POLICE & FIRE PENSION INVESTMENT BOARD
February 5, 2009
Meeting Minutes on Digital Audio

Members present:	Mark Koller - Personnel Director (Voted Chairman early in meeting) Don Herz – Finance Director (entered meeting at 11 am) Jeremy Gegg – Fire Captain Michael Donnelly - Vice President and Regional Director of Wells Fargo Bank, Nebraska Institutional Trust and Investment Services group. Gerry Finnegan – Independent Financial Planner Russell Fosler – Police Investigator (Secretary) Steve Niemeyer – Police Investigator
Members absent:	Mark Westphalen – Edward Jones Co. Registered Representative Brad Thavenet – Fire Captain (Vice Chairman)
Personnel Dept. Resource Staff:	Paul Lutomski – Police and Fire Pension Officer John Cripe – Compensation Manager and assistant Pension Plan Administrator
Others present:	Max Callan – Smith Hayes Financial Services Investment Consultant Todd Peterson - Smith Hayes Financial Services Investment Consultant Mark Dolton - Smith Hayes Financial Services Investment Consultant

Russell Fosler calls meeting to order at 10:00 am and calls for nomination of a new chair for the board as Don Taute is no longer Personnel Director.

Steve Niemeyer nominates Mark Koller and Mark accepts the nomination. No discussion. All members vote in favor and the nomination passes.

Mark Koller calls for a vote to approve or amend the minutes of the October 17, 2008 meeting.

Jeremy Gegg moves to approve the minutes without amendment.

Michael Donnelly seconds the motion and all members vote in favor.

Mark Koller asks Max Callen of Smith Hayes Advisers to begin Smith Hayes' presentation of the economy, market and pension investment manager performance review.

Max Callen:

This is a difficult environment. When I finish Todd Peterson of Smith Hayes Advisors will go over the investment manager performance review. This slide shows all equity asset class' return for 2008. All are negative. The worst was mod-cap growth at -44% and the best was small value at -28%. There was no place to hide.

Next slide are market sectors. Financials were the worst down 55%. They are usually the stable sector. The best performing sector was consumer staples – like groceries - and it was down 15%.

P/E ratios are now about half of their historic average. It is difficult to determine now if a stock is cheap. The value managers bought and the stocks values kept declining.

Next slide, world markets: The S&P at -37% performed the best.

Next slide, by region.

Looking at expansions, we have been comparing to the 1970's for years. We are unsure what the bounce back will be like this time.

Loan defaults and delinquency rates are starting to go through the roof.

I don't know how much is really consumers that can not make their payments. Smith Hayes bought mortgages during the savings and loan crisis. When we visited the mortgage holders some said they stopped making payments because they knew someone would buy their loan and they would have the opportunity to negotiate the loan down and refinance.

Recently an Omaha banker told a client, who tried to refinance at a lower rate, that they could not qualify for the lower rate because they were not 90 days delinquent.

Mortgages used to be a larger percent of income, now they are less.

Unemployment is at 6.7% and will continue to climb.

Inflation is very low now. We will have to be attentive to higher inflation in the future.

Oil should probably have never been $140/barrel and now should not be $40, so we expect it to settle between there.

University of Michigan performs a consumer sentiment survey. Recently it hit a low. When the consumer is most pessimistic is probably when you should buy into the market. The second line shows the market return 12 months later. In the early 90's sentiment hit a low and the market was up 29% 12 months later.

Here is a chart of unemployment. When unemployment spikes 0.5% or more and what happens 12 months out. 12 months out looks good.

Fed funds rate is what banks charge each other to borrow. It is now 0 to .25%

The real return, fed funds less inflation, is a negative return.

I have clients that bought at a negative rate for the government guarantee.

Foreign rates are higher than ours. The Bank of England just lowered it rate to 1% which is the lowest in 300 years. A world investor will go outside the US for longer than a 2 yr investment.

Commercial paper, high yield paper, credit unsureity provides opportunity if you are willing to take some risk. Treasury rates have fallen as the flight to quality was on. High yield bond spreads are very high.

57% of US debt is owned by foreigners. China just eclipsed Japan as the biggest holder. Its good they buy it , but also a disadvantage. Thirty years ago foreigners did not own most US

debt. It was owned by US citizens and companies more likely to support the US. Foreigners are more likely to invest wherever the rates are highest.

High Yield bonds are priced now as if there were a 30% default rate.

If our consumer does not consume our economy is in trouble.

Slide of US P/E versus other countries P/E ratios.

Slide of defined benefit plans of private companies in 2007 shows 60% under funded. Today probably 80-90%.

The Police and Fire Pension Fund is very diverse in terms of allocation. That has helped.

Slide of bull and bear markets. Declines are shorter than expansions.

Hands out papers. Blue paper: Last page 1 year periods back to 1927 – 2008. Red line is zero return. Many big up and big negative years. Actuarial smoothing process averages those out.

Yellow paper: Back page shows 10 year rolling period returns. There are only three periods when the return was negative. Two in the 1930s and then 2008. 1948-1958 best period at 20.04%. Average was 11.07%. Worst was the 10 years ending 2008 at -1.38%.

Paul Lutomski: If 2009 has a lesser return than 1999, the 10 years ending 2009 will be even lower because 2000 and 2001 were both bad years.

Max Callen: Pink is 25 year analysis. Used the S&P 500, calculated the annual average return for rolling 25 year periods beginning with 1927. The worst period averaged 5.88% annually, ended 1953 and included the Great Depression and World War II. The best period averaged 17.25% and ended 1999. The average return for any 25 year rolling period in the study was 11.53% and the median return was 11.74%.

White shows 20 years of daily values per page. The first page shows 1900 – 1920. We talk crash of 1929, but it was really 1931-32. Chart from 1920-40 was sideways. 1940-60 was very up. 1960-80 was mostly sideways again. 1980-2000 up again. Next page is 2000 to now – flat. The last page is the whole 110 year history. As a pension you should stay focused on allocation. Questions?

John Cripe: What is your feeling about the stimulus and it adding inflation later?

Max Callen: There seems to be a lot of pork that doesn't stimulate. Capitalism is based upon succeed or fail, but I'm not in the room deciding. Uncreditworthly loans probably need to be supported or foreigners would not buy our debt. We will have to see if it works.

Gerry Finnegan: That amount of money poured into the system will either have to be removed or inflation, or stagflation could result.

Max Callen: It is much more global than before.

Michael Donnelly: Consumer is not spending. This check will be different that the Bush check that may have been spent. With high unemployment, job uncertainty, this next one will more likely be saved, or spent to pay for prior purchases.

Gerry Finnegan: If we got into this problem with overspending do we really want to encourage that to get out?

Max gives presentation to Todd Peterson to cover individual manager performance.

Paul Lutomski: Cash is 6.8% compared to 1% target. Reason is that the enhanced index funds recently purchased were closed by the manager. The cash could be re-invested with the same manager in the same type of funds that have a different legal structure. We like the cash as it allows us to meet future capital calls and provides about 14 months of operating cash. This means we will not have to sell securities to meet monthly obligations and not risk having to sell at an inopportune time. Cash returned 3.13% overall for 2008.

Domestic Debt has one bond remaining. The other bonds bought and sold were short term to meet real estate capital calls. The lone bond, is backed by insurance companies and has lost 75% of its value. It is still paying interest on time and in full. We called First Tennessee, the company that sold us the bond, and they recommend holding it as it is undervalued.

Todd Peterson: Next tab is corporate bonds. Even what are considered safe bonds lost value as people fled to governments. The Calvert fund lost 11%. It has 14% of total assets. It is on watchlist because it lost more than some of its peers. Expected to rebound in 12-18 months. More explanation.

Next large Growth stocks. Growth Fund of America. Big, but good. Dropped 39%. From Morningstar analysis. In 2008 top 39th percentile. 61% of its peers did worse. Top 3% for 10 years. Hurt by oil and energy and foreign exposure with dollar strengthening. More explanation.

Don Herz enters meeting.

Next large value. Dodge and Cox. 4.52% of portfolio. -43% in 2008. Typically boring companies, such as banks and insurance companies. Not so boring this year. They fell more than peers so it is on watchlist. More explanation. Bottom 9% for 2008. Top 2% for 10 year returns.

Max Callen: Paul and I stopped to see Dodge and Cox. I asked when you buy and the stock is down do you sell. They said no, they are long term managers.

Paul Lutomski: They also said they are analyzing holdings for short term viability.

Todd Peterson: More explanation on Dodge and Cox.

Mid Growth is Alger Mid-Cap Growth. Manager is feast or famine. A year ago took off watchlist due to great 2007. Long term is good. High turnover rate. Missed on energy bets. This space saw losses in part because hedge funds were liquidating positions in mid-cap growth and value companies. Alger is 3.5% of the portfolio and lost 58% in 2008. Maybe trim position in Alger and find manager to compliment and report on that in May meeting.

Mid Cap Value has two managers, Columbia and Hotchkis Willey. Columbia dropped 31% about in line with other managers. 3% of total. Underweight in consumer discretionary. More details given. Manager thinks challenging market for 12-18 months. Other fund Hotchkis Wiley on watchlist. We recommend eliminating this manager. 2% of total. Two years ago this space was 22% of the portfolio. We have been pairing down. 2008 lost 42%. 29% of portfolio in

financials so it was beat up. We have a replacement, a JP Morgan fund. The JP Morgan fund is a good fit with Columbia. They tend not to move together. Should we talk about this change now or later.

Mark Koller: Later.

Todd Peterson: Small growth, Baron Growth, 4.55% of total, -39% for 2008. Top 30th percentile. Discusses types of stocks and weighting it likes. Low turnover.

Small Value, three managers. Earlier in decade this space did well. Not so great later. Roebco Boston Partners 0.72% of total, -34% for 2008. One year rank was 75th percentile, 3 and 5 year in bottom 70ish percentile, 10 year is top 1%, but we have lost some faith here and recommend selling all and dividing among the other two managers in this space. On watchlist. Heartland Value 1.3% of total, -28% in 2008. On watchlist. Either top or bottom performer per year. Does very well in good years. Royce Special Equity 1% of total, -19% for 2008. Top 2% in 2008.. Not as good in up markets, but does well in down markets. Kinda the opposite of the Heartland, so they are a good pair. We are removing it from the watchlist.

Gerry Finnegan: On the Morningstar Royce sheet it shows only 77% invested. How much of the performance is due to holding more cash?

Max Callen: A lot.

Gerry Finnegan: We are according them an element of skill in their ability to time the market and I'm not comfortable with that.

Max Callen: It's difficult to look at any manager and say they are or are not market timers. They may hold cash not for timing reasons, but because they could not find stocks that met their criteria. We can go back, if you want, and look at the times they did not perform well and check their cash position.

Gerry Finnegan: We are hiring these managers to be invested, and when they hold cash it throws off our allocation.

John Cripe: Which of the two pages is correct?

Max Callen: The first page is 12/31/08 and the second page is 11/30/08.

John Cripe: The portfolio analysis date is 9/30/08 and the release date was 12/31/08.

Max Callen: Mutual funds are required to report once a year. Some funds report to Morningstar more often.

Next tab International Equity. American funds Europacific. It has stock of large companies outside the US. 14.6% of total assets. Lost 40% in 2008. Continues to be one of the best in the large foreign space. Top 13% in 2008 and 3,5, and 10 year from top 12% to 6%. Explains stocks it holds.

Tab Global Strategies. American Funds Capital World Growth and Income . They reduced foreign from 73% to 62% in the last year. Continues to be one of the best in the global space. 42% of dollars in Europe. 11% in diversified financials. Looking more at telecommunications and semiconductors, pharma in the next couple years.

Paul Lutomski: Structured Investments. Purchased about a year ago. Most have matured and we are left with two listed, but one of those has actually matured. The remaining one is a Annual Review Note. The way it works is if the S&P 500 is up any amount one year after purchase (which was 8/3/07) we earn 10.67%, if not, and that was the case, it is evaluated one year later. At 2 years after purchase if the S&P500 is up we are paid 21.34% and we are done. If the S&P500 is not higher than 8/3/07 on 8/3/09 we wait another year. If it is up on 8/3/10 we earn 32.01%. If the S&P 500 is down less than 10% at the end of the investment we get our money back, for every 1% it is down more than 10% we lose a 1.11%.

Next tab real estate. 18.79% of total. -2% return for 2008. 3 year 9.6% and 5 year 13%. All three returns above the NCRIEF benchmark. Reporting lags for real estate. Rreef is as of 9/30/08, JP Morgan Strategic Property Fund as of 11/30/08, JP Morgan Alternative Property Fund no lag at 12/31/08, Prudential PRISA III as of 9/30/08. States each fund's returns in order as -0.86%, -0.82%, -10.53%, +4.6%. First two are "core" which means leased out and developed. The other two are "value added" which means not fully leased when purchased and/or not fully built, or in need of updating. We have $2.8 MM outstanding capital call for PRISA III. We have put in a request to sell $8 Million of the JP Morgan Strategic Property Fund to get back to the 14% allocation target. Real estate is under pressure as the economic situation continues to lower lease rates, and lease less square footage. Sale prices are down and therefore it is expected 2009 will be a difficult year for real estate. JP Morgan wrote that "the capital market turbulence and dislocation throughout 2008 . . . continued to see downward pressure on property values. Expectations for future market rent growth, demand occupancy levels, discount rates and residual cap rates are all influenced by the broader economic markets in the communities where we have investments. . . . . The income component of the return, which is the foundation of SPF's performance , is resilient even in periods of market softness, due to high occupancy levels and staggered lease renewals. Despite the challenging environment, the income return was a positive 1.1% for the quarter and a positive 4.97% for the year. The fund is in great shape with strong underlying fundamentals Leasing is on average 90% across the office, industrial and retail portfolios and 89% in the residential portfolio. Other than the residential , which has shorter leases, SPF has, on average, less than 10% lease rollover exposure per year through 2012. . . . . One of the advantages of investing in a large , diversified fund, such as SPF is that no single asset , tenant or industry has undue influence over the fund's value or performance. The fund's size quality, diversification, solid income, high occupancy, low lease rollover, conservative leverage and staggered debt maturities have and will continue to service the fund well in this challenging environment. "

PRISA III, also a core fund, is in a similar situation. The two value added funds have more leverage and take more leasing and renovation risks. The portfolio manager of JP Morgan's Alternative Property fund called me personally to explain the fund's return before the statement was sent out because the 4q2008 return was the worst in the funds history. The loss was a result of risk spread widening and tightening of credit. There are reports and commentary for each of the funds in the notebook.

Todd Peterson: Next tab convertibles. These are bonds that can be converted into common stock. Calamos Growth and Income Fund. 0.6% of the total portfolio with a -34% for 2008. It is a different animal. In our opinion Morningstar has not classified it correctly as "Moderate.". The managers are stating they have never seen so much opportunity. We had been reducing allocation here, but I think we should look at increasing it. Good opportunity over the next three-four years. If you put this fund in the "convertible" category it would be in the top third of all times frames and the #1 fund.

Max Callen: If you look at the Zephyr color pages it is in the upper quartile.

Paul Lutomski: On to Hedge Funds. Amanda Stilmock was at the October 17th meeting. She warned that hedge funds were taking a beating because people wanted to liquidate and because of the restriction on short selling in September and October. 5.94% of total pension assets. Return was -17.26% for 2008. Three yr return was -4% because of last year and 5 year return is 7.8%. The next page describes each of the six strategies: Relative value, Opportunistic, Merger Arbitrage, Long/short, Credit and Short Selling. Next page narrative states "In 2008 the financial system and hedge funds alike endured a series of unprecedented events as uncertainty and illiquidity gave way to insolvency for a number of financial players. In the first half of 2008, our portfolios delivered on their objective of protecting capital amidst 2x-3x standard deviation swings inn the broader markets. It was not until September and October that the depth of the financial crisis took hold in the capital markets , stressing the financial system. The collapse of Lehman Brother was of particular concern to the market. .. . I caused a massive unwinding of positions in the industry, a breakdown in managers' ability to hedge many of their positions and write offs of positive mark-to-market positions facing Lehman. . . . .we were impacted as concentrated and directional managers with levered balance sheets were punished, while at the same time the typical protection provided by our dedicated short sellers was not sufficient." Following pages give more details. That's it.

Max Callen: I'd like to finish up with a couple asset allocation thoughts. The whole market declined, so our overall allocations are not much out of kilter from what we were looking at in August. For corporate debt, we recommend taking 25% of Calvert, an investment grade bond fund, and splitting it between two other high yield bond funds. I have information I can show you about the Wells Fargo and Principal high yield fund. This may be short lived, a year or two. We recommend putting the rest of the alternative investment ideas on hold for a while. Wells Fargo has a higher quality high yield funds and Principal has a lower grade high yield fund. Janis and JP Morgan also have good high yield funds. We are not suggesting we change an of the other allocations.

Second, right now we are a little more growth than value on large caps. We recommend equalizing those now. The reason is that the economy may not grow and value has gotten beat up, so cut back on the growth side and increase value as it may have more upside after its beating.

Paul Lutomski: Here are Smith Hayes recommendations.

- One, sell all Hotchkis and Wiley mid value and buy JP Morgan Mid Cap value.
- Two, sell Rebeco Boston Partners and invest 50% of the proceeds into each of the remaining small value managers. Those being heartland Value and Royce Special Equity.
- Three, sell 25% of Calvert Income Fund and invest the proceeds equally into Wells Fargo and Principal high yield bonds funds.
- Four, even out large cap growth and value percentages.

Mark Koller: Motion on all or each individually, or some discussion?

Gerry Finnegan: I will vote in favor except the replacement of the mid and small cap value. My reasoning is the same. There is a huge preponderance of evidence that actively managed funds underperform their benchmark over time and we are moving out of funds that underperformed and going into another that I expect will be removed for underperformance. If we go with the categories that match the benchmark it is not a problem and the money that is saved is significant because we do not have the internal middle man costs. It is counter intuitive. There are things we know, thing we know that we don't know, thing we don't know we don't know, and things we know that ain't so. One of the things we know that ain't so is that skill

exists either in stock selection or market timing. The number of actively managed funds that beat the benchmark is the number that would be predicted randomly. I'm going to vote against the new funds soley for the reason they are actively managed and because past performance is not a predictive factor of future performance.

Paul Lutomski: We can talk about number Three, sell 25% of Calvert Income Fund and invest the proceeds equally into Wells Fargo and Principal high yield bonds funds, and get back to the other later.

Gerry Finnegan: I'll make that motion.

Russ Fosler: Second.

Mark Koller: Discussion? Vote. (All ayes with Mike Donnelly abstaining because he works at Wells Fargo) Motion passes.

Paul D. Lutomski: Four, even out large cap growth and value percentages.

Michael Donnelly: I'll make that motion.

Jeremy Gegg: Second.

Mark Koller: Discussion? Vote. (All ayes) Motion passes.

Paul Lutomski: Back to number One, sell all Hotchkis and Wiley mid value and buy JP Morgan Mid Cap value.

Jeremy Gegg: I'll make a motion to sell all Hotchkis and Wiley mid value and buy JP Morgan Mid Cap value.

Russ Fosler: Second.

Gerry Finnegan: I would like to make a motion to amend breaking this into two pieces. One to sell and another to buy.

John Cripe: You need a second for the motion to split.

Michael Donnelly: I'll second.

Mark Koller; Discussion?

Michael Donnelly: I don't have a problem with the JP Morgan fund, but I would like to have more than one option and one option may be the index.

Jeremy Gegg: What prompted the choice of the JP Morgan mid cap value?

Max Callen: We did screens and narrowed it down.

John Cripe: Technically we need a vote to split the buy and sell transactions.

Mark Koller: All in favor (all Ayes). Motion passes.

Paul Lutomski: Now we vote to sell Hotchkis and Wiley, or not. Would we put the money in cash if the buy is not approved?

Russ Fosler: I move that we wait on both until our May meeting and do not sell the Hotchkis and Wiley now.

Gerry Finnegan: Second. We would be sitting on cash and out of our allocation model.

Mark Koller: All in favor (all Ayes)

Paul Lutomski: Now what used to be recommendation number two. Sell Rebeco Boston Partners and invest 50% of the proceeds into each of the remaining small value managers. Those being heartland Value and Royce Special Equity.

Jeremy Gegg: I'll make a motion to sell the Rebeco Boston Partners small cap value fund.

Michael Donnelly: Second.

Mark Koller: Discussion?

Gerry Finnegan: I am against this for the same reason as before.

Michael Donnelly: I think this one is different because we have the asset class covered.

Mark Koller: All in favor? (All Ayes except Gerry Finnegan and Don Herz votes Na) Motion passes. Now we have money to spend and I would entertain a motion to buy.

Russ Fosler: I'll make a motion to invest 50% of the proceeds into each of the remaining small value managers. Those being heartland Value and Royce Special Equity.

Michael Donnelly: Second.

Mark Koller: Discussion? All in favor? (All Ayes except Gerry Finnegan and Don Herz votes Na) Motion passes.

Paul Lutomski: At the May meeting we will revisit selling all Hotchkis and Wiley mid value and the buying JP Morgan Mid Cap value or an index or other fund, bring in real estate and hedge fund people.

Max Callen: Maybe a couple infrastructure opportunities.

John Cripe: If LB205 passes it will require investment and ethics education for pension trustees. We will monitor it.

Todd Peterson: Last year Jeremy Gegg, Brad Thavenet, Russ Fosler, Paul Lutomski and I attended a one day American Funds conference. It is coming up early March. It was a good conference designed for pension administrators. No vendors. Let us know soon.

John Cripe: Other managers have client meetings, such as JP Morgan and Prudential.

Michael Donnelly: This is good information, but I think the board would like to receive it in advance of the meeting so we can do some research.

John Cripe: By way of apology, we were working just yesterday to make sure the information we gave you was up to date and focused.

Gerry Finnegan: I know the staff has been inordinately busy in the last couple weeks and I appreciate you still being able to pull all this together.

Mark Koller: Any new business?

John Cripe: We have a lot of labor negotiations coming up. We will try to set up the next meeting around those.

Mark Koller: Any other new business? Then I will entertain a motion to adjourn.

Gerry Finnegan: Motion to adjourn.

Russ Fosler: Second.

Mark Koller: Discussion? All in favor? (All Ayes) Motion passes and the meeting is adjourned at 12:15 p.m.