BWC Board of Directors

# INVESTMENT COMMITTEE

**Thursday, August 27, 2009 12:00 p.m.**
**William Green Building**
30 West Spring Street, 2nd Floor (Mezzanine)
Columbus, Ohio 43215

---

| | |
|---|---|
| Members Present: | Robert Smith, Chair<br>Alison Falls, Vice Chair<br>David Caldwell<br>James Harris<br>Larry Price<br>William Lhota, ex officio |
| Other Members Present: | Charles Bryan<br>Kenneth Haffey<br>James Hummel<br>Jim Matesich<br>Thomas Pitts |
| Members Absent: | None |
| Counsel Present: | John Williams, Assistant Attorney General |

CALL TO ORDER
Mr. Smith called the meeting to order at 12:00 pm.

ROLL CALL
Roll call was taken. All committee members were present at the roll call.

APPROVE MINUTES OF THE JULY 30, 2009 MEETING
Upon motion of Ms. Falls, seconded by Mr. Caldwell, the minutes of the July 30, 2009 meeting were approved as written. Roll call was taken and the motion passed 6-0.

AGENDA
Upon motion of Ms. Falls, seconded by Mr. Price, the agenda was approved as written. Roll call was taken and the motion passed 6-0.

DISCUSSION ITEMS:

MONTHLY AND FISCAL YEAR TO DATE PORTFOLIO VALUE COMPARISONS

Bruce Dunn, Chief Investment Officer (CIO) referred the Committee to the Invested Assets Market Value Comparison-Total Funds chart. The report is incorporated into the minutes by reference. He noted that the funds have shown a strong performance in July 2009. Net investment income in July 2009 was $532 million with a monthly positive return of 3.1%. Equities showed strong performance with a net return of positive 7.5%. Bonds had a positive 2.0% return. The bond value realized a $120 million net loss due primarily to the selling of long government and long credit bonds in order to move forward with the Priority 1 transition to the 15% asset allocation in the Barclays Aggregate fixed income benchmark. The transition, which began in late July, consisted of first closing the Long Government/Credit separate account managed by State Street for the State Insurance Fund and separating and transferring in-kind long government and long credit bonds owned from the closed account into two new separate accounts dividing these two asset classes consistent with the new investment policy mandates. This resulted in an $85 million realized net loss. Mr. Dunn indicated that the realized accounting loss booked was considerably less than it would have been if the account had been closed earlier in the calendar year. Long credit bonds continue to perform better than long government bonds with a positive return of 4.3% for long credit and 1.7% for long government for the month of July, 2009. TIPS had a flat rate of return in July. Equities increased as a result of the market rise and shifting additional cash from bonds. Mr. Dunn indicated that short term rates have decreased modestly in the last month and are likely to decrease further. Mr. Dunn explained that the Investment Division recently visited Northern Trust to perform a due diligence check. Northern Trust offers and manages a variety of money market funds for clients and is barely able to break even in profitability on these funds in this low interest rate environment. He also noted that some firms are no longer offering government money market funds. Mr. Dunn assured the Committee that the U.S. government money market fund managed by JPMorgan utilized by the Bureau is very well managed.

MONTH-END PORTFOLIO ASSET ALLOCATION VALUES

The CIO referred the Investment Committee to the BWC Invested Assets Report as of August 26, 2009. The report is incorporated into the minutes by reference. Mr. Dunn pointed out that both stocks and bonds had a positive rate of return in August, 2009 to date. Equities performed higher than bonds at 4.3% versus 1.3%. In the fiscal year to date, bonds have had a positive return of 3.3% and equities have had a positive return of 11.8%. The month to date market value of bonds plus stocks has increased by $343 million. The Bureau's net assets at the end of last month were $2.95 billion. With the increase in the current month of $343 million, the net assets level of the Bureau is almost $3.30 billion. Mr. Dunn indicated to the Committee that the asset allocation continues to drift upward in equity ownership percentage toward the target asset allocation of 30% in the SIF. The CIO indicated that many stock market observers expect a correction in the equity market. Mr. Smith noted that the Bureau's investments have shown a strong upward movement recently and applauded the staff for their extensive rebalancing that is being implemented due to the investment policy change in the rebalancing policy. Mr. Dunn stated that the Investment Division has been disciplined in implementing the new rebalancing strategy. Mr. Cooper, Principal for Mercer, noted that it was easy to be scared in the economic market of last year into this year and due to that, many of their clients did not perform any rebalancing. Those clients that followed disciplined rebalancing have done better. He also indicated that some clients are still out of the stock market. Although those clients missed the downswing in the market, they are also missing the upswing.

Mr. Dunn pointed out that the Investment Division has developed a new table that shows the month-end asset allocation amounts of each investment class mandate for each of the six Bureau trust funds at the end of June and July, 2009. Mr. Dunn presented these new tables for the end of both June and July, 2009. Both reports are incorporated into the minutes by reference. Mr. Dunn indicated the Investment Division is going to provide these updated tables for each meeting in the future. These tables will allow the Committee to review the progress of the transitions. As of June 30, 2009, prior to beginning the transition, the combined long credit and long government bonds amounted to $8.9 billion in the SIF portfolio. In late July, the Aggregate Bond Fund Transition Manager began the necessary transitions in order to gain the targeted exposure to the Aggregate bond index. Ultimately, an end target Aggregate Bond Fund manager will be chosen and recommended to the Investment Committee and Board for consideration and approval by the RFP Evaluation Committee. From June 30, 2009 through July 31, 2009, the total amount of bonds held in the SIF portfolio decreased by 2.1% while stocks increased by 1.2% and cash increased by 0.9%. Due to the transition, cash increased $150 million by the end of July. Mr. Dunn indicated that the goal of the Transition Manager was to decrease the duration target of the long duration bonds targeted to the Aggregate index from 11 years to 4.5 years. In order to implement this Priority 1 transition, a fair amount of bonds were sold by the Transition Manager and initially remained as cash to achieve this stated duration target within the first several days of the transition. Mr. Dunn indicated that he was pleased with the trading results of the Transition Manager. Mr. Smith asked if the overall objective of the transition was to achieve good performance tracking rather than mitigating risk. Mr. Dunn responded that the transition had both goals. He added that the paramount goal was to reduce the duration as quickly as possible while avoiding excessive trading. Mr. Smith asked if the transition would include the use of To Be Announced (TBA) pools such as those issued by Freddie Mac or Fannie Mae. Mr. Dunn responded that TBA pools are being purchased by the Transition Manager. Mr. Dunn explained that when TBA pools are purchased, the investor has the right but not the obligation to take future delivery of underlying mortgage pools meeting defined specifications and that the investor does not advance cash unless and until this right of deliver is exercised. It is the strategy of the Transition Manager to extend delivery of these TBAs month-to-month at market prices with the intent to deliver these TBAs to the chosen target manager. It is deemed by the CIO and Transition Manager to be very inefficient for the Transition Manager to take actual delivery of what could amount to be thousands of small mortgage-backed pools that the chosen target manager for this bond mandate would likely determine to be undesirable. Mr. Cooper added that this type of investment is allowed in the Investment Policy Statement (IPS).

Mr. Dunn noted that Ms. Falls made the suggestion to present an asset allocation table for all trust funds to the Investment Committee each month. Mr. Smith complimented the format and purpose of these tables.

PORTFOLIO PERFORMANCE- SECOND QUARTER 2009

Mr. Cooper referred the Investment Committee to the Performance Evaluation Summary for the Second Quarter 2009. The report is incorporated into the minutes by reference. Mr. Cooper noted that these reports are presented four times per year in order to give the Investment Committee insight into how the Managers are performing. Mr. Cooper pointed out the US Capital Market Conditions as seen on page 2. With regard to the Gross Domestic Product (GDP) Change, the official definition of a recession would be two consecutive quarters of negative growth. The first quarter of 2008 showed negative growth, but the following quarter brought positive growth. Since then, there have been three quarters in a row with negative growth with a fourth quarter likely to follow. The second quarter 2009 GDP is estimated to be negative 1.0%. Mr. Cooper pointed out that the current short term rates are at an unprecedented low , creating an almost 0.0% rate for three month Treasury yields, cash and short term investments. Mr. Cooper added that there would not be much room to reduce rates more.

Page 4 shows that the second quarter 2009 had better performance for US Equities with all of the indices performing well. The Russell 2000 Growth had a positive 23.4% return for the second quarter 2009 and the S&P 500 had a positive 15.9% return for the same period. Due to a poor first quarter performance, the year to date performance for the Dow Jones was negative

2.0% with positive 3.2% for the S&P 500. All of the International Equities showed a positive return in the second quarter of 2009. The EAFE index had a positive gain of 25.9% in the second quarter and a positive 8.4% for the year to date. The EAFE Small Cap had a positive gain of 34.5% with a 21.8% gain for the year to date. Emerging Markets gained 34.8% for the second quarter and 36.2% for the year to date. Mr. Cooper noted that the new transitions included moving into emerging markets. Mr. Dunn added that some of the foreign stock gains were driven by local currency gains versus the U.S. dollar. He estimated that one-third of the gain in the EAFE was due to a weak dollar. On page 8, the Barclay's Capital High Yield Index had positive second quarter return of 23.1% and 30.4% for the year to date. Mr. Cooper indicated that these gains are in line with other markets with strong gains in the market overall. Barclays Capital Long Government/Credit Index returned 2.8% in the second quarter, but had a negative return of 3.5% in the year to date.

In the Market Summary Returns ending June 30, 2009, the S&P 500 lost an annualized 2.2% in the last ten years. Mr. Cooper indicated to the Committee that this was most probably the worst ten year period in history. In the ten year period ending in 1938, the S&P 500 returned 0.9% while the ten year period ending 1939 was flat. Mr. Matesich asked what the rate of return would have been if the last year were removed. Mr. Cooper responded that the return would be flat or would have a small gain. Mr. Lhota asked when the Dotcom companies lost all of their money. Mr. Cooper responded that this occurred in 2000, 2001 and 2002, adding the market has had four negative years in the last ten year period. Ms. Falls commented that the base year makes a big difference when calculating the ten year rate of return and that the rate of return should increase once the market reaches 2010. TIPS had the best fixed income category performance at 7.2% annualized over a ten year period when compared to the other fixed income indices. In the last ten years, high yield fixed income had a positive rate of return of 4.7% annualized. Emerging markets returned an annualized 9.0%, while real estate returned 9.4% and commodities returned 6.3% for the same period. REITS returned 5.5% and convertibles returned 3.0% for the last ten years. Mr. Cooper pointed out that the second tab contains an executive summary.

Mr. Cooper then reviewed the asset allocation changes as well as the account returns. Page 14 shows the June 30, 2009 asset allocation percentages including 91.6% for the SIF and 6.5% for the Disabled Workers' Relief Fund (DWRF). Mr. Cooper directed the Committee to the chart on page 15 which notes the investment percentages by asset class. He emphasized that the chart will change dramatically over the next six months. Page 16 showed the asset allocation amongst Investment Managers, which is also evolving. Mr. Cooper pointed out that based on the new rule, none of the managers are able to manage more than 50% of total Bureau funds. He noted that BWC must decrease the holdings managed by State Street. The asset allocation percentages based on the interim policy and as of June 30, 2009 were pointed out, as well as the asset allocations as compared to the long term policy on page 17. Mr. Cooper directed the Committee's attention to the portfolio reconciliation by manager, emphasizing that the Bureau has a simple structure with six funds, twenty-two accounts and a small number of investment managers. Mr. Lhota asked if all of the funds were statutorily required. The Bureau Administrator, Marsha Ryan answered in the positive. Mr. Dunn noted that the funds cannot be combined. Ms. Ryan added that they could not be combined absent a statutory change. Mr. Smith inquired if the number of accounts could be reduced. Lee Damsel, Director of Investments, answered that the Investment Division would prefer to combine the funds in order to reduce operational costs, but the Bureau is barred from commingling the funds and required to maintain separate funds. Mr. Dunn added that the management fees are higher because of the separate funds and are especially significant currently with the Coal Workers' Pneumoconiosis Fund (CWPF) due to the imposition of minimum fee levels. However, these fees are still considered reasonable.

Mr. Cooper then discussed the SIF performance. On the Performance Summary Chart, Mr. Cooper pointed out that the total fund value was $17.183 billion and had a three month return of positive 4.6%, a year to date return of negative 0.4% and a one year return of negative 1.1%. He added that there is no benchmark for those numbers. The SIF composite, which consists of the entire SIF, had $15.7 billion with a positive three month return of 4.6% as opposed to the policy benchmark of positive 4.9%. Mr. Cooper also pointed out the one year and year to date returns for the SIF met or exceeded their benchmarks. The SIF portfolio year-to-date return was -0.4% vs. the benchmark return 0.0% and the 1 year return was -1.1% vs. the benchmark return -2.4% for the periods ending June 30, 2009. Mr. Cooper noted that JP Morgan decides what the index funds are worth and that these valuations can differ from other fund managers. He noted that with bonds, there is not any agreed upon pricing method. Mr. Smith stated that there may be discrepancies in pricing and services. Ms. Falls added that TIPS has the same issue. Mr. Cooper noted that the returns were not exactly at the policy benchmark for the composite fund. The one year return exceeded the policy benchmark by 140 basis points (bps). Mr. Dunn asked how the benchmark was computed since the policy has been evolving during the second quarter. Mr. Cooper answered that the benchmark was computed based on what noting that the policy would continue to evolve through the end of the year. Mr. Smith commented that he agreed with the manner of calculation. Mr. Smith also stated that as we transition the SIF we need to examine how the managers performed, not how they compare to the benchmarks. The three month, year to date and one year returns for the Long Duration Fixed Income (LDFI) were mentioned, as well as their benchmarks. Mr. Cooper pointed out that Mercer collects data on other managers in order to calculate the median return. For the three month duration, the median return was positive 4.1%. Mr. Cooper indicated that the SIF LDFI's three month return ranked 65th among other long duration Investment Managers. Mr. Lhota asked how the rank was calculated. Mr. Cooper answered that 65% of other managers had better returns. Mr. Smith inquired if the rank included both active and passive managers. Mr. Cooper responded in the positive. Mr. Dunn added that other active style managers were probably highly invested in credit with very little investment in government bonds. He noted that high investment in long government bonds likely caused the underperformance. Ms. Falls mentioned a report by Standard & Poor's referenced in a recent Wall Street Journal article that studied asset weighted returns for the S&P 500 and fixed income over a five year period. The study found that passively managed funds outperformed actively managed funds over almost all asset classes. Mr. Smith noted that the report should be reviewed. Mr. Cooper pointed out the three month and one year returns for the LDFI managed by State Street and BGI versus the policy benchmark. He noted that although those funds outperformed the benchmark, the difference was based on pricing differences with JP Morgan, as well as being overweighted and underweighted in certain sectors. Mr. Cooper emphasized that although the returns on the fixed income did outperform the benchmark, it was important not to give too much credit to the passive managers for outperforming the benchmark. Ms. Falls commented that the objective was not to outperform or underperform the benchmark, but to reduce the tracking error. Ms. Damsel added that it was important to compare pricing with other managers, rather than relying solely on the pricing of the Bureau's manager, as these investment vehicles are difficult to price. She reiterated that she felt comfortable with the differences in the returns when compared with the benchmarks. Mr. Cooper agreed, noting that using JP Morgan to check pricing was helpful. Mr. Cooper pointed out that TIPS was $3.19 billion. He indicated that TIPS tracked the benchmark by 20 bps. He also pointed out the three month and one year returns for TIPS versus the benchmarks. On page 20, Mr. Cooper directed the Committee to the three month and one year returns from the Northern Trust S&P 500 versus the benchmarks. When asked by Mr. Smith, Mr. Dunn indicated the annual management fee of the SIF account managed by Northern Trust was 0.75 basis points. Mr. Dunn noted that annual management fees are now 0.5 bps for the Disabled Workers' Fund (DWRF) and Coal Workers' Fund (CWPF) due to the conversion in June, 2009 to a commingled fund managed by Northern Trust. Mr. Haffey asked Mr. Smith if the fees were higher or lower than expected. Mr. Smith responded that they were much lower. Mr. Cooper added that the fees would be at least 40 bps, if not higher, for active management.

Mr. Cooper then discussed the specialty accounts and their returns. He pointed out the one year returns for the DWRF composite, LDFI, TIPS and S&P 500 funds as compared to their benchmarks, as well as the BLF LDFI one year returns. Mr. Cooper also reviewed the one year returns on the Public Works Relief Fund (PWRF) and MIF accounts as opposed to their benchmarks. He added that the PWRF returns were lower than the benchmark because the account had been held in cash until recently. Mr. Smith asked for assurance that if there were questions in a fund's performance, then those issues would be added to the report. He also added that the performance needed to be watched closely. He complimented the quarterly reports, noting that they were very helpful to the Committee. Mr. Dunn responded that any unexpected manager performance issues that arise would be brought before the Committee with suggestions on the actions' needed. He assured the Committee that the investment performance was reviewed monthly. Ms. Damsel added that the information protects the Board by having the consultant provide an independent calculation in order to verify the Investment Division's assessment. Mr. Smith noted that the Bureau was not previously using outside calculations in order to validate performance. Mr. Cooper responded that performance was now being calculated monthly by Mercer.

CIO REPORT

Mr. Dunn referred the Committee to the July 2009 CIO Report handed out that included several corrections to replace the earlier distributed version placed in the Board Book. The report is incorporated into the minutes by reference. Mr. Dunn noted that one noteworthy correction pertains to the second strategic goal of the Investment Division where reference is made of Mercer's suggested Mix 5 strategy to correct the reports' previous Mix 6 reference. Mr. Dunn mentioned the Investment Division goals for the 2010 fiscal year. He noted that the first goal was to support execution of the new IPS. The goal encompasses executing remaining transitions for the State Insurance Fund and addressing possible asset allocation changes of the remaining specialty funds evolving from the Mercer asset-liability studies to be conducted. A Request for Proposal (RFP) was issued in early July with eight different mandates, including two mandates to refresh the managers for the specialty funds. It is anticipated that the new managers will be chosen by the end of this year or sometime near the beginning of 2010. An RFP remains active for only six months from receipt of proposals, so the current one will expire in early February, 2010. There were four managers who responded to the RFP: State Street, Barclays, Mellon and Northern Trust. Mr. Dunn noted that a strategy is being formulated to select finalist managers by the RFP Evaluation Committee. He also added that the maximum 50% assets under management per manager in the IPS is very influential in the finalist manager selection process. Mr. Smith asked how the RFPs were advertised and if the burden was on the Investment Managers to locate the RFPs. Mr. Dunn responded that the RFPs were advertised in the Wall Street Journal and in a publication called Pensions & Investments, as well as being posted on the BWC website. He added that the Investment Division also contacts managers who have previously approached the division. Mr. Dunn noted that although the RFPs get wide coverage, only a few managers qualify due to the current passive investing strategy. He explained that he hopes for substantial progression in the transitions in the next 3-4 months with the first quarter of next year being used to focus on the specialty funds. He added that he hoped early 2010 would be used to educate the Committee on the investment strategy for the specialty funds, research on active management and information on considering minority managers for active management. Mr. Smith inquired if the Investment Division had discussed identifying minority managers with Mercer. Mr. Cooper responded in the affirmative, indicating that Mercer would be able to assist in any minority manager search.

Mr. Dunn directed the Committee to the issue of management of cash. Currently JP Morgan manages the Bureau's sole money market fund. Mr. Dunn explained that JP Morgan has done well with portfolio management. Although JP Morgan offers many different government and nongovernment funds, Mr. Dunn explained that the Bureau is not being very penalized by staying with the government money market account. Currently, the JP Morgan Prime money market fund yield is around 0.3% while the Bureau is earning 0.2% in the government money market account. More intensive management of short-term cash assets will require more staff, resources and an extensive amount of time. Mr. Dunn indicated that he and Ms. Damsel were very sensitive to that portion of the portfolio and would be reviewing it. Ms. Ryan added that although there are just three goals for the 2010 fiscal year listed, this should not diminish the focus or scope of the goals. Goals needed to be chosen that could likely be accomplished within one year. The analysis of cash has been added as a new item, but is of equal importance to the other goals. Ms. Ryan noted that the analysis of cash would need to be evaluated to determine how this goal fit in with the other operational goals. She emphasized that the Bureau will spend a significant amount of time evaluating resources and assessing how to best move forward toward accomplishing the goals. Mr. Dunn explained the third goal, noting that the policy and procedure for selecting Transition Managers had been created in fiscal year 2010 already. Originally, the Investment Division did not have any documented process for this important manager selection process. Mr. Dunn added that prior to any selection of active investment managers and minority managers, a process must be documented. Mr. Dunn explained that the Internal Audit

Division has been reviewing all developed internal Investment Division processes and providing good suggestions which are considered. Mr. Smith commented that he was impressed with the additional work that the Investment Division has performed under the direction of the Administrator. He added that the Investment Division has worked hard by prioritizing mandates and performing essential due diligence checks which require on-site visits.

The CIO referred the Committee to the status of the LDFI portfolio divisions for the SIF portfolio. The SIF LDFI portfolio division involved reducing the long government portion of the portfolio and splitting the Barclays Capital US Long Government/Credit Index into two separate accounts. After the split, long credit has a target of 28% and long government has a target of 9%. Mr. Dunn assured the Committee that the long government target should be reached within the next several months. The bonds in the State Street LDFI portfolio had a market value of $7.23 billion resulting in an $85.0 million realized loss from the split. Mr. Dunn pointed out that the long credit portion of the combined Barclays Capital U.S. Long Government/Credit Index portfolio continues to increase in percentage due to the prolific issuance of new credit bonds, including Build America taxable municipal bonds. He added that pension funds in particular have a high demand for these taxable municipal bonds as they provide further bond issuer diversification. Mr. Dunn indicated that maintaining small tracking error has been challenging to Investment Managers who are having difficulty purchasing the many new issue bonds in sufficient quantity consistent with the benchmark index. Mr. Smith noted that the Bureau is progressing toward its goals each month. Mr. Price indicated that he had previously initiated discussions with Mr. Dunn, Ms. Damsel and Mr. Cooper with regard to assisting with locating minority managers. He asked why that priority was not listed among the goals. Mr. Dunn indicated that the second goal encompassed this priority, as reflected in his submitted CIO Report.

COMMITTEE CALENDAR

Mr. Dunn referred the Committee to the Investment Committee Calendar. The calendar is incorporated into the minutes by reference. He noted that deciding on Passive Manager RFP finalists would be performed from September through December. Education on high yield bonds and alternative asset classes would be provided in the January through March, 2010 Committee meetings. Mr. Cooper added that the Investment Committee had spent a significant amount of time reviewing the right investment strategy for the SIF, leaving the rest of 2009 and all of 2010 to study the other four specialty funds, excepting the Self Insured Employers Guarantee Fund. He indicated that it is anticipated the DWRF and CWPF asset-liability reviews would be concluded by the end of the year with the

MIF and PWRF reviews to follow in early 2010. He added that the schedule would be tight for the next several meetings due to the discussions on new managers and the reviews of the specialty funds.

ADJOURN:
Motion was made by Ms. Falls, seconded by Mr. Caldwell, to adjourn the meeting at 1:39 pm. Roll call was taken and the motion passed 6-0.

Prepared by: Linda Byron, Staff Attorney, Legal Division, September 3, 2009