POLICE & FIRE PENSION INVESTMENT BOARD

February 15, 2011

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 3:00 p.m.

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

Russ Fosler motioned for approval.

Jeremy Gegg seconded the motion.

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

All members vote in favor and the motion passes.

Mark Koller states the next agenda items are Five-minute max length presentations by persons that have recently attended conferences and asks John Cripe to begin.

John Cripe attended the Opal Financial Global Asset Allocation Summit - Las Vegas, NV in October 2010 and the Opal Public Funds Summit -Scottsdale, AZ in January 2011. John's summary was that the recent conference was more upbeat then previous and that the old school 60/40 asset allocation model has been replaced with a global diversified model. Investments that were stressed included natural resources, commodities and infrastructure.

Steve Niemeyer also attended the Opal Public Funds Summit -Scottsdale, AZ in January 2011. He

agreed with John that the conference was more upbeat then previous recent conferences but that there were topics of great concern. His summary included that U.S. inflation is still expected, and that other countries including China are buying natural resources from around the world including agricultural land, oil, and commodities and investing in infrastructure much more than the United States. Steve attended the Guns and Hoses conference in San Francisco, CA December 2010. That conference had a wider range of topics. Topics such as benefits, legislation, and politics did not directly pertain to the investment responsibilities of this board. He preferred the Opal conference.

Russ Fosler attended the Opal Financial Emerging Managers Summit - San Antonio, TX October 2010 and agreed that he preferred Opal conferences to others that he has attended. The San Antonio conference covered much the same topics as already discussed. Russ discussed speaker's recommendations regarding the selection of managers for emerging markets. He stated it was stressed that a manager's prior history be consulted even if the history did not pertain directly to the current investment/fund but illustrated the managers' track record.

Jeremy Gegg attended the Opal Financial Global Asset Allocation Summit - Las Vegas, NV October 2010. Jeremy's summary included that this conference speakers also said the traditional asset allocation model is better replaced with a global, more diversified model. He commented that he feels more confident in the changes decided upon in the last meeting after having attended the conference. He explained that emerging markets are are a suitable pension investment if they can be obtained at the correct price.

Mark Heithoff attended the NCPERS conference in Palm Springs, CA October 2010 and the Guns and Hoses-San Francisco, CA December 2010. Both conferences had a range of topics that extended beyond investments. Mark mentioned discussions on several types of DROP plans, presentations on negotiations and topics on other benefits, legislation, and politics as well as investments.

Mark Koller mentioned the recent Journal Star newspaper article regarding pension funding and the follow-up articles as fair and accurate without getting into a lot of detail. Mark introduced Smith Hayes for their annual manager performance review presentation.

Max Callen distributed printouts of his PowerPoint presentation. Some highlights are described below:

Returns by Style: Since Market Peak October 2007 Large Cap Value is still under 19.9%. Small Cap Growth is under by 1%. In 2010 Large Cap Value was up 15% and Small Cap Growth was up 29%.

Returns by Sector: High for 4Q2010 was energy at 21% and low was utilities at 1%.

Investment Style Valuations: Current P/E vs. 20 yr avg P/E for 9 asset classes Large to Small Cap and Growth to Value.

Deploying Corporate Cash: Cash and equivalents are increasing and dividends payouts are decreasing. An expectation for increased merger and acquisition activity.

Fixed Income Sector Returns:

Fixed Income Yields and Returns: Compared to a year ago U.S. Treasury rates are lower, but municipal bonds rates are higher, reflecting increased risk in the payment of coupons and principal.

The Federal Reserve: Balance sheet dramatic increase due to stimulus programs.

Consumer Price Index: Headline CPI increased 1.1% for the 12 months ending 11/30/10. Excluding energy which increased by 3.9% and food which increased by 1.5%, Core CPI increase 0.7%.

Asset Class Returns: Chart displays from years 2000-2010 for 9 classes. For 2010, the top return was Real Estate REIT at 28% and the bottom was Market Neutral at -2.5%.

Diversification: Pie charts shown displaying that more diversification can increase returns and reduce standard deviation. Also a chart of 20 year annualized returns ending 2009 by asset class showing the S&P 500 return as 8.2% and the average investor return as 2.3%.

Employment: Nov. 2010 at 9.8% is still high. The 50 year average is 6%. In the recent recession 8.5M jobs were lost, followed by a 1.2M job gain, net is still 7.3M loss.

Consumer Finances: Improving debt service ratio from 3Q07 of 14% to 4Q10 of 11.6%.

Federal Finances: Hard to cut government budget. 42% of budget is Social Security and Medicare/Medicaid. Cuttable non-defense discretionary is 19% of budget.

Corporate DB Plans and Endowments: 93% are under funded compared to 22% in 1999. National average assumed return is 7.8%.

Max's presentation concludes.

Todd Peterson asks board members to refer to the 3-ring binder distributed to them a week ago. The binder contains returns for 2010 and detailed figures and analysis on each of the pension's investments from sources such as Morningstar and Zephyr. Smith Hayes recommendations were emailed to members a few days ago and were distributed at the meeting in maroon folders. Paul, would you like to discuss the total portfolio?

Paul Lutomski refers members to the first page of the binder and relates the following data:

$153,800,723.50	Value on 12/31/09
6,465,389.51	Additions
3,163,225.69	Income
4,224,767.63	Realized Gain/Loss
11,430,730.89	Unrealized Gain/Loss
11,331,831.67	Expenses
167,753,005.55	Value on 12/31/10
12.378%	Return for 2010

Max Callen refers members to the next page containing Investment Policy Appendix A. He explains that asset class organization was changed to implement the decisions made in the last meeting to group by Income, Equity and Alternative. The target allocation percents established in the last meeting are difference in some cases, from the actual percents, because since the targets were implements the assets have earned at differenct rates. For example, the actual percent of income decreased and the equity in the portfolio has grown from 47.75% to 49.2% because Equity assets appreciated more than Income. Not significant enough to reallocate. The benchmark, benchmark return, and asset class returns are displayed and briefly discussed. The portfolio composite return was 12.38%.

Don Herz offers the idea of using the 2 year Treasury as the cash benchmark because the City Treasurer invest in the maturity pool. Mark Westphalen ask if that is the best place for cash and Don

responds that it earns per the two year maturity and Paul Lutomski states the pool has daily liquidity. There were no motions or further discussion so Paul Lutomski refers members to the Cash tab with a return of 1.17% and balance of $2.7M and the Long-Term High Yield tab. $2M Corporate bond. Floating rate coupon is 3 month LIBOR +200 bps w/no cap – like a TIP, and is callable at par. Matures 5/22/2033, but most likely to be called 3/9/12 – per First Tennessee Financial. 40 issuers with no single issuer comprising more than 5% of total pool. On 01/26/2011, 3 month LIBOR was 0.30%, so the rate is about 2.3%.

Todd Peterson resumes, stating there are eight funds on the Watch List. A fund is placed on the Watch List when it falls below the 50th percentile compared to its Morningstar peers over a 3, 5 or 10 year period.

U.S. Corporate Bonds:

Fund: Calvert Income Fund

Watch List Reason: Peer group ranking of:

85th percentile for 3-years (1026)

76th percentile for 5- years (878)

Comments: This fund is predominately corporate bonds. It suffered a significant decline in 2008 as most bond funds did. In 2009 the fund was up 17.12% which put it in the 27th percentile. In 2010 it had a 7.23% published return and the actual return of the City Pension was 8.4% (source: City of Lincoln) due to timing of investments. It is our recommendation we continue to watch the fund, but not replace it at this time.

U.S. High-Yield Bonds:

Fund: Wells Fargo Advantage Short-Term High-Yield Bond

Watch List Reason: Peer group ranking of:

92nd percentile for 3-years (512)

93rd percentile for 5- years (434)

94th percentile for 10-years (291)

Comments: This fund contains short-term, high yield (low quality) bonds. Morningstar classifies this fund in their "High Yield Bond" category, which would also contain high yield bonds with longer maturities (and therefore higher yields). It is our recommendation we continue to watch the fund, but not replace it at this time.

Large Growth:

Fund: American Funds Growth Fund of America

Watch List Reason: Peer group ranking of:

58th percentile for 3-years (1504)

53rd percentile for 5- years (1286)

Comments: Growth Fund of America has ~14% of it's assets in foreign stocks. In the 2nd quarter of 2010, the PIGS (Portugal, Italy, Greece, Spain) faced financial issues similar to the United States in

2008. The ripple effects of these problems were felt throughout Europe and negatively impacted Growth Fund of America -11.7% for the quarter. The managers of this fund have been in place an average of 11.4 years - it is our recommendation we continue to watch the fund, but not replace it at this time.

Large Value:

Fund: Dodge & Cox Stock

Watch List Reason: Peer group ranking of:

76th percentile for 3-years (1120)

77th percentile for 5- years (956)

Comments: Dodge & Cox Stock fund is still feeling the effects of poor performance in 2007 & 2008. The fund was in the 14th percentile for 2009 and 47th percentile for 2010. The managers of this fund have been in place an average of 15.9 years – it is our recommendation we continue to watch the fund, but not replace it at this time.

Mid Growth:

Fund: Alger Mid Cap Growth Inst.

Comments: We recommend replacing this fund with one of the funds listed on the enclosed sheet. We will return to this fund at the end of the list.

Mid Value:

Fund: Columbia Mid Cap Value

Watch List Reason: Peer group ranking of:

85th percentile for 3-years (360)

Comments: The Columbia Mid Cap Value fund underperformed it's peer group in 2008, but performed better (59th percentile) in 2009 and still better (38th percentile) in 2010. We are still comfortable with the management of this fund and therefore it is our recommendation we continue to watch the fund, but not replace it at this time.

Small Cap Growth:

Fund: Baron Growth

Watch List Reason: Peer group ranking of:

51st percentile for 3-years (670)

Comments: The fund still has the same management team in place for 16 years. This fund has a history of underperforming during strong up markets (94th percentile in 2003, 51st percentile in 2009) and outperforming its peers during difficult markets (2nd percentile in 2002, 30th percentile in 2008). We do not see a reason to remove it from the portfolio at this time.

Small Value:

Fund: Heartland Value

Watch List Reason: Peer group ranking of:

68th percentile for 3-years (307)

Comments: The management team has been in place for a long time. This fund also has a history of top quartile performance (1999, 2001, 2003, 2006, 2009) that is followed by bottom quartile performance (2000, 2004, 2005, 2008, 2010). In 2010 the fund was up a very respectable 21.5%; however, that placed it in the 86th percentile. We do not see any reason to remove the fund from the portfolio at this time.

Returning to **Mid Growth:**

Fund: Alger Mid Cap Growth Inst.

Watch List Reason: Peer group ranking of:

97th percentile for 3-years (677)

82nd percentile for 5- years (594)

53rd percentile for 10-years (392)

Comments: After posting an 11th percentile showing for 2009, the fund slipped again (by comparison) in 2010 with an 82nd percentile category return. This follows a 3rd percentile return in 2007 with a 98th percentile return in 2008. We are uncomfortable with the inconsistent nature of this fund, along with fund manager changes in November of 2010. We recommend replacing this fund with one of the funds listed on the enclosed sheet.

This fund represents 1% of the total portfolio. Almost $3 million was sold and reallocated last year. It was up 13.5% but has been inconsistent and have had several manager changes in the last few years, most recently in November 2010. It did not do well compared to its peers in 2010. To meet our investment objective of 7.5% we want a fund to capture upside and not downside. This fund captures 94% of the downside. We would prefer a fund that captures less downside, maybe 70-80%. We did a search for replacement and are presenting our top three choices.

Todd discusses certain items on the Morningstar sheets for each fund and recommends the Ivy Mid Cap Growth fund. Highlights: It was top quartile for 3, 5, and 10 years; Downside capture was 75%; it will be a good compliment to the Hartford and index funds that are also in this space. We recommend moving the Alger assets to the Ivy Fund.

Mark Koller: Motion to accept the recommendation?

Michael Donnelly: So moved.

Jeremy Gegg: Second.

Gerry Finnegan: I would like some discussion. The inception date shows 2007. Is that just for the institutional class?

Todd Peterson: Yes. The fund inception was about 10 years ago. The same manager has been in place for about 9 years.

Gerry Finnegan: Goldman is listed as having the best fit for the mid cap growth space and more closely replicates mid cap average capitalization. Russell madcap growth market cap is $7B, Goldman is $6.4B and Ivy is $5.1B.

Todd Peterson: There are different ideas what capitalization goes with small and madcap. I heard usually small cap is less than $2 and madcap is $2 - $12B. Ivy is in the madcap space but you are saying it might lean toward the small cap.

Gerry Finnegan: Alger is smaller yet and has a 300% turnover. Neither Goldman nor Ivy has that kind of turnover problem.

Todd Peterson: Alger has about 100 stocks. We would like more concentration. Ivy and Goldman both have about 60 stocks. Both are low turnover 40% for Ivy, 57% Goldman.

Paul Lutomski: How strong is your conviction Todd?

Todd Peterson: We prefer the Ivy because it is more consistent, standard deviation is lower. Refers to the 3, 5, and 10 year SD. Ivy has a higher Alpha than Goldman.

Gerry Finnegan: Alpha is the summation of all things not explained by the asset class.

Todd Peterson: A higher Alpha is better. Alger has a -4 alpha, Ivy +9 and Goldman +8. Beta is the sum of everything that is explained by the benchmark, in these cases the S&P 500. Alger was 1.25, Ivy 1.04 and Goldman 1.12. It is a measure of movement compared to the benchmark. A higher number means more movement both up and down.

Gerry Finnegan: R-squared is measure of the validity of the beta. A higher R-squared value means you can have more confidence in the validity of the Beta.

Don Herz: Is Goldman wiling to waive their $10M minimum investment?

Max Callen: No.

Russ Fosler: Ivy has about 1% more cash and has 3% non-U.S. stocks where Goldman has 0% non-US.

Paul Lutomski: Does Goldman's top holding of Ralph Lauren vs. Ivy's non-high end holdings give any indication of their investment style?

Max Callen: Not necessarily. Goldman could be hold RL because of many reasons.

Mark Koller: Vote?

All members vote in favor of selling Alger.

Russ Fosler: I make a motion to purchase Ivy.

Mark Heithoff: Second.

All members vote in favor of purchasing Ivy.

Mark Koller: Any new business.

Paul Lutomski: We will proceed with amending the Lincoln Municipal Code to stagger the terms of The Police and Fire Investment Board members. At the next election one Police and one Fire members will have a 3 year term and the others will have a 5 year term. After that all terms will be five years.

Mark Koller: I would accept a motion to adjourn.

Jeremy Gegg: So moved.

Michael Donnelly: Second.

All members vote in favor of adjournment.