



Teachers' Retirement System of the State of Illinois

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MINUTES

Meeting of the Investment Committee May 28-29, 2014

A meeting of the Investment Committee of the Illinois Teachers' Retirement System was held on May 28-29, 2014 at the Springfield office of the Illinois Teachers' Retirement System, 2815 West Washington Street. Cynthia O'Neill, Chair, called the meeting to order at 3:28 p.m. A quorum was present.

Roll Call attendance was taken with the following trustees present: Cynthia O'Neill (Chair), Mike Busby (Vice Chair), Mark Bailey, Marcia Campbell, Mark Harris, Cinda Klickna, Sonia Walwyn, and Sharon Leggett. Absent: Rainy Kaplan, Bob Lyons, Enrique Vasquez and Chris Koch.

Others present: Dick Ingram, Executive Director; Stan Rupnik, Chief Investment Officer (5/29); Greg Turk, Director of Investments; Deron Bertolo, Director of Investment Operations; Scottie Bevill, Sr. Investment Officer; Ken Musick, Investment Officer; Kenyatta Matheny, Sr. Investment Officer; Jerry Quandt, Investment Officer; Bob Jiroutek, Sr. Investment Analyst; Kirk Sims, Investment Analyst; Brennan Basnicki, Investment Analyst; Brian Nobis, Investment Analyst; Tim Hays, Sr. Investment Officer; Dakin Sanert, Sr. Investment Analyst; Bill Thomas, Investment Officer; Chuck Handy, Investment Officer; Stefan Backhus, Investment Officer; Tom Gray, General Counsel; Cynthia Fain, Sr. Assistant General Counsel; Kathleen Farney, Director of Research; Stacy Smith, Director of Internal Audit; Tassi Maton, Sr. Internal Auditor, Christina Baker, Internal Auditor; Dave Urbanek, Director of Communications; Tammy Green, Asst. to Executive Director; Sue Billington, Executive Assistant; Pat O'Hara, Cavanagh & O'Hara (Fiduciary Counsel); Becky Gratsinger, Ryan Sullivan, Greg Kanter and Marcia Beard, RV Kuhns (Investment Consultant); Jamie Shen and Sarah Angus, Callan Associates (Real Estate Consultant); and Mike Krems, TorreyCove (Private Equity Consultant)

Visitors present: Shirley Dodds, IRTA; Dennis Murfin, IRTA; Gayla Dial, IEA-R/IRTA; Don Davis, IRTA; Nancy Darrough, IEA-R; Christine Williamson, Pensions & Investments; and Jim Bauer, UNITE HERE (5/29).

APPROVAL OF MINUTES

A draft of the February 19-20, 2014 minutes of the Investment Committee meeting was sent to the committee for review. On a motion by Sharon Leggett, seconded by Cinda Klickna, and by unanimous vote, the minutes were approved as printed.

OLD BUSINESS

Investment Manager Chart

Greg Turk, Director of Investments, provided an organizational chart of TRS's investment managers as of March 31, 2014. Documentation is on file. Allocations are shown for the main TRS trust fund, the POB account and on a total TRS basis. In addition, the committee received a chart detailing the System's top manager relationships.

Cash Withdrawal

Mr. Turk discussed the recent cash withdrawals necessary to fund the System's cash requirements. Documentation is on file. A motion was made by Mike Busby, seconded by Marcia Campbell, that the committee recommend to the Board to authorize a cash withdrawal up to 1.5 percent of the TRS trust fund's total value, or \$653.9 million based on the March 31, 2014 ending market value. The motion passed by a unanimous voice vote.

STAFF/CONSULTANT PRESENTATIONS

Investment Performance Review

RV Kuhns provided an update of the investment performance for the quarter ending March 31, 2014. Total assets: \$43.59 billion. Documentation is on file.

The total fund return, gross of fees:

- 1 year: 13.45%
- 3 years: 9.96%
- 5 years: 14.13%
- 10 years: 7.41%

The total fund return, net of fees:

- 1 year: 12.81%
- 3 years: 9.32%
- 5 years: 13.48%
- 10 years: 6.90%

Watch List

Staff provided an update of the investment managers currently on the watch list for the quarter ended March 31, 2014. Levin Capital Management (domestic equity) and the PIMCO Global Multi-Asset strategy remain on watch due to performance concerns. Staff recommended that American Century (international equity) and Cortina (domestic equity) be added to the watch list due to organizational and performance concerns. A motion was made by Cinda Klickna, seconded by Sharon Leggett, that the committee recommend to the Board to accept the watch list as presented. The motion passed by a unanimous voice vote.

W/MBE Utilization Report

Kirk Sims, Investment Analyst, provided preliminary data on the participation of minority and female-owned brokers/dealers and investment managers within the TRS investment portfolio through March 31, 2014. Assets under management for WMBE-owned investments were \$6.14 billion, representing 14.16% of the total TRS portfolio.

The System's 10th annual Opportunity Forum was held on March 13, 2014 at the Crowne Plaza hotel in Springfield. Senator James Clayborne was the keynote speaker.

Quarterly Compliance Summary

TRS is responsible for monitoring investment manager trading activity to ensure compliance as related to the Investment Manager Agreement. Monthly, staff reviews alerts triggered by the State Street compliance system to determine if there are any discrepancies. Deron Bertolo, Director of Investment Operations, provided a summary of the quarterly compliance for the quarter ended March 31, 2014. TRS is in compliance with Public Acts 95-0616 (Iran) and 95-0521 (Sudan). Documentation is on file.

State Street

The System's Master Trust Agreement with State Street Bank & Trust Company is scheduled to expire on June 30, 2014. State Street is currently in the process of implementing three new investment systems which are scheduled to be completed within a few months. Due to timing, staff recommended the RFP process for master trustee/custodian services be initiated at a later date. Staff recommended extending the current agreement by utilizing the evergreen amendment option that allows a continuation of the agreement until terminated by either party. A motion was made by Marcia Campbell, seconded by Mike Busby, that the committee recommend to the Board to approve an extension of the State Street Master Trust Agreement by utilizing the evergreen amendment option. The motion passed by a unanimous voice vote. Staff will continue monitoring the services of State Street and will provide an update in six months on the status of the relationship.

Real Estate Consulting Contract

The System's real estate consulting contract with Callan Associates is scheduled to expire in December 2014. Public Act 96-0006 requires investment services be re-bid at a minimum every five years and prohibits any type of contract extension without completing a Request for Proposal process. Staff requested authorization to issue a RFP for real estate consulting services. The motion passed by a unanimous voice vote. Finalists are expected to present to the Board in October or December.

RECESS

The meeting recessed at 4:52 p.m. and reconvened the following day at 8:07 a.m.

Carlyle Group - Real Estate

Staff and Callan Associates presented an investment opportunity in Carlyle Realty Partners VII, Limited Partnership and provided an overview of the due diligence that was conducted. Documentation is on file. A motion was made by Cinda Klickna, seconded by Sharon Leggett, that the committee recommend to the Board to commit up to \$100 million to Carlyle Realty Partners II, L.P. subject to successful completion of legal documents. The motion passed by a unanimous voice vote.

Starwood – Real Estate

Staff and Callan Associates presented an investment opportunity in Starwood Global Opportunity Fund X, Limited Partnership and provided an overview of the due diligence that was conducted. Documentation is on file. Trustee Klickna voiced concerns related to allegations concerning some of the contractors used by Starwood in construction projects and asked why representatives from Starwood were not present at the meeting. A lengthy discussion was held regarding communication that some of the trustees received from a labor union regarding the allegations. Stan Rupnik, Chief Investment Officer, stated that due diligence on the fund is ongoing and that trustee concerns would be addressed. A motion was made by Sonia Walwyn, seconded by Mike Busby, that the committee recommend to the Board to commit up to \$300 million to Starwood Global Opportunity Fund X, L.P. contingent upon the successful completion of the ongoing due diligence, as well as negotiation of legal documents. The motion passed by a unanimous voice vote.

NEW BUSINESS

Black River – Private Equity

Staff and TorreyCove presented a re-investment opportunity within the System's private equity program and provided an overview of the due diligence that was conducted. Documentation is on file. Staff recommended a \$75 million commitment to Black River Food Fund II to make growth oriented private equity investments in the production, process, and distribution of food in emerging markets. The System is currently invested in the Black River Food Fund I. A motion was made by Cinda Klickna, seconded by Sharon Leggett, that the committee recommend to the Board to commit up to \$75 million to Black River Food Fund II, L.P. contingent upon successful completion of due diligence and legal documentation. The motion passed by a unanimous voice vote.

JMI – Private Equity

Staff and TorreyCove presented a re-investment opportunity within the System's private equity program and provided an overview of the due diligence that was conducted. Documentation is on file. Staff recommended a commitment of up to \$50 million to JMI Equity Fund VIII, L.P. The System is currently invested in JMI Equity Fund VII. A motion was made

by Mike Busby, seconded by Mark Bailey, that the committee recommend to the Board to commit up to \$50 million to JMI Equity Fund VIII, L.P. contingent upon successful completion of due diligence and legal documentation. The motion passed by a unanimous voice vote.

RECESS

The meeting recessed at 9:40 a.m. and reconvened at 9:50 a.m.

Shasta – Private Equity

Staff and TorreyCove presented a re-investment opportunity within the System's private equity program and provided an overview of the due diligence that was conducted. Documentation is on file. Staff recommended a commitment of up to \$20 million to Shasta Ventures IV, L.P. The System is currently invested in Shasta Fund I. A motion was made by Sharon Leggett, seconded by Marcia Campbell, that the committee recommend to the Board to commit up to \$20 million to Shasta Ventures IV, L.P. contingent upon successful completion of due diligence and legal documentation. The motion passed by a unanimous voice vote.

Cash Management

Staff initiated a review of alternate cash management options since contract negotiations with State Street Global Advisors were not successful. Upon due diligence of existing managers' cash management strategies, staff recommended Garcia Hamilton & Associates (GH) to manage a portion (up to \$300 million) of TRS's overall residual U.S. dollar cash balances currently held in STIF. Cash balances under \$300 million and over \$600 million will continue to be invested in the State Street STIF. The purpose utilizing GH to manage a portion of the residual cash is to earn additional or excess interest income over the current STIF yields. A motion was made by Marcia Campbell, seconded by Sonia Walwyn, that the committee recommend to the Board to select Garcia Hamilton & Associates to manage a customized \$300 million short term duration cash portfolio for the TRS fund. The motion passed by a unanimous voice vote.

Prudential Investment Management – Fixed Income

Staff provided an overview of Prudential's relative value strategy (PRV) and how it would be a beneficial addition within the overall Prudential mandate. Staff proposed a 60/40 mix between core and PRV within the portfolio. A motion was made by Sonia Walwyn, seconded by Cinda Klickna, that the committee recommend to the Board to approve the addition of Prudential's Relative Value strategy as part of the overall Prudential mandate within the global fixed income asset class. The motion passed by a unanimous voice vote.

Vista Equity Partners – Fixed Income

Representatives of Vista Equity Partners presented an investment opportunity in Vista Credit Opportunities Fund I, L.P., a first time credit fund that invests in debt of enterprise software, data and technology-enabled companies. Their presentation booklet is on file. Staff provided an overview of the firm and due diligence that was conducted. A motion was made by Marcia Campbell, seconded by Sonia Walwyn, that the committee recommend to the Board to commit \$40 million to Visa Credit Opportunities Fund I, L.P. within the System's Emerging Manager Program. The motion passed by a unanimous voice vote.

Fixed Income Target Changes

Due to the addition of Prudential's relative value strategy, staff recommended increasing Prudential's target within the core/core plus tactical allocation. A motion was made by Cinda Klickna, seconded by Mark Bailey, that the committee recommend to the Board to approve the proposed revision to the TRS Investment Policy. The motion passed by a unanimous voice vote.

Asset Allocation/Rate of Investment Return

Staff and RV Kuhns reviewed the asset allocation modeling including liquidity modeling/analysis. The following target changes were proposed to improve diversification, balance between private and public capital, and risk/return profile. Documentation is on file. A new asset allocation strategy will be presented for approval at the June Board meeting.

- Increase to private equity (+2%)
- Increase real estate (+1%)
- Increase real return (+1%)
- Decrease international equity (-2%)
- Decrease domestic equity (-2%)

Buck Consultants, the System's actuary, reviewed the current assumed rate of investment return and discussed options for a revised rate of return to be adopted in the June 30, 2014 actuarial valuation. The Buck study of economic assumptions was done in conjunction with the asset allocation study performed by RV Kuhns. Documentation is on file. Buck recommended reducing the investment return assumption from the current 8 percent to 7.5 percent to increase the likelihood of achieving the assumed rate of return, lowering TRS inflation assumption from 3.25 percent to 3.0 percent per year as well as reducing all rates of salary increase by 0.25 percent, and changing the current TRS real rate of return assumption to coordinate with the investment return and inflation. The Board plans to take a vote on the recommendations at its June Board meeting. If adopted, the System's total accrued liability, unfunded liability, normal cost and employer contribution rates will increase. The results will be used in preparation of the June 30, 2014 actuarial valuation.

Alphadyne Asset Management – Absolute Return

Representatives of Alphadyne Asset Management presented an investment opportunity in the firm's Alphadyne Global Rates Fund. Their presentation booklet is on file. Staff provided an overview of the due diligence that was conducted. A motion was made by Cinda Klickna, seconded by Mark Bailey, that the committee recommend to the Board to commit up to 10% of the absolute return asset class to Alphadyne Asset Management for investment in the Alphadyne Global Rates Fund. The motion passed by a unanimous voice vote.

Veradero Capital – Absolute Return

Representatives of Varedero Capital presented an investment opportunity in the firm's Varedero International Fund. Their presentation booklet is on file. Staff provided an overview of the due diligence that was conducted. A motion was made by Marcia Campbell, seconded by Cinda Klickna, that the committee recommend to the Board to commit up to 8% of the absolute return asset class to Varedero Capital subject to completion of contract negotiations. The motion passed by a unanimous voice vote.

EXECUTIVE SESSION

A motion was made by Marcia Campbell, seconded by Cinda Klickna, that the Investment Committee enter into executive session for the purpose of discussing investments as permitted under the following exception set forth in the Open Meetings Act which authorizes the closing of the meeting to the public: 5 ILCS 120/2(c) (7). Roll call resulted in affirmative voice votes from Trustees Bailey, Busby, Campbell, Harris, Klickna, O'Neill, Walwyn, and Leggett. Motion CARRIED.

No action was taken during executive session. A motion was made by Mike Busby, seconded by Cinda Klickna, that the Investment Committee come out of executive session. Roll call resulted in affirmative voice votes from Trustees Bailey, Busby, Campbell, Harris, Klickna, O'Neill, Walwyn, and Leggett. Motion CARRIED.

ADJOURNMENT

There being no further business to come before the Investment Committee, the meeting adjourned upon conclusion of executive session at 3:40 p.m.



Richard W. Ingram, Executive Director

Approved 6/24/14