South Carolina Retirement System Investment Commission
Meeting Minutes

November 30- December 1, 2006

Wampee Training and Conference Center
1274 Wampee Plantation Road
Pinopolis, South Carolina 29469

Commissioners Present:
Mr. Reynolds Williams, Chairman
Mr. James Powers, Vice-Chairman
Treasurer Grady Patterson
Mr. Blaine Ewing
Mr. Allen Gillespie
Mr. Travis Pritchett

Others present for all or a portion of the meeting on Thursday, March 9, 2006: Ashli Aslin, Bob Borden, and Nancy Shealy from the South Carolina Retirement System Investment Commission; Anne Macon Flynn from the Budget and Control Board Office of General Counsel; Rick Patsy, Frank Rainwater, and Shakun Tahiliani from the State Treasurer's Office; Dick Charlton, Rhett Humphreys, Chris Levell from New England Pension Consultants; Ernie Cruikshank and Keith Wood from Jamison, Eaton & Wood, Inc.; Peggy Boykin, Sarah Corbett, Tammy Davis, Danielle Quattlebaum, and Travis Turner from the South Carolina Retirement Systems; Bon French from Adams Street Partners, LLC; Rob Arnott from Research Affiliates, LLC; Bruce Lavine, Loraine McElvoy, Jeremy Siegel (via telephone), and Luciano Siracusano from Wisdom Tree Asset Management; Brian Reynolds from M.S. Howells; Don Trone from Center of Fiduciary Studies; Kyle McDaniel and Chuck Riley from Austin Capital Management; Jack Calcagno from Victory Capital Management; Steve Drobny from Drobny Global Advisors;
Others present for all or a portion of the meeting on Friday, March 10, 2006: Ashli Aslin, Bob Borden, and Nancy Shealy from the South Carolina Retirement System Investment Commission; Anne Macon Flynn from the Budget and Control Board Office of General Counsel; Rick Patsy, and Shakun Tahiliani from the State Treasurer's Office; Dick Charlton, Rhett Humphreys, Chris Levell from New England Pension Consultants; Ernie Cruikshank and Keith Wood from Jamison, Eaton & Wood, Inc.; Peggy Boykin, Sarah Corbett, Tammy Davis, Danielle Quattlebaum, and Travis Turner from the South Carolina Retirement Systems; Steve Drobny from Drobny Global Advisors; and John Helmers from Swiftwater Capital Management.

I. CALL TO ORDER, CONSENT AGENDA, AND CHAIRMAN'S REPORT

Chairman Reynolds Williams called the meeting of the South Carolina Retirement System Investment Commission (Commission) to order at 9:30 a.m. and welcomed the Commission and guests to the Investment Retreat at Wampee.

Chairman Williams called for objections or amendments to the meeting's proposed agenda and to the minutes from the Commission meeting on October 19, 2006. There being none, the proposed agenda and the minutes were adopted as presented.

Chairman Williams reported that the Commission was very pleased with the favorable results of Constitutional Question 3A in the November state-wide referendum, which would amend the constitution to allow further diversification of the portfolio of the South Carolina Retirement

Systems (Retirement System). Chairman Williams thanked the Commissioners, staff, and others, particularly Mr. Van Newman, who volunteered personal time to the educational efforts.

Mr. Blaine Ewing made a motion that the Commission send a letter to Mr. Newman acknowledging his invaluable contribution and assistance. Mr. Allen Gillespie seconded the motion, which passed unanimously.

II. PRIVATE EQUITY

Mr. Robert Borden, Chief Investment Officer (CIO), introduced Mr. Bon French from Adams Street Partners, LLC and recognized him for a presentation on private equity investments.

Mr. French provided a primer on the private equity industry, which included structure, risk, and performance compared to the Standard & Poor's 500 Index (S&P 500) and the National Association of Securities Dealers Automated Quotations (NASDAQ). Mr. French stated that, due to the illiquidity of the private equity market, it was primarily an institutional asset class.

Mr. Borden asked how the private equity market valued enterprises. Mr. French explained the process of milestone financing and stated that a third party investor may initiate a change in value. Mr. French noted that he was very comfortable with the industry valuation guidelines.

Mr. French explained that, since draw-downs occur over an extended period of time, many funds consider over-committing their private equity allocations to ensure the desired level of exposure. He explained that capital would be returned on profitable ventures as private investments mature, which could reduce the allocation at a rate faster than capital is reinvested. Mr. Borden stated that funds would typically over-commit 130 to 150 percent of the desired allocation to private equity. He described the difficulties involved in rebalancing private equity and suggested that generous target ranges be set around the asset class to accommodate the expanding and contracting business cycles.

Chairman Williams and the Commission thanked Mr. French for his presentation.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit A).

III. FUNDAMENTAL INDEXING

Mr. Gillespie introduced Mr. Rob Arnott of Research Affiliates, LLC, and recognized him for a presentation on Fundamental Indexing.

Mr. Arnott discussed the Efficient Market Hypothesis and noted that the academic community commonly accepted that all assets were priced at fair value. He noted, however, that most people outside of the academic community believed that the price of an asset was the market's best guess at true fair value.

Mr. Arnott explained that conventional capitalization-weighted indices weighted components according to the total market value of the included assets. He opined that this was an inefficient method which caused the index to be overweighted in stocks trading above fair value and underweighted in stocks trading below true fair value, which creates a drag on the return of capitalization-weighted indices. Mr. Arnott suggested that an index comprised of assets which are selected and weighted using fundamental, valuation-indifferent factors, such as profit, book value, sales, and dividends, could eliminate the structural bias and return-drag of capitalization-weighted indices.

In response to a question concerning the cost of rebalancing a fundamental index versus a capitalization-weighted index, Mr. Arnott explained that a capitalization-weighted index had an average annual turnover of approximately 6 percent, while a fundamental index had an average annual turnover of approximately 10 percent. He noted that the marginal increase in the cost of rebalancing was more than compensated with excess returns.

In response to a question by Mr. Ewing, Mr. Arnott explained that in the short term, a capitalization-weighted index would outperform a fundamental index when the market favored growth over value. Mr. Arnott stated that if larger companies were included in a fundamental index in the long term, the returns would be similar to that of a capitalization-weighted index.

Chairman Williams and the Commission thanked Mr. Arnott for his presentation.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit B).

Mr. Gillespie introduced Mr. Bruce Lavine, Ms. Loraine McElvoy, Professor Jeremy Siegel, and Mr. Luciano Siracusano from WisdomTree Asset Management (WisdomTree) and recognized them for a presentation on Fundamental Indexing. Professor Siegel participated in the presentation via telephone conference call.

Mr. Lavine provided an overview of WisdomTree's history and stated that WisdomTree's dividend-weighted portfolios offered a viable, attractive alternative to capitalization-weighted indices.

Professor Siegel stated that extensive research conveyed a strong positive correlation between dividend yield and return. He explained that WisdomTree's dividend-weighted products, comprised only of dividend-paying securities which are weighted based on the company's cash dividend payout, offered strong returns in up markets, better potential protection of capital in down markets, and lower volatility than capitalization-weighted indices.

Mr. Siracusano discussed WisdomTree's execution of its rules-based methodology for stock selection and index construction and the characteristics of the resulting product. He stated that weighting within the index was based on the most recently declared dividend per share with an annual adjustment for relative value.

Mr. Siracusano also discussed the performance of WisdomTree's fundamentally weighted dividend indices, noting that they outperformed comparable capitalization-weighted indices with generally less risk during the long-term periods tested.

Chairman Williams and the Commission thanked Mr. Arnott for his presentation.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit C).

IV. INTER-MARKET COORELATIONS

Mr. Gillespie introduced Mr. Brian Reynolds from M.S. Howells and recognized him for a presentation on Inter-Market Correlations.

Mr. Reynolds discussed recent trends in the valuation of stocks versus corporate bonds and how the markets interrelate. He stated that most bond investors appear to know very little about the equity market and vice versa. He discussed several factors which could affect economic markets, including global tensions, an inverted yield curve, the weakening of the housing market, the declining dollar, and the amount of debt in the financial system.

Mr. Reynolds compared the valuation of the corporate bond market and the corporate stock market, noting that corporate equity investors were less optimistic than corporate bond investors. He said this is common as equity investors and bond investors consistently reach different conclusions about the state of the economy, which leads to a disconnect between the two markets.

Chairman Williams and the Commission thanked Mr. Reynolds for his presentation.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit D).

V. STRATEGIC PLANNING

Chairman Williams reviewed the strategic planning outline that was prepared at the Commission's retreat in March 2006 and noted the progress that had been made. He recognized Mr. Borden and Mr. Rhett Humphreys of New England Pension Consultants (NEPC) to lead the strategic planning session.

Mr. Borden reviewed the Commission's primary goals and the key values required to reach those goals. He discussed the Commission's target rate of return, which was comprised of the actuarial assumed rate of return (7.25 percent), operating costs, and excess return which the Budget and Control Board (Board) could use to reduce the Unfunded Accrued Liability (UAL) or fund Cost of Living Adjustments (COLAs) for retirees. He suggested that the Commission's target rate of return total 8.15 percent.

Mr. Borden reviewed asset allocations for comparable funds and discussed various implementation timelines including a search schedule-based approach, a dollar-cost-average approach, an asset class-specific approach, and a "big bang" approach.

Mr. Borden explained that a Beta overlay manager could be engaged after asset allocation and implementation timeframes were determined. He stated that this would be a very efficient, low-cost implementation strategy using synthetic instruments such as futures, swaps, options, and/or swaptions to affect an asset allocation.

Mr. Borden suggested that the Commission use risk budgeting to determine the best long-term implementation strategy for each asset class. He noted that in very efficient asset classes, traditional long-only approaches did not consistently generate attractive levels of risk-adjusted alpha, so non-traditional strategies should be considered, i.e., long-short, portable alpha, or low-cost indexing. He added that in very inefficient asset classes, long-only approaches generated more attractive levels of risk adjusted alpha and could be the only alternative for exposure to a particular asset class.

Mr. Borden recommended that the Commission consider creating an opportunistic allocation to allow the CIO, upon collaboration with the consultant, to commit to time-sensitive opportunities that were consistent with the asset allocation and implementation strategy plan.

Mr. Humphreys presented several asset allocation recommendations, explained how those asset allocations were developed, and discussed the expected return and risk associated with each allocation.

Mr. Humphreys reviewed asset allocation principles and noted that all funds should periodically perform an asset allocation study to review and identify optimal combinations of asset classes and assess appropriateness of asset allocation policy.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit E).

VI. HOW TO DEFINE FIDUCIARY CULTURE FOR A PUBLIC PENSION PLAN

Mr. Gillespie introduced Mr. Don Trone from the Center for Fiduciary Studies for a presentation on fiduciary responsibility relating to public pension plans.

Mr. Trone explained the significance of defining a global standard of excellence for investment fiduciaries. He stressed the importance of promoting a culture of fiduciary responsibility defined by reliable fixed standards.

Mr. Trone noted that until the Center for Fiduciary Excellence (CEFEX) was created in 2006, there were no international fiduciary standards. He stated that CEFEX serves as an independent, international certification organization for investment fiduciaries and provides an independent recognition of a fiduciary's conformance to defined fiduciary practices. He said that conformance to the defined practices implies that a fiduciary can demonstrate adherence to industry best practices and is positioned to earn the public's trust.

Mr. Trone discussed various U.S. statutes that cover investment fiduciaries including the Employee Retirement Income Security Act (ERISA), Uniform Prudent Investor Act (UPIA), Uniform Prudent Management of Institutional Funds Act (UPMIFA), and Uniform Management of Public Employees Retirement Systems Act (UMPERSA). Ms. Shealy stated that South Carolina was the first state to adopt a portion of UMPERSA, which was the basis for its investment statutes.

Mr. Trone explained that CEFEX determined that seven practices were common to each of the legislative acts. The seven practices, called Global Fiduciary Precepts (GFPs), include: know standards, laws, and trust provisions; diversify assets to the specific risk/return profile of the client; prepare an investment policy statement; use "prudent experts" (investment managers) and document due diligence; control and account for investment expenses; monitor the activities of "prudent experts"; and avoid conflicts of interest and prohibited transactions. Mr. Trone stated that each of the GFPs should undergo the process of organization, formalization, implementation, and monitoring.

Chairman Williams and the Commission thanked Mr. Trone for his presentation.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit F).

VII. INVESTING IN A FUND OF HEDGE FUNDS

Mr. Gillespie introduced Messrs. Kyle McDaniel and Chuck Riley from Austin Capital Management and Mr. Jack Calcagno from Victory Capital Management for a presentation on Investing in a Fund of Hedge Funds.

Mr. Riley provided an overview of the hedge fund market and discussed the evolution of the hedge fund industry as demonstrated by its growth, increased sophistication, increased regulation, and participants. Mr. Riley stated that the goal of hedge fund investing is to offer reduced risk and consistent returns by way of low correlation to traditional markets and diversification through hedging.

Mr. McDaniel discussed three hedge fund strategies, hedged equity, event-driven, and relative value, and he explained the process of constructing a diversified fund of funds containing those strategies.

Mr. McDaniel described common myths of the hedge fund industry and refuted them as misconceptions. Mr. McDaniel discussed the fees associated with investing in hedge funds and the risk and liquidity of the hedge fund market compared to the private and public equity markets.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit G).

VIII. EXECUTIVE SESSION

Chairman Williams asked for a motion to convene in executive session. Mr. Powers made a motion that the Commission convene in executive session to discuss contractual and personnel matters. The motion was seconded by Mr. Ewing and passed unanimously. Chairman Williams announced that the Commission would meet in executive session for the purpose of receiving legal advice relating to a contractual matter and to discuss personnel matters.

The Commission reconvened in open session and Chairman Williams reported that the Commission met in executive session but did not take any action. Mr. Powers made a motion that the Commission authorize the CIO to hire a Director of Research, and Research Analyst, and an Equity Officer within the salary guidelines discussed in executive session. Mr. Gillespie seconded the motion, which passed unanimously.

Mr. Powers made a motion that the Commission post the positions of Fixed Income Officer and Investment Operations Coordinator within the salary guidelines discussed in executive session. Mr. Gillespie seconded the motion, which passed unanimously.

Chairman Williams recessed the meeting at 6:15 p.m. on Thursday, November 30, 2006, to resume at 8:15 a.m. on Friday, December 1, 2006.

Chairman Williams reconvened the meeting at 8:15 on Friday, December 1, 2006 and welcomed Commissioners and guests.

IX. GLOBAL HEDGE FUNDS

Mr. Gillespie introduced Mr. Steve Drobny from Drobny Global Advisors and recognized him for a presentation on Global Hedge Funds.

Mr. Drobny discussed the history of hedge funds and alternative investments. He described the current state of the economy and the hedge fund/alternative investment market.

Mr. Drobny explained that the optimal pension fund would be 100 percent invested in US Government Bonds; however, the yield of such a portfolio would not cover the liabilities.

Therefore, he explained, diversification across various uncorrelated asset classes was required to increase returns while reducing volatility. Mr. Drobny noted that a portfolio constructed solely of long-only of assets was an implicit bet that low volatility, low inflation, low interest rates, and large global imbalances would continue.

Chairman Williams and the Commission thanked Mr. Drobny for his presentation.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit H).

X. ALTERNATIVE INVESTMENTS, INSTITUTIONALIZATION OF HEDGE FUNDS, AND IMPLEMENTATION OF AN INVESTMENT STRATEGY

Mr. Gillespie introduced Mr. John Helmers from Swiftwater Capital Management and recognized him for a presentation on alternative investments, the institutionalization of hedge funds, and the implementation of an investment strategy.

Mr. Gillespie explained that embedded in the return expectation of each asset was an inflation expectation, which if incorrect, could affect expected long-term return.

Mr. Helmers discussed the similarities between alternative investments, commodities, and foreign exchanges. He discussed whether alternative investments, such as commodities and foreign exchange, actually constitute asset classes because they lack future cash flow and liquidity.

Mr. Helmers discussed the institutionalization and growth in the hedge fund industry. He stated that the institutionalization and growth in the industry made hedge funds more suitable for institutional investors while impacting opportunities for above average returns. He discussed implementation strategies for hedge funds and how those strategies could lead to optimal results.

Chairman Williams and the Commission thanked Mr. Helmers for his presentation.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit I).

XI. QUARTERLY REPORTS

Chairman Williams recognized Mr. Borden for a summary of the Quarterly Investment Performance for Periods Ending September 30, 2006. Mr. Borden reported that during the third quarter of 2006 the total portfolio increased 3.9 percent, compared to a median return of 3.8 percent for large public funds. He explained that the robust return was attributed to both strong Large Cap Equity and Fixed Income markets. He noted that the relatively high weighting of US Large Cap and Core Fixed Income resulted in significant improvement in the portfolio's peer group ranking. Mr. Borden reported that falling interest rates across most maturities led to significant outperformance by the fund's Fixed Income portfolio. Mr. Borden explained that the Equity portfolio made a positive contribution to the portfolio, but noted that active management within the equity portfolio was not an optimal use of risk capital.

Mr. Humphreys updated the Commission about changes with several individual investment managers. He noted that there were personnel changes at WCM Investment Management (WCM), but stated that those changes should have minimal implications to WCM's investment process and performance in the future.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit J).

XII. CONTRACTUAL MATTERS

Chairman Williams asked for a motion to ratify the execution of a contract with NEPC for general investment consulting services and the termination of the contract with Mercer Investment Consulting effective December 31, 2006. Mr. Powers made the motion, which was seconded by Mr. Gillespie and passed unanimously.

XIII. STRATEGIC PLANNING

Chairman Williams recognized Mr. Humphreys and Mr. Dick Charlton from NEPC to continue the strategic planning discussion from the previous day.

Mr. Charlton discussed diversification options and outlined NEPC's key capital market observations. He provided an overview of diversification strategies that could provide higher, more stable returns. Messrs. Charlton and Humphreys discussed NEPC's investment and consulting philosophy.

Mr. Humphreys summarized NEPC's recommended asset allocations and the strategies required for successful implementation.

The Commission discussed the timing of implementing a new asset allocation. Mr. Borden recommended that the Commission have a long-term strategic direction with a phased implementation plan.

Mr. Ewing made a motion that the Commission adopt mix three from NEPC's presentation as the strategic long-term asset allocation for the Retirement System's portfolio. Mr. Gillespie seconded the motion, which after thorough discussion, passed unanimously.

Mr. Borden stated that, since an asset allocation target was adopted, the Commission should begin to develop an implementation plan. At the Commission's request, Mr. Borden agreed to begin working on a proposed implementation plan.

Mr. Borden provided a more detailed explanation of an opportunistic allocation that would allow the CIO, upon collaboration with the consultant, to commit to time-sensitive opportunities consistent with the asset allocation and implementation strategy plan.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit E).

XIV. NEW BUSINESS

The Commission determined that regular Commission meetings for 2007 would be scheduled for the third Thursday of each month, except in February 2007 which, due to scheduling conflicts, would be scheduled as soon as possible.

Mr. Powers stated that there were problems with the lease for the Commission's new office facilities, and he agreed to keep the Commission apprised of the situation.

XV. ADJOURNMENT

Chairman Williams thanked everyone for attending the meeting. Mr. Powers made a motion to adjourn. The motion was seconded by Mr. Gillespie, and the meeting adjourned at 12:15 p.m.

[Staff Note: In compliance with S.C. Code Ann. §30-4-80, public notice of and the agenda for this meeting were delivered to the press and to parties who requested notice and were posted at the entrance, in the lobbies, and near the 2nd Floor Conference Room at 202 Arbor Lake Drive, Columbia, SC, on November 28, 2006 and were posted at the Wampee Training and Conference Center at 1274 Wampee Plantation Road, Pinopolis, SC on November 28, 2006.]