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5 NEW YORK CITY TEACHERS' RETIREMENT SYSTEM

6 INVESTMENT MEETING

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9 Held on Thursday, May 5, 2016, at 55 Water Street,

10 New York, New York

11

12 ATTENDEES:

13 JOHN ADLER, Chairman, Trustee

14 SANDRA MARCH, Trustee

15 THOMAS BROWN, Trustee

16 MICHAEL HADDAD, Comptroller's Office

17 SUSANNAH VICKERS, Trustee, Comptroller's Office

18 CHARLOTTE BEYER, Trustee

19 DAVID KAZANSKY, Trustee

20 MICHAEL SOHN, Trustee

21 MELVYN AARONSON, Teachers' Retirement System

22

23 REPORTED BY:
YAFFA KAPLAN

24 JOB NO. 0235931

25

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2 ATTENDEES (Continued):

3 SUSAN STANG, Teachers' Retirement System

4 JOE NANKOF, Rocaton

5 ROBIN PELLISH, Rocaton

6 PATRICIA REILLY, Teachers' Retirement System

7 VALERIE BUDZIK, Teachers' Retirement System

8 LIZ SANCHEZ, Teachers' Retirement System

9 SHERRY CHAN, Office of the Actuary

10 PAUL RAUCCI, Teachers' Retirement System

11 DEBORAH PENNY

12 ANTONIO RODRIGUEZ, Mayor's Office

13 PETYA NIKOLOVA, Bureau of Asset Management

14 RON SWINGLE, Teachers' Retirement System

15 JOHN DORSA, Bureau of Assset Management

16 MILES DRAYCOTT, Bureau of Assset Management

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2 MR. ADLER: Good morning. Welcome to

3 the Teachers' Retirement System of the City of

4 New York Investment Meeting for May 5th.

5 Happy Cinco de Mayo.

6 MS. REILLY: Gracias.

7 MR. ADLER: Pat, can you call the roll.

8 MS. REILLY: John Adler?

9 MR. ADLER: Here.

10 MS. REILLY: Thomas Brown?

11 MR. BROWN: Here.

12 MS. REILLY: David Kazansky?

13 MR. KAZANSKY: Here.

14 MS. REILLY: Sandra March?

15 MS. MARCH: Present.

16 MS. REILLY: Michael Sohn?

17 MR. SOHN: Here.

18 MS. REILLY: Charlotte Beyer?

19 MS. BEYER: Here.

20 MS. REILLY: Susannah Vickers?

21 MS. VICKERS: Here.

22 MS. REILLY: We do have a quorum.

23 MR. ADLER: Great, thank you.

24 So let's turn it over to Rocaton for the

25 Passport Fund's agenda.

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2 MS. PELLISH: Thank you. So we have
3 copies. I am just going to pass these down,
4 the monthly report ending March that -- you
5 have all received this electronically. And so
6 I will begin talking as they are passed
7 around, if I may.
8 As of the end of March, the Diversified
9 Equity Fund totalled slightly over $10 billion
10 in market value, very strong -- in a very
11 strong equity market in March. So the
12 Diversified Equity Fund was up 6.65 percent
13 for the month, which gave it a first quarter
14 return of just under 70 basis points. But
15 over the past year, it's down 2-1/4 percent.
16 If you look at what added value during the
17 month, the strongest component was the passive
18 equity allocation which is half of the
19 diversified equity composite. That was up
20 slightly over 7 percent. In a strong market,
21 you would expect the defensive strategy
22 composite to lag and that yielded a
23 respectable positive return, but still up 4.5
24 percent. And the actively managed U.S.
25 equity composite lagged for the month. During

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2 the month, the non-U.S. equity markets had a
3 very strong month due to both weak dollar and
4 strong local markets, so that composite was up
5 almost 8 percent. So, again, in aggregate the
6 Variable A or Diversified Equity Fund was up
7 6.65 percent for the month. The bond fund
8 which had $327 million at the end of the first
9 quarter had a modest positive return of about
10 80 basis points, which brings it to .18
11 percent for the quarter. Slightly ahead of
12 the benchmark, but still reflecting the fact
13 that this is a very high-quality
14 short-duration portfolio. As I mentioned, the
15 international equity markets had a
16 particularly strong month so that the
17 International Equity Fund was up 8.1 percent
18 for the month. Basically flat for the
19 quarter, but still negative for the one-year
20 period, negative 5 percent. The Inflation
21 Protection Fund, which you will recall has a
22 fairly heavy equity component as well as
23 allocations to TIPS and other inflation-linked
24 securities, had a positive return during the
25 month of 2.8 percent. That gives it a return

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2 of 2. -- 2-1/2 percent for the quarter, but
3 still again because of its heavy equity
4 exposure a loss for the one-year period of 5
5 percent. And the Socially Responsive Fund had
6 again very strong month, 7.1 percent basically
7 flat for the one-year period.
8 There is a lot of detail about manager
9 performance in the following pages. Happy to
10 talk about any individual managers.
11 If there are questions, comments? If
12 there are none, we have a preliminary update
13 report for the month of April. I will pass
14 these around as well.
15 So April was not a spectacular month for
16 the equity market but still positive, in
17 positive territory for the month. So the
18 Russell 3000 up about 60 basis points.
19 International equity markets again the dollar
20 was helpful, so for the month the
21 international composite benchmark was up
22 almost 2-1/2 percent. The defensive
23 strategies again a modest, but positive
24 return. And so when we allocate all of those
25 benchmark returns, our estimate for the month

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2 of April is that the Diversified Equity Fund
3 returned almost 1 percent which would for the
4 calendar year-to-date raise the return to 1.7
5 percent. The bond fund we estimate earned
6 about 50 basis points. And the International
7 Equity Fund we estimate earned 2-1/2 percent,
8 robust return which would bring the calendar
9 year-to-date return a little over 2 percent.
10 The Inflation Protection Fund earned 2.4
11 percent for the month of April which gives it
12 a calendar year to date return of almost five
13 percent. And the Socially Responsive Fund had
14 a modestly positive return of 20 basis points.
15 So positive return for the month of April,
16 particularly strong for non-U.S. equity
17 markets.
18 Okay, you want me to keep going?
19 MR. ADLER: Yes.
20 MS. PELLISH: Thank you. Happy to do
21 that.
22 So we have also sent out material in
23 advance that we hope is responsive to the
24 board's questions regarding the 2016 asset
25 allocation study for the pension fund. We

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2 distributed that material in advance, but we
3 have many color copies here if anyone would
4 like one. Pass some down.
5 And I brought my colleague, Joe Nankof,
6 who you met previously to this meeting so that
7 he can present this dec. You have met him
8 before. He has attended quite a few
9 investment meetings. Joe is head of our asset
10 allocation team at Rocaton and one of the
11 founding partners at Rocaton. This step was
12 prepared in collaboration with BAM, so I am
13 sure Mike Haddad will have some comments and
14 was very, very much part of this presentation.
15 And I would also like to encourage
16 questions and interruptions and comments along
17 the way. So with that, let me start with the
18 introduction.
19 So, again, the purpose of this material
20 is twofold really; first and most importantly,
21 to be responsive to comments and questions
22 that were raised by the board at previous
23 meetings and the second objective is to give
24 you a sense of the progress that's being made
25 and the direction that BAM and Rocaton are

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2 going in towards the -- towards the final

3 objective of bringing you some recommendations

4 for the asset allocation of the Teachers'

5 pension fund.

6 So at the top of page 2, we identified

7 the questions that we are trying to be

8 responsive to. So the first one is what's the

9 expected impact of long bond allocations

10 either on their own or with the core plus 5

11 program. So you will recall that we spent a

12 lot of time talking about long bonds and

13 Rocaton's belief that long have bonds have an

14 important role to play in portfolio

15 allocations, particularly ones that have a

16 heavy equity allocation and ones that have a

17 very long term horizon such as the pension

18 fund. The second question is again dealing

19 with long bond allocations, how do you parse

20 the advantages and issues. I think everyone

21 can identify the primary advantage of long

22 bond, which is providing defensive components

23 to the portfolio really in times of equity

24 market turmoil. But clearly buying large

25 portfolios of long-dated securities at a point

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2 in time when interest rates are historically
3 low raises lots of issues and concerns for
4 investors, so we want to address both those
5 issues as well as some other advantages and
6 issues associated with long bond allocations.
7 And then the third primary focus of this dec
8 is talking about lowering private equity
9 commitments going forward. Not reducing
10 private equity allocations today, but over
11 time changing the pacing of private equity
12 commitments such that over a reasonably long
13 period of time the actual allocation declines
14 from the 5 to 6 percent to something closer to
15 4 percent and what are the implications of
16 doing that.
17 MS. MARCH: Can I ask you: What are our
18 percentages now?
19 MS. PELLISH: Yes, I think if we look at
20 the dec on page 5 --
21 MS. MARCH: To tell you the truth,
22 looking at this even with my reading glasses I
23 had trouble.
24 MS. PELLISH: They had small numbers,
25 sorry. So today we are pretty close to the

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2 target. You are about 5.3 percent and the

3 long-term target is 6.

4 So there are a couple of important

5 things, factors that influence our analysis.

6 First, as everyone is aware, the basket clause

7 is a limiting factor to how we allocate to

8 certain asset classes. We have information

9 about exactly how the basket clause would work

10 with your current portfolio as well as any of

11 the other alternative portfolios, so we

12 brought that. Rocaton's view on long bonds is

13 certainly driving much of this analysis and we

14 are prepared to talk extensively about that.

15 We also believe that much of the cost of

16 investing in long bonds, which is tied to

17 investing at a point in time when rates are

18 historically low, can be mitigated if we have

19 an effective transition plan of having to get

20 into long-bond allocation. We have

21 information about that here too. And then the

22 fourth point is really important and it's one

23 that would probably have, more have a -- are

24 at one end of the spectrum relative to the

25 other consultants that are working with BAM.

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2 That's our view on U.S. equity returns within
3 the next seven to ten years.
4 So we don't in any way, shape or form
5 pretend we have a crystal ball. We never make
6 short-term forecasts. We think it's very
7 difficult/impossible for anyone to do and we
8 have no -- no expectation that we can do that.
9 However we do think that there is a rational
10 way to view immediate to longer-term returns
11 for most asset classes if you believe that
12 broad asset classes have a mean reverting
13 property, which we do believe that, and that
14 there are certain crises mechanisms that exist
15 in markets such as the U.S. equity market that
16 can give you a signal about whether an asset
17 class is significantly expensive or
18 inexpensive. So, again, we are not
19 forecasting returns over the next 12 months,
20 but we have some information in here as well
21 as in this other paper that we distributed to
22 you electronically that talks about why we
23 have come to this conclusion that U.S. equity
24 market returns are likely to be over the,
25 again, next seven to ten years low relative to

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2 historical returns.

3 So that view on U.S. equity markets has

4 a significant influence on our view on markets

5 that are linked to the U.S. equity markets, so

6 that includes private equity markets, that

7 includes convertibles, and that includes

8 REITs. And so you will see those assumptions

9 reflected in the analysis that was done on the

10 following pages. What we have done here is

11 provided information about two illustrative

12 asset allocation policies, and they

13 include -- they both include long bonds to

14 varying degrees. One of them has a

15 significant decrease to your U.S. equity

16 allocation. And so by providing those two

17 illustrative portfolios, we hope to bring to

18 light what view is on the market and the

19 assumptions we have used in this analysis mean

20 for expected returns.

21 And then last but certainly not least

22 important, something that we have talked about

23 on a number of occasions at investment

24 meetings is it's important to develop a

25 long-term perspective and long-term target and

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2 long-term roadmap, but we support the
3 recommendations that's been made at this table
4 by both BAM and Rocaton that we should be
5 reviewing asset allocation more frequently
6 than we have in the past. So it was very much
7 standard practice to review asset allocation
8 every three to five years historically for
9 pension funds, but that practice has really
10 changed for most pension plan sponsors and
11 today most plan sponsors are looking at asset
12 allocation every 12 to 24 months in view of
13 significantly-changing market conditions.
14 Everything is changing much more rapidly than
15 it used to. So that is not said with the idea
16 in mind that we would necessarily
17 significantly change our asset allocation
18 policy every 12 to 24 months, but we want to
19 review and reconfirm it.
20 So with that, I would like to turn to
21 page 3 and have Joe go through some of the
22 themes that you will see when we go through
23 the specific numbers.
24 MR. NANKOF: Thanks, Robin.
25 So we have a list which you certainly

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2 don't need me to read to you, but I will
3 highlight some of the key point themes and
4 rationale for those themes that came out of
5 the analysis. Again, all of this would be the
6 idea that we are showing you illustrative
7 asset allocations. These are not final
8 recommendations, but we want to at least
9 encourage a discussion and questions about how
10 we reached these conclusions and the
11 conclusions themselves.
12 So Robin has already referenced private
13 equity. The theme that came out was to
14 modestly reduce the future target allocations
15 and, therefore, the pacing or commitments to
16 private equity. We referenced some of the
17 rationale for that. It's obviously an
18 expensive asset class to invest in. The fees
19 are high and relatively opaque and it
20 consumes -- 100 percent of the allocation
21 consumes basket clause or basket capacity, if
22 you will. So it has those challenges which
23 are reflected in the theme. It is also highly
24 correlated to the U.S. equity market, which is
25 another large allocation within the asset

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2 allocation. So we find -- our belief is and
3 it's been proven through time that private
4 equity, being mostly U.S. focused is heavily
5 tied to the U.S. market. Therefore, it
6 doesn't really offer much in the way of
7 diversification, but does offer or could offer
8 a return premium net of fees. It's not
9 necessarily. You have to execute effectively
10 of course.

11 Real estate we find offers more
12 diversification. Recently the last year or so
13 has been a good example, where the U.S. equity
14 markets have done nothing and the real estate
15 markets performed quite well. It also does
16 not consume on the first dollar invested up
17 until 10 percent any basket clause capacity.
18 So it has more diversification benefit than
19 private equity and does not consume basket
20 clause capacity. So private real estate and
21 we think -- so there is a very wide variety of
22 real estate allocation or strategies that you
23 can invest, in which means that at any given
24 time there are different strategies which
25 might be attractive. So today certain real

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2 estate strategies may be less attractive than
3 others, but there are some strategies that are
4 attractive within the real estate sector.
5 MS. VICKERS: With private real estate,
6 do you have the same concerns around fees that
7 are in other private investments?
8 MR. NANKOF: Potentially. Any private
9 investment that is going through funds, there
10 is a potential for -- there is generally
11 higher fees and they can be opaque. We think
12 there are ways of implementing that can help
13 get around that. Either -- separate accounts,
14 which given the scale of the system, is
15 something that should be considered. As you
16 know, we are not the real estate consultants
17 or experts, but we know there are large
18 investors who do invest directly in real
19 estate properties in a separate account.
20 Is there a question or comment?
21 MS. MARCH: No, there was not. I would
22 like us to buy a few buildings. We have had
23 success with buildings that exist.
24 MR. NANKOF: That could be a much
25 lower-fee way of investing in real estate than

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2 doing so through funds.
3 We already talked about U.S. equity and
4 our return expectation. Happy to take any
5 questions now or talk further about it as we
6 continue the discussion, but as we see
7 it -- and we know that there is a range of
8 views among the consulting universe and we are
9 at one end. We would also say that
10 consultants, generally speaking, over time
11 have not been -- they have not made a name for
12 themselves on taking a stand on return
13 forecasts for markets and we rely on the data
14 and analysis to provide us with guidance on
15 what return expectations should be. There is
16 only certain ways you can generate returns by
17 investing in different markets. Fixed income,
18 it's pretty straightforward. You can get a
19 yield, you can clip a coupon, and you can get
20 your money back at maturity. That's pretty
21 straightforward. In the equity markets, it's
22 essentially nominal earnings growth or GDP
23 growth, which can lead to earnings growth and
24 then you can also improve profit margins. But
25 given the starting point we are at today in

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2 the U.S. market, we don't see there is a way
3 to really do that.
4 We are at peak profitability in the U.S.
5 market and we have had an environment where
6 the Fed has encouraged risk-taking and has
7 inflated asset prices. So given the starting
8 point we are at, and our paper details this
9 pretty clearly, we think if you look at the
10 decile we are at which is the top decile
11 evaluations for the U.S. -- and we have been
12 here many times through history and we show
13 over a hundred years of data here. The
14 average return giving the starting point of
15 top-decile evaluations, the average return
16 through time that we have seen is 2-1/2
17 percent. So our 4-1/2 percent seems
18 reasonably optimistic given that point. So I
19 am not trying to depress anyone with the
20 discussion. So maybe I already have so too
21 late, but I think -- again, I don't
22 think -- unfortunately, consultants are not
23 paid to take a stand and our view --
24 MS. PELLISH: We are not here to bash
25 the consulting industry.

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2 MR. NANKOF: No, we are not. But we are
3 just trying to, you know, suggest that
4 we -- we are just relying on the data to
5 provide us with guidance on what the return
6 expectations would be for the next ten years
7 and we don't see how the data suggests
8 anything more than 4-1/2 percent. And we
9 would love for it to be higher than that. We
10 would love to be wrong in that regard, but
11 that's what we are seeing.
12 MR. ADLER: Joe, can I ask a question?
13 MR. NANKOF: Please.
14 MR. ADLER: Further down your list for
15 the justification for increasing the total
16 allocation to investment grade fixed income,
17 the second to the bottom you basically say the
18 reason for doing that is to lower return
19 expectations for U.S. equity, particularly on
20 a risk-adjusted basis. So are you saying that
21 your expectation is that investment grade
22 fixed income would generate a higher
23 risk-adjusted return than U.S. equity?
24 MR. NANKOF: So risk-adjusted would be a
25 sharper ratio. So if you look at the return

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2 above cash relative to the risk you are
3 taking, then investment grade income for the
4 next ten years, our return expectation which
5 is in the back so core plus 5 for the next ten
6 years, this is on page 11, is 3 percent. With
7 a volatility of risk level of about 3 percent
8 and U.S. equity is only 4.6 percent with a
9 risk level of 20 percent. So if you take
10 those -- roughly speaking those ratios, you
11 are getting much more return per unit of risk
12 in the fixed income markets than you are in
13 the equity markets. And we might -- and if we
14 are reviewing asset allocation on a regular
15 basis we are not, you know, saying there would
16 be an equity market, severe equity market
17 correction in the next 10 to 12 months, but we
18 might find there would be a better time to
19 allocate U.S. equity in the next two years
20 than today.
21 MR. ADLER: I am struggling with this
22 because essentially you were talking about,
23 you know, creating an asset allocation for the
24 next five to ten years. And I understand we
25 will review it on a 18, 24-month basis which I

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2 support, but like the notion that we would
3 increase -- so this is what I am trying to
4 wrap my head around, is that we are -- you are
5 recommending that we go dip into long bonds
6 and essentially create a hedge for what could
7 be a correction in the equity markets, if I am
8 understanding that correctly?
9 MR. NANKOF: Not predicting it but, yes,
10 that's correct.
11 MR. ADLER: And at the same time you are
12 saying we should increase the allocation to
13 investment grade fixed income I think for,
14 more or less, the same reason? In other
15 words, it's higher risk-adjusted return even
16 though it's a lower absolute return?
17 MR. NANKOF: Correct.
18 MR. ADLER: And so there is an awful lot
19 of risk reduction in that formula and I am
20 just worried that we are going to be so
21 focused on risk reduction, that we are going
22 to -- you know, looking at the five to
23 ten-year expectation, that we are going to cut
24 into our long-term return. And I guess what I
25 am saying is at the end of the day, what we

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2 need is long-term return. That's -- this is a
3 long-term investor with liabilities that
4 stretch out decades. I am not saying anything
5 that anybody doesn't know. So are you
6 focusing too much on risk reduction at the
7 expense of long-term return?
8 MR. NANKOF: That is a fair
9 characterization of the recommendation, of the
10 alternative I should say. And if you went
11 with more fixed income, that would be what you
12 are doing and it's a shift. It's not a
13 dramatic shift; it's a modest shift.
14 And the volatility reduction is outlined
15 on page 5, so you are producing volatility
16 from 11.8 to 9.7 with this allocation. And
17 given -- and I mentioned this a minute ago, we
18 see the risk premium curve being pretty flat
19 right now. So if you look at finish -- if you
20 just think of the world in a very
21 straightforward way, you get paid to take risk
22 some incremental return. Whether it's
23 equities or high-yield fixed income, there is
24 lots of ways you can take risk. But given the
25 Fed's action, they pushed down the curve at

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2 the long end. So the higher-risk strategy are
3 today expected to generate lower returns than
4 they would ordinarily. And we are thinking
5 about the world through I would say that
6 simple lens. Of course there is lots of
7 detail in here that we can talk about,
8 but -- and in that environment we are taking
9 modestly less risk is prudent. Twenty-four
10 months from now we might see a risk curve
11 which is steeper and we might say that is a
12 time to take more risk, we might be somewhere
13 in the middle. We don't know where we will to
14 be. And that's the benefit of looking at
15 asset allocation in a more consistent rhythm
16 and more frequently over time because we can
17 move, especially in liquid markets. There are
18 illiquid markets in the portfolio where you
19 can't move quickly, but much of the markets
20 that you are invested in are quite liquid and
21 you can make allocation shifts that are
22 prudent.
23 So one way to generate good long-term
24 returns is to avoid losses in periods where
25 you are getting paid less to take risk and I

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2 don't -- we can't predict the next two years.
3 What we can tell you is you are getting paid
4 less -- we see you are getting paid less to
5 take risk today than you would do normally and
6 that's been manufactured by the Fed. I think
7 we have all seen their actions in the last six
8 years and that's what has led us to these
9 conclusions. So I think it's a -- so what we
10 do want to generate long-term returns, but
11 there is a lot that you need to navigate over
12 the long term to get there.
13 MS. PELLISH: So just to add a point to
14 that, it used to be if we were having this
15 discussion ten or fifteen years ago, we would
16 be using our thirty-year numbers and we would
17 be saying long-term we think the equity market
18 should produce 7 percent with a volatility of
19 17 percent and there will be rough periods
20 along the way and we will just ride through
21 them. But what we have all learned over the
22 past decade is that to get to the long-term,
23 you have to able to live through the short
24 term. And it's true that contributions are
25 smoothed and there is an entire actuarial

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2 process which smooths returns over time.
3 Nonetheless, what we have focused on over the
4 past decade and again what most pension plans
5 sponsors have come to focus on is let's make
6 sure we are getting paid to take risk over the
7 next five to seven years to make sure we could
8 live through to the next thirty years.
9 And so this recommendation, to summarize
10 Joe's comment, is based on our view that you
11 are not really being paid to take a lot of
12 risk right now. But at some point, you will
13 be paid to take risk and that point will occur
14 when after -- most likely after there are
15 significant equity market losses. So we have
16 to be prepared to do the counterintuitive
17 thing, which is to buy low and to sell high.
18 And we have had a pretty good run over the
19 past five to seven years in our equity
20 portfolio.
21 MR. NANKOF: So I don't know,
22 John --
23 MR. ADLER: No, that
24 certainly --
25 MR. NANKOF: -- if that fairly

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2 responded.

3 MR. ADLER: No, you responded. I think

4 it indicates your point of view and I don't

5 know if the board shares it or not.

6 MR. NANKOF: And there is degrees of how

7 far you take it. So none of this is an

8 absolute. It's -- that's why we show you two

9 alternatives. This is alternative 1 and

10 alternative 2. There are different ways to

11 reflect the views that we had and, again, what

12 the data we believe is supportive.

13 So let me -- I will quickly run through

14 the other. So we say as part of that,

15 eliminating allocations to REITs convertibles,

16 TIPS. REITs and convertibles have very much

17 tied to the U.S. equity market. TIPS also

18 seem somewhat expensive, so we would say those

19 are asset classes that don't look so

20 attractive today. OFI though so one of the

21 other themes that we have seen play out in the

22 last six years is the traditional players in

23 the bond market, the big banks, have less

24 capacity to invest in fixed income balance and

25 hold fixed income on their balance sheets.

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2 Therefore, there is less liquidity in the bond
3 market and there are ways to opportunistically
4 take advantage of that and make better returns
5 and hopefully make up for the fact that equity
6 markets and other markets are not offering the
7 same kind of returns we have hoped for. And
8 OFI is a way to do that, so I would say
9 continue to allocate to OFI and implement that
10 program at its full level which is targeted at
11 5 percent. At the same time, there are some
12 asset classes which have sold off and look
13 more attractive relative to the risk you are
14 taking in those asset classes. Bank loans and
15 emerging market debt are two of them.
16 Emerging markets -- while the U.S. has come
17 out of the global financial market crisis much
18 quicker than the emerging market, emerging
19 markets are trading at relatively attractive
20 levels. So you can earn reasonable returns in
21 those markets by lending money to sovereign
22 borrowers that essentially you are getting
23 6-plus percent yields at lower risk levels
24 than U.S. equity markets. We already talked
25 about long bonds and we believe strongly that

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2 an allocation to long bonds should involve a
3 transition plan to get there over time and it
4 should not be done all at one time immediately
5 and that's an important point.
6 So we talked about the other issue, so
7 happy to take other questions.
8 Long-duration fixed incomes pros and
9 cons are outlined on page 4. We talked about
10 many of them. I will go through the pros and
11 cons just to be fair about this and balanced.
12 We already know that U.S. treasury yield curve
13 is at a low point. So relative to the U.S.
14 treasury yield curve, historically it looks
15 actually like it's trading at relatively high
16 yields relative to other developed bond
17 markets, if you look at the Japanese bond
18 market. European -- about a third of the
19 European bond market inside of five years is
20 trading at negative yields. So there is room
21 for the U.S. market treasuries to come down on
22 yield as opposed to going up, which is what
23 most people have been predicting for years.
24 Some people expect the Fed will tighten.
25 Right now odds seem very low in 2016 that they

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2 will. The handicap right now, it's unlikely
3 to tighten in 2016. But even if they do
4 tighten, the curve could just flatten. So
5 tightening is certainly a risk. Investing in
6 long corporate bonds, that market is
7 relatively -- it's somewhat illiquid, so it's
8 something that you need to be cautious about.
9 And there are ways to maybe address that as
10 you consider investing in long corporate bonds
11 by investing in other long-duration securities
12 that are not corporates or treasuries. And if
13 there is higher inflation rates, rates move
14 higher, nominal rates move higher, that
15 obviously could negatively impact both equity
16 and long-duration allocations. So you have
17 two allocations within the portfolio that
18 would suffer and that's a risk and concern
19 that is worth noting.
20 Any questions before I move to page 5?
21 MS. BEYER: The final pro, rising rates
22 provides opportunity to purchase or invest
23 with higher future expected returns, I am not
24 clear why that's a pro for going with long
25 bonds.

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2 MR. NANKOF: So the notion being that if
3 you have a transition plan to move into long
4 bonds over time, it's likely that rates rise
5 in the next few years that you will be buying
6 not only at current rates but you will buy at
7 higher rates as well, which you are buying at
8 yields of 4 percent, 5 percent, whatever the
9 rates. You will generate better returns than
10 today, so it's the transition plan that
11 addresses that.
12 MS. BEYER: Thank you.
13 MR. ADLER: I just have a question on
14 the recommendation to eliminate the strategic
15 allocation to REITs convertibles and TIPS. We
16 have managers that specifically manage those
17 assets. So if we eliminate those allocations,
18 then we would be essentially firing those
19 managers. And, you know, if we decide in
20 eighteen months that the conditions have
21 changed and we want to go back into one or
22 more of those asset classes, then we have to
23 do a whole new procurement, correct me if I am
24 wrong?
25 MR. DORSA: Not necessarily.

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2 MR. ADLER: Do you want to explain that,
3 John?
4 MR. DORSA: And there are folks in the
5 room that might be even more familiar. As
6 long as a manager is managing money for one of
7 the other systems, they are still in the
8 contract to the city. So it's not necessarily
9 provoking a new procurement. However, there
10 what would be taken into consideration is the
11 duration of since the last RFP. So I don't
12 know the specifics of.
13 MS. MARCH: Wasn't it nine years?
14 MR. DORSA: It's nine. The contract is
15 one, two, three-year return with two,
16 three-year renewals for a total of nine years.
17 I can't tell you off the top of my head when
18 we did -- for example, for REITs I can't say
19 when exactly we did the last procurement, so I
20 don't know if that would be the tail end of
21 the three, three, and three and we have to do
22 it anyway.
23 MS. VICKERS: But we could check into it
24 before we do the next meeting.
25 MS. MARCH: But the goal should

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2 be -- and I would love to see it when I am no
3 longer a trustee. The goal should be to make
4 the world and the City of New York understand
5 that investing assets should not be done under
6 the present RFP process. It should be done by
7 learning what the world of investment managers
8 are and keeping a list and having all of the
9 consultants in the city and the comptroller's
10 office working to understand it.
11 You see, historically I believe, John,
12 when the whole policy procurement was done, it
13 was done as a result of the fact
14 that -- unfortunately, I don't know how to say
15 it gently. It was done at a time when we had
16 to make sure that the City of New York as a
17 government was doing the right thing, because
18 we had some people who were in charge of the
19 government in the City of New York who did the
20 wrong thing. And I truly believe that the
21 pension boards did not understand that we
22 should have done something to get a different
23 RFP process for the investments through the
24 comptroller's office because the investments
25 through the tax-deferred annuity program are

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2 done very differently, because we rely on the
3 institution that we trust to run the RFP
4 process, because what you are doing is you are
5 spending a lot of money.
6 Hiring an investment manager is not like
7 buying a ream of paper. And that's -- no one
8 in the city in the 32 years that I sat on the
9 board -- and I will admit that I was trustee
10 in 1985, but I wasn't as smart then as I am
11 now. And I would love the boards and the
12 comptroller's office and the mayor's office to
13 sit down with representatives from the five
14 boards and see how we can change the
15 procurement policy for the selection of
16 investment managers. I will tell you the
17 previous comptroller's office and this
18 comptroller's office have attempted to do it,
19 but they have not been totally successful.
20 And since the policy procurement board is made
21 up of mayor representatives and comptroller
22 representatives, I wish you would deal with
23 investment experts and change that process.
24 It would save the city a lot of money and it
25 would allow the retirement boards to be much

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2 more nimble and I urge you to please do that.

3 MR. ADLER: Let me just ask this

4 question, which is a question asked: Is

5 changing the procurement process for over -- I

6 know we did it for the emerging managers. We

7 did a --

8 MS. VICKERS: For the graduation policy.

9 MR. ADLER: So if we were to change the

10 overall procurement process, is that something

11 that can be done through the procurement

12 board?

13 MS. MARCH: Yes, I do believe it could

14 be done through the procurement board.

15 MS. VICKERS: If it was done, it would

16 be done.

17 MS. MARCH: We do not need any other

18 governmental institution to approve it, but

19 the policy is the procurement board. There is

20 no need for state legislation. And I would

21 suggest that the mayor's office and the

22 comptroller's office talk to the tax-deferred

23 annuity people at the Teachers' Retirement

24 System because we have been doing it for

25 years. Because when TDA came in, even before

1 Proceedings
2 there was an occurrence in 1985, everybody was
3 intelligent enough to understand that there
4 should be some kind of procurement process,
5 but not a procurement process that strangled
6 your ability to be nimble when you wanted to
7 make an investment.
8 MR. ADLER: And I believe that the
9 deferred compensation plan also has its own
10 procurement process.
11 MS. MARCH: Yes, I believe it does. I
12 think it does.
13 MR. ADLER: So separate issue. I just
14 want to make sure that eliminating the
15 allocation wouldn't -- and I think it would at
16 the moment.
17 MS. VICKERS: Why don't we check on the
18 procurement status of each of those managers
19 if they are in other funds and we can report
20 back, because whatever plans we would be able
21 to undertake wouldn't be applicable
22 necessarily to this situation that you are
23 talking about.
24 MR. ADLER: Thank you.
25 MR. NANKOF: If we were going to

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2 prioritize, we would say REITs and TIPS would

3 be the first to eliminate and convertibles

4 would be the third in terms of --

5 MS. MARCH: Every time we as a board

6 chose to go into a different investment, type

7 of investment through our pension plan with

8 the comptroller's office handling it, it took

9 us too long to get into the investment. So

10 the advisors are saying it's time to get into

11 private equity or it's time to get into REITs

12 or TIPS and, you know what, because of the

13 policy procurement policy it takes us a year

14 to get into the investment, and you know what,

15 you may miss quite a lot of earnings because

16 it took you that year to do it. If our

17 consultant recommends there should be a change

18 within the tax-deferred annuities diversified

19 equity program, we can do it in a month or

20 two.

21 MS. VICKERS: I think I can speak for

22 the comptroller's office and all the staff

23 here that we would love to streamline the

24 process.

25 MS. MARCH: I know that. I do not -- I

1 Proceedings

2 do not believe that you would not like that to
3 happen.
4 MS. VICKERS: I guarantee you we would
5 love it.
6 MS. MARCH: Let's get it to happen,
7 because it is truly hurting the investments of
8 the qualified pension plan for all five
9 systems. Everyone is shaking yes so I would
10 like you to tell me on my one-year anniversary
11 as a retired trustee, you have accomplished
12 it.
13 MR. ADLER: So noted.
14 MR. KAZANSKY: I have got a question
15 about page 5 and maybe you mentioned it
16 somewhere else and I just didn't see it. So
17 when we talk about intermediate targets and
18 long-term targets, what kind of time frame are
19 we looking at? What do you guys consider an
20 intermediate target, is that five years?
21 MR. NANKOF: Well, intermediate would be
22 12 months. So we think over the next 12
23 months, we can get to that intermediate
24 target. The more ambiguous or difficult to
25 predict would be how long it takes to get from

1 Proceedings
2 the intermediate to the long-term target and
3 give you some sense of how long we think that
4 would take. And it would be different for
5 different asset classes, but I think overall
6 real estate, for example, would be a glaring
7 example of where it would take, you know, a
8 long time, probably five years to get from
9 intermediate to the long-term target. That's
10 a reasonable expectation. Could take a little
11 longer, probably not shorter. Most of the
12 other allocations could be done inside of five
13 years, you know, say two years, two, three
14 years. And that includes the long-duration
15 fixed income allocation of which the
16 transition is outlined on another page.
17 But does that help?
18 MR. KAZANSKY: Yes, no. Yes, it does
19 help. Because my issue is, in fact, in 12
20 months when we are at this intermediate moment
21 if at that point we want to pick up and move
22 in a different direction, how far along are we
23 on the path whether it's 12 months from now or
24 two years from now, and how much time do we
25 give until it changes to see if they are going

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2 to take hold and work the way we think they
3 are going to work, and how liquid are some of
4 those?

5 MR. NANKOF: So we completely understand
6 and, therefore, we expect -- well, we
7 understand that some of these allocations are
8 illiquid and would need to be viewed as
9 relatively permanent allocations through time.
10 And given that we are steering a battleship
11 here, it's a big pool of money, we need to be
12 cognizant of the fact that illiquid assets in
13 the case of private equity, we are at 5
14 percent. To navigate down to 4 percent, that
15 will take years. And the same for real
16 estate. But we believe a 4 percent allocation
17 private equity and a 9 percent allocation to
18 real estate are reasonable allocations to have
19 for the long term.

20 And that as we see -- as I mentioned
21 earlier, as we see that risk curve maybe move
22 up and down or steepen and flatten, most of
23 the shifts in asset allocation that we would
24 contemplate in the interim, the 12 to 24
25 months that we are suggesting, would happen in

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2 the liquid markets. So you would almost never
3 want to have to go to the markets and sell
4 your illiquid assets because you get punished
5 to do so; it's not something that you want to
6 do. You take haircuts on those investments
7 when you try to sell them in the secondary
8 markets, so you would be selling public
9 equities/buying fixed income, selling fixed
10 income/buying public equities. Those are the
11 things that would be moved the most in the 12
12 to 24 month reviews.
13 MS. MARCH: So I have a question and I
14 thought it was a foolish question, so if you
15 have -- you said about 14 percent of
16 non-liquid assets. Is that hurting us in any
17 way? If, in fact, you are recommending that
18 we are living in times when we should
19 reconsider our asset allocation on a more
20 regular basis, should we have a smaller
21 percentage of illiquid assets?
22 MR. ADLER: I think it's actually more
23 than that because OFI is primarily illiquid as
24 well.
25 MR. NANKOF: If you include OFI, that

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2 would bring us up close to 20 percent. We
3 believe that something on the order of 20
4 percent is reasonable. And illiquid
5 investments can take advantage of markets
6 returns and generate returns and
7 diversification, which are hard to get in the
8 public market. So we think that allocation,
9 we also think we would get return if it went
10 way beyond that. And there are
11 investors -- you know, good example, some of
12 the very large universities during the
13 financial crisis had very -- much more
14 sizeable allocations to illiquids, 30, 40, 50
15 percent, and those are levels we almost never
16 recommend to clients. And in this case given
17 the size of this portfolio, we definitely
18 would not go beyond the 20 percent. So 18, 19
19 percent seems reasonable, so we don't think
20 it's impeding your ability to move the
21 portfolio when you review it every 24 months.
22 MR. KAZANSKY: Joe, do you believe a 9
23 percent real estate target is doable?
24 MR. NANKOF: It's ambitious.
25 MR. KAZANSKY: Well said.

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2 MR. NANKOF: We are -- we are ambitious
3 people. But I think we would like to say over
4 a long period of time, we think we can get
5 there. We do not want to get there in too
6 short a period of time because then you are
7 putting money to work in a market too quickly
8 and you don't have the diversification you
9 would want to have in a real estate market and
10 there are so many flavors of real estate,
11 whether it's core office properties in
12 Manhattan.
13 MS. MARCH: Don't leave out workforce
14 housing?
15 MR. NANKOF: Put any kind of real
16 estate, so there is many. There is
17 infrastructure, which there is a mass of
18 infrastructure market both in the U.S. and
19 outside the U.S. that could unlock tremendous
20 opportunity. There is many different food
21 groups. There is again office, multifamily,
22 there is senior living, there is all of these
23 different types of real estate opportunities
24 which you could -- which you could take
25 advantage of and they do run in cycles. So

1 Proceedings
2 with help from a legal advisor, we certainly
3 think we could put this amount of money to
4 work over a long period of time. So again
5 that's a five-year plan, if you will.
6 MR. KAZANSKY: During this five-year
7 plan, the money that would be put into real
8 estates would come from the equity market, the
9 U.S. equity?
10 MR. NANKOF: It's primarily coming from
11 the U.S. equity, yes, and REITs which are the
12 public.
13 MR. KAZANSKY: So those are the pools we
14 would pull from?
15 MR. NANKOF: Exactly. So you could see
16 REITs going from three to zero. REITs are
17 publicly-traded real estate companies and
18 those are very richly valued today, just like
19 most of the U.S. equity market. So that's
20 another area where we would say the return
21 potential for the publicly-traded REITs seems
22 to be, you know, low relative to the risk you
23 are taking there. And in the private real
24 estate market, there are probably other
25 opportunities which have better risk-adjusted

1 Proceedings
2 returns today looking forward.
3 MS. VICKERS: So just so I understand:
4 When we are looking at the long-term target,
5 which is what I think we are talking about,
6 the allocation to the core real estate space
7 is the same, but where the increase in pacing
8 would be in opportunistic because it's
9 doubling from 3 to 6 percent?
10 MR. NANKOF: That's what we are
11 suggesting might be attractive. Again, we
12 also understand, and in discussions with BAM
13 have covered this, that you would want to work
14 with your real estate advisor to come up with
15 a plan to implement this and get their views
16 as well.
17 MS. MARCH: So how do we include
18 workforce housing? I don't really want to
19 repeat myself, but I just have a need. How do
20 we do it?
21 MS. VICKERS: Well, you know, our
22 allocation to ETI is there. Cross-asset
23 classes drawing from the allocation.
24 MS. MARCH: The comptroller's office has
25 been wonderful in the ETI department and the

1 Proceedings
2 comptroller's office has been wonderful in
3 bringing us other investments of that nature,
4 but you get to the point where you are dealing
5 with only a manager who is willing to do it.
6 And what I am saying is I think
7 this -- I don't know how we do it, Susannah.
8 I don't have it. I really don't know.
9 MS. VICKERS: I don't think it's in here
10 because I think the return assumptions that
11 are baked into this aren't for workforce
12 housing.
13 MS. MARCH: But it doesn't have to be in
14 here. It's the real estate industry that has
15 to be willing to earn only 8 or 9 percent
16 instead of 30 or 31 percent. That's the
17 problem. The problem is not the assumption.
18 MR. ADLER: And partly we have to find
19 managers.
20 MS. MARCH: So we have somebody who is
21 willing to do it, but you can only give one
22 manager so much money.
23 MS. BEYER: But also the ETI, as we have
24 heard for the last several months, is hard to
25 find opportunities and it's slower. And I

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2 guess that's your question, why is it so slow
3 and why can't we speed it up.
4 MS. MARCH: My question really is what I
5 said before. It was my statement. We have
6 been trying -- that's what the real problem
7 is. It is true, it's hard to do more in the
8 ETI area and it's hard to give the one manager
9 who lost nothing during the great financial
10 disaster more money. And what I am saying
11 here is: How do we as an institution get the
12 message to the outside world that it's all
13 right to do that? They can earn 8 percent and
14 still -- how do we do that? I know no one has
15 the answer.
16 MS. BEYER: It's a good question.
17 MR. ADLER: I do have a question about
18 this split between core and opportunistic.
19 You don't have sharp ratios on your asset
20 class assumptions, but just eyeballing it it
21 looks like core has a better sharp ratio than
22 opportunistic, you know, that return
23 percentage is higher than the increase in risk
24 for opportunistic. So I am wondering why you
25 feel like that is a -- that we should

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2 essentially have twice as much from
3 opportunistic than we have in core when we are
4 currently at 50/50.
5 MR. NANKOF: So, John, you are looking
6 at page 11?
7 MR. ADLER: I am.
8 MR. NANKOF: So on page 11, and I used
9 the shorthand earlier, and just looking at the
10 expected return which is the first column and
11 dividing by the risk which is the third
12 column, so I would be guilty as charged for
13 using the shorthand. The way we would think
14 of it is in terms of sharp ratios of
15 risk-adjusted return would be the return above
16 the risk-free rate or cash. For the next ten
17 years, cash call it maybe 2 percent. So what
18 you are getting from core plus 5 is only 1
19 percent more than risk-free and 2 percent, you
20 know, cash is yielding zero today, close to
21 zero.
22 MR. ADLER: You guys have it at 1.4.
23 MR. NANKOF: Oh, I'm sorry, it's 1.4.
24 So 1.6.
25 MR. ADLER: Is the core plus 5?

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2 MR. NANKOF: So 1.6 divided by 3 is
3 about a .5 and opportunistic fixed you are
4 getting 6-1/2 percent above cash, 7.9 versus
5 1.4 which is actually a little bit better than
6 .5. So you have slightly better risk
7 adjustment.
8 MR. ADLER: I am talking about real
9 estate though.
10 MS. VICKERS: Core versus opportunistic
11 real estate.
12 MR. ADLER: I am talking about real
13 estate which is at the bottom of equity.
14 MR. NANKOF: So there we have about 7
15 percent excess return over cash divided by
16 18.6, so it's a slightly worse risk-adjusted
17 return than core fixed income.
18 MR. ADLER: No, I am in core real
19 estate. So you have 5 percent for core real
20 estate over cash.
21 MR. NANKOF: They are close.
22 MR. ADLER: So then why double the
23 opportunistic versus the core?
24 MR. NANKOF: Because, you know, it's a
25 place where you can get return. It's a way to

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2 generate premium return over ten years. So it
3 may not -- you are not diminishing your
4 risk-adjusted return, but you are getting more
5 return. There aren't many asset classes -- so
6 we saying the actuarial assumed rate of return
7 is 7 percent, right? There aren't many asset
8 classes on the page that can get you more than
9 7 and opportunistic real estate we think is
10 one of them. So it's an attractive asset
11 class just by virtue of having the ability to
12 generate premium returns without reducing your
13 risk-adjusted return.
14 MS. BEYER: But is it worth the doubling
15 is I heard the question.
16 MR. NANKOF: Is it worth --
17 MS. BEYER: -- doubling on the core real
18 estate, if it's close?
19 MR. NANKOF: Real estate is a very
20 inefficient market and skilled managers we
21 found over time have been able to generate
22 strong returns in real estate markets. It's
23 even less efficient than the private equity
24 markets and there is so much variety of
25 commercial real estate.

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2 MS. BEYER: No, not the real estate by
3 itself. I heard John's question, if I heard
4 it right, as if the risk-adjusted returns are,
5 more or less, in all those fancy stuff are,
6 more or less, a close call, why have a double
7 on the opportunistic real estate rather
8 than --
9 MR. ADLER: -- core real estate?
10 MS. BEYER: Even it out.
11 MS. VICKERS: Return assumptions are
12 only there for opportunistic, not for core.
13 MR. NANKOF: And we also find that the
14 managers investing in opportunistic real
15 estate are generally the most skilled
16 managers.
17 MS. BEYER: That's probably your
18 reasoning because otherwise it's risk adjusted
19 is what we are using our -- as our mantra
20 here, so that's why.
21 MR. ADLER: Slightly higher risk
22 adjusted on private real estate
23 versus -- excuse me, core real estate versus
24 opportunistic. And to go double just seems
25 like I could see somewhat -- you know, right

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2 now we are 50/50. And you can go to 60/40 and

3 we are close to 60/40. I think we are like

4 58/42, something like that in our current

5 allocation opportunistic to core; is that

6 right? Anyway, so it just seems like that

7 much when -- and truthfully I am skeptical

8 that we can get to 9 percent in five years

9 because, you know, we are under 4 percent

10 today. And, you know, it's not like we

11 haven't been looking for, you know, looking

12 to -- you know, I think the real estate team

13 is really looking to do as much real estate as

14 they can handle. Right now we have a 6

15 percent policy and we are at 3.6 percent. So

16 to get from 3.6 to 9, you know, in five years

17 when we have been going gangbusters and blah,

18 blah, blah seems like not -- I don't think

19 that we have the capacity to do it.

20 MR. NANKOF: And I think it could take

21 longer, but we don't think that this taking

22 longer is not a reason to aim for 9 percent.

23 We also don't believe that -- if you

24 told us you would have to live with a 50/50

25 mix of core and opportunistic, so 4-1/2,

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2 4-1/2, we would still say it makes sense
3 because of the diversification benefits and
4 also because it's not taking up basket's
5 capacity relative to other asset classes you
6 could invest in. So this -- these
7 illustrations are not predicated on it being a
8 two-thirds, one-third, or double opportunistic
9 versus core and we fully expect that BAM would
10 work with and the board would work with the
11 real estate consultant to determine what the
12 best mix is. We wouldn't want -- we would
13 also say we wouldn't want it to be two-thirds
14 core and one-third opportunistic. That would
15 -- so we wouldn't go that direction. But
16 somewhere between the 1-1/2 -- the 50/50 and
17 two-thirds, one-third, somewhere in that range
18 still would make sense.
19 MR. KAZANSKY: And because it's going to
20 take some time to get to that percent, we
21 could theoretically by the time of the next
22 asset allocation see how we tracked so far and
23 see how close we are, whether or not these
24 goals are realistic going forward.
25 MR. NANKOF: Absolutely. I think every

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2 review, we would look at where we are relative

3 to the long-term target. There would be a

4 pacing analysis that would be done to

5 determine at what pace you would make

6 investments. So it's a -- it would be

7 something you would work towards over a long

8 period of time.

9 MS. VICKERS: Have we looked at other

10 scenarios that have less of a slowdown in

11 private equity if they have -- they have the

12 same allocation to private real estate in

13 those areas?

14 MR. NANKOF: I am absolutely certain

15 because we looked at many scenarios.

16 MS. VICKERS: I can go back and look.

17 MR. NANKOF: I don't remember. I am not

18 sure the money came directly out of private

19 real estate to fund private equity. Because

20 generally speaking when we did the analysis,

21 the basket capacity traded across asset

22 classes where real estate is not eating up

23 that basket capacity. So it would have come

24 from other asset classes, maybe like non-U.S.

25 equity, of course other asset classes down

1 Proceedings
2 below like opportunistic fixed income.
3 MS. VICKERS: And my question for
4 Petya's benefit, she is our asset
5 infrastructure: When you talk about
6 infrastructure being part of private real
7 estate in the past, it's been a larger asset
8 class, public real assets.
9 MR. NANKOF: Okay.
10 MS. VICKERS: Would it change the
11 structure?
12 MR. NANKOF: So we would put it as part
13 of the -- we could call it real assets or real
14 estate including infrastructure. Either way
15 it fits in there.
16 MS. VICKERS: It's just a label.
17 MR. NANKOF: It's how you label it, but
18 we would absolutely believe that
19 infrastructure -- and infrastructure we do say
20 is part of core which is not to say that there
21 aren't infrastructure investors that look more
22 opportunistic, and there are. So we don't
23 want to suggest that they are exclusively, so
24 there are things like toll roads which are
25 very much core like policy, lower yielding low

2 return expectations. There are other
3 infrastructure investments like more energy
4 related and transportation, which are higher
5 value added and more opportunistic and might
6 be some leverage. So there is a variety of
7 infrastructure investments which you would
8 want to consider and they can fit in either
9 core or opportunistic, so we wanted to make
10 that -- they tend to be a little bit more
11 core, but not exclusively.
12 MS. PELLISH: So I think when you step
13 away from all these numbers and we at BAM look
14 at streams of numbers, the fundamental
15 questions that I think need to be addressed by
16 the board is do you buy this scenario of lower
17 U.S. equity returns, therefore. You want to
18 move in a direction of lower U.S. equity
19 allocations and do you buy this logic that
20 lengthening the duration in the fixed income
21 program makes sense. I think we can play
22 around with the numbers, but we put together
23 illustrative portfolios that based on our
24 assumptions give you the same or even slightly
25 better expected return over the next five or

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2 ten years with lower risk. So we have given
3 you two different illustrative portfolios that
4 do that, but at the heart of all of this is
5 whether you are comfortable with changing the
6 nature and -- changing the composition and
7 magnitude of the U.S. equity and fixed income
8 allocation.
9 MR. ADLER: Before we answer that
10 question: Can I just call on my colleague
11 Antonio Rodriguez, because he had a question.
12 MR. RODRIGUEZ: Two questions.
13 First one is: A lot of your perspective
14 on kind of essentially risk-adjusted returns
15 kind of relative values between the different
16 asset classes, to what extent do you think
17 rebalancing are going to solve that issue?
18 Because when we are doing asset allocation, we
19 are also doing rebalancing point. So whether
20 or not -- you know, for instance, right now
21 emerging market debt are attractive, bank
22 loans are attractive. Like now in the extent
23 they not end up not being attractive, to do
24 the rebalancing ranges kind of solve for that
25 particular issue versus saying we have a

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2 strategic allocation of zero to REITs
3 convertibles and TIPS. And like John says, if
4 illiquid becomes attractive, again do we have
5 to go through another process to get there?
6 That's the first one.
7 Second question is on the numbers OFI.
8 I think we have been happy with OFI's
9 performance overall, but in the modelling it's
10 high yield plus 3 with no increase in
11 volatility. I just want to know what your
12 take on that potentially if there is no
13 increase of volatility for this particular
14 asset class.
15 MR. NANKOF: So -- okay. So the first,
16 taking the first question, you could take the
17 view that we would -- we shift asset
18 allocation within ranges based on relative
19 values, so I think that's a fair way to look
20 at this. The question is, really what it
21 amounts to is, what's a board decision to come
22 up with in terms of the strategy. So it's
23 really parsing who is responsible for the
24 decision. Is it the board deciding we want a
25 strategy that looks like this and we want BAM

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2 to implement that strategy or does the
3 strategy stay the same and we want BAM to make
4 these relative value calls. So it's really
5 who owns that decision is the answer to that
6 question. We are saying we think that, you
7 know, the board should at least consider going
8 on the decision based on these illustrations
9 and saying we want BAM to implement a target
10 that looks like this.

11 And I can stop and see if there are any
12 comments or questions.

13 MS. PELLISH: And so going off from
14 that, I think that -- I think you raise a very
15 good question. And different regimes at BAM
16 have viewed the answer to that question very
17 differently.

18 So currently I think Scott Evans views
19 his mandate as rebalancing in such a way as to
20 maintaining allocations indications as being
21 close to target as part of the responsibility.
22 That's the board set allocation. And the
23 rebalancing ranges are wide really to
24 take -- to allow for tolerance during extreme
25 market situations, but not such that he would

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2 take a view on asset allocation. His job is
3 getting back to target. Prior CIOs have taken
4 the view that their responsibility was to
5 actually move within those rebalancing ranges
6 based on their market views. And I think that
7 is a policy decision that needs to be decided
8 by the board.
9 MS. MARCH: Previously, if I remember
10 correctly, we always had the targeted range.
11 But if certain things were happening in the
12 world, I think it's the obligation of the CIO
13 to come to the board and let the board make
14 the decision. Because we have gained by
15 understanding if our range was 3 percent and
16 in fact we had a higher number because of what
17 was going on, if it was the time to leave it
18 at the higher number the board made the
19 decision and we have had an advantage in our
20 earnings because of that. And I think -- I
21 don't think the target range should be so
22 plastic that you follow the plastic. I think
23 you have to follow the market.
24 And at some point, for example, there
25 was a time when we had excess cash and we are

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2 not into holding excess cash, but it was the
3 wise thing to do. And the CIO at that time
4 came to us and explained that to us and we
5 said, yes, we should do that. And that's the
6 way I think the policies should be determined.
7 MR. ADLER: If you do execute the
8 systematic and much stricter rebalancing which
9 brings you back to target, it has the inherent
10 benefit of generally selling assets that do
11 well and buying assets that did poorly and
12 rebalancing into the more attractive, and out
13 of the less attractive over time. So it's
14 been a practice which has been around for
15 longer than our careers and we expect it's
16 just a good discipline and something we
17 believe very strongly in. So having a target
18 to rebalance to is a just a good practice and
19 should help performance as well.
20 MS. PELLISH: So I think our point is,
21 do we really need to change the allocations?
22 MR. RODRIGUEZ: Not necessarily change
23 the allocations, but I guess not so much in
24 the kind of broad view of things if we believe
25 that U.S. equities are overvalued or fairly

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2 valued. I mean, more -- I was thinking more
3 in the sense of the credit assets in
4 particular where we think that -- or the
5 spread assets, excuse me. That like emerging
6 market debt or bank loan, right now we should
7 set a strategic allocation to them because we
8 think they are attractive. But that
9 attractiveness is based off the risk-adjusted
10 returns from your estimates from the next ten
11 years or five years versus saying we believe
12 over long period of times we should continue
13 to be in this market, we should continue to
14 access this particular beta, that this should
15 be part of our strategy long term.
16 So that's what I was wondering, whether
17 or not with those type of assets should we
18 essentially zero out any of them at any time
19 or essentially say we are allowed to dance
20 around in these ranges a little bit more
21 because they are not core like U.S. equity and
22 core fixed income, but kind of marginal. But
23 the assets that are going to make up a core
24 program.
25 MS. BEYER: May I just try to rephrase

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2 what I think I heard and I just want to make
3 sure that I wasn't completely confused.
4 I thought it's the job of the investment
5 committee trustees to set a strategic
6 allocation and it's in our investment policy.
7 And so what you were talking about to me
8 sounded more like tactical, not strategic.
9 MR. RODRIGUEZ: What I am saying is
10 that --
11 MS. BEYER: We would never go to zero if
12 we have a strategic allocation of 6 percent to
13 something.
14 MR. RODRIGUEZ: What I am seeing,
15 essentially what this is saying, is REITs
16 convertibles and TIPS should not be part of
17 this allocation.
18 MS. BEYER: But we might revisit it 12
19 to 24 months later is what I heard, because
20 things have changed and the strategic
21 allocation which used to be able to be done
22 for 20 years, people don't accept that
23 anymore. We would look at it -- how often are
24 you suggesting? 12 to 24, so we are
25 constantly monitoring the strategic

1 Proceedings

2 allocation. Now, whether that becomes

3 tactical allocation or not, that's

4 a --

5 MR. RODRIGUEZ: If we are hopping in and

6 out of asset classes, that's what I am saying.

7 MS. BEYER: But if, in fact, that isn't

8 tactical under today's environment and we

9 could be comfortable embracing a strategic

10 allocation, but revisiting it and being

11 careful as things change.

12 First of all, these times really are

13 unprecedented, which brings me a little bit to

14 my next question which builds on yours a

15 little: You said on page 14, this analysis

16 builds in an expectation that interest rates

17 will rise over time. And my question is:

18 What if we go the way of the negative interest

19 rates? I mean, I know it's a black swan

20 maybe, but what if that happens?

21 MR. NANKOF: We would wish we owned as

22 much in long bonds as possible.

23 MS. BEYER: I know we would, so I am

24 just saying it's not a huge -- it's not a

25 black swan. It could -- it is in the sense

1 Proceedings
2 that we don't expect it, but it doesn't ruin
3 all these calculations, does it?
4 MR. NANKOF: No. I mean, the
5 alternatives that we are looking at in that
6 scenario, potentially more attractive than it
7 looked on the whole breakdown of the analysis.
8 In other words, long-duration fixed income is
9 more attractive in that scenario.
10 Equities -- probably not very attractive to
11 own equities in an environment where interest
12 rates go negative because of the
13 reasons --
14 MS. BEYER: But back to what you were
15 asking about: Are we becoming tactical; if we
16 as a board continue to endorse the strategic
17 allocation every 12 to 24 months that has
18 targets like these, one of the these, then
19 does that satisfy your worry?
20 MR. RODRIGUEZ: I was thinking there is
21 a difference between saying REITs convertible
22 and TIPS are not attractive right now or we
23 don't think they -- they are not attractive
24 period. And that's what I am trying to get
25 at.

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2 MR. NANKOF: That's a fair -- that's
3 a -- I can understand the question, given the
4 illustrations I should say. So two parts to
5 the answer. One is that for as long as
6 we -- when we look at this every 12 to 24
7 months, we are using long-term views forecasts
8 to inform that decision. It doesn't in our
9 view reach the level of tactical because if we
10 said -- if we came in and said based on our
11 next one or two-year expectation which we
12 would not rely on for a decision like this, we
13 would recommend that you move in the following
14 way. That very much feels tactical and again
15 is not -- it's very hard to come up with a one
16 or two-year view. The ten-year view
17 is -- it's based on long-term expectations for
18 growth, inflation, interest rates and current
19 pricing for all these assets. And if the
20 long-term view is such that these asset
21 classes don't look attractive, it could be in
22 two years we will come back and say they are
23 more attractive. Why are they more
24 attractive, because they sold off and you
25 would be happy you didn't own them. They

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2 would be more attractive from a valuation
3 standpoint and we would all say -- and
4 congratulate ourselves and say it was good not
5 to own those in the last two years. So there
6 would be no surprises.
7 And my team when we talk about every
8 quarter, the new forecast we come up with,
9 they are schooled in knowing that the
10 expectations change based on what markets do
11 during the quarter. So long things sell off,
12 we have a more attractive view in the future.
13 If they really rally strongly, then we have a
14 less attractive view for the next ten years.
15 And that's the way markets have behaved over
16 decades.
17 MR. RODRIGUEZ: Just because we hire
18 managers instead of doing internally if you
19 find something attractive and you have to go
20 give money to a manager than -- rather than go
21 to somebody at BAM and say hey, go buy this,
22 right now it looks good.
23 MS. PELLISH: The implementation.
24 MS. MARCH: I don't -- we have done
25 asset allocation for five years. I hear your

1 Proceedings

2 recommendation and I don't agree with it.

3 Part of the thing is if you are going to

4 review every 12 to 24 months and 80 percent of

5 the assets are those that you can change

6 because they are liquid, so you make your

7 changes. You have decided that 15 to 20

8 percent of your assets are going to be

9 illiquid. You can make your changes and you

10 can be more nimble. And the reason we are

11 doing it more often is because we are smart

12 enough through the people who educate us to

13 understand markets are different. And so as

14 long as you have 80 percent of your assets, I

15 am not worried about the recommendation on

16 REITs because I know they are liquid. And if

17 18 months from now or 24 months from now we

18 change the asset allocation, you just go back

19 into the REITs.

20 MR. ADLER: Well, I think there was a

21 second question.

22 MR. RODRIGUEZ: It was on OFI

23 assumption.

24 MR. NANKOF: That's a very fair

25 observation. We could have increased the

1 Proceedings

2 volatility.

3 MR. RODRIGUEZ: Not -- that's it's not

4 attractive. I was just wondering.

5 MR. NANKOF: I think if we increased the

6 volatility commensurate with the return

7 expectation, we could say OFI given the

8 environment. And this is a fundamental shift

9 of the environment that we have seen in the

10 last several years, so we think OFI even with

11 more volatility would be attractive.

12 MR. KAZANSKY: So, first of all, I want

13 to thank not only Rocaton and BAM, but

14 everybody here because these discussions have

15 been fascinating.

16 However, I am now feeling like we should

17 be in cut-to-the-chase mode and we should

18 be -- we have one more investment meeting

19 before we break for the summer. And I don't

20 want to allow this discussion to languish in

21 the summer months, we still don't come to a

22 decision finally where we want to go. Because

23 I would love for us to have some sort of final

24 decision that we can decide on in June so that

25 starting in July and August, BAM can start

1 Proceedings
2 making the necessary changes so that when we
3 come back in September we are already moved
4 toward these targets.
5 So what do you all need from the board
6 or what do we need from you between now and
7 the June investment meeting that will allow us
8 to make that decision? Whether it's
9 documentation, whether it's more different
10 allocation assumption numbers that you are
11 going to give us, whether or not maybe a
12 smaller group of us need to meet a couple of
13 times between now and then to hammer out our
14 own internal issues, what do you need, what do
15 we need to lock this thing up in a month's
16 time.
17 MR. ADLER: Well, one thing we haven't
18 discussed yet which you raised is this
19 question about reducing the U.S. equity
20 allocation from where we are now to -- which
21 is the alternative 1 versus alternative 2
22 business, which is less of a reduction. It's
23 no reduction really in the U.S. equity
24 allocation, so there the long-term target is
25 33 and today we are at 33.4. And today we are

1 Proceedings
2 at 33.4, whereas the first one goes to 23.
3 MR. NANKOF: So, John, to that I did
4 want to -- I meant to highlight the difference
5 between the two on pages 5 and 6. And the
6 answer to that question, in response to that
7 question, is really summed up in the bottom
8 right table of the table which if you compare
9 one page versus the other, the expected
10 compound return based on our assumptions which
11 we talked about and are the basis for this
12 analysis. So we have to suggest that the
13 current -- as I said, the risk curve was flat.
14 So taking the additional more than about
15 2 percent more earned more on risk, 9.7 versus
16 11.6 doesn't really yield much more in the way
17 of return. So if we are not getting much more
18 return for that additional 2 percent. And 2
19 percent sounds like a low number, but it's 20
20 percent more risk. It's 10 versus 12, and I
21 am rounding of course. So that it's easy to
22 look at a 2 percent differential and conclude
23 that that's not much, but it's -- really in
24 terms of the scale it's 20 percent more, 12
25 versus 10, and with little benefit in our view

1 Proceedings

2 in doing so. And therein lies why I would
3 lean toward alternative 1 versus alternative
4 2.
5 None of this, as I mentioned earlier,
6 should be viewed as absolute. So I think we
7 have discussions with BAM that we intend to
8 have, so that's -- I am not sure if there is
9 more answer to that question.
10 MS. VICKERS: You know, I hate to say
11 this because I know we need to move ahead, but
12 I wasn't clear that these are our two
13 alternatives that you were kind of working off
14 to get finalization because I think there are
15 a lot of assumptions baked into here that
16 haven't been fully discussed and I don't think
17 we have -- I don't think we have consensus
18 now. So I wouldn't be comfortable deciding
19 these two sort of being our jumping-off point.
20 MS. PELLISH: These portfolios are
21 portfolios which we think are reasonable, but
22 they are here primarily because they address
23 the questions of what does it mean to lower
24 U.S. equity allocation, what does it mean to
25 raise fixed income, what it does it mean to

1 Proceedings
2 lengthen duration. And there are infinite
3 variations of these themes, but those are the
4 primary drivers of our view that we can lower
5 risk without sacrificing return given the
6 payment that we are getting for risk today.
7 MR. ADLER: So I think it's fine to use
8 these as sort of jumping-off points now that
9 we have got our -- you know, that all the
10 numbers are exactly where they ought to be.
11 And I do think it might make sense to
12 have --
13 MS. PELLISH: But the problem with using
14 these as jumping-off points, then they become
15 the only two scenarios.
16 MR. ADLER: No, jumping-off
17 points -- the point of jumping-off points is
18 not where you land. So it's not the end, it's
19 the beginning.
20 Let me just tell you what my fundamental
21 question is. I feel like we are making a bet
22 here and, in my view, the bet is both baked
23 into the assumptions and baked into the
24 allocations and the bet is that equity markets
25 are going to underperform compared

1 Proceedings
2 to --
3 MS. PELLISH: U.S.
4 MR. ADLER: U.S. equity markets are
5 going to underperform and, frankly, that the
6 international markets are going to outperform.
7 And I am a little uncomfortable making that
8 bet with a $55 billion portfolio, whatever it
9 is.
10 MS. PELLISH: So can I respond to that?
11 MR. ADLER: Yes.
12 MS. PELLISH: Because I would take the
13 word "bet" away, but I think that's right.
14 These numbers reflect that perspective. But
15 maintaining the current allocation is also a
16 bet that the only thing we do know is that the
17 volatility numbers will continue to be higher
18 for equity, right? That's the only thing we
19 are pretty certain about. And the current
20 allocation assumes that you are going to get
21 paid for that higher volatility.
22 MR. ADLER: I hear that and understand
23 that, so I am not necessarily -- here
24 is -- what I am saying is that I like the idea
25 of figuring out how do we reduce the

1 Proceedings
2 volatility, which is what you are advocating
3 that we do through the use of the
4 long-duration bonds.
5 And I guess my question is -- and I go
6 back to the point that you made in that
7 consultants meeting at BAM a couple of months
8 ago, which is that the long-duration bonds are
9 sort of supercharged risk reduction in terms
10 of the equity risk. And if we are using the
11 supercharged risk reduction, can't we then
12 take more equity risk so that if in fact the
13 bet on equity performance is wrong it would be
14 okay and if it's right we have this
15 supercharged risk reduction built into the
16 portfolio so that we are not, you
17 know -- I am trying to think of a polite way
18 to say it -- messed up --
19 MS. PELLISH: Very polite.
20 MR. ADLER: -- through that equity drop?
21 MS. MARCH: Can I ask a question. How
22 long has the equity market domestically been
23 in the state of a bull at this now; how long
24 has it been?
25 MS. BEYER: Twelve years.

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2 MR. ADLER: Not twelve. 2009.
3 MS. PELLISH: Over the last seven years
4 the Russell 3000 has compounded an annual
5 return of 15.3 percent, seven years.
6 MS. MARCH: In answer to that question:
7 I don't know how much of an investment expert
8 I have to be to understand the fact that, am I
9 correct that this is the longest bull market
10 we have had?
11 MR. NANKOF: It is certainly.
12 MS. MARCH: In modern times. If we are
13 dealing in modern times, is it not.
14 MR. ADLER: The market in the '90s.
15 MS. PELLISH: It's a long time.
16 MS. MARCH: So I am saying you are not
17 suggesting we totally move out of domestic
18 equities. You are saying in your opinion the
19 bull market is at an end.
20 MS. PELLISH: Well, it's hard to -- what
21 I am saying is it's hard to figure out how it
22 continues at this pace.
23 MS. MARCH: So you said it your way and
24 I said it my way, but it means the same thing
25 in the end.

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2 So I am saying, John, I hear what you
3 are saying. I am very partial to my domestic
4 equity market, but I must do whatever I have
5 to do to see that this system earns as much as
6 it possibly can.
7 MR. ADLER: No, of course. Completely
8 correct.
9 MS. MARCH: So that is why if I were
10 voting on the allocation, it would be one of
11 these two.
12 MR. ADLER: But they are very different
13 from each other.
14 MS. MARCH: I understand that. I didn't
15 say which one I prefer. I said one of these
16 two and -- because I didn't want to vote and
17 my experience, I didn't want to influence
18 anybody.
19 MR. BROWN: What did you say?
20 MS. MARCH: I didn't want to influence
21 anybody. And I am saying since we are coming
22 to the conclusion that we have to address
23 asset allocation on a more nimble basis and
24 since we learned today that 80 percent of our
25 assets are going to be very nimble, we are not

1 Proceedings
2 making a life decision. We are making a
3 relatively shorter decision than we have ever
4 made before. So that is my answer to what you
5 said.
6 MR. ADLER: The thing is we can't time
7 it and I think that's what you are saying.
8 MS. MARCH: No, we are not timing it and
9 I don't think that's what these guys are
10 saying. If I were timing it, I would have
11 voted three months ago.
12 MS. PELLISH: This is really very
13 interesting to look at. Joe, does everyone
14 have this paper in front of them? You are in
15 luck.
16 MS. MARCH: Because I can concur a
17 thousand percent of what my colleague said,
18 even though in June I am not going to be his
19 colleague.
20 MR. NANKOF: If everyone could, turn to
21 page 3, Figure 2. So what we are looking at
22 on Figure 2, what this is doing, what this
23 chart is illustrating is the gray line is a
24 measure of the valuation of U.S. equity
25 market. And what does that mean, that just

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2 means what are you paying for every dollar of
3 earnings you -- your equities, you have a
4 right to the current and future earnings of a
5 company common -- you bought common stock in.
6 That's plain and simple. So what are you
7 paying for those earnings, that's the
8 measurement we are looking at.
9 And what this measurement does, it
10 doesn't look at the last one year or the next
11 one year. It looks at long-term average,
12 because one-year measurement of earnings could
13 be very depressed or very inflated given lots
14 of factors. So we want to try to smooth those
15 out. And this is a well-known measure of the
16 Shiller-CASE shift and CASE is just a
17 cyclically-adjusted price earnings multiple,
18 so that's the gray line. So look where we are
19 now the end of this chart, that's the far
20 right. And we have been here three times in
21 history. One was in the mid-2000s before the
22 financial crisis. So just move your eye to
23 the left, you can see we were here before the
24 global financial crisis. Does everybody see
25 that? We were also here, "here" meaning where

1 Proceedings
2 we are in valuations, in 2000/early 2000s
3 before the tech bubble burst, which was
4 euphoric times and people were thinking things
5 have changed forever. And then we were also
6 here in 1929.
7 MR. ADLER: What happened then?
8 MR. KAZANSKY: It's not important.
9 MR. NANKOF: So we are not foretelling
10 that the market, which happened in each one of
11 these cases, went down 50 percent or more. We
12 are not suggesting that's going to happen in
13 the next twelve months, but what's more
14 important any time we have been at these
15 inflated earnings level -- and you can see we
16 are also plotting on the same chart what were
17 the next ten-year returns for the equity
18 market given that starting point. And the
19 reason there is no green line for the last ten
20 years is because we don't know what the next
21 ten years are given the starting point today,
22 because if we knew that we would all be day
23 traders.
24 MS. PELLISH: We wouldn't be sitting
25 here.

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2 MR. NANKOF: But you can see they
3 generally track each other. But when they
4 track each other, the returns are plotted on
5 the right scale and it's an inverted scale.
6 So the higher the valuation, the lower
7 returns.

8 Now, let's turn to one other figure in
9 the paper which is on page 5. And all this
10 does is breaks all the points more than a
11 hundred years of history we are showing you.
12 It says let break them into ten buckets.
13 Let's try to simplify this exercise and
14 identify where we are and there's -- we broke
15 them into ten buckets and said given the
16 lowest starting valuations which is the
17 opposite where we are today which is the far
18 left of this figure, what were the next
19 ten-year returns on average. And that's 15
20 percent and that's where we were in 2009.
21 That's why we have generated 15 percent for
22 the last seven years.

23 MS. PELLISH: It's nice that the numbers
24 all work out.

25 MR. NANKOF: Unfortunately we are at the

1 Proceedings
2 right-hand side of the figure, which is in the
3 top decile of valuations and the
4 range -- the max return for the ten years
5 assuming you start at the top decile
6 valuations, the maximum, not the top 1
7 percent, not the top 5 per percent, is 8.9
8 percent. So could we generate 9 percent
9 returns for the next ten years, it's
10 plausible. We are not saying it can't happen.
11 It's within the range what we are forecasting.
12 But the average given we are in the top
13 decile, not even as high as we are at now, is
14 2-1/2 half percent. That's the number I
15 referenced earlier and this is the dilemma we
16 face, which is we love to have a better
17 picture of what we think returns will be for
18 the next ten years. We can at a minimum look
19 back and say what Robin said, which is for the
20 dollars we would have had invested in U.S.
21 equities for the last seven years we have more
22 than doubled. We are 15 percent for seven
23 years. You know the Rule of 7, everyone knows
24 that; if you are in 10 percent for seven
25 years, you have doubled your money.

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2 So more than doubled your money in the
3 U.S. equity markets for the last seven years,
4 so that is what led us to the point where we
5 are at which is which valuations manufactured
6 by the Fed easing emerging interest rates,
7 stimulating investments, stimulating house
8 recovery, stimulating job growth, job recovery
9 and that's all -- and U.S. corporations are
10 printing or generating profitability because
11 the revenues have grown. They haven't really
12 started so much in the way of wage pressure.
13 So if that -- the economy continues to grow
14 and wage pressure, might erode corporate
15 profitability. And that alone, even with the
16 growing economy, could impact valuations in
17 the U.S. So I think we are struggling to see
18 how you get much better in 4-1/2, 5 percent
19 with a lot of volatility potentially.

20 MS. MARCH: Can I ask a question. We
21 started at the low point and we earned that.
22 We didn't start at the high point. So what I
23 am saying is: We are at the high point right
24 now. My first-grade intuition tells me if we
25 are at the high point, whatever I do out in

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2 the rest of the world I do. But sitting here
3 in this room I have to do whatever I determine
4 will save us at the high point, and that's the
5 end of what I have to say, by June.
6 MR. KAZANSKY: And I think to your
7 point, you know, the PE managers, Robert Smith
8 or whoever for this equity, and I note him
9 because he was on the panel that was reported
10 just the other day, these guys consider
11 themselves to be the smartest guys in the
12 room. And when those PE guys are telling
13 everybody not only is PE tied to U.S. equities
14 but because of that, you know, where they like
15 to stand around and thump their chest at this
16 immense rate of return they are able to
17 provide us and saying to everybody don't
18 expect that for a while, that kind of leads me
19 to lean in the direction that it seems like
20 everybody is on the same page. But U.S.
21 equities are not going to be what we want them
22 to be for the foreseeable future, so it makes
23 sense to me based on what you guys represented
24 and what's out there in the world is that, you
25 know, reducing our allocation to U.S.

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2 equities makes sense.
3 MS. MARCH: And, by the way, just to
4 follow up: They are the easiest investments
5 to get into if there is a change.
6 MS. BEYER: So could I ask a rather
7 simple or maybe simplistic question: What has
8 to happen between now and June? Is there a
9 reason we can't give some consent on the
10 board's preference so that certain things can
11 begin to be put into process? What do we need
12 as a committee to hear before we can feel
13 comfortable making a decision on the
14 presentation?
15 MS. VICKERS: Well, I think from our
16 perspective, you know, BAM still has some
17 questions that are areas that are not, you
18 know, sort of finalized between Rocaton and
19 BAM. And not that we need more than time, but
20 I think that -- you know, I don't know if,
21 Mike, you want to speak to some of those
22 things and then we need to, you know, sort of
23 get Scott in the mix deciding what that would
24 be.
25 MS. MARCH: Susannah, listen, we don't

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2 have to make a decision today. We can make a

3 decision in June. But at this point in time,

4 it's not BAM making the decision. It's the

5 trustee making the decision.

6 MS. VICKERS: Absolutely, the trustee

7 and the comptroller's office is one of the

8 trustees.

9 MS. MARCH: So if you are asking as a

10 trustee to please hold it off until June,

11 please do it as a trustee and not as our

12 investment advisor.

13 MS. VICKERS: No, but as a trustee I

14 know because I happen to work at BAM that

15 there are lingering questions that haven't

16 been fully aired. So as a trustee --

17 MS. MARCH: I have no problem with you

18 as a trustee asking us not to make a decision

19 today. I do have a problem with you asking

20 the question from BAM's perspective.

21 MS. VICKERS: Right. Well, I am not

22 doing that, so there is no problem.

23 MS. PELLISH: So just to jump in, we

24 have scheduled a series of conference calls

25 between Rocaton and BAM throughout the month

1 Proceedings
2 of May such that with the objective and coming
3 back to the board with recommendations in
4 June.
5 MS. BEYER: How will they be different?
6 MS. PELLISH: I can't answer that
7 question because it's a collaborative effort,
8 but I wish I could.
9 MS. BEYER: Well, I was at the BAM
10 meeting with all the consultants, so that's
11 why I am a little confused because I thought
12 that was the time where a lot of this was
13 being aired.
14 MS. VICKERS: Mike?
15 MR. HADDAD: So I will speak on behalf
16 of BAM and some sources of disagreement that
17 we have -- sources of questions that we have
18 with Rocaton. I think they have done a
19 fantastic job and I applaud the non-consensus
20 that they have, I think it's fantastic. That
21 being said, the view on long duration is a
22 very different view than most consensus on the
23 market. Many of the factors that have been
24 cited by U.S. equities are risk -- has to do
25 virtually everything is measured off the

1 Proceedings

2 risk-free rate, which is the treasury curve.
3 The treasury curve is the single most
4 influenced marketplace by Federal Reserve
5 action. Both where they set short-term rates
6 and the quantitative easing they have done,
7 the single most influenced. If the Fed is
8 going to retract either on negative on rates
9 or on quantitative easing, that's the place
10 that's going to get affected first and
11 foremost.
12 So if we think equities are going to
13 underperform for a period of time due to
14 changes with inflation or monetary policy,
15 long-term interest rates are going to suffer
16 as well. If U.S. equities are going to
17 underperform because we are going to a
18 deflationary environment, long-term treasuries
19 are going to be the single best performer in
20 our portfolio. So those are big, big
21 questions and I will say flat out.
22 MS. MARCH: And all the decisions are
23 made by the board. I want -- I understand.
24 MR. ADLER: But I am interested in
25 hearing BAM's view.

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2 MS. MARCH: I have no problem hearing
3 their view.
4 MR. HADDAD: So if U.S. equities are
5 rich, I don't think that Rocaton is opining
6 that international equities or emerging market
7 equities are as rich. I think a question
8 for -- the board may want to consider is
9 whether that allocation to U.S. equity should
10 go into other equity markets in order to
11 achieve the actuarial return. So there is a
12 host of issues within this that I think that
13 we need to spend more time on.
14 I think to your point, having some
15 direction would be helpful for us. If you
16 definitively want U.S. equities down, that's a
17 piece of direction for us. If you are
18 open-minded to it, do you have an opinion on
19 long duration, do you want us to go one
20 direction or another, or do you want to hear
21 alternatives in that direction.
22 MS. MARCH: We are happy with our
23 consultant's decision.
24 MS. BEYER: Well, I would just suggest
25 if we break it into two pieces, it might be

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2 helpful for the discussion. From my being in
3 the BAM meeting and hearing about the long
4 duration, I support that I think for one. And
5 keeping that over here, the second piece is on
6 equities. I would be very open to hearing
7 that maybe we don't reduce the equity down by
8 10 percent or 9 percent, but rather look
9 elsewhere. You are suggesting real estate,
10 which we all agree would take a long, long
11 time. So I think of those as two different
12 decisions, but I think as a board perhaps the
13 trustees are ready to give you our feeling if
14 we do segregate it that way. I don't think we
15 should frame this decision as we know equities
16 are going down, thus we want to do this. I
17 think what we are saying is that it's -- well,
18 I guess we are saying that. And we want to go
19 down, but we are going down gradually.
20 MS. MARCH: Where does it come from?
21 That's the question.
22 MS. BEYER: And I think from where I saw
23 it on your alternatives, I felt comfortable
24 with where it was going. And I just think
25 that that sense, John, might be important for

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2 preparation for June's meeting. That's all.

3 What do you all think?

4 MR. KAZANSKY: I agree for the most part

5 with you and Sandy. I believe that our

6 consultants know far more about this than I do

7 and what I -- maybe to some degree some sort

8 of alternative to see from what Michael was

9 saying just a minute ago, okay, maybe let's

10 see what one allocation looks like with

11 removing from U.S. equities and putting more

12 into real estate, more into the prolonged

13 duration bonds. And then maybe a different

14 version based on what Michael said now, you

15 know, putting it in emerging or non-U.S.

16 developed and see, all right, what's the

17 standard deviation for that, what would it

18 look like for that, and what the compounded

19 return look like for that and are they

20 similar, are they wildly different and,

21 therefore, is it more than just a gut move or

22 is there one clear kind of rational decision

23 going on. But I tend to lean in the direction

24 of Rocaton's assessment.

25 MS. PELLISH: Of reducing U.S. equities?

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2 MR. KAZANSKY: Of reducing U.S. equities

3 and getting into the long-duration bonds.

4 MS. VICKERS: If we are doing that,

5 maybe the second alternative that we might

6 review the standard deviation.

7 MS. MARCH: Why don't we pick up on what

8 David said before. We are not making a

9 decision now. We would like to make a

10 decision by June and we can have whatever

11 meetings we would like to have to discuss the

12 issue. We are not voting now.

13 MR. KAZANSKY: I guess we are just

14 asking what are the things that we need to

15 tell you now so that when we step back to the

16 table in June, we don't --

17 MS. BEYER: We can vote.

18 MR. KAZANSKY: Or we can decide.

19 MS. BEYER: Or have consensus.

20 MR. KAZANSKY: Because my fear is we can

21 continue this right up until the date when we

22 have a new, brand-new asset allocation in 12

23 to 24 months, so I would rather set something

24 down in June --

25 MS. VICKERS: Yes.

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2 MR. KAZANSKY: -- and put this to bed.
3 MS. BEYER: And 2, policy alternative 2
4 versus 1, they are very different, but they
5 both use the long-duration bonds. They are
6 just very different with where they take it,
7 what they are moving around. Equity remains,
8 more or less, what it is today all in and so
9 does fixed. It's just inside there where we
10 are shifting it around.
11 MS. VICKERS: And they both rely on this
12 large allocation to real estate.
13 MS. PELLISH: Yes. I know that's one
14 thing that Scott wants to discuss.
15 MS. BEYER: And that's the one thing
16 that you are saying that maybe needs to be
17 looked at in terms of other equity that you
18 can get into that's a little bit more liquid.
19 MR. ADLER: Let me ask a question. It
20 seems like it would be useful to have either
21 all interested trustees or a subcommittee as
22 someone suggested?
23 MS. MARCH: I think we should just leave
24 it to meetings, John, or to discussions.
25 MR. ADLER: Well, what I am afraid of is

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2 if we want to make a decision in June then I
3 think that if we just go from now until June
4 without another discussion with Scott Evans in
5 the room, then I feel like it's going to be
6 hard to make a decision in June.
7 MS. MARCH: Agreed. So we understand
8 that.
9 MR. ADLER: Okay. So what I am asking
10 is -- first I have an open meetings law
11 question.
12 MS. BUDZIK: If you have a quorum, you
13 have to --
14 MR. ADLER: Maybe do it the day of the
15 board meeting when we are all here anyway,
16 which is in two or three weeks.
17 MS. MARCH: It's the last Thursday of
18 the month.
19 MR. ADLER: Last Thursday in May which
20 is only a week before the next investment
21 meeting, right? So do we want to do it then?
22 As a open meeting where -- and I don't know if
23 you can commit to Scott being there.
24 MS. VICKERS: I don't have his calendar,
25 but we can certainly try. If that's the

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2 meeting, that's where we want to do it.

3 MR. KAZANSKY: And maybe some

4 smaller -- some things before then, so that

5 meeting we are all kind of on the same page.

6 And whatever final questions we have we can

7 put together, so when we come back in June

8 everybody is satisfied.

9 MS. BEYER: My concern, John, is that's

10 too -- could we also explore, John, just

11 having the ability for dial in?

12 MR. ADLER: On the 26th.

13 MS. BEYER: Well, I would think we need

14 to have a discussion before then. Today is

15 the 5th. The 26th is 21 days today and

16 learning some of these possibilities is not a

17 two-week job or three-week job.

18 MS. VICKERS: So maybe we all agree we

19 need to have additional conversations.

20 MS. BEYER: Before.

21 MS. VICKERS: Maybe finalize the dates

22 over e-mail and decide when we are meeting

23 when.

24 MR. KAZANSKY: That works for me.

25 MS. BEYER: And have some ability to

1 Proceedings
2 dial in if I can't physically be there.
3 MS. MARCH: Absolutely.
4 MR. ADLER: If we were to do it that
5 day, we should start it earlier than 3:30.
6 MS. MARCH: We are available.
7 MR. ADLER: So to be determined. So
8 does that leave it where it needs to be?
9 MS. PELLISH: I believe so.
10 MR. ADLER: Okay. So I think we have to
11 do a executive session, right?
12 MS. VICKERS: Quick.
13 MR. ADLER: So do we have a motion to
14 exit?
15 MS. PELLISH: We actually don't have
16 anything -- oh, you do.
17 MR. ADLER: We still need a brief
18 executive session.
19 MS. MARCH: I move pursuant to Public
20 Officers Law Section 105 to go into executive
21 session for discussion on specific investment
22 matters.
23 MR. ADLER: A second?
24 MR. KAZANSKY: Second.
25 MR. ADLER: Motion made and seconded.

1 Proceedings
2 Any discussion?
3 All in favor of the motion, please say
4 aye. Aye.
5 MR. BROWN: Aye.
6 MR. KAZANSKY: Aye.
7 MS. MARCH: Aye.
8 MS. BEYER: Aye.
9 MS. VICKERS: Aye.
10 MR. SOHN: Aye.
11 MR. ADLER: All opposed? Any
12 abstentions?
13 Okay, so that concludes the public
14 session for now. Are we good to go, Liz? I
15 think so.
16 (Whereupon, the meeting went into Executive
17 Session.)
18 MR. ADLER: Okay, we are back in public
19 session. Susan, do you want to give a summary of
20 executive session?
21 MS. STANG: Absolutely. In executive
22 session an exception to the infrastructure
23 policy was discussed. Consensus was reached
24 which will be announced at the appropriate
25 time.

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2 MR. ADLER: Very good. Thank you very
3 much.
4 So I think that brings us to the end of
5 the agenda. Do we have a motion to adjourn?
6 MS. MARCH: So moved.
7 MR. ADLER: Is there a second?
8 MS. BEYER: Second.
9 MR. ADLER: Motion made and seconded.
10 All in favor of the motion to adjourn, please
11 say aye. Aye.
12 MR. BROWN: Aye.
13 MR. KAZANSKY: Aye.
14 MS. MARCH: Aye.
15 MS. BEYER: Aye.
16 MS. VICKERS: Aye.
17 MR. SOHN: Aye.
18 MR. ADLER: Opposed, please say nay.
19 Any abstentions?
20 Okay, the meeting is adjourned.
21 [Time noted: 12:14 p.m.]
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1
2 C E R T I F I C A T E
3 STATE OF NEW YORK)
4 : ss.
5 COUNTY OF QUEENS)
6
7 I, YAFFA KAPLAN, a Notary Public
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12 by me therein.
13 IN WITNESS WHEREOF, I have hereunto
14 set my hand this 15th day of May, 2016.
15
16
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18 YAFFA KAPLAN
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