positions in private companies in advance of their going public.

MR. ERLENDSON asked if the nontraditional participants are seen as a threat or an opportunity for Abbot Capital's way of asset management. MR. ROTH stated he does not see it as a threat or an opportunity. It is viewed as a development which needs to be considered to understand the marketplace. MR. ERLENDSON asked if liquidity demands of large pools of capital changes the dynamics of the market. MR. ROTH believes when the liquidity needs impact the ability to maintain the equity investment in the privately held company, that is when there could be an opportunity for secondary buyers to provide that liquidity.

MR. TRIVETTE asked if the company efficiencies and smaller deal amounts are going to impact the returns. MR. ROTH stated it does provide a greater challenge to find and create ways to access smaller venture capital funds to stay ahead of the curve and be more proactive. The buyout market prices are full and fair, and the standards are set high in evaluating managers. The venture market has changed dramatically and opportunities will continue to be sought on a selective basis.

DR. MITCHELL requested comments regarding general partners and limited partners trends. MR. ROTH explained there has been an improved dynamic between general partners and limited partners over the last number of years because of more scrutiny from government reviews and better focus by limited partners.

MR. SHAW requested additional explanation of covenant-lite loans. MR. ROTH explained a typical buyout transaction includes leverage. For example, if a company is bought for a billion dollars and the equity contribution is considered to be 40%, then $400 million will be provided and the other $600 million will be in the form of a covenant-lite loan. The covenant-lite loans offer enormous amounts of flexibility by the general partner sponsor.

MR. SHAW noted Abbot Capital Management continues to be a steady firm, managing approximately seven billion dollars on behalf of institutional clients. There are 11 managing directors at the firm and no turnover at the senior level, other than the two co-founding partners retiring in 2000 and 2009, respectively.

MR. MALONEY reviewed the commitment activity and distribution activity in 2013 and year-to-date in 2014. Eleven commitments were made in 2013, totaling about $130 million and seven commitments in 2014 were made, totaling about $106 million. He believes the allocated target of $175 million will be reached this year. All of the funds are listed in the appendix. The IRR of the fund is at 9.5% and has increased steadily during the last few years after the great financial crisis. 2013 was a sellers' market and the fund returned about $216 million in distributions, which correlated to about $140 million net cash. The general partners are clearly taking advantage of the high valuation environment. Most of the portfolio has been allocated to developed private equity markets, the majority of which is in North America.

One of the themes of the overall portfolio is resiliency. Two major negative events occurred during the past 17 years of the portfolio, the financial crisis and the dot-com bubble in 2000. The portfolio has rebounded since the financial crisis and the portfolio diversification construction has been able to preserve value and will benefit when valuations increase. MR. MALONEY sees very strong opportunities for the rest of the year.

DR. MITCHELL requested comments on the paucity of investments in Asia. MR. MALONEY stated they have been covering the private equity market in Asia in earnest, but it is still a maturing market with few high quality opportunities and they do not want to sacrifice the quality of management.

CHAIR SCHUBERT noted when the original ASPIB Board considered hiring Abbott Capital, the deliberative investment process and their good contacts with various partnerships was important. She believes this is still the case and congratulated Abbott Capital.

CHAIR SCHUBERT recessed the meeting from 10:17 a.m. to10:34 a.m.

8. PATHWAY CAPITAL MANAGEMENT

JIM CHAMBLISS, Managing Director Pathway Capital Management, and CANYON LEW, Director Pathway Capital Management, provided an update on their firm, an overview of the private equity environment, and a review of the ARMB portfolio. Pathway's assets under management have increased since last year. There have also been two new investment professionals and a couple of new investment analysts hired. The expectation is to continue to hire at the junior level over the next six to nine months. Two new partners were invited to join the partnership, bringing the total to 18 partners at Pathway.

MR. CHAMBLISS noted the private equity environment is good and is a sellers' market. The M&A and IPO markets for private equity have been strong for the last 12 to 24 months, seeing record distributions in the industry. MR. CHAMBLISS believes one reason prices are increasing is that credit markets for private equity remain very accommodative. However, he would like to wait for an entire year's worth of data before making a full comment on whether there is increased pricing and froth in the marketplace.

MR. CHAMBLISS feels confident about the venture capital marketplace and believes the asset class has been shrinking for the last seven years. He believes it is a very competitive marketplace and valuations are increasing. MR. CHAMBLISS does not believe this is a good environment to purchase distressed companies.

DR. MITCHELL requested comments on the fund of funds gatekeeper environment. MR. CHAMBLISS believes the trend of the fund of funds, the institutional marketplace, is more interested in specialized funds, whether it is secondary funds or emerging markets. From a general institutional standpoint, he sees an increase in allocations to private equity.

MR. LEW noted last year was very good and very active. There were 14 new commitments added to the portfolio, totalling $151 million. Performance has been strong over the last year, with gains in all four quarters, totalling $173 million and a one-year net return of 24%. The portfolio monitoring remained active, which included the participation of 108 annual and advisory board meetings and 61 one-on-one meetings with managers in the portfolio. MR. LEW believes the tactical plan is on track with $74 million committed of the targeted $175 million annual commitment and feels good about their pipeline and ability to reach the target.

MR. LEW explained the portfolio remains comfortably within all of its long-term strategy targets. It is currently split 51% acquisitions, 26% venture capital and 23% special situations. There is a nice subdiversification within each of these core strategies and the portfolio is well-diversified by strategy, industry, and geographic region with no significant changes since the last Board meeting. The contribution activity fell for the second consecutive year in 2013, totaling $103 million, while the distributions have increased every year since 2009, establishing an all-time high of $225 million last year. The portfolio generated $123 million of positive net cash flow as distribution activity outpaced contribution activity by a ratio of more than two to one. In 2014, the distribution activity has remained strong. The portfolio's net return from March 31, 2013 to March 31, 2014 was 24%. The net IRR stands at 13.9%.

Last year was a particularly strong year for venture capital funds, returning 28%. The acquisition strategy generated a 25% one-year return and special situations generated an 18% one-year return. MR. LEW noted it has been a strong year for both IPOs and M&As.

MR. CHAMBLISS reviewed the performance comparison pages and the ARMB portfolio has been in the upper quartile all but twice in the last 11 years. The portfolio has outperformed both the Thomson Reuters' and Russell 3000 benchmarks over the last 11 years. The portfolio's out-performance of the Russell 3000 has resulted in nearly $300 million of incremental gains over the index since the program's inception.

DR. MITCHELL requested comments regarding publically traded general partnership versus private general partnerships. MR. CHAMBLISS stated publically traded general partners add complications and their interests may not be aligned with Pathway or with the ARMB portfolio. He does not generally like them because they seem to be asset gatherers rather than investment managers.

9. PERFORMANCE MEASUREMENT - 1ST QUARTER

MR. ERLENDSON expressed this has been a reasonably good year, but a little traumatic for some of the small cap managers. Inflation is subdued with capital market projections of 2.25%. The GDP growth rate has been improving. The Federal Reserve has begun to taper their quantitative easing. Markets will continue to react to that kind of behavior going forward. The Euro-zone GDP growth has been flat and there are broad concerns a period of deflation may be entered. This is causing investors to be cautious. The Federal Reserve lowered the 2014 GDP forecast from 2.9% to 2.2%, which suggests we are still in a very sensitive part of the recovery. Unemployment in the Euro-zone is above 10%, which means those people who are not working are not producing and if they are not producing, they do not have disposable income. Investments are just one part of the interrelated social fabric.

CHAIR SCHUBERT asked if these unemployment numbers are accurate or if they hide the fact some folks have simply given up looking for work. MR. ERLENDSON commented the structural unemployment is growing in concern because even though we are close to the same number of people officially employed before the financial crisis, a number of those people are in lower paying jobs or underemployed. There are also pockets of the economy, particularly in the technology fields, where the number of skilled workers within the U.S. are not available. MR. ERLENDSON believes, and stated some of the Federal Reserve Board members have spoken about, that the official unemployment rate understates how bad the employment situation is. The labor participation rate has decreased post recession from 67% to 63%, mainly because of retirement, disability, and people going back to school.

MS. HARBO asked if a lot of the people who have used up their unemployment are then using disability claims. MR. ERLENDSON noted he cannot answer that question, but has read that income awards based on disability continue to increase and less than 2% of those people who get disability claims ultimately go back into the workforce, which causes a significant drain to the economy.

CHAIR SCHUBERT asked about the impact of the student loan issue this generation of young adults is facing with large debt and little to no work for them. MR. ERLENDSON noted the last slide of the presentation addresses that issue, particularly concerning post-graduate education. The median amount of debt based on this research is almost $100,000. The think tank who did the research did not believe there was any cause for alarm and the debt for undergraduates was more manageable around $20,000. The debt for more than half of the people that have some college education is less than $10,000. However, this is debt that cannot be dismissed and is $10,000 or more of future earnings. MR. BROWN noted there is a phenomena of people who are in their 20's and underemployed moving back in with their parents, which does have negative long-term implications on the economy.

MS. HARBO commented the mindset of people going to college today and borrowing huge student loans is different from when she went to college, when a person paid for college as they went or worked until they could pay for college. MR. ERLEDNSON commented many of the more opportune places within the economy are in technical fields where advanced degrees are typically needed. This is where people are acquiring these large student loan debts.

MR. ERLENDSON reported the investment results across the markets since the recovery have been incredibly robust. Even the Russell 2000, the small cap benchmark, quarter-to-date is finally positive. For the one-year period, the equity-oriented asset classes have had higher returns. The three-month treasury bill over the last 10 years has returned less than 2% a year, which is less than inflation. MR. ERLENDSON discussed a recent survey of several thousand defined contribution participants to measure their financial literacy and only 10% of that population answered the five survey questions correctly. He suggested as more employees become reliant on their defined contribution balances, it is important to make sure their decisions are based on information, rather than emotion.

MR. ERLENDSON noted U.S. sector performance has been positive, except for consumer discretionary, where people are continuing to grow more concerned and discretionary spending has decreased. The current P/E valuations of the 10 major sectors are higher than the 10-year average, with the exception of telecom and information technology. Broadly speaking, the U.S. dollar has been declining in value and exhibits weakness versus most other currencies.

MR. ERLENDSON stated that private market real estate returned a significant rate of 12% last year. The publically traded REIT segment has been challenging, particularly for smaller-cap value managers, and global real estate securities have had even lower returns in the 2% to 3% area over the last year. Housing demands remain muted, but the housing starts are beginning to grow from a low rate. This will be a strong underpinning for a long-term healthy economy.

MR. ERLENDSON noted 88 basis points of excess portfolio return above the benchmark is due to the fact that the portfolio managers have beaten their benchmarks. This is the added value the managers bring to the portfolio. MR. ERLENDSON stated some managers will always be lagging because it is statistically impossible to have every manager beating their benchmark.

MR. BROWN advised the total fixed income pool exceeded its targets across all periods. The in-house portfolio has consistently outperformed over all the trailing time periods against its benchmark. The Non-U.S. Fixed Income manager has better than benchmark results for cumulative periods five years and longer, but has lagged the benchmark in nine of the 13 quarters since 2011.

MR. BROWN explained one of the lead managers of MacKay Shield departed the team earlier in the year for personal reasons. In discussions with MacKay Shield, they do not anticipate any change to their approach due to this departure and the rest of the team remains intact. The replacement is an experienced investment professional who has been with MacKay since 2006. MR. BROWN suggested paying attention to this going forward, but does not believe they should be added to the watch list. MR. ERLENDSON commented the senior management at MacKay Shield forwarded a letter to staff attesting to the fact the departure was purely for personal reasons and not for legal or regulatory issues.

MR. BROWN continued the review and noted total domestic equity is ahead of the benchmark and the peer group for the year. Page 37 shows a good example of how managers are combined to be complimentary. Within the small cap pool are the micro cap managers, DRZ, who is a value-oriented manager focused on high quality and dividends, paired with Lord Abbott, who is a growth-oriented manager. DRZ trailed their benchmark, even though they were up 22% this year, and Lord Abbott had very strong performance and was ahead of their benchmark, returning 59% this year. The combination of international managers has also worked well for performance of the composite over the last year and quarter. The total timber composite performance is good relative to the index, which is also due to the pairing of managers.

MR. BADER requested additional information as to why the Alaska Balanced Fund is red, even though it outperformed its benchmark, and is it misleading by calling it a balanced fund. MR. BROWN believes the peer group is more aggressively positioned and this fund has a more conservative positioning, which could possibly be misleading from one year to the next. MR. BADER informed the Board the Alaska Balanced Fund is a very conservatively managed portfolio and is achieving its target allocation. He believes the Board may want to address this issue so it does not appear like the Board is not paying attention. He suggested discussing this issue with the Defined Contribution Committee.

CHAIR SCHUBERT recessed the meeting from 11:57 a.m. to 1:32 p.m.

10. INVESTMENT/PROCUREMENT ACTIONS

MR. BADER added two more things to his CIO report. He noted MR. JOHNSON is planning a retirement and the Department of Law will issue two RFPs. One will be for legal counsel who would provide assistance with investment contracts, governance and counsel to the Board during meetings. The other legal counsel would be involved in reviewing things like limited partnership agreements and custody contracts.

A. Res 2014-11 Convertible Bond Investment Guidelines

MR. BADER advised Advent Capital is currently the only convertible bond manager and has done a very good job for the Board in managing this space. The guidelines require that Advent cannot hold non-rated convertible securities if they exceed 35% of the total market value of the portfolio. When the ARMB first began the relationship with Advent, the index had 20% of non-rated securities in it and this guideline was quite easy for Advent to work within. Advent has requested a change in the guidelines loosening the restriction on unrated securities in recognition of the changing investment environment by allowing 1.5 times the non-rated securities in the index to be held in the account. Staff recommends this change in Resolution 2014-11.

MS. HARBO moved to adopt Resolution 2014-11. MS. RODELL seconded the motion.

MR. TRIVETTE asked if there is any expected additional risk by adopting this resolution. MR. BADER believes the risk would be in diminished investment performance if this resolution were not passed. There may be risk in terms of the non-rated securities, but it is a tradeoff and this has been a very good manager in the portfolio.

A roll call vote was taken, and the motion passed unanimously.

B. Res 2014-12 Delegation of Authority

MR. BADER stated the Board approved an action memo at the April meeting granting discretion to the Chief Investment Officer (CIO) to contract with certain investment managers in good standing with the ARM in an amount up to $200 million. The Board requested, at that time, for staff to bring the item back to the Board in the form of a resolution and to consider whether the $200 million was a large enough amount of money or if it should be expressed in a different way.

MR. BADER explained Resolution 2014-12 grants the same authority to the CIO, and rather than having a fixed amount of authority, it places the amount per single transaction at 1% of the total Defined Benefit Plan investments, which today is about $200 million. When the assets of the fund expand in the future, the authority of the CIO would also expand. Staff believes this is efficient and is in keeping with the desires expressed by the Board in passing the previous action memo.

<u>MR. TRIVETTE moved to adopt Resolution 2014-12. MS. RYAN seconded the motion.</u>

MR. BRICE wanted to ensure there will still be communication to the Board regarding actions that are being taken and asked how the Board would express concerns during interim times. MR. BADER noted the same process would occur if the Board disapproved of an investment decision. MR. BRICE asked how would the Board communicate any questions regarding the allocation of the 1% to a particular program. CHAIR SCHUBERT noted the CIO already has authority to allocate funds and the report to the Board would be informational.

TRUSTEE RODELL believes MR. BRICE's concerns are from a governance standpoint and asked what mechanisms there are for the Board to ask staff to reconsider its investment decision. MR. BADER does not believe there is an entirely satisfactory way of reversing an investment decision. Some of the actions can be reversed within the cancellation within an investment contract. Other investments are firm commitments and could possibly be backed out of with some negotiation, but the contracts are relying on the authority to act.

MR. BRICE believes this is a question of process and the asset allocations should remain within their bands. MR. BRICE noted he supports this resolution with tentative concern and desires the Board participate and be engaged in these types of investment decisions. He encouraged MR. BADER to be very judicious in the exercise of the authority.

MS. RODELL commented she is in support of this resolution. She noted the Permanent Fund Corporation has a similar policy in place, which has allowed the staff to become very nimble in their responses to opportunities. MS. RODELL commented there is a tremendous amount of communication and briefing on potential actions. She believes there are corrective actions the Board can take in the future if this is in any way being abused or misused.

MR. JOHNSON advised the concept of delegation is certainly appropriate and a note of caution needs to be included. He suggested adding an indicator of consultation with one or more of the members of the IAC if a significant transaction exceeding half a percent is to occur.

CHAIR SCHUBERT stated she is confident with this delegation of authority to MR. BADER and if a new CIO were to come onboard, then the authority could be paused until a level of assurance was reached. MR. PIHL echoed those comments.

A roll call vote was taken and the motion passed unanimously.

C. Res 2014-13 Asset Allocation

MR. BADER explained the anticipated receipt of the appropriated three billion dollars will be in three installments, the first billion dollars on July 15, the next billion dollars four months after that, and the last billion dollars four months after that. The allocations will be according to the legislation and further divided up among the trust funds in accordance with recommendations from the actuary, as communicated by the Department of Administration.

A large influx of money into the plan will require a group of modifications to the asset allocation the Board approved in April. Because many of these assets cannot be immediately put to work in private equity, real estate, infrastructure and areas like that, there has to be some capability of holding more assets in some of the other asset classes. The proposed change to the asset allocation does not change the target amounts, but expands the band in three of the asset classes. The fixed income band would increase by plus or minus 3%. The alternative equity strategies band would increase by plus 2%. The cash band would increase to up to 7%. The intent is not to have the target asset allocation be 7% cash, but would allow that much cash to be held without being in violation of the policy, until it can be put to work.

MR. PIHL moved to adopt Resolution 2014-13. MR. BRICE seconded the motion.

MR. BRICE asked if this resolution gives enough room to accommodate for the three billion dollars. MR. BADER believes this resolution provides enough room and the public equity asset class band, which is also liquid, is large enough.

MS. RODELL requested more detail regarding the investment strategy for the three billion dollars. MR. BADER stated the plan is written down, but he does not have it with him today and will describe it by memory. The first billion dollars transferred on July 15 will be allocated with $100 million to go into a multi-strategy bond contract with Pyramis, $300 million to go into cash and/or fixed income, $400 million to go into international equity, and $200 million into Russell 1000 Growth or Russell 1000 Value, depending upon the portfolio's valuation. The next transfer of one billion dollars will be in November and the last one billion-dollar transfer will be in March. The determination as to allocation of these funds is still being reviewed. Board-approved investment searches will occur. Alternative equity strategies and investments with floating interest rates are being considered.

MR. BRICE asked what the IAC's involvement is in this asset allocation vetting conversation. MR. BADER stated he has not engaged the IAC in this conversation.

A roll call vote was taken and the motion passed unanimously.

D. Manager Search Approval

MR. BADER explained this action memo gives the CIO authority to engage the services of the investment consultant to do manager searchers and reviews.

MS. HARBO moved to authorize the CIO to engage the services of the Board's general consultant or real estate consultant for manager searches. MR. TRIVETTE seconded the motion.

A roll call vote was taken and the motion passed unanimously.

E. Cornerstone Real Estate Advisers

MR. BADER advised a proposed change in the portfolio manager by Cornerstone caused staff to reflect on the separate account relationships with the real estate managers. When Cornerstone was hired in 2003, they were to make new investments and expected to take over value-added assets to improve the core strategy holdings. Unfortunately, there were not many assets that were converted from value-added status to core status and the separate account managers were diminishing. There are currently two assets in the portfolio, an office building in Glendale, California, and an apartment building in Stanford, Connecticut.

Staff proposes to terminate Cornerstone Real Estate Advisor and transfer the office building to another of ARM's separate account managers, UBS Realty. The remaining dollars would be provided to Lasalle Equity Real Estate Advisors to invest. The apartment building would be transferred to Sentinel, who has been an apartment manager for the ARM for 25 years and has done a very good job.

MR. TRIVETTE moved to terminate Cornerstone Real Estate Advisers, LLC, as a core separate account manager and transfer the assets and remaining commitment to ARMB's other separate account advisors in a manner that staff determines will produce the best result. MS. HARBO seconded the motion.

A roll call vote was taken and the motion passed unanimously.

F. RFP Performance Consultant Audit

MR. BADER explained this action item would direct staff to prepare an RFP for an independent audit of the state's performance consultant as required under AS 37.10.22(a)(11).

MR. BRICE moved the Board direct staff to prepare an RFP for an independent audit of the state's performance consultant as required by AS 37.10.220(a)(11). MS. HARBO seconded the motion.

A roll call vote was taken and the motion passed unanimously.

G. RFP 2014-010 General Consultant Search

MR. BADER provided the Board with action memos related to actuaries and consultants. A Proposal Evaluation Committee for the general consultant was appointed by the Chair and consisted of MR. BRICE, MS. HARBO, MS. KATHY LEA and MR. BADER. The Committee conducted interviews, consolidated scoring sheets and recommends to the Board that staff publish a notice of intent to award the general investment consulting services contract to Callan Associates, and upon an expiration of a 10-day notice period with no objections, that a contract be entered into with Callan Associates. This is a three-year term with two optional one-year renewals.

<u>MR. BRICE moved to accept the recommendation of the Committee that staff publish a notice of intent to award the general investment consulting services contract to Callan Associates, Inc., and, upon expiration of a 10-day notice period, if there are not protests, that a contract be entered into with Callan Associates, Inc.</u> <u>MS. HARBO seconded the motion.</u>

A roll call vote was taken and <u>the motion passed unanimously.</u>

H. GRS Contract Option

MR. BADER explained Gabriel Roeder Smith (GRS) is currently the contractor of actuary review services. The contract period runs from July 1, 2013 to 2014, with three optional one-year extensions. Staff recommends the Board exercise the first one-year optional extension of the contract to June 30, 2015.

<u>MS. HARBO moved to direct staff to exercise the first one-year contract option, extending the contract with GRS until June 30, 2015.</u> <u>MS. RYAN seconded the motion.</u>

A roll call vote was taken and <u>the motion passed unanimously.</u>

11. ACTURAIAL REVIEW/ACCEPTANCE- Certification of FY13 Valuations

A. Update on Legislation
SCS HB385(FIN) and HCS CSSB119(FIN) AM H

MR. JOHNSON noted the Board is well aware of the recent legislation passed and signed by the Governor, SB 119, the appropriation of three billion dollars to the Retirement Funds, and HB 385, containing additional issues and matters related to the Retirement Funds. Copies of the legislation are provided in each Board member's packet. SB 119 provides the three billion dollars appropriation to be divided, two billion dollars to TRS, and one billion dollars to PERS, and was contingent upon passage of a version of HB 385, which occurred.

The Legislature provided two statements of intent in the appropriation. MR. JOHNSON explained a statement of intent is an expression of the will and desire of the Legislature. It is not binding law and it is not a directive that has to be specifically followed, but is important to consider. MR. JOHNSON stated the Attorney General transmitted to the Governor his opinion on the statements of intent and quoted, "If the Executive Branch agencies are considering not complying with the language, we request that the Department of law be consulted for a detailed and thorough analysis."

MR. JOHNSON advised it is the intent of the Legislature that the ARMB and the Department of Administration direct the plans' actuary to eliminate the two-year rate setting lag in the PERS and TRS actuarial valuations. The second intent of the Legislature is that the ARMB and Department of Administration direct the plans' actuary to eliminate asset value smoothing from the PERS and TRS actuarial valuations.

MR. JOHNSON explained the ARMB fiduciary obligations and responsibilities remain the same. HB 385 imposes a new rule on actions and deliberations which is, "The appropriate contribution rate for liquidating the past service liability of the Defined Benefit Retirement Plan under TRS or the past service liability of the Defined Benefit Plan under PERS, must be determined by a level percent of pay method, based on amortization of the past service liability for a closed term of 25 years." MR. JOHNSON believes the provisions instruct the Board to apply this new rule to the specific calculation action already taken for FY15. These are substantive provisions and are consistent with the Legislature's authority to enact.

MR. TRIVETTE asked if there is additional information in terms of the reasons behind these changes. MR. JOHNSON noted he has not found any written statements of specific legislative intent and only has the literal words of the statute to direct the responsibilities. MR. TRIVETTE asked if the Board has to redo the 2015 rates. MR. JOHNSON agreed the Board has to reinitialize the amortization of the past service liability of FY15.

MR. PIHL believes the change would only affect the amount of state assistance in 2015, but that would be replaced by the three billion dollars provided by legislation. MR. PIHL wondered if counsel at the Department of Law should be sought to see if this process and incurred costs need to occur. MR. JOHNSON stated the Department of Law should be consulted, but he does not know what the financial and numeric effects of these changes will be.

MR. TRIVETTE noted it seems the actuary report reviewed in April is no longer valid because of the new legislation. He suggests this new process be taken slowly so the Board will have a good understanding of what it means to comply with the legislation, as well as being clear on the financial impacts the statements of intent will create. MR. JOHNSON stated the Legislature presumes the Board will act deliberatively and do what is appropriate to make the correct decisions.

MR. BRICE sees the statutory direction as clear and the intent language needs further conversation and study. He suggested the payment for the actuarial work come out of the state general fund and not the retirement funds.

B. GRS Review Comments

LESLIE THOMPSON, of Gabriel Roeder Smith, expressed her appreciation to DAVID SLISHINSKY, of Buck Consulting, for the time he spent in providing her details for their recommended procedures for implementation of the funding method changes under HB 385 and SB 119. MS. THOMPSON noted GRS is in complete concurrence with Buck's valuations. She defines lag as the timing difference between a known rate and when the rate is actually implemented. Plans usually have a one-year lag. MS. THOMPSON does not believe a lag can be eliminated, which is what the statute is directing. She believes the plan can recognize the lag more fully immediately, which makes the contribution rate higher, except for this year, when the appropriations come in of one billion and two billion, which actually lowers the contribution rate.

MS. THOMPSON noted the elimination of smoothing creates the amortization over a 25-year closed period beginning in 2014. She believes this will create more volatility in the state assistance during that 25-year period. Initially, the state contribution is less because of the legislative contribution.

MR. PIHL asked if MS. THOMPSON, as an actuary, would support eliminating the smoothing. MS. THOMPSON stated the way she would support the elimination of smoothing is if she could ascertain that the level of resulting volatility is acceptable to the contributing plan sponsors. MR. PIHL asked if MS. THOMPSON would recommend not having smoothing. MS. THOMPSON stated she does not recommend going to market value for any of her clients because of their low tolerance for volatile contribution changes.

MR. TRIVETTE asked if the issue of eliminating smoothing was discussed in any of the work MS. THOMPSON recently did for the Senate Finance Committee. MS. THOMPSON answered the issue of smoothing did not come up.

MS. RODELL asked if the new GASB rules and this issue of smoothing are related. MS. THOMPSON noted they are not at all related. The financial statements will no longer reflect the benefit of any smoothing, but the actuarial reports may continue to show smoothing.

C. Presentation re Rate Setting Lag

MR. SLISHINSKY noted this has been a very busy spring with the changes in the funding method due to the passage of HB 385 and SB 119. He provided recommendations with regard to the implementation of those changes. The current ARM Board funding policy has employers contributing to both the Defined Benefit Plans and the Defined Contribution Plans for PERS and TRS. The PERS employers' rate is capped at 22% of total payroll and TRS is capped at 12.56%. If the actuarial rate is above those capped rates, the state makes an additional on-behalf-of contribution to both PERS and TRS.

The actuarial cost method adopted by the ARM Board determines the amount of the recurring costs and how any unfunded liabilities are amortized. The actuarial value of assets uses a rolling five-year smoothing. There is a corridor of 80% to 120% of the market value, which means if the actuarial value is outside 80% to 120% of the market value, then an adjustment to the actuarial value is made. The unfunded liability is amortized on a level dollar basis that was established in 2002 over a closed 25-year period. Changing assumptions will impact the unfunded liability, creating another base and a layering approach to the amortization.

SB 119 appropriates three billion dollars from the Constitutional Budget Reserve Fund, one billion to PERS and two billion to TRS in FY15. MR. SLISHINSKY noted the Legislature's intent is to eliminate the two-year rate setting lag for PERS and TRS. He understands this intent to be a nonbinding intent. Another intent is to eliminate the asset smoothing methodology from the actuarial valuations for PERS and TRS.

HB 385 also changes the amortization of the unfunded liability to a closed 25-year period, which MR. SLISHINSKY believes will eliminate the layering. Reinitializing the amortization back to 25 years, actually lengthens the amortization payments, extending the payments longer than under the current approach. HB 385 also changes the methodology back to the level percentage of pay, rather than a level dollar amount, which makes the initial payments of amortization less, but they increase each year as the payroll increases. Typically what happens during that first period of amortization is the interest on the unfunded liability is not even being met and as a result, the unfunded liability grows, until the amortization payment catches up. MR. SLISHINSKY noted his projections on the closed 25-year period in PERS and TRS shows an increase in the unfunded liability over the first eight-year period.

MR. SLISHINSKY discussed implementation of these changes. The contribution rates for FY15 have been set and the employer rates were capped. If the FY15 rates are recalculated under the new methodology, those amounts are only going to be less and since the three billion dollars appropriation for FY15 is greater, it seems a moot point to go back and recalculate the FY15 rates. MR. SLISHINSKY noted he can write a letter stating the appropriation in SB 119 meets the amortization schedule of HB 385 or he can recalculate the numbers, even though there will be no additional amount the state will have to contribute.

MR. TRIVETTE noted it makes common sense not to spend money having the actuary recalculate the numbers. MR. TRIVETTE noted, if there was no objection from the Board, he requests MR. SLISHINSKY provide a letter stating their position. There was no objection from the Board.

MR. SLISHINSKY advised when Buck issues a report on the 2014 valuation, the 25-year amortization will be shown and all the new changes will be adopted. The asset value to market value will be reinitialized. The question is not for the FY15 rates, but it is for the FY16 rates using these method changes. The OMB has stated they would like to see what the amount of the state's on-behalf-of contribution is and whether or not it will be the capped rates or less. They want to know by November 7th in order to set up their budgets for the coming fiscal year. The 2014 valuation is not going to be ready by November 7th. The data is collected in September and sometimes the audit report is not completed until the first part of November. All of the data is combined, screened, cleaned up, and valuation-ready to run through the valuation software to determine liabilities, which are then merged with the audited assets, calculating the actuarial value of assets to calculate the contribution rates, and put into a report by the end of December.

That report then goes to GRS to be reviewed. A draft report of projections also gets sent to GRS for review usually in January. The whole process takes until about April before the results are presented to the ARM Board, and rate setting action usually takes place during the June meeting.

MR. SLISHINSKY suggested using a process he believes is consistent with the intent of SB 119 to eliminate the lag by using a roll-forward valuation. He explained roll-forward valuations are common and are used every other year in JRS and National Guard valuations. GASB will allow roll-forward valuations for GASB purposes over a period of 24 months. The actuary calculates the liability side of the balance sheet and the accountants calculate the asset side of the balance sheet. If the audited assets can be provided as of June 30, 2014, that number can be used to meet the November 7th deadline. If the benefits payments for the year ending June 30, 2014, are known, the actual benefit payments can be used to roll forward the accrued liability in the 2013 valuation from June 30, 2013 to June 30, 2014. Also, if the benefit payment information is not available, then Callan could provide a rate of return for the year and roll the assets forward using the said rate of return as a proxy for the assets as of June 30, 2104.

MR. TRIVETTE asked if MR. SLISHINSKY expects direction from the Board today on these suggestions and issues. MR. SLISHINSKY does not expect any action from the Board today and would like to present his options and have a discussion. More time is necessary to review the issues before any decisions can be made. He does not believe the proposed state contribution number will be ready by the September Board meeting. To develop the contribution rates for FY16, the roll-forward valuations of assets and liabilities projected to June 30, 2015 will be used.

With regard to the intent to eliminate the asset smoothing, MR. SLISHINSKY recommends eliminating the asset smoothing as of June 30, 2014, and then reinitialize the five-year smoothing as of July 1, 2014. MR. SLISHINSKY believes this will effect the intent of the legislation to eliminate smoothing, but then reinitialize smoothing because it helps reduce the volatility on the contribution rate. He does not recommend eliminating asset smoothing completely.

MR. PIHL believes elimination of smoothing produces unintended consequences and complications. He recommends the Board continue smoothing and express appreciation to the Legislature for their intent. MR. PIHL requested Buck provide the Board with valuation projections with and without smoothing, and with and without the lag roll-forward valuation. MR. TRIVETTE agreed and would like to have figures on paper to review while these issues are being discussed. He believes it would be good to continue the current direction and discuss the unintended consequences with the Legislature in the winter.

MR. BADER commented the Legislature appropriated three billion dollars to the trust funds and if there is going to be an alternative method of preparing contribution rates, it ought to be supplemental to preparing contribution rates exactly as prescribed by the legislation and legislative intent.

MR. SLISHINSKY commented Buck will provide that information to DRB and Board members. He noted the last change he would recommend is to remove the 80% to 120% corridor. GASB is no longer using the corridor. MR. SLISHINSKY believes the five-year smoothing method is sufficiently short and meets actuarial standards of practice. MR. SLISHINSKY gave a detailed review of the roll-forward valuation calculations provided in the presentation used to eliminate the two-year lag.

CHAIR SCHUBERT recessed the meeting from 3:37 p.m. to 3:46 p.m.

D. Board Discussion/Questions

Action: Board Acceptance of GRS Certification for FY13 PERS/TRS, DC Plan, Roll-Forward NGNMRS, JRS

MR. PIHL moved to approve the certification from GRS of the actuarial review. MS. RYAN seconded the motion.

A roll call vote was taken and the motion passed.

Action: Board Acceptance of FY13 Buck Valuations for PERS/TRS, DC Plan

MS. HARBO moved to accept the actuarial valuation reports prepared by Buck Consultants for PERS and TRS Defined Benefit, and PERS and TRS DCR Plans. MR. PIHL seconded the motion.

A roll call vote was taken and the motion passed.

Action: Board Acceptance of FY13 Buck Roll-Forward NGNMRS Valuation

MS. RYAN moved to accept the roll-forward actuarial valuation for the National Guard and Militia Retirement Systems. MS. HARBO seconded the motion.

A roll call vote was taken and the motion passed.

Action: Setting contribution Rates/September 2014

MR. BADER explained that staff recommends, in coordination with the Office of Management and Budget and MR. BARNHILL from the Department of Administration, the Board direct the actuary to prepare contribution rates in accordance with law and sound actuarial practice for consideration at the September 18-19 meeting, or as soon as possible thereafter. MR. BADER understands this may be difficult for Buck to accomplish, given the timeliness of the data received from Retirement and Benefits. The Office of the Governor needs this information for the preparation of the FY16 budget.

MR. TRIVETTE moved to direct the actuary to prepare contribution rates in accordance with law and sound actuarial practice for consideration at the September 18 - 19, 2014 trustee meeting, or as soon as possible thereafter. MR. BRICE seconded the motion.

MR. PIHL requested Buck also prepare the contribution rates and long-range projection based on eliminating the smoothing and continuing the smoothing. CHAIR SCHUBERT noted this is a request to Buck and does not need to be included in the action item motion. MR. JOHNSON suggested Buck's analysis be linked tightly to the legislative intent and then compare alternative reports which include the lagging and rolling-forward issues.

MS. ERCHINGER acknowledged the tremendous amount of work the Department of Administration will endeavor during the next six months in preparing for GASB 67 and GASB 68, in addition to attempting to meet these really challenging deadlines placed on Buck Consulting. She noted it may be impossible for Buck to prepare the contribution rates by the next meeting.

A roll call vote was taken and the motion passed unanimously.

RECESS FOR THE DAY

CHAIR SCHUBERT recessed the meeting at 3:56 p.m.

Friday, June 27, 2014

CALL BACK TO ORDER

CHAIR SCHUBERT reconvened the meeting at 9:01 a.m.

Trustees Trivette, Harbo, Erchinger, Rodell, Brice, Ryan, and Pihl were also present.

12. ECONOMIC ROUND TABLE DISCUSSION

MR. BADER explained the round table discussion today includes representatives from the Board's small cap and micro managers, including Frontier, Jennison, Lord Abbett, and Luther King. The discussion will include the opinions on the economy, items of interest, and any questions the Board may have. The panelists introduced themselves; TOM O'HALLORAN, Lord Abbett, who manages the micro, small, and large growth strategies, T.J. DUNCAN, Frontier Capital, who co-manages the small cap value strategy, STEVE PURVIS, Luther King Capital, who manages the small cap core strategy, and JEFF MCCCARTHY, Jennison Associates, who is a portfolio specialist for the small cap core strategy.

MR. BADER asked what the view is of high frequency trading, given all the recent attention. MR. O'HALLORAN believes high frequency trading needs to be regulated, but in a manner that does not take away from the liquidity of the market, because that would make things worse. MR. DUNCAN stated it is hard to know exactly how high frequency trading has been impacting the portfolios. The traders at Frontier have discussed with their partners about implementing different strategies to try and avoid the gaming that is occurring with high frequency trading. MR. DUNCAN believes when someone is stepping in front of another person and then turning around and trading it back, that is creating false liquidity. He believes it is an insider's game.

MR. PURVIS believes the ability for people to get ahead of investors has been greatly reduced over the last 20 years. Unfortunately, there are always going to be bad guys in this industry and it needs to be cleaned up. MR. MCCARTHY noted the biggest concern is creating regulation without impacting liquidity. MR. O'HALLORAN added there are technological solutions being developed, which may be a better solution than regulation.

MR. BADER informed the Board high frequency trading is in the news now because of a best-selling book. There will be a presentation from a high frequency trader at the education conference, who will provide a different perspective.

MR. BRICE asked what the opinion is on how inflationary expectations will impact the small cap markets. MR. DUNCAN explained small caps have done well when GDP is less than 3.5%. When GDP gets stronger than 3.5%, small caps have tended to underperform large caps. A modest inflationary regime is fine for small caps, but exceptional inflation is probably not a good environment. MR. O'HALLORAN added the expectation for inflation appears to be about 2%, which is a good environment for small caps. Inflation above 3% and deflation below 1% both present problems for small caps.

MR. BADER inquired what economic force or trend is the market currently underappreciating. MR. DUNCAN believes asset classes, other than equities, may be underappreciated and the long-term risk-free rate is extraordinarily low. MR. PURVIS believes the market is underappreciating just how strong the underlying economy is. His opinion is the economy continues to be strong and in mid-cycle for several more years. MR. O'HALLORAN believes inflation risk is underappreciated. He believes the risk of terrorism is underestimated. He believes the power of innovation in this world is underappreciated, which is great for equities, especially small cap.

MR. BADER asked which industries or sectors are currently underappreciated. MR. DUNCAN expressed there is a lot of pessimism around property and casualty insurance and their standard deviation on a P/E basis is below their historical median. MR. MCCARTHY believes there is much pessimism around health care, but the overall utilization rates are improving, which translates positive for balance sheets.

MS. RYAN asked which sectors are small cap managers investing and which sectors are being avoided. MR. O'HALLORAN answered the sectors that have done well this year and are still fine to be in are utilities, REITs, semis, transports and oil. The secular growth names that are being moved back into include biotechs, social media companies, and cloud computing companies. He believes the biotech drug companies are greatly underappreciated. MR. PURVIS stated there is still good value in industrial stocks and some of the technology companies. MR. DUNCAN noted their weightings in technology have been increasing, particularly in semiconductors. He stated the REITs look very expensive now.

MR. PIHL requested opinions as to where we are in the current market cycle and how much upside is left. MR. DUNCAN believes there are two years left on this increasing returns cycle based on historical post-recessionary periods of small caps. MR. PURVIS noted interest rates have not been raised, which would suggest time left for the economy to continue to grow and expand. Typically, the stock market will follow the economic trends and earnings of the underlying economy fairly closely, but periodically there will be an external shock that will send concern and uncertainty into the market, including high oil prices, political and government unrest, or a terrorist attack.

MR. O'HALLORAD confidently added we are not in the first inning of this bull market, but he does not know whether we are in the fifth or ninth inning. He believes if the Federal Reserve ends the quantitative easing strategy, that could cause a 20% bear market, but for the moment, his firm opinion is the market will continue to go up.

MR. BADER asked what one asset class would these managers invest in, if they had to exclude small cap. MR. O'HALLORAN stated large cap growth would be one area, because the innovation is remarkable in America today. Real estate would be another area. MR. DUNCAN stated he would invest in mid-cap American companies. MR. PURVIS answered he would invest in an outside ownership in commercial real estate, because of the rebound in property values. MR. MCCARTHY believes large-cap growth looks attractive.

MR. BADER asked which is more sensitive to interest rate changes, large cap companies or small cap companies. MR. PURVIS noted his view is to stay away from the blanket statement that increasing interest rates would be bad for small cap. He stated tightening of credit, historically creates a headwind for small cap, but not all small cap. MR. DUNCAN believes rising interest rates would be more challenging for smaller companies than larger companies, but not as much as it has been in the past because of improved capital structure. MR. O'HALLORAN commented that in general, small caps are more exposed to interest rate risk, but factors like improved balance sheets, low debt-to-cap ratios, better cash-to-assets ratios could mitigate the impact rising interest rates would have on small caps.

MR. ERLENDSON asked what skill sets, five years from now, will investment asset managers need to be successful. MR. O'HALLORAN believes they will need to be technologically astute in order to utilize the technical analysis tools to strengthen fundamental research. MR. DUNCAN noted the volume of information one can receive has increased and the ability to take advantage of that information in a timely manner on a short-term basis is much harder today.

MR. BRICE asked each manager what is his biggest barrier in the small cap market. MR. MCCARTHY noted global activity has created a fairly volatile current backdrop and he is conscious of this as an ongoing trend. MR. PURVIS commented that as a high quality manager, there is not much he worries about at a company level. He would be concerned if excitement grew in the market and everyone wanted to own small cap stocks, because it would be hard to keep up in that environment. MR. O'HALLORAN stated he works hard and sleeps well at night, but he is concerned with industry trends and the unrelenting pressure on active portfolio managers from lower-cost technological alternatives. MR. DUNCAN stated the toughest thing for him is when the market returns are divested from the companies' profit fundamentals, which is when the companies who are leading the market are not earning money.

MR. BADER gave the scenario if a company was expected to earn a dollar a share for the quarter and they announced 80 cents, what action would each manager take within the next week. MR. O'HALLORAN noted it depends on the quality of the company and the reason for the miss, but typically he would sell when things change negatively. MR. DUNCAN stated he would have to understand contextually how that relates to the long-term thesis and earnings potential of the company. There is also a different reaction if he bought the company at 10 and it is now at 40 and starts missing numbers, as opposed to if he bought the company at 10, expecting it to go to 40, and now it is at eight and is missing numbers. MR. DUNCAN believes the most expensive time to sell is on the day the company reports.

MR. PURVIS commented, to be successful, the emotional aspect of the business needs to be removed. This business is about process, execution, day-to-day blocking and tackling. There are several processes in place to review the investment thesis over the next few weeks to understand why the company reported those numbers and what is the outlook going forward. MR. MCCARTHY noted their focus tends to be on annual results, rather than quarterly results. Many questions factor into the decision to sell within the first 10 days including, where was it trading on a valuation perspective, was it trading at a premium, is this a competitive positioning scenario, and is this a margin miss.

MR. BADER requested the panel provide their thoughts regarding the IPO market in general. MR. MCCARTHY noted they pay very close attention to the IPO market and tend to participate more often than not when it is a company who poses a threat to an existing position and is priced appropriately. He does not see a slow-down in IPO activity in the near-term. MR. PURVIS believes the IPO window has opened back up within their high quality strategy and they have bought three IPOs in the last year.

MR. DUNCAN noted as a small cap value manager, they do not play the IPO market, because it is not particularly helpful to their portfolio. MR. O'HALLORAN noted as a growth manager, they are keenly interested in the IPO market. He believes it was white hot last year, stone cold in March, and is now warming up again. He looks at it as the best opportunity for discovery.

MR. BADER expressed his appreciation to all the members of the panel for their discussion and different points of view. He congratulated the managers for the fine work they have done for the ARM Board. This has been a very good year.

13. FRONTIER CAPITAL (small cap mandate)

MR. DUNCAN provided a detailed PowerPoint presentation regarding the firm, their process, and the portfolio performance. Frontier Capital is over 30 years old and manages only institutional assets, with a focus on U.S. small and mid-cap equities. They manage about $13 billion across six portfolios. There are currently eight portfolio managers and nine analysts. They are looking to hire a person in September who is a recent graduate from the Tuck Business School at Dartmouth. Frontier has a history of investing in their employees, giving opportunities to grow as investors, start portfolios or join current portfolio teams.

The investment philosophy permeates the firm, not just the portfolios. Frontier Capital is looking for companies they would want to own, even if there was not a public market, and that the company will earn, over long periods of time, above their cost of capital. These companies are being bought, typically when they are not earning their cost of capital, which is when the valuations are attractive. The investment philosophy also considers the downside risk to investments and determining whether the upside potential outweighs the downside risk.

Performance is related to bottom-up individual stock decisions, rather than an overweight or underweight in any particular sector. The top 10 holdings are usually between 20% and 25% of the portfolio. Currently the portfolio is overweight in insurance companies and underweight in REITs. For annualized periods ending March 31, 2014, the one year performance was 24.9%, three-year was 20.0%, and five-year was 30.5%, all in excess of the benchmark Russell 2000 Value for the same periods.

MR. BADER asked if Frontier Capital advises any mutual funds. MR. DUNCAN stated yes, Frontier Capital sub-advises for a few mutual funds. In this portfolio, they are advisor for Vanguard's Explorer Value Fund.

MR. ERLENDSON requested further explanation on how Frontier allocates capacity while closing products to new assets. MR. DUNCAN advised existing relationships are allowed to add to their position. However, there is a maximum capped amount for the sub-advisory relationships because of the potential for huge disruption to the portfolio.

DR. MITCHELL inquired what percentage of sales are due to realizations, mistakes, and capitalization beyond the small cap space. MR. DUNCAN noted positions are sold if they get too large, usually around a 6.5 to seven billion-dollar market cap size, and his guess is it could be 20% of the portfolio. MR. DUNCAN believes 20% or so of their sales are due to mistakes and maybe 80% are successes and realizations.

DR. JENNINGS asked for comments regarding benchmarking small cap managers and perhaps a better way to evaluate small cap managers. MR. DUNCAN is worried the benchmark is creeping into becoming a financial services benchmark. In 1999, the financial services were about 24% of the benchmark and now, they are 40% of the benchmark. REITs are now part of the benchmark at about 14%. MR. DUNCAN believes the Russell 2000 Value Index is a fair benchmark.

14. JENNISON ASSOCIATES (small cap mandate)

PETER REINEMANN and MR. MCCARTHY of Jennison Associates provided a detailed PowerPoint presentation regarding the firm, their process, and the portfolio performance. Jennison is in its 45th year of business as an investment manager and is focused on generating results for clients while creating an environment that will attract and retain the best investment talent. There are approximately $178 billion of assets under management. The underlying common theme is selecting securities, fixed income or equity, that can add value by understanding the company at the company level. The fixed income business has tripled in the last five years. The global equity capability has grown to three billion dollars at this point. The small and SMID-cap has about seven billion dollars under management. The small cap does not have any openings in capacity. The SMID-cap does have an opening in its capacity and the portfolio manager makes the decision as to whether or not a capacity should remain open.

MR. REINEMANN noted, within the last 18 months, clients have expressed tremendous interest in unconstrained equity mandates in the multi-asset and opportunistic areas, where a manager has the latitude to go into stocks, regardless of their style, value or growth, and capitalization, as an additional source of value added. The relationship with the parent company Prudential Financial remains very strong.

MR. MCCARTHY advised the investment team philosophy is very much a hands-on, bottom-up, qualitative assessment of business models with the additional belief that the small cap asset class is inherently volatile. The typical end result of the investment process is a portfolio with characteristics including embedded earnings growth assumptions and discounted P/E ratios. The beta, which is a fallout of the process, has historically been below one, which is less volatile than the benchmark Russell 2000. The investment team is the most important component. JOHN MULLMAN is the head of the small and mid-cap team today and co-manages this portfolio with JASON SWIATEK. There have not been any changes within the last year.

MR. ERLENDSON noted MR. MULLMAN historically has been the lead manager and late last year MR. SWIATEK was appointed co-portfolio manager and received some shared responsibilities. He asked if there is a message about MR. MULLMAN's future plans. MR. MCCARTHY explained there is no message regarding MR. MULLMAN's future plans, but rather that as the assets of the portfolio have grown, it was a natural progression to add MR. SWIATEK as a co-manager to this portfolio. MR. SWIATEK has co-managed most of the small cap products since 2004.

There are currently 14 portfolio managers with an average of 28 years' experience and 31 analysts with an average of 17 years' experience. The collective group meets every morning chaired by SIG SEGALAS, founder and CIO, as an open information sharing among the growth team, value team, large cap, small cap, and review every open order with the head trader and discuss any relevant research that has come out the night before. The same exercise with just the small cap team is completed immediately following that meeting.

MR. REINEMANN believes one of the benefits the team enjoys from the open information structure is the large footprint that Jennison has as a growth equity investor, particularly for the IPO market, and to be able to sit in on sessions with MARK ZUCKERBERG, for instance, for the IPO of Facebook.

The sectors adding the most value in the portfolio have been industrials, financials, and tech. The portfolio has been overweight in financials for two-plus years. For the year-to-date period ending May 31, 2014, the portfolio's performance was down 1%. The benchmark Russell 2000 Index was down 2%. Fast forward three weeks later to today's performance, the portfolio is up 5.5% and the benchmark is up 2.5%. The longer trend performance numbers for 1-year, 3-year, and 5-year are all above the benchmark.

MR. ERLENDSON asked how Jennison evaluates cyber security threats to the industries and companies reviewed. MR. MCCARTHY stated security is a huge theme right now and has become a little volatile with the most recent announcement that the government no longer will control the ICON, the oversight for domain name coverage. Jennison tries to participate in where they see the strong revenue potential in companies who offer a renewable contract and have a recurring revenue structure. He believes the threat for cyber security appears to be here to stay. MR. REINEMANN added it is hard to emphasize how difficult it is to truly have a handle on the sorts of threats the company sees and their willingness and ability to protect against it. He believes this will be a terrific investment space, but at the same time, it is a very real threat that companies are investing a lot of money in prevention.

MR. PIHL requested comment on the relatively high P/E ratios in 2014 listed on page 15. MR. MCCARTHY noted much of the growth last year, broadly speaking, came from multiple expansions. Cavium is trading at 33 times current year's earnings and has realized substantial growth to associate with the earnings. This chart is showing the top 20 of the 125 positions and the P/E ratios begin to moderate as position sizes decrease.

CHAIR SCHUBERT recessed the meeting from 10:38 a.m. to10:47 a.m.

15. LORD ABBETT (small cap mandate)

FRANK PAONE and MR. O'HALLORAN provided a detailed PowerPoint presentation regarding the firm, their process, and the portfolio performance. Lord Abbett has had a singular focus on the management of money since 1929. They are investment-led and investor-focused.

There are 65 partners that own and operate the organization, within three distinct and collaborative groups; client services, investment services, and core services. There are 133 investment professionals with an average of 17 years in the business. They manage a global perspective, which spans the capital markets, at $142.2 billion in assets. There are 66% of those assets in fixed income and 34% of those assets in equity.

MR. PAONE believes MR. O'HALLORAN's background as a district attorney in Rhode Island gives him a competitive advantage in his understanding of management and personalities, which helps in the selection process of companies. MR. O'HALLORAN, ARTHUR WEISE, and VERNON BICE, manage the portfolio and are supported by three dedicated research analysts under Centralized Research, three risk officers under Risk Management, 29 additional investment professionals under Equity Resources, and 10 equity traders under Equity Trading.

MR. O'HALLORAN stated the investment approach for the fund is to seek out special companies: that 1) have a business model that as the company increases sales, it will become more profitable and have a smoother revenue stream; 2) have intelligent people who are focused, transparent, and honest; 3) are operating within healthy industry conditions; and 4) are the leading company or a company who is gaining market share. There are six big areas where these special companies are most prevalent; digitization, U.S. mass consumerism, emerging nations, modern medicine, the American manufacturing renaissance, and the North American energy revival.

MR. O'HALLORAN believes one of the reasons small caps got hit hard between January and May is because they got overheated last year. It is critical to understand when small caps are in favor and when small caps are out of favor. This is achieved by thinking about the macro economy and having an opinion on the market, as well as looking at the technical profile of individual stocks to deliver alpha, which is becoming increasingly difficult because of the competition from other alternatives.

MR. O'HALLORAN explained when the market embraces these types of companies, like it did last year, the portfolio gets aggressive, and when the market is hostile to these types of companies, like it was between January and May of this year, the portfolio protects as much as possible and moves toward more defensive names and pockets of strength. Then when the special companies stop going lower, the portfolio gets back involved again.

The portfolio maintains a well-diversified strategy, which is an important part of the process. The top 10 holdings make up 14.6% of the portfolio. MR. O'HALLORAN commented the portfolio will generally pay a reasonable premium from a valuation standpoint and the growth will generally be faster than that of the index. The portfolio was above the benchmark Russell 2000 Growth Index three out of the four recent quarters.

16. LUTHER KING (small cap mandate)

MR. PURVIS provided a detailed PowerPoint presentation regarding the firm, their process, and the portfolio performance. He noted the bottom line is Luther King is a great firm and continues to get stronger. The assets are growing. The investment staff is growing. The fee income continues to be reinvested to grow investment staff, which benefits clients. Small cap and mid-cap is very important to Luther King, making up over 20% of their total assets.

MR. PURVIS explained the goals are clearly to generate superior returns with lower volatility relative to the benchmark. The process is bottom-up and fundamentally-driven, identifying and investing in high quality companies that are competitively advantaged. The companies have proven their business model and tend to be profitable, generating free cash flow which can be reinvested back into the business to grow value over time.

MR. PURVIS and LUTHER KING are the portfolio managers. There are three small cap analysts and a fourth analyst will be added this month, as part of the continued investment staff build-out. The portfolio also utilizes the nine firm-wide sector analysts. The portfolio holds about 90 companies and will sell those companies when they grow out of the small cap. The benchmark used is the Russell 2000, which gets reset every year. The market cap is now up to four billion dollars and Luther King will increase their market caps to stay consistent with the benchmark.

The current portfolio is underweight in financials and utilities relative to the benchmark and those sectors have done well for the benchmark in the last six months. One of the reasons the portfolio is underweight financials is that sector includes about a 9% weighting to REITs. The managers believe there is a higher probability interest rates will increase resulting in a positive effect for the portfolio. The top 15 holdings comprise about 23% of the portfolio. The energy and materials sectors are currently adding value to the portfolio. MR. PURVIS commented it is essential to realize consolidation or a rest period in the market the first six months after a very strong year is not uncommon and believes this is being shown in the current market.

The return on equity of the companies in the portfolio is well above the benchmark and roughly the same return on equity as the S&P 500. The debt level at 28% is in line with the benchmark and below that of the S&P 500. The portfolio is diversified at the sector level and the stock level. The focus is on high quality companies that trade at sizeable share values and have good market caps.

The portfolio performance returns have trailed the benchmark on an annualized basis ending March 31st, on a year-to-date, one-year, and three-year periods. The five-year return was equal to the benchmark and the 10-year and since-inception returns were greater than the benchmark. The returns shown in the presentation are gross of fees.

MR. ERLENDSON asked what percentage of the composite assets in small cap are non-institutional, and is there a concern regarding an exodus of retail money from small cap because of short-term time horizons. MR. PURVIS stated there is roughly $2.3 billion in the small cap strategy, of which one billion dollars is in a non-institutional mutual fund. There has been rebalancing on the institutional side, given the strong previous year. The portfolio stopped taking new accounts when it reached two billion dollars in order to preserve capacity for existing clients. There are 45 total portfolios and 44 of those are institutional assets.

MR. TRIVETTE requested MR. PURVIS' definition of a high quality stock purchased for the portfolio. MR. PURVIS noted a key consideration is a company that is profitable with a well-capitalized balance sheet and has no excessive debt relative to cash flow. The debt-to-book ratio can get confusing with small stock and so the analysts look more intently on the debt to cash flow ratio.

UNFINISHED BUSINESS

1. Calendar
Action: Adopt Proposed 2015 Calendar

MS. HALL noted the proposed 2015 calendar was based on the 2014 calendar of meetings and in conjunction with the Permanent Fund Corporation's calendar to avoid conflicts.

MS. HARBO moved to adopt the proposed 2015 calendar. MR. BRICE seconded the motion.

A roll call vote was taken and the motion passed unanimously.

2. Disclosure Report

MS. HALL advised the Disclosure Report was included in the packet and there is nothing unusual.

3. Legal Report

MR. JOHNSON stated he presented much of his legal report to the Board yesterday with respect to the legislation passed last session. MR. JOHNSON informed he has been working with MR. CARSON and MR. MITCHELL on a number of transactional documents. He requested to provide a 20-minute presentation on governance issues to the Board at the

September meeting. CHAIR SCHUBERT agreed to include his presentation on the next agenda.

NEW BUSINESS

None

OTHER MATTERS TO PROPERLY COME BEFORE THE BOARD

None

PUBLIC/MEMBER COMMENTS

None

INVESTMENT ADVISORY COUNCIL COMMENTS

DR. MITCHELL addressed the questions during the round table discussion regarding, is the market too high, are valuations too high, are we in some sort of an equity bubble? DR. MITCHELL noted bubbles historically have occurred with some regularity every eight to 10 years. They are not unusual. The two basic valuations to pay attention to are price/earnings ratio and yield. At the moment, the market is slightly above average in price/earnings ratio and slightly below average in yield.

DR. MITCHELL believes one of the early warning signs in bubbles occur when people start saying that price/earnings ratios are not important, which one tends to hear these days is P/E ratios are not important because the Fed is keeping interest rates low. Another warning sign is hearing people talk about all the cash on the sidelines that as soon as the market goes down, all this cash is going to flow in the market and buoy it back up. DR. MITCHELL believes the market is currently on a bubble trajectory, heading up toward a bubble and it is time to be cautious. The ARMB portfolio is not immune to bubbles, but because of its diversification is in a lot better shape than those who only invest in equities. He does not advocate any radical changes and believes the Board and staff have done a great job diversifying the portfolio, but would be on the lookout.

DR. JENNINGS praised the approach of splitting the appropriation into three parts providing a phased dollar-cost averaging method to investments. DR. JENNINGS recommended having a 20-minute presentation on ARBM expenses, including investment management expenses and staffing costs. He realizes the Budget Committee normally has that focus, but believes taking a holistic look would be beneficial in highlighting the incredible value of the internal staff.

MR. SHAW commented he very much enjoyed the conversation around labor force participation and unemployment. He believes inflation is two years away and the conversation around college debt and people being under-employed is significant.

TRUSTEE COMMENTS

MR. TRIVETTE expressed his gratitude to MR. BADER and staff for their wonderful job. He appreciates the emails from MR. BADER providing a ballpark figure of the end of year numbers, even though final numbers will not be out for another two or three months. As a Trustee and public member, MR. TRIVETTE noted he receives numerous requests from people and appreciates the support from staff.

FUTURE AGENDA ITEMS

MS. RODELL informed the Board received a policy and procedures manual in early June, which needs to be reviewed and adopted by the Board. She requested this be added to the September meeting..

MR. PIHL requested the interest assumption be included on the agenda under Buck's experience analysis for the next meeting and requested the experts provide advice from all angles. MR. TRIVETTE suggested looking at all of the assumptions at the next meeting. MR. PIHL believes the experience analysis covers all of the assumptions, except the interest assumption.

ADJOURNMENT

There being no objection and no further business to come before the Board, the meeting was adjourned at 11:47 a.m. on June 27, 2014, on a motion made by MR. BRICE and seconded by MS. HARBO.

Chair of the Board of Trustees
Alaska Retirement Management Board

ATTEST:

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Corporate Secretary