Police & Fire Pension Advisory Committee Meeting

February 17, 2010

Members present:
Mark Koller - Personnel Director (Chairman)
Michael Donnelly - Vice President and Regional Director of Wells Fargo Bank, Nebraska Institutional Trust and Investment Services Group.
Russell Fosler – Police Investigator (Secretary)
Mark Westphalen – Edward Jones Co. Registered Representative
Steve Niemeyer – Police Investigator
Jeremy Gegg – Fire Captain
Don Herz – Finance Director
Gerry Finnegan – Independent Financial Planner
Mark Heithoff – Fire Captain

Members absent: None

Personnel Dept. Staff:
John Cripe – Compensation Manager and Assistant Pension Plan Administrator
Paul Lutomski – Police and Fire Pension Officer

Others present:
Max Callan – Smith Hayes Financial Services Investment Consultant
Todd Peterson - Smith Hayes Financial Services Investment Consultant

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Mark Koller: I call the meeting to order (1:30 p.m. Wednesday February 17, 2010). Is there are motion to approve or amend the minutes of the October 20, 2009 meeting.

Gerry Finnegan: I move approval of the minutes.
Russ Fosler: Second.
Mark Koller: First and seconded. Do we have any other discussion? Seeing none, I'll put it to a vote. All those in favor, say "aye".

(Chorus of "Aye"s)

Mark Koller: Opposed, same sign. Then it's passed as presented. Now are we going to do the reports? I think.

Russ Fosler: Steve and I attended the OPAL conference in Santa Barbara, California, September 23rd to the 25th. The main bullet points we came away with is REITs that we currently have and how they could be in trouble with new contracts coming up in 2011, 2012. How those might take one more beating before they finally come around and turn the corner, and look somewhat productive once again. They did stress don't get all upset about this, don't get frustrated. They will come around, but be prepared to take another beating on those

The other thing that we thought was interested was Managed Futures Funds. Their 15 year return was 605%. I liken it to our structured notes and, as you all know we recently got some structured notes and they didn't quite perform as we'd all hoped they would. Of course, the market didn't perform like we all hoped it would either.

The last and final point was most favored nation status. I know we're a small fund and we're not going to get the breaks that a lot of the bigger funds get.

Max Callen: Most of the investments you have right now are in mutual funds, or ETFs, and they have kind of one price. Institutional trading price. Could you set up an account directly with some of these managers, negotiate differing fees? Yes, you could, but you'd probably have to allocate much more of the resources to one manager. Most of our values are at 5-6 million, and in the big world, that's not very much money. They negotiate at 50 million, 100 million -.

Russ Fosler: I know they were talking about the larger funds that were doing 50, 100 million or more, , but the presenter brought forth that even with a lot of smaller investments, you should be able to at least get the same breaks as everybody else with same amount of money.

Max Callen: Through the mutual fund vehicle you wouldn't get any break. You'd have to have direct accounts with managers.

Steve Niemeyer: Other than we do have institutional shares.

Max Callen: Yes. We're using the lowest priced share class that you can use in the mutual fund world.

Russ Fosler: Those were the three major things that I brought back. I'm sure that Steve had some other things that impressed him. I also have the presentation booklet, in case anyone would like to look it over.

John Cripe: They always include a CD too.

Russ Fosler: The CD is in the back.

Steve Niemeyer: We both went to that conference. I also went to a second conference January 6th to the 8th in Scottsdale, Arizona. It was a very, very good conference. Between the two conferences, I felt the one in Scottsdale was a little better. The one in Santa Barbara was emerging trends, alternative investments. This one was just more general. Some of the same information presented at both places, but just a lot more people here, a lot more vendors, a lot more ideas. They're emphasizing the boards and trustee education, especially after what we went through, to educate ourselves, to have an idea of what we're doing because of our fiduciary responsibilities. Nebraska has a law pending, I don't know if it's gone through yet or not.

John Cripe: It's still pending as far as I know.

Steve Niemeyer: There was a presenter from Omaha, Nebraska and he said based on this law we're going to be required to have three hours *(indecipherable)* training, six hours of pension training, once you come to the Board, and then once every four

years after that. Which we have the opportunity to go to these conferences, and if we go to these conferences, we'll be able to meet that just by going to conferences, so it shouldn't be an issue for us as long as we get to a conference.

They talked a lot about the globalization of the economy. How the game is really changed and probably will stay that way in the future. International investing is becoming more important. Diversification and including internationals is becoming important. I know that's been our focus the last couple of meetings that we had. We have done some reallocation, and they would agree with that. They talked a lot about emerging markets, how the gross domestic product is increasing so much more in these emerging markets than it is in the United States. Some good investment opportunities.

An alternative area at both conferences were life settlements. They were sort of intriguing. There's three main companies that do this. Basically these companies are buying life insurance policies from high net worth individuals. They try to get a big pool of them. It's all based on actuarial information and they talk a fairly nice return on your investment.

John Cripe: He was talking about 12% return. They actually have the people that they're buying from through a broker, take a physical, and they run their life expectancy through the tables, and then they're pooling all this money in whole life and paying out certain portions to the individual in cash, and so when they die, the policy matures, they collect the extra money. They've been doing that for about 10 or 15 years, he says they've gotten a 12% return.

Steve Niemeyer: And evidently these life settlements have been a pretty common investment strategy in Europe for years, they were saying. Of course, it's new to us Americans. But it might be something to look at for an alternative.

Real estate at both conferences. Commercial estate bubble that will probably burst here coming up. Again. A lot of opportunity for good investments into real estate. It's real interesting about the lending that's going on and how the presenters were saying that if you're looking for a loan for over $50 million, you're not going to find one very easily.

John Cripe: More opportunities for mezzanine ones.

Steve Niemeyer: Yes. They were talking a lot about Chinese real estate. I've heard in the news where the Chinese real estate might be heading for a bubble. But they were saying that the middle class is rising there so quick and that this middle class has been saving for years. They have all this money, they all want housing now, and they're putting up these large tact housing developments, these large condominium type projects, and they're selling as quick as they can build them. What they said was nice about it is that it's low leverage, because they've got so much money saved over the years.

Private equity. They think that there will be a big return to private equity coming up here in the future, where smaller private equity firms, they're going to be able to produce a lot more than larger ones in the past.

There's just so much information, it's hard to cover all of this quickly. One interesting note that I stayed around for our Treasurer's round table, it really had nothing to do with pension investing but I was there and I was kind of interested in what they were going to say, and this really has nothing to do with our pension, but it was just interesting. The Arizona State Treasurer was saying in his state, one of five people are on welfare, and they said that there are more people on their welfare rolls than there are attending the public schools, and they can fire every state employee in Arizona, and even doing that, they would not have a balanced budget.

Mark Koller: For us, Steve, thank you. Anybody have any questions? Okay. Good.

Paul Lutomski: I have a list of upcoming conferences I can pass out to everybody.

Mark Koller: Very good. Okay, the next agenda item is to elect an investment board vice-chair. Do we have a slate, Paul?

PaulLutomski: We do not. We're willing to accept nominations. If someone's interested, please speak up. Brad Thavenet, Fire Captain, previously was the Vice-Chair. If Mark is not here the Vice-Chair would run the meeting, and Vice-Chair would not vote as Mark does not vote, unless it's a tie.

Gerry Finnegan: Mike, would you be interested?
Michael Donnelly: Anything but Chairman.

Paul Lutomski: Okay. Mike is on the list. Any other nominations?

Gerry Finnegan: The reason I'm prodding Mike is I like the level of his expertise. I think that would be helpful on the Board officers.

Paul Lutomski: Anybody else?

Michael Donnelly: Do I not vote if I'm acting chair? Or do not vote period?

John Cripe: You just don't vote if you're acting chair unless there is a tie.

Mark Koller: So I guess it's time to close the nominations. So we have Mike who has graciously stepped forward. We need a first and second.

Gerry Finnegan: First.

Jeremy Gegg: I'll second it.

Mark Koller: All those in favor, say "aye". *(Chorus of "ayes")* Opposed, same sign. Congratulations.

Mark Koller: Okay, I think we're at the point now where we get the presentation on the 2009 portfolio security returns, and I will turn this over to Max and Todd.

Max Callen: Okay, thanks. Steve, you gave a nice introduction to some of our slides in terms of the state of the economy and affairs. This session is focused on how the managers did, but as a backdrop, I wanted to give you a little historical. Russell Large Value, up about 19%. Growth up 37%. The hot spot was Mid Cap Growth, up 46% last year. Through March, it was negative, negative, negative news. About the mid-part of March of '09, it turned around and started going. It

was pretty much a rocket that straight up and then. On a PE basis right now, now at 28 times earnings. So on a relative basis, the market's fairly expensive right now. Average is about 19. This is the S&P 500 going back to 1990 here. So that's why in a portfolio like yours we have a blend of lots of different investments. Because you're trying to get an average, a good average rate of return, not necessarily always hitting that hot sector group. It's hard to decide what is indeed a hot sector. On the global basis, emerging markets up 79%. As you know, from the October meeting, we did add a small allocation to emerging markets. Getting back to the globalization that Steve talked about, this is kind of an interesting slide I ran across. You can't read the names here, but this shows you the percent of sales that each company has outside of the country of domicile. So you take Nestle's, they have about 84, 85% of their sales that happen outside of Switzerland. Coca Cola has roughly almost 80% of their sales that happen outside the United States. So if you took any company, I don't care which one it is, Sieman's, Bayer, there's a lot of them here, Novartis, and if they didn't have the world to sell their product to, it would be a much different company. So when we talk about global, we could buy almost every company that was domiciled in the U.S., but a significant piece of their sales are happening elsewhere.

We're about 3.8% decline in GDP. The Great Depression was about 26%, so while what we're going through is severe, it was nothing like what they went through in the '20's and '30's. Personal savings rates, I don't know if you've seen this in the bank, Mike, but people are starting to pay down their debts some. They're starting to save a little more. It used to be we were almost at 0 personal savings rate. It is bouncing back. As a consumer society, through, that's a negative. You don't want people saving. You want them consuming. So that's part of the dilemma that's going on right now. We build up for 20, 30 years consumer engine, but now when people start putting some money away, paying down debt, it has a negative connotations. On the home sales side, the sales of existing homes are starting to pop back up. Inventories, this is existing home inventory for sale. It's starting to come down. But we're not building many new homes. New home construction is still pretty dead. But a lot of inventory out there that's starting to move.

John Cripe: I saw in the news that stock housing was up 2.8% last month. Surprisingly after new construction. I think that was on the news this morning, Max.

Max Callen: Okay. I didn't catch that. But that would be a surprise to see it pop something l ike that.

John Cripe: Plus the news would be affordability index being up in the 70's again, which if –. Basically what that means is 75% of homes in the United States are affordable by the average consumer now, which is great news. Great news.

Max Callen: People sharpening pencils. You can buy more home than you used to be able to buy. You hear lots on the federal budget deficits, and again what's going on in Congress, now the democratic or republican issue, there's so many entitlements that are in place that it's hard for anybody to stop what's going on, so that deficit is just going to continue to grow, as we are an aging population. Unless they do some massive things. This chart, that Greece and Iceland

boxed here. There's been a lot on the news about Greece and some of the upheaval they're having over there. But this is budget deficits as a percentage of GDP, and they're up in the 12% to 15% range. They've got a 120% public debt as a percent of GDP. The U.S. as a whole, we're always behind. We're approaching that 90% debt to GDP number. There's something magical, but I don't know what it is about 90%. When you get to that number, it's almost impossible to reverse and go the other way. So, again, for America to think that we'll never default on our debt, that's not necessarily true. We've got to stop spending somehow. As a percent of our GDP. These are additional, just charts on that. This is non-TARP troubled asset relief program, and non-stimulus debt. That's really increasing. This is federal spending as a percent of GDP and that's going through the roof and obviously the government's, when you do get in a recession or appearance, there are things that they should do and try to do to stimulate the economy, but they have to be very, very wise as to how they spend those dollars. This chart we've used before. This is '08. It hasn't been updated for '09, but at the end there, 61% of our federal debt was owned by foreigners, so China, biggest one, Japan, and these guys really are controlling our destiny, and rates are very, very low right now, and if they want a little more interest rate, and they control the purse strings, so rates could be popping up, but having said that, there were threats that they weren't going to buy our debt, etc. I don't think they'll follow through on those, because they'll shoot themselves in the foot if they do. Because they own so much of it already. But they will have more and more input in terms of that whole political process. It's going to make a little distress away. Unemployment, up above 10, and in terms of economies coming back and how the, the building and commercial real estate coming back, it could be years in housing, as you have spikes in unemployment and then it takes - this was about 12 years or so before you go back to really full employment, or at least to an average of a 5% range. Here's fed funds rates, with 0. A quarter of 1% is what banks are charging each other. That's virtually *(indecipherable)* and then budget the federal reserve balance sheet how much they own in the debt. It spiked last October of '08, and it's remaining very, very high. So, that's the general context. Again, great year from a true performance perspective. That's probably because we're so beat up way too far the year before. But it's time - Todd's going to go through the investment return folders, and you'll see a lot of 20, 25, 30% returns in the portfolio.

Todd Peterson: Thanks, Max. Paul, you and I didn't rehearse this. But as a reminder this meeting we cover each of the individual investments, the managers, make sure they're doing what they should be. What the funds that may be on watch list. We'll talk briefly about the funds that are doing the right thing. Because I don't want to spend too much time on those. But we certainly want to celebrate those successes. But, we'll probably spend more time talking about the funds that we're keeping an eye on. The watch list. Everybody has a notebook. Paul how do you want to do this?

Max Callen: Before you get started, the third page back from the front is the total portfolio, and it just shows that at the start of the year $136 million, end of the year at $153 million. About a 16.3% return for the combined, all the assets in the portfolio. You know the benchmark that we tried to have is that 7.5%. So it was a good year from that perspective.

Michael Donnelly: What's included in the expenses category on that balance sheet?

Paul Lutomski: Expenses would be pension monthly payments, DROP payments, refunds to members of their contributions, management fees paid for the hedge funds and real estate, and to Smith Hayes, administrative expenses which is my salary and what we pay to the Finance Department, the Information Services Department, any sort of legal services that we outsource, the rent for my office, supplies....

Pension payments $7.5 million for retirees, $2 million DROP.

The additions would be the employee contributions and the contributions from the taxpayers. Income or dividends and interest payments from the investments. Realized and unrealized gains.

Max Callen: The next page shows the allocation, our target within each investment category. Then the returns versus benchmarks. The equities are pretty much right in line with the target number. A little bit over on the foreign, not a lot. The investment performance of foreign has been a little bit better than the U.S. So there really isn't anything that I think needs to be adjusted from your policy perspective.

Paul Lutomski: Cash tab. Started out with $13 million and ended the year with $1.2 million. Governments and agencies TAB. This is the one bond that we have left over from the days when we purchased individual bonds. This bond took quite a valuation decline in 2008. It came back 227% last year, but the par value is $2 million and the end value is $1.3 million. The next page talks about that bond. A group of insurance companies got together to make this bond. What we're getting on it right now is a floating rate of LIBOR plus 2%. It's 2.25% right now. We bought the bond from First Tennessee Financial. It is callable however, they don't think it's going to be called until maybe March 2012. If it is we'll get our $2 million back.

Max Callen: The yellow tabs would be things that the City generally oversees and manages, and the white tabs would be more of the things that Smith Hayes is helping on for you.

Todd Peterson: Which leads us to corporate. The first fund is Calvert Income. We've had this for some time. It has been on our watch list. It had a difficult 2008. Corporates in general got beat up. Had a good recovery year last year. Has about 12% exposure in high yield bonds, which really had a big year last year, so that's what helped it. We'll keep it on the watch list, because it's three year and it's five year in the lower half of their peer group. But last year, it had a published return of 17%. The actual performance was 16.12%. But last year's return put it in almost the top quartile of its peer group, so it had a good rebound.

Max Callen: For those of you who are newer on the committee, the actual return that we get from Paul and his software, the City number was at 16.12%. The returns from the fund say what the fund do for the whole year with no new money added, no money taken away, and cash flows do make a difference. So the fact that we put some money in and took some money out, that is what changes your return versus what the fund is actually showing.

Paul Lutomski: What I understand from the software manufacturer is that mutual fund managers use a return method that does not include the timing of the money that they receive. Their returns are time sensitive but not dollar sensitive, while ours are time weighted and dollar weighted.

Todd Peterson: We'll see that as we go along. Like emerging markets. We'll see a published return of 75%, but because we were only in it for 3 months, we have a lesser return. So we'll keep that on the watch list, though like I said, last year's were good. As you keep going, a few pages into that, the blue divider. We're happy to drill down on any information that we have here. I think if we went page by page, we'd be here until October, but if there's a specific number that you'd like us to talk about, we're happy to do that. Morningstar sheets for the fund that has some of Morningstar's takes and some analyst's thoughts about the fund. There's also a colored sheet that has information provided by Zephyr.

The next fund is the PIMCO Real Return Fund. PIMCO Real Return is made up of TIPS, which are Treasury Inflation Protection Securities. We just got into this back in August of last year. About $2 million invested, or 1.3% of the total assets. This area, depending on who you talk to, but most people are expecting inflation at some point. The experts that we listen to, and I guess our thoughts are that it's probably not for another year. But it's still good to have some of this, and last year, in fact, this fund's published return was a positive 17%, but because we were in it, just from August 20th, we have 2.59% return, but because of all the money that's been pumped into the system, we would expect TIPS to do well over the next several years, at some point when inflation starts to maybe get a little bit tough. Any inputs on that? Jerry?

Jerry Finnegan: Just a question about the rationale. We're giving up 1.09% to the expense ratio. That means we're giving up have of our inflation adjusted return. I like the idea of TIPS, I'm just wondering could we do that better individually than in the fund? At least a fund that's this expensive.

Max Callen: You might be able to. That would mean buying individual bonds, TIP bonds, laddering some different maturities.

John Cripe: We did that for quite a while. We've gone away from individual bonds, If you all wanted us to return to that, though $3 million is not much. It's all up to you.

Todd Peterson : Maybe the one advantage with this fund is there is some leeway within the fund. They don't strictly have to buy just TIPS, they have some wiggle room with about 5% or 10% of the portfolio that they can do some other types of investments that are maybe with agencies, things like that, and that's why last year they were able to get 17%, and I don't know what TIPS specifically did last year, but they can do, they do have a little bit of wiggle room with the portfolio.

Max Callen: The expense ratio includes the 12B1 fee, and that's being paid back to the pension fund, so the expense ratio - it's 60 basis points, is what you're paying the manager to pick the bonds for you.

Jerry Finnegan: It was just a thought..

Paul Lutomski: Do you have a turnover ratio number?

Todd: 915%. That means about once every ....

Max: 30 seconds.

Jerry Finnegan: PIMCO bond funds tend to be arbitrage funds.

Mark Westphalen: Do we see putting a lot of money into this kind of a category, or do we think 2 million is probably where we're going to be?

Max Callen: Until we started seeing some inflation really coming back in, 2 or 3 million is probably where we'll be at. Then 15, 20 million, when it's spiking.

John Cripe: Real estate kind of acted like a bond portfolio for a number of years, and then it drifted a little south, and we started to pick up these TIPS so the question is whether you move some of that money that we have coming from real estate in to fixed. What do we have in the queue,$6 million?

Paul: Six and a half.

Max: Until bond get up in the 5, 6, 7% range, it doesn't make a lot of sense to have a lot in bonds, you know. At 2% or 3%. It just drags your portfolio.

Todd Peterson: A couple pages beyond that we get to another blue divider. We have the Wells Fargo Advantage High Yield Bond Fund. This is investing in, junk bonds, but they're -

Max Callen: Good junk.

Todd Peterson: Junk is double B rated and below. These are shorter term bonds, and it means their duration is shorter. In fact, in this portfolio, it's about 1.6 years. This technically will fall into the watch list category. As you look at the bottom, you'll see the 5 year and the 10 year results are in the bottom half peer group. I'm not sure that's fair, because it's short-term and there is not a short term high-yield category at Morningstar. There's just a high-yield category. So this is getting compared to all the other high yield funds out there that have duration of four and a half years, like the Principal Fund. That's great when times are tough, like they were in 2008. In a strong recovery year like we saw in 2009, it won't look as good. Even though it had a 15% return last year, that put it in the 98 percentile, the bottom 2%. So technically, it's on the watch list, but the reason we have this plus your other ones is they complement each other very well, short term and long term. We may peel back a little bit on high yields this summer.

Max Callen: You're probably going to have some opportunities in the market. Such as the next one Todd's going to talk about. Principal up 41%. That typically doesn't happen in bonds, and that's some real opportunity. So, while we don't want to throw money in and out of things, there may be situations where we hold something as a category for a year and then we don't hold it, because we've

taken advantage of that opportunity, and look at the next opportunity.

Todd Peterson: Next fund, the Principal High Yield. Here we're talking about longer term bonds. This duration is four and a half years. As Max mentioned, this had a 42% gain last year, which is just unheard of in the bond world. That still put it in the bottom 30th percentile. That's fine. It's 3 year, 5 year, and 10 year are all still very, very good. We put money into this February 6th, and got 35.5% return, so that was a good, good move.

Next tab, Large Growth. Growth Fund of America is one of the larger holdings. Large company stocks had a growth year. It's up about 34.5% last year for the year. That put it about in the middle of its peers. American Funds would say they maybe had some exposure to financials that they thought might rebound a little bit quicker that have not yet. Also, these are mostly large caps. They don't have much mid-cap, and the mid-caps, as you saw earlier from Max's presentation, really did well and they didn't have as much exposure to the mid-caps. But it's still been a very, very good fund. Technically, it does fall in the watch list, because it's 3-year is in the 53rd percentile. The bottom half by 3 basis points. We're not concerned about this fund. Over time, this has been a great fund, it does carry about 15% outside the United States and that's helped it quite a bit over the years.

Max Callen: There are two different share classes for this fund, A and F1. When we first started working with the pension fund years ago, American Funds did not have the F Share class, so class A shares were bought. Today Advisory clients always buy the F Shares. Expense ratios are the same. So we may do some consolidation, sell the A and move them into the F Share class.

Todd Peterson: Next tab, Large Value. These are going to be more of your dividend paying, well established companies. This is the Dodge and Cox Stock Fund. It had been on our watch list from last year. Technically it will still be on our watch list, because the 3 and the 5 year are in the bottom half of their peer group, but it really did have a nice rebound here in 2009. It was up 36%. It put it in the top 14th percentile of its peer group. This has been a good complement to the large growth fund, Growth Fund of America. But it's good to see that rebound. They've made some bets in 2008 in financials that really bit them hard, and it's going to take some time to work 2008 out of the system. You'll see hopefully over time that the 3-year and the 5-year start to improve, as we start peeling off the years.

Mid-growth, as Max mentioned, this was the best category for domestic. There's about 7% of the total pension dollars in mid-growth space scattered across a few funds. The first one being the Alger Mid-Cap Growth Fund. This has been on our watch list, and it will continue to be. The 3 and the 5 year fall in the bottom half of its peer group, but again, like Dodge and Cox and a couple of others that we've owned over time, this had a great rebound year. It was up 39% last year for the pension. The published return was a positive 51.4, which put it in the top 11th percentile of its peer group. We added some money to this. I can't off the top of my head remember what date we did that, but we started the year with 44.8 million, we added 1.6, so this Alger has done a good job in this space over time, and it was good to see that rebound for last year. This is

more volatile. It has a higher standard deviation than, as you keep going through the pages, than the Hartford Mid-Cap Growth. This is one that we added in April to complement the Alger. We invested $1.7 million into this. This has been a more conservative mid-cap growth fund. It avoids lower quality names that Alger might be looking at, and so we do feel like these will complement each other well. About a 30% gain for the pension. About a 30% return for the published. That's nice, but it puts it in the 78th percentile. That's not anything we're real concerned about. Hartford will say, "we're fine not getting the highest highs during the recovery. We just want to try to avoid the lowest lows." And so as we look at the Hartford and we look at Alger, and a couple others, they kind of complement each other very well. Going a few pages, you get to the I Shares. This again was new as of April. This is an index that is simply trying to mirror the returns of the Russell Mid-Cap Growth Index. We invested $3.3 million at a nice 38% return. The published return was about 46.5% return, but because we got in it in April, we had a little bit less than that.

Jerry Finnegan: Any idea how an index fund can end up beating its benchmark?

Todd Peterson: Jerry, but you can never get the exact return, because there are buys and sells.

Jerry Finnegan: Typically it does run a little below.

Paul Lutomski: The description that says it invests 90% of its assets in the underlying index using a representative sample and strategy.

Jerry Finnegan: Well, I have no problem with it. I was just curious as to how that happened.

Max Callen: We'd like to know ourselves. We'll find out and get back to you.

Todd Peterson: Next tab, Mid-Cap Value. Columbia Mid-Cap Value Z. It is on the watch list because of 3 year. It is just below the top half of its peer group. Underperformed a little bit last year. Had again some exposures to financials, and if you think about value managers, they try to find value, and in some cases you look at financials and say, "wow, they've been trumped so bad, they represent a good value." And the managers that got hurt on that were just a little bit early. It still hasn't panned out totally, but in the case of this fund, they just had a little bit too early of an exposure to financials and that hurt them compared to some of their peers. But last year the fund was up about 33% and for the pension it was up about 29.5%, so we did redeem some money out of this. Again, that was part of our April reallocation. Go a few pages behind the blue divider, you have the Hotchkiss and Wiley Mid-Cap Value Fund. This one was eliminated. We sold that out in April, so that is no longer in your portfolio. That had been underperforming for a good two, two and a half years. Go a few pages beyond that, you get to the I Shares Russell Mid-Cap Value Fund. We invested in that in April of $1.5 million. Jerry, to your point, that did not outperform for the year. That is interesting. But you would think also the underperformance would be a quarter percent because that's what the expenses are.

A couple pages beyond that, we get to the Perkins Mid-Cap Value Fund. In July this fund had a name change and a ticker change, because of the software with

the name change, these numbers won't be exactly right, because you see a value at the first of the year at 0.

Paul Lutomski: The software basically sold Janus and bought Perkins, but we actually didn't do either one of those two things.

Todd: The new symbol is JMVAX.

Paul: We bought $1.5 million on April 23rd, July 1st, it was we purchased for a 1.677 million. Also on July 1st there was a dividend reinvestment the accounts purchased. A sale on July 1 for a million 677 also, so I can send out an email explaining the numbers.

Michael Donnelly: Why don't you just send us out a substitute page?

Paul Lutomski: Okay.

Todd Peterson: The fund has been performing well.

Next tab, Small Growth. Baron Growth. We've owned this one for some time. Basically had a good year last year with about 34%. That put it right in the middle of the pack for its peers. It's in the top half for the 3 years and 5 years with its peers. This one is a little bit more volatile. The managers look for small caps that they think really have some explosiveness to them. It's been good in its space, so no reason to be concerned about that one.

On the next tab, Small Value. Here you're talking about smaller companies that represent a attractive share price. The first one you'll see is the Robico Boston Partners. We actually sold out of that February 6th after our last meeting so there's no money in that one. But we do have dollars in other small cap value funds. We have $2.2 million with Hartford Value. Had a great year last year, up about 45%, for the pension it was up about 46.5%, so a great rebound year. Surprisingly they took some health care pops that they thought were beat up more than they should have been and they put money on that, but put that one in the top 14 percentile for last year, so we would take this one off the watch list from last year.

A few pages beyond the Royce Special Equity. The Royce Special Equity is almost synonymous in the small value investing. They've always done a good job. This fund was up about 30% for the pension. In the middle of the small value pack, but this is a good defensive holding. It really did well for us in 2007, and 2008 when things were going to heck in a hand basket. It represents about 1.7% of the total portfolio.

Go to the International Equity tab, EuroPacific has been the one that we've owned for a long, long time, and I'd say in my 17, 18 years in the business, this has been truly one of the best foreign funds out there. The most consistent fund in that space. These are going to be developed companies in developed countries, and not the emerging world. They did a great job of navigating the financial meltdown in 2008, and then had some good rebound in 2009. It was up 39% for the pension and for the published return. It put it in the top 15

percentile of its peer group. Just as a reminder, last year in 2008, it was down about 40%, but it was still in the top 13 percentile of its peer group

Go a couple pages beyond that, you get emerging market funds. These are new to the portfolio as of October. Capital Guardian is the parent company, affiliated with the American Funds Group. This fund has been around since 1983 and has been one of the best emerging market funds out there. It is more of a private labeled fund. It's not a public mutual fund per se. Since we were only in from October, it was up 9.3% for the pension, but on the year it was up about 78%. That represents right now about 1% of total. I'm guessing we will continue conversations at our asset allocation meetings about how much we should be exposed to the emerging markets world. One thing to keep in mind also is like EuroPacific, those are developed companies in developed countries, but they have quite a bit of exposure to Asia, Russia, Brazil, China. EuroPacific for example will own a steel manufacturer in Australia. Australia is not a developing country but that steel company is supplying a lot of goods to China and India. I guess what I'm saying is you don't have to have 10% in emerging markets. You can do it indirectly through something like EuroPacific and some of the other funds that you own. We also bought the Oppenheimer Developing Market Fund. That is a public fund. About 1% exposure in that right now. We bought that at the end of October, and a very similar return.

On the next tab, the Global Strategies Fund. This is Capital World Growth and Income Fund from American Funds. These are going to the well established companies in well established countries. These are companies that are leaders in their industry that are paying some dividends. It represents about 11.3% of the total pension assets. The fund does have about 70% exposure outside the United States in foreign. I did the math and that puts your overall total of the pension somewhere around 27% outside the United States. So your comments earlier, Steve, I think about a quarter of the total pension assets are outside the United States. But getting back to Capital World Growth and Income, these are dividend paying blue chip companies. Last year for the pension, it made 31.4%. Right about half of the middle of the pack of the world stock category. The next tab, get into the real estate, and I'm going to turn it back to Paul to tell you.

Paul Lutomski: Real estate is down. We have 16 million dollars of assets in real estate. Only 10% of the portfolio. The first fund Rreef is a core real estate fund of developed properties well leased. That fund was down 39%. It is paying us roughly 6% income.

The JP Morgan Strategic Property Fund also is a core fund, it's also paying about 6% income. We put in a request for $8 million in redemptions. We've received 2 payments totaling about $1.4 million, so we're looking for another $6.6 million out of that fund. The next payment could be more, could be less.

The next fund is the JP Morgan Alternative Property Fund. We invested in that at about the wrong time, because immediately after our investment the market went down, and that fund lost 44% in 2009. JP Morgan has decided that they're going to liquidate that fund. They're going to take about four years to liquidate it. They don't think that they're going to have to do any fire sale type of liquidation, because they're going to shop the market, take their time. The reason for the

liquidating, which is in a letter further down, is because they don't feel that the market exists for this type of fund to attract the new investments needed operate the fund to original expectations. So rather than continue on with a lesser amount of assets under management, they decided to liquidate. $2.5 million in value.

The Prudential Prisa3 Fund. We made $5 million commitment to them. They have tried not to call any money in. We're still obligated for about $1.6 million new money to them. They're down 51%. Those two funds, the Alternative Property and the Prisa3 are not paying any income payments. Prisa3 used to pay a small income payment, but they've stopped very shortly after the October meeting. They're not paying any income because they don't want to call in investor money. So in total, the real estate for 2009 decreased 37.2%. After all of these redemptions, however long they take, instead of $16 million, we should be down to about $7 million in real estate and 6% of assets. The benchmark is 29.8%. For the 3-year period we're down 13 and the index is down 9.8. Five years, we're up 1%

I should tell you, the JP Morgan Strategic Property Fund, was still as of 12/31/09 $3 million on the plus side compared to what was initially invested. On to Todd and alternatives.

Todd Peterson: One that I'll talk about is the Global Hard Asset Fund. We just started this in October as well. This is going to be some precious metals, industrial metals, energy. Basically the fund has, as you read in the paragraph, 50% of its revenues from exploration, development, production and distribution relating to hard assets. Last year, the fund had a published return of about 52, 53%. We got into it in October. We've got about 9.68% of that return. But this has done well, again, compared to its peers, and it's not on the watch list or anything like that. It's done well. We'll turn it back over to Paul.

Paul Lutomski: About a year and a half ago, we invested a million dollars into structured investments. This is the only one that has not matured yet. It's called an annual review note based upon the S&P 500. It did go down quite a bit, and then in 2009, it came back it earned a positive 36.6%. This investment's going to mature August 3rd or 5th of 2010. At that time, the level that it was purchased at, the S&P level will be compared against the August 5th, 2010 S&P level. If the S&P level in August 2010 is greater than 1458, which was the level this bond was purchased at, then we're going to earn a 32% more than what this structured investment was purchased for. Right now it's less than 1,000. We're protected for loss for up to a 10% decline, which means that if the S&P closes at 1313 or better. That's probably not going to happen. So if it closes at less than 1313, then our downside protection is gone, and since we get protection on the downside for 10%, you actually get hurt more if it's below the 10%. So every percent under that 10%, it's 1.1111 is going to be our loss. So we'll have to wait and see. If the S&P stays where it's at right now, about a 1,000, we're going to get $140,000 back of the original $200,000.

Todd Peterson: The convertibles tab. We talked briefly about the Calamos Income Fund. Convertibles are bonds that can be converted into stocks. Ideally this is the best

of both worlds kind of investment, where you hope not to have the downside drop during the bad years, although this fund did go down 30% in 2008. But yet you hope to capture quite a bit of that equity returns in good years, and we had a 38% gain last year. Calamos is synonymous with convertibles. They've always been a leader in this space. There's about 1.4% of the assets in this. It is a different animal. Morningstar has a tough time categorizing it, but they throw it into the Large Growth category. We've put it into an alternative space. But it's been a good one.

Paul Lutomski: Now on to hedge funds. $8.7 million of assets comprising 5.7% of the total pension assets. The first fund yielded 10% in terms of my accounting, because there is a lag as to when I receive the numbers so the 10% is actually November to November. The returns that JP Morgan calculates are December to December, which I just got those a couple days ago and that's 13%. The other one, again, because of the lag, is 4%, and the JP Morgan numbers are 8.5%. While those are both positive, I can't help but say that I'm disappointed in the hedge funds performance. These assets were purchased with the idea that they would be non-correlated with the rest of the markets, and then in 2008, when everything went down, these went down with them. Now, as you can see, domestic equities and international equities are going up 30%, and these are still 10%. So, I would invite any discussion regarding your feelings about this. I still think the assets are not correlated, but I was expecting hedge funds would at least keep up with domestic equity returns or exceed them in 2009.

John Cripe: We also had Amanda contact us *(indecipherable)*.

Paul Lutomski: Last time she was here, she did say that we would not want to sell then because the sale price would most likely be less than what the underlying assets were worth.

John Cripe: You can have her come for the July meeting, if you wish.

Mark Westphalen: If I remember that conversation, the issue of why these did not break the way they should have is because of the taking away of the short selling activity that they employ, so it put them into an investment strategy they didn't really want to be in, and that's part of the issue.

Paul: That explains the 2008 underperformance. Now my question is why didn't these keep up with the domestic equity performance in 2009? The short selling restriction didn't impact that.

Mark Westphalen: Yes, how much was the original investment on each one of these.

Paul Lutomski: I don't have that number here. I can tell you that our ending gain over the original price was a million fifty on the first one. So subtracting a million fifty-eight thousand from five million, so I guess about four million or so on the first one. The ending gain on the second was a negative $411 thousand, so $3.1 million on the second one. We're still in total up for $600,000 over our purchase price.

Mark Westphalen: If we ask the question "why didn't they perform better?" is there any way to get an answer?

Paul Lutomski: JP Morgan will come down here, or they'll send an e-mail.

Mark Westphalen: My guess is if they were taken out of their strategy, they're probably stuck holding a lot of cash for the rebound. That's probably why it looked so bad last year.

Paul Lutomski: They've provided a fourth quarter 2009 review. They'll tell you why they made the money they made, but not why they didn't produce as well as long equity.

The last tab is private equity, the Tenaska investment. We committed a million dollars. They've had three capital calls totaling $449,000. The accounting is a little convoluted, so there's a $70,000 removal number, which actually they didn't send us $70,000. They had investments that they sold that our share of the proceeds totaled $70,000, and they turned around and put it back into the limited partnership. But also the dividends and interest, they didn't send us a check for $9,502. It was reinvested. I didn't expect this to have a positive return so soon because the first part of the private equity life cycle is acquisitions. There's a couple things that's after that, regarding some announcements that they send when they buy or sell. They are having an annual meeting June 9th, I think, in Chicago. That's all I have for private equity.

Max Callen: Any questions about anything that we've covered? Or not covered?

Michael Donnelly: So you're not recommending any fund changes, though we have several on the watch list?

Max Callen: Correct. Obviously we'll watch it. Six months we'll be talking again as we go through our allocation discussions. But no, at this point.

Todd Peterson: The ones on the watch list last year that are still on the watch list had a lot of big improvements. This was kind of a make or break year. If these funds don't come out of the gate and really do what we're expecting them to do, then we're going to have to have a serious talk about getting rid of them. For the most part, they did what we expected, and the one that looks like it didn't is that short-term high yield fund, and you can certainly understand why that doesn't look as good is because it's being compared to all the other high-yield bond funds out there with longer durations.

Mark Westphalen: Can we get audited financial statements on Tenaska Capital?

Paul Lutomski: I would suppose.

Mark Westphalen: Just something that would verify the existence of the properties that they've purchased, and that kind of stuff.

Paul: Okay.

Mark Westphalen: From an asset allocation standpoint, do we care which sector of the economy is moving which way, or do we take care of that by our asset allocation being split between large, mid, small, value, growth, that kind of thing?

Max Callen: With a pension fund like this we're not moving from sector to sector. You let the mutual fund guys try to do some of that for you. Probably the closest thing that we will have done to that mindset of moving would be the high-yield opportunity last year. We may go a different direction this year.

Todd Peterson: Emerging markets a little bit.

Max Callen: Chances are merging markets on a long term basis will probably stay in the portfolio at some level for quite a while. Just because of the growth of those economies compared to our growth.

Mark Westphalen: It just seemed like there was a common conversation through the Morningstar analysis of the large cap growth managers coming into financials before they really should have. It just seemed like a common thing. Manager after manager after manager made the same mistake.

Max Callen: Because of the reporting rules with regard to the mutual funds, where they just report once a year, and their allocations they had within their fund, you may get one that reports June 30 and you may get one that reports September 30, and one 12/31. We could do an overall snapshot of the whole account, but it's not necessarily going to be a true picture as to what they 12/31.

Mark Westphalen: Well, and without any proper guidance telling you where the sectors are and where they anticipate the growth in the sectors to be 12 months out, I mean, absent that information, I think that kind of an exercise is fruitless. But if there was somebody out there that tended to give fairly good guidance, it might be worthwhile saying we've got this fund and this manager is weighting financials or some sector higher than the S&P 500, maybe we ought to be careful about allocating money there, because other smart people are telling us that that sector isn't going to work.

Max Callen : There are sector rotation funds, and so rather than this committee or ourselves trying to do that, we can look for some funds or ETFs.

Mark Westphalen: So hold steady?

Max Callen: Yes. If we have a September of '08 type of event, we would visit again. I'd be curious Mark, Mike, Jerry, what you guys are saying, but I don't think we've got a train wreck coming. I think it's going to be rather slow growth out of where we are right now. But I don't see any major disasters right around the corner.

If you look at just the S&P returns and you put them all on a scale, how many times S&P go up from 5% to 10%, and from 10% to 20%, how many times did it go down? We've just come off a 28% return year and there was only one year in the last 70 years that you had a 28% return and the next year was better than

that. Most of them are all worse than that. It doesn't mean that they're negative. It just means last year was a very, very good equity year. So this may be a 10% year, maybe 5%. It probably isn't going to be 28 again.

Mark Westphalen: If we want to look at anything in the tax-free bond arena? I had a conversation with a Lord Abbott individual, and I was asking them if they saw these Build America bonds as being a real major disruption into the municipal bond market, meaning they're going to see fewer and fewer municipal bonds being issued because of the Build America bonds and I talked to another guy here, who works here in Lincoln, that sells bonds for another firm, and he says they are just seeing tons of Build America Bonds being issued in the state of Nebraska. Some of them are so small that not a lot of investors are picking them up. I mean they're being sold other places but there might be a potential price increases on these bonds with smaller quantities being out there. You might see an upward pricing pressure gap. From a tax-free income nature, yes, they don't mean anything to a pension fund, but it's there mainly for the price potential of the underlying bond portfolio. That was the only reason I brought it up. You're just seeing lots of Build America Bonds being issued all the time.

Max Callen: It makes sense from the government's perspective to issue those. From the individual investor perspective, they aren't quite as good as the old tax-free bonds. I don't know that those have a place in this portfolio. Because of the tax free pension nature. What comes out of Washington is going to have a significant impact on us as a country. We cannot continue to run the deficits that we're running. I think the meeting in May, maybe do some education or something?

Paul: Well, we haven't totally decided yet. We'd like to hear from you folks, as to what you're thinking. I'm passing out a list of upcoming conferences. We're going to talk about skipping the meeting in May, encouraging some conference attendance. Made little scratch marks next to the ones that would be applicable to this group. We have a travel policy. The policy is that the Police and Fire members need to go to one conference a year. The rest of you don't have to do this, but that means that the firefighters this year need to go to one conference. All the OPAL conferences are zero registration cost. On the next page is the Tenaska annual meeting in Chicago, and then always a good one is the NCPERS conference. But definitely anybody that's interested in going to any of these would be welcome to be considered to go to a conference. The question is if we do want to have a May meeting, what would you like to have presented at the meeting?

Max Callen: Historically we've brought managers in.

Michael Donnelly: It might be good to hear from some of our challenging asset allocation areas. The real estate, the hedge funds, alternative investments.

Max Callen: On a general allocation basis, based upon this committee and the type of fund it is, etc., you'll probably always have or should have something allocated to real estate.

Paul Lutomski: This isn't the committee's concern really, but regarding cash flows, we're

spending $10 million a year on benefits and you can see we're bringing in $5 million a year in taxes and employee contributions, so there's a $5 million gap there. Last year, about $2.5 million of that gap was made out up of dividends and interest rates, so that means $2.5 million needs to come out of funds that we're holding, so we're going to need to sell basically $2.5 million in funds over the course of the next year, to make our cash flows.

Mark Heithoff: What do the payouts look like in the future? When you project 5, 10 years, is it going to stay at about $10 million?

Paul Lutomski: Oh, no, it's going to go up.

Mark Heithoff: What percentage do you anticipate?

Paul Lutomski: I want to say roughly 7% or so increases.

Michael Donnelly: What was our funded status?

Paul Lutomski: 95% on an actuarial basis. 72% on market value basis. Back to cash flow, even if we have real estate redemptions we may have to do some slight sales and rebalancing month to month. The bulk of the dividend payments come in December. As Mike recommended maybe we have JP Morgan talk about the hedge funds and real estate, but we do have some conference trip requirements.

Michael Donnelly: I'd like to have JP Morgan come.

Mark Heithoff: Real estate is 8% worse than the benchmark. Can they explain that?

Max Callen: When you talk real estate and benchmarks, it's different than an S&P 500 benchmark which is easy to measure. You've got all sorts and different types of real estate, so it might be a little bit of an apples and oranges kind of comparison.

Russ Fosler: I just want to be encouraged that something's going to happen on for 2011. A rebound.

Mark Westphalen: The thing that goes that goes through my mind when you think about real estate, "Are you going to put your seat belt on, and stay attached to it for 5 or 10 years just to break even," and if that's the scenario, is it worth holding the asset for that long? To me that's the big unknown. You could have a 5-story office building here and a 5-story office building across the street and they are going to be two completely different buildings.

Max Callen: And you got a warehouse, and a shopping mall, and all sorts of different types of properties. Apartments.

Paul Lutomski: The JP Morgan Strategic Property does fall in the NCRIEF index relatively closely in terms of its sector weigh-ins. But the REIF fund, which is why we purchased them, does not follow NCRIEF at all about.

Steve Neimeyer; A lot of opportunity in real estate, it's just a matter of when does that opportunity surface and what can you be in, and I think that lot of the people that were doing good right now they're buying these properties cheap, and I don't know if that's something that maybe we should try to find, a fund that going after these distressed properties, because there's going to be more of them rather than commercial land becoming distressed. I mean, case in point, Lincoln, Nebraska, out there by Kohl's, a beautiful new shopping belt, sitting completely empty. There's places just like that all over the country, and there's people going to start selling them, and there's companies waiting to buy them.

Paul Lutomski: We were contacted by Mark Oczkus of Prudential regarding a debt fund that they're starting up. They're buying the debt of places that have purchased properties and and buying it at a deep discount. That's where they think the money is going to be in real estate. Rather than properties. We could have them come in and talk about that and PRISA 3, the real estate hedge fund.

Mark Koller: Okay. Any other discussion? So I guess we'll make this happen for the groups to come in to talk to us, Paul.

Mark Heithoff: When will that be?

Paul Lutomski: May. Anybody has any conflicts that they know of right now, we can schedule around that.

Mark: Okay. Any new business to discuss? That's on the agenda? I don't know of any.

Paul: I don't have any.

Mark: Okay. So I guess we'll entertain a motion to dismiss.

Jerry Finnegan: Moved to adjourn.

Mark Koller: Second?

Russ Fosler: Second.

Mark Koller: All in favor say, "Aye."

(Chorus of "Ayes")