



Final Minutes
Endowment Fund Investment Regular Board Meeting
May 19, 2009

A regular meeting of the Endowment Fund Investment Board (Board) was held in the Board Conference Room at 816 W. Bannock Street, Ste. 301, Boise Idaho on May 19, 2009. Chairman M. Dean Buffington called the meeting to order at 10:40 a.m. and recognized that a quorum was present.

Member's Present:

Dean Buffington
Gavin Gee
Representative Max Black
Vaughn Heinrich
Tom Kealey
Susan Simmons
Richelle Sugiyama
John Taylor
Senator Chuck Winder

Member's Absent:

Staff Present:

Larry Johnson
Chris Halvorson
Andy Potter
Judy Shock

Legal Counsel:

Julie Weaver

Guests:

Janet Becker-Wold, Callan
Bill Reese, JRF (10:40 a.m.-12:05 p.m.)
Rhet Hulbert, Clearwater (10:45 a.m.-12:05 p.m.)
Dave Boren, Clearwater (10:45 a.m.-12:05 p.m.)
Patrick Hodges, IDL (11:00 a.m.-12:05 p.m.)
David Groeschl, IDL (11:00 a.m.-12:05 p.m.)

Hard copies of board materials were mailed and delivered seven days prior to the scheduled board meeting and a meeting notice and agenda was posted on the door of the EFIB office beginning May 4, 2009.

Board Meeting Minutes: *Approved*

The board discussed the motion at the previous meeting to assign the Callan contract to Mercer. Since the merger did not occur, the assignment is null and void.

Mr. Gee made a motion that the minutes of the February 18, 2009 regular meeting be approved as submitted. The motion was seconded by Ms. Simmons. The motion was unanimously approved by the Board.

Recent Fund Returns

Mr. Johnson discussed results of the endowment fund in April – up 7.3%. Mr. Halvorson reported on the month-to-date May performance for the endowment fund (2.8%), the Judges' (3.5%) and Ritter Island (2.8%).

Mr. Halvorson indicated that three new managers have been hired recently. Times Square, a Mid Cap Growth manager, was funded April 15th from the S&P 400 index fund, previously managed by Northern Trust. Two emerging markets managers, Grantham Mayo (GMO) and Capital International, were funded March 6th, from the domestic equity portfolio.

Mr. Johnson presented historical data on the equity risk premium. For the last nine years, the cumulative risk premium (return of stocks minus return of bonds) has been negative. The investment policies for all EFIB clients assume that equities will outperform bonds in the long term and Mr. Johnson said, based on long-term historical data, the assumption remains valid. In addition, the key forecasters that EFIB staff follow all predict a significantly positive equity risk premium over the next 5-7 years.

Fund Performance

Endowment Fund: The endowment portfolio posted a -6.53% return for the quarter ended March 2009, 90 basis points above its benchmark, and -26.86% for the last 12 months, 191 basis points above its benchmark. Relative to peers, the fund ranked in the 63rd percentile for the quarter and 48th percentile for the year relative to public funds (64th percentile for the quarter relative to endowments and foundations).

Judges' Retirement Fund: The JRF portfolio posted a -7.45% return for the quarter ended March 2009, 45 basis points above its benchmark, and -26.4% for the last 12 months, 225 basis points ahead its benchmark. Relative to public fund peers, the fund ranked in the 82nd percentile for the quarter and 44th percentile for the year.

State Insurance Fund: The SIF portfolio posted a -.65% return for the quarter ended March 2009, 0.2 above its benchmark, and -2.82% for the last 12 months, 120 basis points above of its benchmark.

Ms. Becker-Wold said that she and EFIB staff had, the day before, proposed to the Manager of the State Insurance Fund and representatives of the Supreme Court that they consider replacing their core Mid Cap Equity manager, Chicago Equity, with the two Mid Cap managers utilized in the endowment fund – Systematic and Times Square – and also consider replacing their Russell 2000 Growth index fund with an active mandate managed by Eagle Asset Management. Both clients said they would seriously consider these changes. It was also suggested to the Supreme Court that they increase their weight in international equities, similar to what is being done in the endowment fund.

Review of Clearwater Passive Rebalancing Overlay

Mr. Johnson said staff would like the board to review the endowment fund's passive equitization and rebalancing process to understand the risks we take and benefits we strive to obtain. He added that staff and Callan have reviewed the process and recommend we continue with the present overlay strategy using Clearwater. However, the overlay strategy is an auxiliary activity and is not core to the endowment fund's investment approach.

Clearwater has been managing the mandate since its inception five years ago and Mr. Johnson said staff is very pleased with the relationship with Clearwater.

Mr. Johnson asked the board for feedback regarding whether the endowment fund should continue with a passive equitization/overlay process; and if staff should devote time investigating another overlay manager.

Mr. Rhet Hulbert of Clearwater, gave an overview of the strategy, including historical results and associated risks.

The board discussed the pros and cons of the overlay strategy, including the frequency of rebalancing. Mr. Kealey and Ms. Sugiyama expressed concern that there may be hidden risks. Ms. Sugiyama suggested staff explore using Clearwater to manage the cash in the endowment fund so that the cash instruments would be held in the fund's name, rather than in the name of the custodian.

Mr. Gee asked how common it is for public funds to utilize an overlay strategy, whether there were any catastrophes in the recent market turmoil, and to what degree the strategy was audited. Ms. Becker-Wold responded that while it is not common for funds to use an overlay, it is not rare, either. Staff and Clearwater stated that there have been no catastrophes and that the fund's auditor reviews all transactions in the strategy in exactly the same way that they do for all other investment managers.

Mr. Johnson stated that he understood the consensus of the board was to continue with the strategy for now but to explore rebalancing less frequently than daily. He said staff would also examine the practicality of having Clearwater manage the endowment fund's cash.

Issues Impacting Long-Term Endowment Land Revenues

Mr. Johnson introduced both Patrick Hodges and David Groeschl from the Dept. of Lands. Mr. Groeschl presented the just-completed update of the Forest Asset Management Plan. The plan calls for boosting annual harvest levels from 212 million board feet to 247 million board feet for the next ten years. This will liquidate overmature timber and allow the overall growth of the forest to move up from 170 million board feet today to 225 million board feet. Harvest levels will drop to this long-term sustainable level in about ten years.

Implementation of the plan will require an increase of 6 employees and some changes to scaling practices in some regions.

Mr. Groeschl also presented revised income forecasts. Deposits to Earnings Reserves, net of Dept. of Lands' administration costs, are expected to be \$22-\$31 million in FY2010 and \$21-\$38 million in FY2011. The nine-year historical average is \$44 million/year.

Mr. Reese departed at 11:30 a.m.

The board took a break at 12:00 p.m.

Mr. Groeschl and Mr. Hodges departed at 12:05 p.m.

The board reconvened at 12:15 p.m.

Capitol Permanent Fund Distribution

Mr. Johnson gave an overview of the Capitol Permanent Fund Spending Policy. He presented forecasts based on the current policy of distributing 5% of the fund balance. While the fund would continue to meet its objective of real growth (after inflation) from 2004 under the current policy, with the recent severe downturn in fund returns, distributions will very likely decline. Therefore, the

current policy does not result in a sustainable distribution in the near term. Mr. Johnson proposed that a temporary policy be instituted until financial markets recover or land revenues improve.

Mr. Johnson stated that the Capitol Commission will be meeting the next day, May 20, 2009. Preliminary indications from the Commission's financial staff are that their cash reserves are strong and therefore they may request that the EFIB make a low distribution in FY2010.

Mr. Heinrich moved to authorize distribution of up to \$600,000 (3.7% of the 3-year average) effective July 1, 2009 from the Capitol Permanent Fund to the Capitol Commission. The motion was seconded by Mr. Taylor. After discussion, Mr. Heinrich amended his motion to clarify that distributions beyond FY2010 would be based off of \$600,000 escalated with inflation. The amended motion was seconded by Mr. Taylor and approved unanimously.

Securities Lending Update

Mr. Johnson updated the board on Securities Lending. The unrealized losses in the pools are still significant but have shrunk modestly in the last month. Also, the liquidity of the pool associated with the index funds improved enough to allow funds to be withdrawn for rebalancing and funding of new managers. Staff's objective remains to withdraw from securities lending when there are no significant unrealized losses in the collateral pools.

Mr. Black and Mr. Kealey asked if it would be better to remain in the lending program. Ms. Becker-Wold replied that the whole lending industry would likely be restructured to improve the risk/reward ratio for lenders. Therefore, it makes sense to withdraw as soon as practical and then revisit the program when it has been reconstituted.

EFIB Strategic Plan

Mr. Johnson presented minor wording changes to the Strategic Plan for FY 2010. Board members proposed four additional wording changes.

Mr. Kealey made a motion to approve the updated Strategic Plan revisions. The motion was seconded by Mr. Gee and approved unanimously.

Land Board Distribution Policy

Mr. Johnson presented a forecast of FY 2011 distributions based on March 2009 balances. Based on this analysis, he recommended that no changes be made to the existing Distribution Policy.

At the August board meeting, staff will update the analysis with year-end results and an updated land revenue forecast. If these updates result in no significant change to the outlook, staff will recommend that reserves in excess of five years be transferred to the permanent fund and that FY2011 distributions remain at FY2010 levels, with the possible exception of a small increase for one endowment.

Mr. Heinrich made a motion to recommend to the Land Board that there be no changes in the current Distribution Policy. The motion was seconded by Mr. Gee and approved unanimously.

Investment Policy Revisions Related to Rebalancing

Mr. Halvorson reported that staff and Callan worked together to review rebalancing points and asset class ranges. Equities will be rebalanced vs. bonds when they stray more than 3% from the 70/30 target and domestic equities will be rebalanced vs. international equities when they stray more than 5% from target.

Mr. Kealey made a motion to approve the proposed rebalancing changes to the investment policies for the Endowment Fund. The motion was seconded by Ms. Simmons and approved unanimously.

Mr. Halvorson informed the EFIB that the Parks and Recreation Board recently approved an EFIB staff recommendation to increase international equities for the Ritter Island endowment to 30% of the equity portfolio, up from 20%. As a result, staff has prepared appropriate modifications to the Ritter Island investment policy.

Mr. Gee made a motion to approve the proposed asset mix changes to the investment policy for the Ritter Island Endowment. The motion was seconded by Mr. Kealey and approved unanimously.

Ms. Becker-Wold departed at 2:00 p.m.

EFIB Staff Reports

Ritter Island Endowment Fund – Mr. Halvorson reported that the fund's April-to-date returns are up 5.3% and since inception are down 9.5%.

Market Value Report, Expense Report, Coverage Ratio, Land Revenues vs. Forecast – Mr. Potter reported that EFIB is expected to finish 9% under budget for expenses.

Timber Market Update – Mr. Johnson reviewed three graphs on key drivers to land revenues, all of which show continued weakness.

Gift Log – There were no questions on the Gift Log.

Upcoming Issues – Mr. Johnson reviewed upcoming agenda items for the August meeting.

School Bond Guarantee Program – Ms. Weaver indicated that a draft of administrative rules for the school bond guarantee process has been written and asked for direction from the board regarding fees.

Mr. Heinrich made a motion to assess an application fee of actual cost up to \$1,000 for administrative expenses. The motion was seconded by Ms. Sugiyama and approved unanimously.

After further discussion, Mr. Kealey stated that it was consensus of the board that staff and legal counsel also explore charging a basis point fee for guaranty/insurance.

Executive Session

At 2:20 p.m., Mr. Gee made a motion that the board enter Executive Session pursuant to *Idaho Code* §67-2345 for the purpose of personnel/agent matters §67-2345 (1)(b) and consideration of records exempt from public disclosure §67-2345 (1)(d). The motion was seconded by Ms. Sugiyama and approved unanimously. The board went into Executive Session at 2:20 p.m.

The roll call vote was as follows:
Chairman Dean Buffington – Aye
Gavin Gee – Aye
Representative Black – Aye
Vaughn Heinrich – Aye
Tom Kealey – Aye
Susan Simmons - Aye
Richelle Sugiyama – Aye
John Taylor – Aye
Senator Winder – Aye

Guests present during Executive Session:
Larry Johnson (first five minutes)
Julie Weaver

At 2:49 p.m., a motion to return to regular session was made by Mr. Gee, seconded by Senator Winder and approved unanimously.

Mr. Heinrich made a motion to approve the plan prepared by Mr. Johnson dated May 18th to achieve legislated personnel cost reductions. The motion was seconded by Senator Winder and approved unanimously.

Adjournment

There being no further business to come before the Board, Mr. Gee made a motion to adjourn, seconded by Ms. Sugiyama, and passed unanimously. The meeting adjourned at 2:51 p.m.