MINUTES
PUBLIC MEETING
February 15, 2013
9:00 am
State Auditor's Conference Room

I. Call to Order/Roll Call

Auditor Tim Berry called the meeting to order at 9:03 am. Other committee members present were, Zac Jackson, Deputy Budget Director, Mike Frick, Deputy Treasurer, Steffanie Rhinesmith and Martha Lake. Also present were Kirke Willing; Deputy Auditor, Jaimie Beisel with Great-West Financial (Third Party Administrator to the Plan), Mike Paton of Barnes & Thornburg (Counsel to the Committee and the Administrator), Tiffany Spudich and Joe Bill Wiley with Capital Cities (Investments Consultants to the Committee) and Erin Sheridan with the Auditor of State's Office.

II. Reading of the Minutes

Tim Berry asked for a motion to approve the minutes from the November 16, 2013 meeting. After suggesting minor grammatical errors be corrected, Mike Frick moved to approve the minutes. Steffanie Rhinesmith seconded. The minutes were approved unanimously.

III. Administrators Report

Auditor Berry welcomed newly appointed board member Zac Jackson to the committee meeting. Zac is the appointee of newly elected Governor Mike Pence.

Kirke Willing from the State Auditor's office gave the Committee a brief synopsis of the Agreed-Upon Procedures Report for 2012 that was performed by BKD LLP. The procedures are performed annually in due diligence at the request of the Administrator to ensure that both the Plan Sponsors (State and Local Governments) and Great West Financial are complying with the requirements set forth in the Plan Document. The report also helps focus on changes that will help continually improving the Plan.

Also, Auditor Berry noted that Indiana Code 5-10-1.1-4(h) requires the Committee report to the State Board of Finance annually on the status of the Hoosier S.T.A.R.T. Deferred Compensation Plan. Auditor Berry will present the 2012 Annual Report provided by Capital Cities to the State Board of Finance at their March 19, 2013 meeting.

IV. Management Consultants Report

Market Review

Joe Bill Wiley from Capital Cities began the meeting with a Market Overview that he presented to the committee. Concern over policy uncertainty within the market environment remained center stage in 2012, and it continues into 2013. Overall, the road ahead is still likely to be rocky and the actions of policy makers will continue to shape the markets. U.S. Economic growth in 3Q12 was revised upward by 0.4% in late December to just above 3%, well ahead of the 20-year average rate in the post-2008 recovery. Results for 2012 showed a sharp jump in all equity segments, fueled by a strong first and third quarter. International markets staged a remarkable comeback from steep drop in 2011, although not enough to recoup their losses.

Equity styles performed in line with one another for the year, with the bulk of the return earned during the "risk on" environment of the first three months. Additionally, investors should expect continued volatility as dramatic equity markets swings will adversely impact returns and fixed income will be limited in providing meaningful long-term protection.

Capital Cities continues to recommend proactive asset allocations and risk assessment based on future capital needs for both plan sponsors and individual investors, given the risks in the market. We continue to forecast muted returns and increased volatility across asset classes. Due diligence reviews and an adherence to a well-develop investment policy remain the most prudent long-term course for investors.

Manager/Operations Update

During the September meeting, the Committee voted to offer a new Indiana Flexible Bond Fund as a stand-alone option and as a component of the Indiana Target Date Funds. Reams Unconstrained, Lazard Global Core Plus, and PIMCO Unconstrained were selected to comprise the Indiana Flexible Bond Fund, with each manager representing one-third of the Fund. Unfortunately, Lazard and Great-West could not come to an agreement with regards to the Lazard Global Core Plus commingled product due to some issues on Lazard's side. Lazard has proposed their mutual fund at an expense ratio of 80 basis points which is 35 basis points more than the commingled fund that was originally presented to the Committee. Capital Cities recommended proceeding with a 50% PIMCO and 50% Reams structure for the Indiana Flexible Bond Fund (69 basis point expense ratio) and then look to potentially diversify the composition of the Fund in the future, as assets grow.

Steffanie Rhinesmith made the motion to proceed with PIMCO and Reams recommendation for the Indiana Flexible Bond Fund. Mike Frick seconded the motion and the motion was carried unanimously

Target Date Funds Construction Discussion

During the November meeting, the Committee also voted to include new exposure to Passive International Equity, Passive SMIP Equity, Unconstrained Equity and Alternatives within the custom Target Date funds only. Today the committee will need to decide how the construction of the Target Date Funds will look going forward with the new Fund Components incorporated into the portfolio with the current components. Tiffany Spudich provided the committee with two options to choose from and explained each in detail. Currently the Target Date Funds glidepath begins at an 80% allocation to equities at the early stage and ends with a static 30% to equities at retirement. The glidepath has been divided into three phases to better focus the manager structure decision. Phase I - Younger Investors (ages 30 and younger) will have a high equity allocation of 80%. Phase II – Transitional Investors (ages 31 to 64) will gradually become more conservative over time with increasing fixed income. Phase III – Retirement Investors (ages 65+) asset allocation will remain static at modest 30% to equities, with the majority of the exposure in fixed income and real return strategies.

Option #1 splits the equity between active and passive management evenly throughout the glidepath, as this allows the portfolio construction to provide better downside protection and upside participation. The fixed income component is divided evenly between Unconstrained and Core/Core Plus within Phase I, while in Phase II this exposure is decreased at the age of 40 as TIPS and Stable Value are introduced. Once in Phase III, the following allocation is maintained as a percentage of fixed income throughout retirement: 40% to Unconstrained, 16% to Core/Core Plus, 14% to TIPS, and 30% to Stable Value. Exposure to Alternatives starts in the glidepath at 10% as a diversifier to equity and fixed income. This exposure grows throughout Phase II to 15% at retirement, as the need for inflation and downside protection increases.

Option #2 splits the equity between active and passive management evenly throughout the glidepath, as this allows the portfolio construction to provide better downside protection and upside participation. The fixed income component is divided evenly between Unconstrained and Stable Value throughout the glidepath. Exposure to Alternatives starts in the glidepath at 15% as a diversifier to equity and fixed income. This exposure grows to 25% at retirement, as the need for inflation and downside protection increases.

There was much discussion about anticipating the performance and if the change would be problematic to the Participants. After further discussion Steffanie Rhinesmith made the motion to adopt Option #2. Zac Jackson seconded, the motion passed unanimously.

<u>Performance & Evaluation Report</u>

Tiffany Spudich from Capital Cities updated the Committee on several funds.

Perkins Mid Cap Value Fund short-term performance (last three-year time period) now ranks in the bottom quartile of peers and has historically underperformed during up markets, while providing protection in the down markets. Long-term performance (last five-year time period) ranks favorable in the top third of peers. The Fund has historically taken less risk than peers and the index. The Fund's more defensive positioning, particularly an average 10% to cash and lack of exposure to highly leveraged companies, has detracted over the short-term. Capital Cities will continue to monitor.

BlackRock Large Cap value continues to be on the Watchlist due to short-term under performance, although Tiffany mentioned progress in the past Quarter. Black Rock has announced changes to the Fund, including the retirement of PM Bob Doll and improvements to the Philosophy/Process. While generally viewed positively, the numerous changes still warrant continued Watchlist status and careful monitoring.

Wells Fargo Adv Capital Growth continues on the Watchlist, but the strategy has displayed strong performance year-to-date, posting a 16.4% return compared to the index at 15.3%, and ranking in the 35th percentile of peers. Capital Cities will continue to monitor firm assets and personnel.

<u>The Fees</u>

All of the Funds in the Plans have expense ratios below the median of their respective peers with the exception of the Fidelity Diversified International Fund, which is slightly above the median. The Indiana

Retirement Funds are competitively priced 37 to 41 basis points.

The approximate investment management fees paid would be $3.5 million, based on 12/31/12 market values. Of which, approximately $280,000 would have been provided to the Plans in the form of revenue-sharing.

$2,027,466 in Administration Fees were collected by Great West during the calendar year 2012 and the actual fees paid to Capital Cities for consulting services in 2012 were $75,375.

IV. Old Business

V. New Business

No new business was reported.

VI. Adjournment

There being no further business before the Committee the meeting was adjourned at 10:08 a.m. Next scheduled meeting will be on May 17th, 2013.