POLICE & FIRE PENSION INVESTMENT BOARD

August 19, 2010

Summary Minutes

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. Mark Westphalen – Edward Jones Co. Registered Representative Gerry Finnegan – Independent Financial Planner Russell Fosler – Police Investigator (Secretary) Steve Niemeyer – Police Investigator Jeremy Gegg – Fire Captain Don Herz – Finance Director Mark Heithoff – Fire Captain
Members absent:	None
Personnel Dept. Resource Staff:	John Cripe – Compensation Manager and Assistant Pension Plan Administrator Paul Lutomski – Police and Fire Pension Officer
Others present:	Max Callen – Smith Hayes Financial Services Investment Consultant Todd Peterson - Smith Hayes Financial Services Investment Consultant Mark Dolton - Smith Hayes Financial Services Investment Consultant

Mark Koller calls the meeting to order at 10:00 a.m. .

Mark Koller asked for a motion to approve or amend the minutes of the May 13, 2010 meeting.

Don Herz motioned for approval.

Russ Fosler seconded the motion.

Mark Koller asks if there is any discussion. There is none.

All members vote in favor and the motion passes.

Paul Lutomski reports on a recently attended Opal Financial conference. He relayed the major themes as:

1. In the US equity growth is expected to be slow, so reduce investment in growth stocks relative to dividend and growth stocks.
2. Equity Growth expected to be found more in emerging markets and pre-emerging markets than developed markets.
3. Diversification and non-equity-correlated assets should provide stability and more downside protection.
4. Less constraints allow managers the chance to capitalize on opportunities and avoid risks.

Max Callen presents.

Current economic data

- Chart on returns by market sector since market peak of October 2007 range from -9.2% to -11.7%.
- Chart on S&P 500 level for 2010 shows turbulence and ended at a lower level.
- Chart of ten year U.S. treasury yield history chart from 1986 shows 10%+ to 2.96% now.
- Chart of global rates and yield curves shows correlated movements and yield levels.
- Chart of foreign ownership of U.S. Treasuries from 1978 to 2009 shows increase of 12% to 57%.
- Chart of the share of federal income taxes paid from 1980 to 2007 shows an increasing trend wherein the top 10% pay 71% of taxes and bottom 50% pay 2.9% of taxes.

History – A long View

- 1900 – London was world economic leader
- 1940 – Germany was world economic leader
- 1960 – USA was world economic leader
- 2000 – Soviet Union collapsed
- China is capitalist in function
- S&P Index return for decade is flat
- 2010 - Global economic uncertainty
- 2020 – Where will economic leader be?

Large allocation classes will be:
Debt
Equity
Alternatives

The investment industry generally classifies alternatives as:
Hedge Funds
Private Equity
Real Estate
Infrastructure
Commodities/Natural resources
"Go Anywhere" World allocation funds
Sector rotation (could also be classed as equity)

Current investments re-classed into the industry recognized alternatives results in allocations of:
Debt 22%
Equity 61%
Alternatives 17%

Using visual and print media Max Callen presents Smith Hayes recommendations for Debt, Equity and Alternative allocations, sub-class allocations and specific managers/funds for each sub-class. He gives reasons for the each recommendation including return, risk of each investment and correlation of each investment to the other investments in the sub-class. When available printed Morningstar or other data was distributed.

The recommended portfolio allocations are:

Debt 25%
Equity 40%
Alternatives 35%

At the end of his presentation Max relays Board Member Mark Westphalen's idea for a separate account containing regulated utility stocks to be transacted using parameters to be created by the Board.

Gerry Finnegan moves that the Board not vote on anything today. (59M30S) No second. Gerry states he calculated Smith Hayes recommendations would result in a 14% allocation to domestic equity. He states strategies that allow manager flexibility in terms of US vs. international are problems as they are not true to the asset class allocations. He states we need to know the expected return and standard deviation of the current portfolio compared to the recommended portfolio.

Michael Donnelly: The recommendation is a big change and contains significant increase in exposure to markets outside the US. He expects standard deviation to increase 1-2%.

Max Callen explains that the recommendation is not allocating solely based on asset classes, but also on strategies, and therefore is not designed to adhere to asset class allocations. He explains expected returns and standard deviation are calculated based on historical numbers and he is not comfortable using past performance as an expectation of future performance given the recent turbulent nature of the market, but he can provide the figures. He states that funds allowed to allocate internationally that are increasing their international allocation should be telling us something. He states the US allocation may not meet the return target. This asset mix has a chance to attain the 7.5% target return. You will have to take more risk to have that opportunity.

Gerry Finnegan states the pension has an infinite time horizon and recommends sticking to "our knitting" rather than chasing the last hot thing.

Max Callen reminds the group that in 1900 London was the economic leader and the leader has changed several times since. When advising they need to take a fresh look and not be influenced by current holdings. The sector rotation (active strategy) is equity, but felt it was better classed as an alternative. The "Go Anywhere (Do Anything)" funds are mostly either equity or debt, but felt they were better classed as an alternative. The only alternatives being suggested as an addition are infrastructure and managed futures.

Gerry Finnegan states that whether classed an alternative or not, they are the last hot thing and more discussion should occur before a vote.

Russ Fosler states it appears that if we don't do something we are setting ourselves up to fail.

Gerry Finnegan states that viewpoint is human nature, that people see patterns when none exist, that a council of economists publicly cautioned chasing the last hot thing (1H9M)

Max Callen states the Board's recommendation is the end result of a process and he will assist the Board to work through the process.

Mark Westphalen suggests taking each category and working through it to see if there is consensus. Where there is consensus we can move to approve it on a transaction level. Where there is not, we can do something different.

Gerry Finnegan asks if we want to a) use year to year timing to change our allocation, and b) is this the allocation we want.

Todd Peterson states they are not chasing the last hot thing, rather are adding diversification with the new investments.

John Cripe: During the budget process we caught flack about the pension return due to the market. If there is a way to achieve a better return how can we defend not taking it?

Mark Koller: The concern regarding pension funding should be long-term, but short term questions arise. We would like direction regarding asset allocation. If we do not approve a particular investment, we will need to decide what to do with that allocation.

Gerry Finnegan: The members need to know about outside pressures and cashflow.

Paul Lutomski: We don't need to receive investment income as we can sell investments to meet cashflow. I would encourage the Board to think in terms of a total return objective. The reason for a shift toward income investments is that developed market growth is expected to be slow and Smith Hayes now sees income as a way to obtain more of the total return than previously.

Don Herz: Would these changes be implemented all at once or gradually?

Max Callen states his expectation was that an approved recommendation would be implemented as soon as possible.

Gerry Finnegan would like discussion on an implementation schedule.

Mark Heithoff would like to discuss the investments that are of concern and go forward.

Gerry Finnegan states his big concern is the change in allocation from equity to alternatives.

Max Callen suggests discussing the Debt portion of the recommendation to move forward.

Gerry Finnegan states his big concern is the sense of market timing he is getting.

Max Callen states the new investments are being considered because their risk/return is now considered good (relative to other choices) for the future, whereas in previous years they were not considered good.

Michael Donnelly recommends re-working the recommendation to reduce the Alternatives category. For example, the sector rotation funds are equity, so they could be moved into the Equity category. Second, what he is concerned about the increase in emerging markets. It might be the place to be, but this is a large shift. (1H28M) Risk is higher in foreign funds. Can you defend this mix?

John Cripe: We are looking for non-correlated assets. This mix has non-correlated assets, so yes we can defend it.

Michael Donnelly: I think this board was designed to set asset allocations, not pick specific funds. So I think we should go back to the asset allocation.

Paul Lutomski: The City has hired Smith Hayes for investment advice. They are the ones that need to justify their recommendations. If the Board adjusts the Smith Hayes recommendations, the Board

needs justification for their changes.

Gerry Finnegan: It is a good idea Smith Hayes talk to the Board before issuing its recommendation. They may want to fill a particular asset allocation slot, we would want to see a high correlation to that asset class. The choices they gave us have a terrible correlation. These have 20 and 30 R-squared. They have a 5 star rating and that's great but not useful to us. These are the sort of things we could thrash out preliminarily in small groups.

Mark Koller: Are we at the point we would entertain a motion?

Mark Westphalen: I move we review the fixed income recommendations, fund by fund.

Russ Fosler: Second. (1H35M)

Mark Westphalen: My concerns are the Multi-sector and the Loan segments.

Mark Koller: All in favor?

8 members vote Yes and Mr. Donnelly votes no.

Gerry Finnegan: The first is Templeton World Bond fund. The R-squared is 12. This is not a good fit to this category. This fund is 1/3rd cash.

Paul Lutomski: Cash allows the manager flexibility to take advantage of opportunities and avoid downside.

Todd Peterson: I would rather a manager allocate to cash than be 100% in a class and lose, or not earn as good a return.

John Cripe reads list of locations of the funds top holdings. All are non-US.

Todd Peterson: The upper right shows returns and compares them to category returns. The fund compares favorably to the category index. That is what we are shooting for. We are hoping the fund managers have the judgment to be where the best opportunities exist to generate Alpha.

Gerry Finnegan: All Alpha is, is that portion of the return not attributable to the asset class. They would like to attribute it to their skill, but the evidence says that is not the case.

Russ Fosler: (1H42) Correct me if I'm wrong, but aren't we talking about do we want to buy index funds or do we want a manager? We need to decide manager, or index or a combination.

Mark Westphalen: If we find a world bond fund with an R-Squared of 100 and a return of ½ this fund would we select it?

Gerry Finnegan: Then we are hiring someone to be a market timer, not invest in an asset class. Management skill would have to exist in a measurable way and we would have to be able to find that manager. These managers are so rare they do not show up in statistics.

Max Callen: When markets are good there are few managers that beat the index because they hold cash. When markets are tough there are a lot of managers that beat the index, because they hold cash and hold assets different than the index.

Gerry Finnegan: Factor analysis attributes return/risk to the asset class, timing of cash decisions and the costs of the fund. (1H45M)

John Cripe: What was the S&P 500 index return over the last 10 years?

Gerry Finnegan: Slight positive with dividends.

John Cripe: That is not good enough. This committee will cease to exist if returns are consistently low.

Gerry Finnegan: The March 2000 Money magazine average advertised return was 85%.

Mark Koller: We are getting bogged down. The closer we can come to achieving our return expectation the better off we are. This allocation is our best chance of achieving our return expectation.

Gerry Finnegan: Allocation determines virtually all of your return. That is why we have an allocation and why we should not change it and should stick with it through the ups and downs.

Paul Lutomski: We are interested in what you have to say, but you are controlling the conversation. There are nine people on the Board and it is a majority vote to determine an asset allocation. You are not going to get nine people to unanimously agree with 100% satisfaction on this issue.

Gerry Finnegan: I have spoken a lot and will speak less. The Templeton R-squared is 12 and the PIMCO is 35. These are not good representatives of the asset class.

Jeremy Gegg: I do not think the new recommendation is a large change. I also think Smith Hayes has done due diligence on the funds within their scope. I am not as comfortable with the Prudential mezzanine fund.

Mark Heithoff: Can we discuss the Prudential?

John Cripe: It is an opportunity to make loans in the cases when banks are not lending. This is not the first time we have invested in a mezzanine loan. We invested in a CNL loan and did extremely well. The return estimates are double digits and this is not a stock market pick.

Russ Fosler: What is the biggest problem with the recommendation?

Mark Westphalen: Multi-sector bonds. If we can buy Build America Bonds at 6.5-7% with good credit quality I would rather have those.

Russ Fosler: I will make a motion to pass Smith Hayes' proposal.

Steve Neimeyer: Second.

Mark Koller: Discussion?

Gerry Finnegan: I would urge the Board to look at who is making what arguments. Mike is concerned. I am gravely concerned. There is no need to act on this today.

Jeremy Gegg: Is there a certain amount of fear due to change?

Michael Donnelly: I think there is too much allocation to foreign.

Don Herz: Should we gradually change?

Michael Donnelly: Fund selection is excellent. I would like less foreign exposure and less alternative investments. (2H1M) I would like this tabled and to have another meeting.

Mark Westphalen: I think we should investigate the taxability of the MLPs.

Michael Donnelly: We are fine regarding MLP taxability. The funds classified as domestic have a non-US component. Growth Fund of America is 17% non-US, Alger madcap 10% non-US, Heartland Value is 23% non-US. That plus the other foreign funds is a substantial exposure to foreign. How much non-US exposure do we feel comfortable with? However, I agree there is a little less risk than there used to be on the global side.

Paul Lutomski: How much non-US would you be comfortable with?

Gerry Finnegan: Mike has used a similar method to mine and has come to the same opinion and has real concerns.

Mark Westphalen: (To Smith Hayes) Can you tell us the total US vs. non-US percentages of the current portfolio and the recommended portfolio?

Max Callen: Yes, but we do not have that software with us, so we would have to get back to you.

Michael Donnelly: We (Wells Fargo)are 15-20% total foreign exposure.

John Cripe: We have never been followers of other's allocations.

Paul Lutomski: What would be an acceptable level to the Board?

Michael Donnelly: 15-20% for me.

Don Herz: Can we look at a standard deviation comparison?

Max Callen: Yes.

Mark Koller: (2H12M) We have a motion to accept all of the recommendations. The discussion is moving toward tabling the recommendations. We need a vote on the motion before entertaining another motion. Any further discussion?

Don Herz: I was going to vote in favor, but now would like more information.

Steve Niemeyer: My position is that we pay Smith Hayes for advice on the best way to earn a 7.5% return. Risk will increase with this new recommendation. By not taking their advice we may be decreasing our chance to earn 7.5%. If more information and another meeting is desired that is fine, but we need to make a decision at this or that meeting.

Mark Koller calls for a vote on the motion to approve all of Smith Hayes recommendations.
Aye: Fosler, Niemeyer, Heithoff.
Nay: Donnelly, Westphalen, Herz, Gegg, Finnegan
Motion fails.

Russ Fosler: I make a motion Smith Hayes produce the statistics discussed and we meet in 2-3 weeks

to make a decision.

Max Callen: We will benchmark where the portfolio is today in terms of return expectation, standard deviation and percent of US vs non-US and compare that to the recommendation.

Mark Koller: We will need a second.

Don Herz: Second.

Jeremy Gegg: Friendly amendment the next meeting occur no later than 30 days.

Russ Fosler: Accepted.

Vote was all Ayes.

Russ Fosler: Motion to adjourn.

Jeremy Gegg: Second

Vote was all Ayes.