

**MINUTES OF THE
TEXAS MUNICIPAL RETIREMENT SYSTEM**

**Board of Trustees
Investment Committee Meeting**

September 25, 2008

On September 25, 2008, the Investment Committee of the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 2:06 p.m. at the TMRS Headquarters, located at 1200 North IH 35, Austin, Texas, with the following members present:

Board of Trustees

Carolyn Linér, Vice Chair
Ben Gorzell, Jr.
Pat Hernandez
April Nixon
Frank Simpson

Absent: Roel (“Roy”) Rodriguez

Present also were:

Eric Henry, Executive Director and CIO
Ian Allan, Director of Internal Audit
Rhonda Covarrubias, Director of Finance
Eric Davis, Deputy Executive Director
Bernie Eldridge, Director of Human Resources
Debbie Farahmandi, Investment Operations Specialist
David Gavia, General Counsel
Nancy Goerdel, Director of Public Investments and Asset Allocation
Leslee Hardy, Staff Actuary
Holly Macki, Director of Fixed Income
Michelle Mellon-Werch, Associate General Counsel
Debbie Munoz, Director of Member Services
Candace Nolte, Controller
Kate Reed, Investment Analyst
Eddie Solis, Director of Government Relations
Sean Thompson, Membership Analyst
Bill Wallace, Director of Communications
Cindy Morse, Executive Assistant
Kristin Qualls, Investment Analyst
Scott Willrich, Director of Information Systems
Bob Klausner, Klausner & Kaufman, PA
Russ Kuhns, R. V. Kuhns & Associates, Inc.
Peter Madsen, R. V. Kuhns & Associates, Inc.
Gary Shilling, A. Gary Shilling, Inc.

Guests: Jim Moore, Assistant Fire Chief, City of Mesquite
Jim Parrish, Director of Human Resources, City of Amarillo
Bob Scott, Director of Finance, City of Carrollton/GFOAT
Ray Spivey, TRS

The meeting was called to order at 2:06 p.m. and the invocation was given by Pat Hernandez.

**Consider and Act on Adoption of Minutes from the June 25, 2008 Board of Trustees
Investment Committee Meeting**

Mr. Henry presented the Minutes from the June 25, 2008 Investment Committee for the Committee's approval. Mr. Simpson moved that the Minutes be adopted as presented and without any changes. Ms. Hernandez seconded the motion, which carried unanimously.

Quarterly Investment Report

Mr. Henry gave an overview of the portfolio summary, noting the portfolio allocation.

Mr. Simpson asked if R. V. Kuhns could develop performance numbers regarding the Russell 3000 index and the MSCI EAFE index that reflects an apples-to-apples comparison between our performance and the performance of the two indices. Mr. Madsen stated that they are working on getting that comparison. Mr. Henry stated that TMRS is getting the broad diversification it sought in equities by investing in these indices. With regard to fixed income, TMRS has reduced duration, reduced interest rate risk and improved yield. Mr. Simpson asked about the opportunity to further reduce duration. Ms. Macki stated that we are currently below 8 on duration. She stated that at the present time, we are somewhat constrained in further reducing duration because of the fixed income securities we currently own.

Investment Education Session: Equity Asset Class

Mr. Kuhns began the education session by reminding the Board about the risk associated with equities. The discussion included examples of "equity return" and "equity risk." They showed the role equities play in a total return strategy. The discussion then shifted to decisions to be made when entering into the equity asset class. They discussed "active" vs. "passive" management. There are several versions of passive portfolios and there is ongoing debate whether active or passive investing is the best. Typically, there will be both in a portfolio.

Mr. Madsen then briefly discussed value vs. growth investing. Then he moved on to market capitalization. He said that like other factors, there will be times when one sector out-performs the other. International equity is another asset class to consider. Adding international equity can enhance returns through diversification and potentially produce higher returns for moderately higher risk premiums.

In summary, Mr. Madsen stated that equities are a positive driver over the long run. Since the event horizon is very long term, institutional investors can better weather downturns. There are other equity market segments that TMRS can consider in the future. As TMRS gets legislative authority there will be opportunity to further diversify. By educating now, staff can begin looking at new efficient frontier modeling and identify new asset classes so that staff can begin manager searches.

Mr. Gorzell asked Mr. Kuhns to put together a timeline on how and when the “next steps” suggested should play out.

Economic Advisor Annual Presentation

Mr. Shilling began by stating that it is the leveraging in relation to revenues (household and financial) that are causing the current vulnerable situation. What we are seeing now is deleveraging, and there are only three ways to do this: (1) bring in more capital; (2) sell assets; and (3) write them off, which destroys capital.

Mr. Shilling explained that there are four factors of this recession. The first factor is the excess inventory in housing. Foreclosures are throwing more inventory into the market. The percent of equity people have in their homes is going down. Half of the people with mortgages will be underwater, and when people are under water, they tend not to make mortgage payments. Fannie & Freddie are leveraged on the basis of 50 to 1. They either guarantee or own about 50% of the mortgages that are securitized. The second factor is Wall Street. If we are getting into the goods and services side of the economy, many non-financial companies will be in trouble. The third aspect is the effect on the consumer. Personal spending is likely to go down, as incomes are declining. Mr. Shilling stated that so far, this recession has been financial, but it is spreading to the consumer side. People typically think that one thing they can cut back on is payments—credit cards, loans, etc. Savings rates have climbed and people are retrenching. The fourth aspect is the rest of the world. As consumers retrench, imports will decline, which will depress their economic activity. So we are basically in a world wide recession.

Mr. Henry asked where the dollar is headed, and where in the U.S. are we headed as a power. Mr. Shilling said that the dollar should be headed up because of the world wide recession. Long rates (long treasuries) should come down to around 3%. As far as the U.S. role, Mr. Shilling stated that he thinks China and the developing countries have been well over played. These countries are developing, but they are not far enough along to be self-sustaining. He mentioned that there has been a movement to the Euro for currency reserves.

Consider and Act on Recommendation to Revise Hillswick Asset Management’s Contract for Investment Advisory Services

Mr. Henry introduced this item and explained that there will not likely be a need to continue services beyond the end of the year. Mr. Simpson asked if there was a need for additional economic advisory services. Ms. Goerdel and Mr. Henry suggested that there is no need since we are no longer managing fixed income internally. Ms. Goerdel suggested that there are other risk management tolls that would better serve us. Ms. Macki mentioned some of the other risk management tools and who provides them. She stated that many of these analytics are designed to give us a look into the underlying basis of the securities so that we know what questions to be asking.

Mr. Gorzell asked for, at a future date, an explanation of the roles of the advisor and who is watching who.

Ms. Nixon moved that the Investment Committee recommend to the Board of Trustees that Hillswick Asset Management's contract for investment advisory services not be renewed beyond the end of the year. Ms. Linér seconded the motion, which carried unanimously.

Consider and Act on Recommendation to Change Investment Policy Fixed Income Investment Guidelines

Ms. Goerdel reviewed each of the proposed changes to the Investment Policy, explaining the reason for each suggested change. These changes are further clarifying restrictions in the Policy, not making the Policy fit what we are doing. Mr. Simpson asked that the Board be given more time to consider changes to the Investment Policy. Mr. Gorzell suggested making a presentation on the issue at one meeting and then taking action at the next meeting.

Mr. Simpson moved that the Investment Committee recommend to the Board of Trustees that changes to the Investment Policy Fixed Income Guidelines be adopted. Ms. Hernandez seconded the motion, which carried unanimously.

Consider Any Other Business

Mr. Henry informed the Board that Northern Trust has incurred a loss and recognized a collateral deficiency in the collateral pool. Our share of the deficiency is approximately \$2.0 million. Mr. Henry suggested placing Northern Trust on an internal watch list and bring Northern Trust back to the Board at the October meeting. Staff will conduct further research and bring a related recommendation to the Board at its next meeting.

As there was no further business of the Committee, the meeting adjourned at 4:10 p.m.