DEPARTMENT OF CITY CLERK

CITY HALL

OCTOBER 28, 2003

The Board of Investment Commissioners meets this day at 2:30 o'clock P.M., in the Conference Room, Third Floor, City Hall.

PRESENT: Mayor David N. Cicilline, Chairman, Vice-Chairman Alex Prignano, Stephen T. Napolitano and Mark Harriman – 4.

ABSENT: Councilman Kevin Jackson, Allan M. Edwards and Myrth York – 3.

Also present are Eric Bertonazzi, Wainwright Investment Counsel; Saro J. Picciotto, Wainwright Investment Counsel; Jonathan Lang, Executive Director, Development Corporation for Israeli Bonds; Susan Licht-DeBlasio; Michael Mello, Chief of Staff, Mayor's Office; John Simmons, Acting Director of Administration; Michael R. Clement, City Clerk and Lori L. Hagen, Assistant Clerk.

I INVESTMENT PERFORMANCE ANALYSIS

1.) Recent Performance Estimate

2.) Portfolio Structure and Performance Summary: Asset Class

3.) Manager Performance: Benchmark vs. Manager Analysis

A.) US Equity Managers
B.) International Equity Manager
C.) Fixed Income Managers

II DISCUSSION RELATIVE TO THE DEXTER DONATION FUND AND OTHER TRUST ACCOUNTS

III PRESENTATION BY JONATHAN LANG RELATIVE TO ISRAELI BONDS

MAYOR CICILLINE: Let's proceed with item number one, the recent performance estimate.

MR. BERTONAZZI: Since we were here last, as you – if you look at your flash report, again this shows account value estimates as of close of business Friday, so last Friday.

VICE-CHAIRMAN PRIGNANO: Do you have one? I don't think the Mayor has a flash.

MR. BERTONAZZI: No?

VICE-CHAIRMAN PRIGNANO: There it is. Okay, he's got it.

MR. BERTONAZZI: You'll see that since last time we were here, not much has changed actually. The markets sort of went down after we were here the last time at the end of September, came roaring back in October, gave some back. So, on net it hasn't been much of a change. For – for reference you can see that the account is up 21% year-to-date through that time. The S & P is up seventeen through that time. So, the portfolio with bonds and other diversifying lower risk strategies, happens to be beating the market this year, which is – I couldn't have expected that. It's better than – it's better than I could have really hoped for at the beginning of the year, even in a market rebound. That's because our small cap is doing well and I'll start to – and to sort of add to that, I'll go down through the list. If you just look at Brandes, who is the international equity manager, they deserve some – some recognition here, up over 30% year-to-date, made 4.1% month to date. They continue to just be incredible, very, very strong performance year in and year out. This year is no exception. They really added a lot of value. And the weakening dollar has helped them but remember they're unhedged, so when the dollar weakens, and we hold equities, in this case in an international manager in Euro positions, British, you know, pounds sterling positions, yen positions, that type of the thing, Canadian dollar, Australian dollar, the dollar weakens, those positions are worth more in dollars. So, one of the reasons that they're up that much is because the dollar has weakened, and that is precisely why we have them in the portfolio to capture that. The same is true for the international fixed income manager, who is Rogge, a few lines down. That's a bond – that's a very conservative bond portfolio, government bonds, et cetera, of other countries, G7 developed countries, France, Germany, Great Britain, Canada, that type of thing, up 12.7% year-to-date, which is very, very strong for a bond manager. Again, one of the reasons, the dollar has been weakening, so any positions we hold in those bonds benefit in the same way as out equities. So, that's a very strong return there for our international bond manager, and it's exactly why they're in the portfolio is to be able to take advantage of – of that type of an environment, the environment that we are in. Similarly, although they are domestic, Loomis Sales, our biggest manager, our core bond manager, our domestic bond manager, who focuses on corporate bonds, you might recall, is up 9.1% year-to-date, a very strong year for – for a bond manager. Again, this is only through, you know, through late October. That's a very good year in and of itself. We've got a couple of months to go here. One of the reasons that our portfolio is performing so well this year, and relative to other public pension plans, and the rankings will come out next month at the next meeting and you can see them updated, I predict they will be very strong, is because the Board wisely chose years ago, in my opinion, to – to focus on Loomis, who is a corporate bond picker. They do not hold as much government bonds as many of the other bond managers out there. Government bonds are getting clobbered this year, or you know, flat to down year-to-date, depending on where you look. So, most other folks corporate bond – government bond positions in their portfolios either are not making any money or are down, are in the negative. Ours up 9.1% and that's because corporates are doing much better obviously than governments. So, that's working very well for the portfolio, and Loomis is doing a good job capturing that. The real story this year, of course, is the equity markets. As I said, the S & P is up 17% through last Friday, which is a big rebound from last year's 22% loss. So, it's still got a long way to go but going in the right direction. And you can see if you look at our large cap and mid cap and small cap managers, returns just what you might expect in an environment like this, in a rebound, in a rebound in the economy and a rebound in that markets, which is what we're seeing, small cap is out performing large cap. You'll see, for example, McKinley is up 37% year-to-date, Boston Partners small cap value up almost 35, mid cap up 25.6, and our large cap having a strong year but not as strong, up 16, 17, 18%, depending on which manager you're talking about. So, that's helping us as well this year is that small cap is out performing and we're getting a real – a real bump to value from – from that market. And even our hedge funds and – are doing well this year. We have some low risk hedge funds, TQA arbitrage, Forrest Fulcrum, those are convertible bond arbitrage managers, as we've talked about before, up 7½ to 8½% net year-to-date with very low volatility. That's the kind of returns we're looking for for them, eight or 9% per year, that type of thing, maybe ten, and we've got a couple of months to go and we're – we're on track to get that. So, they've been adding value as well. Quellos Strategic is, of course, a fund of funds, which has many hedge fund strategies in it. It's also designed to be low risk and it has been, very low volatility, up 7.7. So, things going – things going very well year-to-date, stronger than I could have really hoped for at the beginning of the year. Again, economic rebound, don't be surprised if you see, I think, GDP growth in the third quarter of this year could be six, 7% annualized rate, which is staggering. And it's going to continue, I think, for the next three quarters with tax cuts and monetary stimulus with low interest rates is helping a lot, and then just time. So, we're – we seem to be quite definitely in the middle of a recovery here, and the portfolio is reflecting that, and I think on average the managers are doing a pretty good job capturing that.

MR. HARRIMAN: The large cap SSGA?

MR. BERTONAZZI: Yes, that's State Street Global Advisors. That's the index growth, and that was the replacement of New England, New England Trust because it's a very cheap, diversified index approach to large cap growth. So, it's not been there the whole year, that's why –

VICE-CHAIRMAN PRIGNANO: The Board needs to decide if they want to just keep it in that index fund or go out and –

MR. HARRIMAN: Okay.

VICE-CHAIRMAN PRIGNANO: -- you know, hire a large cap – a new large cap manager, which we haven't done.

MR. BERTONAZZI: I also – we have for you – Mr. Edwards had – had requested some information on the starting values of the managers in the portfolio, and that's what the second page shows, sort of how much we gave them initially. Now, there's been some net inflows and outflows from rebalancing, et cetera. For example, the most extreme case if you look at Loomis Sales, we gave them $85 million dollars initially. Over the years we've added 69.7 million. That's where most of the funding from the City goes, but we've taken out almost 155 million across that time, and that's to pay the benefits.

VICE-CHAIRMAN PRIGNANO: That's the pension account.

MR. BERTONAZZI: So – and currently they are at, oh, 54 million I guess if you count the Israeli bonds, which are inside that portfolio. If we break them down it's 54.64 million. But that – that has serviced the benefits. So, you can see what the net outflows and inflows have been to the managers in the initial amount of funding, and that was something Mr. Edwards had requested, so that is provided for you. You can see that there has been a lot of movement over the years, inflows and outflows, rebalancing, that type of thing. Additionally, Mr. Edwards had asked us to update the Next Wave situation at Halpern Denny. Halpern Denny is one of our five equity players, and made a really large hit, a good score on the Next Wave bonds. And he had asked us just to update that, and very quickly, as you recall Next Wave bought those licenses from the FCC for cell phones. They went bankrupt. The FCC tried to take those back because they didn't pay but the court ruled that Next Wave had the same protection under bankruptcy protection as any – as any company and that the FCC was just another creditor so that they could not take those – those licenses back. This was Halpern Denny's position when they made a debtor in possession loan to Next Wave. That loan has been now paid back in full plus 7% compounded interest returned, and that money came back to the City – was it in September – October 10th it was wired back to the City, the initial investment plus interest, and in addition over the next year part of the deal that Halpern Denny cut was that they would get another $50 million dollars in preferred return if this case turned out the way it did. It did. When they sell some more of their assets Halpern Denny will take in another fifty million of pure profit. The City's part of that will be $750,000.00. So that will represent essentially a 100% return to the City on that investment. And that has been, of course, a very good hit for Halpern Denny and for the City. Mr. Edwards had asked for an update on that, which – which we've provided now. So, they – they expect within a year or so to get that second piece of that, the all profit piece. We do have all of your capital and your interest back on the loan, which that was wired into Fleet cash account. So, that worked out very well. And does anyone have any questions? I can go into anything in more specific here if they wish. Things are going very well.

MAYOR CICILLINE: Anyone have any questions?

MR. NAPOLITANO: No. I move acceptance of the report as presented.

MAYOR CICILLINE: Motion has been made to accept this report as presented, is there a second?

VICE-CHAIRMAN PRIGNANO: Second.

On motion of Mr. Napolitano, Seconded by Vice-Chairman Prignano, it is voted to accept the report as presented.

MAYOR CICILLINE: All those in favor signify by saying "Aye".

COMMITTEE: Ayes.

MAYOR CICILLINE: Opposed? Motion carries.

MR. BERTONAZZI: Would you like to do –

MAYOR CICILLINE: I'd like to do the presentation by Jonathan Lang, if we could do that next.

MR. NAPOLITANO: Okay.

VICE-CHAIRMAN PRIGNANO: Then we can go back and do the Dexter.

MR. NAPOLITANO: Okay.

MR. HARRIMAN: Is he here at our request?

VICE-CHAIRMAN PRIGNANO: Excuse me?

MR. HARRIMAN: Is he here at our request?

MAYOR CICILLINE: What happened was apparently the bonds expired and they were not renewed, which was the history of the City questions were raised why we didn't do that, and I'm not sure of the answer. So, it's sort of at my request.

MR. NAPOLITANO: Okay.

MR. LANG: I appreciate the opportunity to allow us to come talk about Israel Bonds and the relationship that the City of Providence has had since 1989, I believe. First of all, I'd like to introduce Susan Licht-DeBlasio, who is the Israel Bond Chairperson, my leader in the Providence area. She is a partner at Tillinghast Leach –

MS. LICHT-DE BLASIO: -- Perkins Smith and Cohen, downtown.

MR. LANG: Susan is my – she's my eyes and ears in Providence. My – I'm based in Boston but obviously we're – we're in Providence quite a bit. I rely on Susan and her expertise in the community down here, and I appreciate her support. Um, I believe that we're here to hopefully shed some light on a positive relationship that we've had over the years in terms of purchases that have been made by the City of Providence retirement fund of Israel bonds, and I'm here to answer any objections in terms of question about the – the instruments and the terms. And what I would ask you to do is I will briefly run you through some of the material that you have here in your folders. On the left-hand side you'll see the current holdings that the City has, and it's listed by the issue – the issue date, the amount, the maturity date, when interest payments are made, what the current rate is, what the last payment was and the date of the last payment. You will see behind that a listing of the various funds and institutions that have purchased Israel bonds over the years. As you can see, quite a number of state and public employee funds have purchased bonds. In this area, the most recent purchases have been made by the Commonwealth of Massachusetts for $5 million dollars, the City of New Haven $2 million dollars, the City of Hartford $1 million dollars – who else – is there's anyone else?

MS. LICHT-DE BLASIO: New York.

MR. LANG: The City of New York, thank you, just did $10 million dollars and the State of New York just did $20 million dollars. Not only are – are these purchases made but quite a number of unions have purchased for their pension funds, not the least of which in this area have been the teamsters pledged a purchase of a million dollars. So, you can see that support. On the right-hand side you'll see our current instruments and interest – and interest rates, and behind that you'll see that outlines of the current rating by Moody's and Standard and Poor's. And you'll see that we are currently rated A2, A minus, which is investment grade, and those ratings have not changed in over two years. What I asked the Mayor and the City to do this year was re-invest $650,000.00 of Israel bonds that matured this year, and make and additional purchase of $350,000.00 to make a – because I like round numbers – a million dollar purchase in 2003. Obviously, we're looking to 2004 now. I'm not really sure of the circumstances behind the – the non-re-investment of the $650,000.00, but I was under the impression that there was some concern on – on this particular level, and that's why we asked for some – some time to answer any questions of any concerns. So, I – I'd like to open it –

MAYOR CICILLINE: I'm not sure the – the re-investment was not because there were concerns but I think that the Board no longer was taking action, that that decision was being –

VICE-CHAIRMAN PRIGNANO: What we – what we had done was we had moved the Israeli bonds, who kind of used to sit out there on their own, and the Board used to make decisions on these on its own –

MR. NAPOLITANO: Right.

VICE-CHAIRMAN PRIGNANO: -- and no other trades that happened, you know, with the system, so we moved them under the auspices of Loomis, who manages all our bonds, to also manage these bonds.

MR. HARRIMAN: May I interject for one point, Alex? Mayor, just for your edification, it was about two years ago we actually discovered that we actually had these bonds in our portfolio.

MR. NAPOLITANO: Right.

MR. HARRIMAN: So, we were not – we were not accounting for them in the way we account for them now.

MR. NAPOLITANO: So, they're sitting in Loomis. And they –

VICE-CHAIRMAN PRIGNANO: Yeah, Loomis – Loomis, is – is the, you know –

MR. NAPOLITANO: -- the person who does that.

VICE-CHAIRMAN PRIGNANO: That's right. They handle our – all our other bond positions so we move these bonds under that same –

MAYOR CICILLINE: Right but we have the ability to direct Loomis to – to repurchase the State of Israel bonds I presume.

VICE-CHAIRMAN PRIGNANO: The Board – I guess the Board could take that action.

MR. NAPOLITANO: On all our managers. We would be able to do that on all our managers. We haven't in the past. As a practice we defer to the advisors and they in turn hire – I mean we have the final approval but we can do it. We have that authority.

MR. LANG: Let me be the first to say that I understand the – the fiscal responsibility that this group has in terms of protecting the City's investments, and that is always the top of my list when we're – when we're dealing with – with this type of purchase. And again, we try to answer those objections in terms of protecting, you know, the hard earned money that gets put into the system.

MS. LICHT-DE BLASIO: And certainly, Jonathan, you went through a list of the cities that – in our area that made substantial purchases recently and had substantial holdings, as well as the unions and the – the pension and retirement boards, and they also have advisors presumably who assist them in investments.

MR. LANG: They do. Well, what you're looking at, Mayor, is you're looking at some of the fixed rate –

MAYOR CICILLINE: Right.

MR. LANG: -- instruments on the upper left-hand corner, and that rate is better than the floating rate. I think the last purchases that were made, there was a bet, if you will, that interest rates were going to be going back up, and unfortunately LIBOR has been fairly stagnant over the last 24 months.

MR. NAPOLITANO: The whole bond market.

MR. LANG: The whole bond market has. Another one of the reasons that I believe that the City purchased the floating rate LIBOR bond is that as opposed to being a ten year term, after three years, because it is on your pension fund, you can then cash out. So, it gives you a little more flexibility.

MAYOR CICILLINE: May I – I don't know what the other Board member's thinking on this is but I – I think it makes sense for, as strictly as an investment decision, that we renew the existing bonds. And I think is a separate question of whether or not it makes sense to invest additional amounts in it. I don't know what people's feelings are on that.

MR. HARRIMAN: Just for another point of clarification, probably in April of '02 –

MR. NAPOLITANO: Um.

MR. HARRIMAN: -- we had an issue of which you have –

MR. NAPOLITANO: -- nothing to do with.

MR. HARRIMAN: -- nothing to do with.

MR. LANG: I know of what you're speaking.

MR. HARRIMAN: Yes, it was an issue where the previous Chairman of this Commission had misinterpreted the rules to the point where monies were actually transferred in to purchase Israeli bonds, and it was discovered after the fact, and that we brought up the whole issue of the propriety of dealing with the managers and so forth.

MAYOR CICILLINE: I'm not sure – transferred, what do you mean by transferred to what?

MR. NAPOLITANO: Directed a purchase of the bonds without the authority of the Board.

MAYOR CICILLINE: Oh, no. I –

MR. HARRIMAN: Thank you, Stephen.

MAYOR CICILLINE: Which is why – I'm sorry – which is why I think this requires a decision of the Board obviously.

MR. HARRIMAN: Yes, so we went through all of that and did discuss it and so forth, and I believe it was eventually ratified by the Board.

MR. NAPOLITANO: Um-hum.

MR. HARRIMAN: So, that could be one of the issues here. My – my feeling is I don't have a problem with the bonds. I have a problem with the way it was handled previously that we needed to straighten it out internally for us.

MAYOR CICILLINE: Right.

MR. LANG: Fair enough.

MAYOR CICILLINE: And I think that's what led to the request to make a presentation before the Board, that this was ultimately a Board decision. I – I think based on the rates of returns, I mean I – again, I'd like to know what other Board members feel. I certainly think that the renewal of the bonds is something that we – the Board should authorize, and I'm certainly prepared to authorize the additional $350,000.00 purchase.

VICE-CHAIRMAN PRIGNANO: When do these bonds come due, the current or is it –

MR. LANG: The current bonds, the next maturity date is March of 2007.

VICE-CHAIRMAN PRIGNANO: Do we have that?

MR. LANG: It should be on the left-hand side of your folder.

MR. NAPOLITANO: Right over here.

VICE-CHAIRMAN PRIGNANO: Oh. Okay, thank you. I didn't see it.

MR. NAPOLITANO: We present –

MR. HARRIMAN: What is your thought on this?

MR. BERTONAZZI: With respect to what?

MR. HARRIMAN: The bonds, purchasing and so forth.

MR. BERTONAZZI: Um, you know, like – like the first time that we went through this, you know, they're A rated bonds. They're investment grade bonds and we certainly need a portion of that in our portfolio. Now, clearly there's probably a little bit more risk in Israel right now than there has been in the past but they've never missed a payment, they're very strong credit, and I don't think you'd have to worry about that. I think even in the doomsday scenario you'd still get your money back because I believe that they're going to be backed by the United States government to be honest.

MR. NAPOLITANO: Yes.

MR. BERTONAZZI: Although, that's not –

MR. NAPOLITANO: Sure.

MR. BERTONAZZI: -- explicit but that's my feeling.

MR. NAPOLITANO: Um-hum.

MR. BERTONAZZI: Rates are low so you have to keep that in mind and currently right now they are a little bit more than a half a percent of the portfolio. So, I don't think you want to get them up to a level where they start representing, you know, two, 3% of the portfolio, but if you want to take it to 1% of the portfolio and make that a part of our 21% – well, really 25% of the portfolio that's in bonds in general, then I wouldn't see any undue risk associated with that.

MAYOR CICILLINE: And if raising it to this $650,000.00 renewal plus an additional $350,000.00 would not get it above that point, correct?

MR. BERTONAZZI: No, that would essentially double it, almost double your existing position and then you would be around 1% or so, and I think that would be, you know acceptable.

MAYOR CICILLINE: Does anyone have any questions, comments, thoughts?

MR. NAPOLITANO: As long as it's keeping with our style of investment, I don't see any problem. The exposure's not going to be any more.

MAYOR CICILLINE: I'll entertain a motion to authorize that investment.

MR. NAPOLITANO: So moved.

MAYOR CICILLINE: Second?

VICE-CHAIRMAN PRIGNANO: You seconded it?

MR. NAPOLITANO: I moved.

MAYOR CICILLINE: He moved it.

VICE-CHAIRMAN PRIGNANO: I'll second it.

MAYOR CICILLINE: Is there any discussion?

On motion of Mr. Napolitano, Seconded by Vice-Chairman Prignano, it is voted to authorize the investment in Israeli bonds, by the following Roll Call Vote:

AYES: Mayor Cicilline, Vice-Chairman Prignano, Mr. Napolitano and Mr. Harriman – 4.

ABSENT: Councilman Jackson, Mr. Edward and Ms. York – 3.

Motion carries.

MR. BERTONAZZI: What I would add is that I think it would be a good idea if I were to go over the choices that we have –

MR. NAPOLITANO: Yes.

MR. BERTONAZZI: -- with the bond manager –

MAYOR CICILLINE: Absolutely.

MR. BERTONAZZI: -- and see what his feedback is and then report back to the Board, and make the –

VICE-CHAIRMAN PRIGNANO: I think we should let Loomis decide.

MAYOR CICILLINE: Yeah, absolutely.

MR. NAPOLITANO: Do you – do you want to amend the motion to that effect?

MAYOR CICILLINE: Yeah, sure. Yeah, the motion would be amended to authorize Loomis to make the recommendation that will be presented to the Board as to where within the range of options the investments will be made. Does everyone agree with the amendment?

MR. SIMMONS: Does that mean to execute or come back to the Board with a recommendation?

MAYOR CICILLINE: What's the Board's pleasure?

MR. NAPOLITANO: No, I'm –

MAYOR CICILLINE: I'm satisfied to let them.

MR. NAPOLITANO: Right, exactly. No further action of the Board will be necessary, just to report back to us in your regular annual report type thing.

VICE-CHAIRMAN PRIGNANO: Yeah, the Board doesn't – doesn't get involved with those decisions.

MR. BERTONAZZI: Correct. We'll work with Loomis and then State Street and whoever, including Ed Hershaw.

MR. LANG: Thank you all.

MAYOR CICILLINE: Thank you very much, Mr. Lang. Our final item, Dexter Donation and other trust accounts.

MR. BERTONAZZI: Just updating you on how this portfolio is doing, which is also quite well. You'll see it's up, 21, 22% year-to-date. It has no hedge funds in it. It's a smaller bond portfolio. Again, we can afford to take a little bit more risk because it doesn't have the payout needs as the City's pension, so it's more of an 80/20 type position when it comes to equity, fixed income, and that's also doing very, very well this year, very well diversified. I'm quite pleased with everybody that's in there. I have no recommendations for change of managers, et cetera. It's really – it's really doing very well also this year. As you can see, you can go through, it updates you. They all are similarly invested. They started at slightly different times. That's why the returns are a few basis points different year to date, et cetera. Again, only good news to report there.

MR. NAPOLITANO: I move acceptance of the report.

MAYOR CICILLINE: Motion's been made to accept this report.

VICE-CHAIRMAN PRIGNANO: Second.

On motion of Mr. Napolitano, Seconded by Vice-Chairman Prignano, it is voted to accept the report presented.

MAYOR CICILLINE: All those in favor signify by saying "Aye".

COMMITTEE: Ayes.

MAYOR CICILLINE: Opposed? Motion carries.

ADJOURNMENT: On motion of Mr. Napolitano, Seconded by Vice-Chairman Prignano, it is voted to adjourn the meeting at 3:06 o'clock P.M.

Michael R. Clement
ans

City Clerk

Lori L. Hagen
Assistant Clerk