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3 NEW YORK CITY TEACHERS RETIREMENT SYSTEM

4 INVESTMENT MEETING

5

6 Held on Monday, September 13, 2010

7 at

8 55 Water Street,

9 New York, New York

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1 ATTENDEES:

2 MELVYN AARONSON, Chairperson, Trustee
NELSON SERRANO, Teachers Retirement System
3 LARRY SCHLOSS, Comptroller's Office, Trustee
SANDRA MARCH, Trustee
4 MONA ROMAIN, Trustee
RANJI NAGASWAMI, Office of Management and Budget
5 DIANE BRATCHER, Finance, Trustee
THAD McTIGUE, Comptroller's Office
6 MARTIN GANTZ, Comptroller's Office
JOHN DORSA, Comptroller's Office
7 SEEMA HINGORANI, Comptroller's Office
JOHN MERSEBURG, Comptroller's Office
8 KEN SYLVESTER, Comptroller's Office
9 MORAIMA PARES, Comptroller's Office
MARC KATZ, Teachers Retirement System
10 YVONNE NELSON, Comptroller's Office
11 JOEL GILLER, Teachers Retirement System
12 SUSAN STANG, Teachers Retirement System
13 ROBERT C. NORTH, JR., Actuary
14 MICHELLE DAVIDSON, PCG
15 ROBIN PELLISH, Rocaton
16 CHRIS LYON, Rocaton
17 ROBERTA UFFORD, Groom Law Group
18 STEVE BURNS, Townsend
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1 P R O C E E D I N G S

2 (10:10 a.m.)

3 MR. SERRANO: We are going to begin the

4 September 13, 2010 investment meeting of the

5 teachers retirement board by calling the

6 board.

7 Melvyn Aaronson?

8 MR. AARONSON: Here.

9 MR. SERRANO: Kathleen Grimm? Note that

10 she is not present.

11 Tino Hernandez? Note that he is also

12 not present.

13 Larry Schloss?

14 MR. SCHLOSS: Present.

15 MR. SERRANO: Sandra March?

16 MS. MARCH: Here.

17 MR. SERRANO: Ranji Nagaswami?

18 MS. NAGASWAMI: Here.

19 MR. SERRANO: And Mona Romain?

20 MS. ROMAIN: Here.

21 MR. SERRANO: Okay, we do have a quorum.

22 And, first off, I would like to welcome

23 Ranji Nagaswami as the new representative for

24 the mayor. Welcome to the team. We do have

25 the quorum and if the board would like

1 to --

2 MR. SCHLOSS: I would like to nominate

3 Mel.

4 MS. NAGASWAMI: I would second that.

5 MR. SERRANO: All in favor say aye.

6 (All said aye.)

7 Any opposed, any abstentions?

8 Okay, Mel, it's all yours. You are the

9 acting chairperson.

10 MR. AARONSON: Okay. First thing as

11 acting chairperson, I would like to

12 congratulate Ranji on her appointment to the

13 board and hopefully we are going to work very

14 well together and do the best we can for

15 members and beneficiaries of the system.

16 MS. NAGASWAMI: Thank you.

17 MR. AARONSON: First, we are going to do

18 public session and I believe that the variable

19 A public agenda is first.

20 MR. LYON: Okay. So good morning,

21 everyone, and I would like to start by

22 presenting the green-bound quarterly reports

23 that everyone should have a copy of, and we

24 are going to cover the variable funds

25 investment through June 30th. In the interest

1 of time I am going to go through just some
2 brief highlights and observations. And if
3 anyone has questions at this meeting, feel
4 free to ask. Or as you take this with you if
5 you have questions at the next meeting, feel
6 free.
7 On the first page -- I will bring you up
8 to speed later on how the markets have done
9 subsequently, but we do have performance for
10 various programs behind tab 1 on page 1 end of
11 June 30th. And just to refresh your memory,
12 you recall the second quarter was a pretty
13 rough quarter for most of the major markets,
14 particularly the equity markets. And you can
15 see many of the markets were down 10 percent
16 plus, so that's the backdrop on the equity
17 side. While on the fixed income side, it was
18 a particularly strong market with rates coming
19 down. The longer duration, the better for
20 fixed income as well.
21 When we get into the actual specific
22 programs, the first program is the diversified
23 equity fund behind tab 2, also known as
24 variable A. And you can see there are some
25 highlights on page 3. For the quarter, the

1 fund was down 10.84 percent after fees, which
2 was a little better than the Russell 3000 but
3 more in line and slightly behind the
4 diversified hybrid benchmark. For the year
5 the fund was up 14 percent, which was behind
6 the Russell 3000 but closer to the hybrid
7 benchmark. And over the longer haul, you can
8 see the performance observations for three and
9 five years. For three years the fund returned
10 minus 9.8 percent. It's a little behind the
11 Russell 3000, but the funds returned core net
12 of fees. For the five-year period the fund
13 was almost flat on an annualized basis,
14 negative 30 basis points for the five-year
15 period and that was a little bit ahead of the
16 Russell 3000.
17 You can also see variances of the hybrid
18 benchmark. Importantly, and there is an
19 exhibit on this, that we tend to look at very
20 regularly together the fund has had less total
21 return volatility than the broad equity
22 market. The fund is predominantly invested in
23 equity. It does have some other diversified
24 strategies and the defensive composite.
25 During the quarter was down only 5.44 percent,

1 so it was only half as negative. So it does
2 provide some degree of downside protection,
3 though still a negative return. And you can
4 see over the longer haul, the composite
5 had -- and over the five-year period not only
6 has it had less risk, but it also enhanced the
7 return of variable A.
8 The international, you can see some
9 comments here that it did outperform during
10 the quarter though it went down 13.36 percent,
11 so down even more than variable A. But,
12 again, over the long haul, let's define that
13 as five years for the moment, the
14 international equity composite has helped
15 total returns for variable A. So the
16 diversification benefits have been there, but
17 these would have been return enhances during
18 this particular five-year period.
19 And the composites of the variable A
20 fund were generally in line with their target,
21 but we do have some assets allocated on an
22 interim basis that would normally be in the
23 active composite that are in the passive
24 composite, and that explains the biggest
25 deviations from the published targets.

1 There is a lot more information in this
2 section, but I believe I covered everything in
3 text format. So I will just pause and see if
4 there are any questions on variable A.
5 And hearing none, I will move onto
6 variable B.
7 And variable B on page 16, you can see
8 that variable B the quarter ended at $422
9 million in assets. These were split roughly
10 equally between two managers, BNY Mellon
11 Stable Value and NISA. And variable C D and E
12 are contained on tab 4 starting on page 18 of
13 the observations and you can see the sizes of
14 each of the funds. C is international equity
15 fund at around $56 million at quarter end. D
16 is the inflation protection fund around $14
17 million at quarter end. And E is the socially
18 responsive equity fund around $13 million at
19 quarter end.
20 And commenting briefly on performance of
21 these options still on page 18 for the
22 quarter, the international equity fund which
23 is unitized with the international composite
24 variable A returned minus 13.3 percent, a
25 little bit behind its benchmark. And for the

1 one-year period you can see the fund is
2 meaningfully ahead of over 6 percent, its EAFE
3 benchmark.
4 The inflation protection fund for the
5 quarter returned 2.2 percent, just behind one
6 of its benchmarks but ahead of CPI. And,
7 again, all these returns on the funds are net
8 of head fees. And for the one-year period,
9 the inflation protection fund has outperformed
10 its benchmarks by 8.6 percent and 11 percent.
11 Lastly, the socially-responsive equity
12 fund was down just under 7 percent for the
13 quarter. That was a meaningfully, better than
14 the S&P 500 at 11-1/2 percent for the
15 benchmark, being liberal about rounding. And
16 for the one-year period, you can see the fund
17 has outperformed by 3-1/2 percent net of fees.
18 MR. SCHLOSS: Do you know what the
19 outperformance was in the inflation protection
20 fund?
21 MR. LYON: The inflation protection fund
22 is tactical allocation strategy. It's
23 difficult to benchmark, frankly, but it
24 allocates across a variety of PIMCO mutual
25 funds, so it's not just TIPS. And it has a

1 TIPS benchmark, so some of the value added
2 comes from the tactical elements of the
3 allocation and some of it comes from the
4 underlying allocations. And they invest in
5 all kinds of different funds, but the funds
6 that are the top holdings are listed on page
7 22. So they have a lot of credit exposure,
8 some long fixed income. They can invest in
9 equities, commodities, REITS and other things,
10 but it's typically fixed-income dominated and
11 typically inflation-sensitive, all those
12 things.
13 MS. NAGASWAMI: When they go in and out
14 of these funds, are there fees that are paid
15 or is there a special class to allow us this?
16 MR. LYON: Yes. We are invested in a
17 fund that is structured as a fund of funds at
18 PIMCO, so there is no explicit transaction
19 costs paid by the systems. But, of course,
20 there is transaction fund costs.
21 MS. NAGASWAMI: Are there fund fees, are
22 there layering fees?
23 MR. LYON: No, there is one fee that
24 looks through that includes the underlying
25 fees.

1 MR. AARONSON: Any other questions?
2 MR. LYON: In the back of this
3 report -- which we won't go through, we
4 created it for your convenience.
5 The next topic on the agenda is to
6 review the July 31st performance flashes for
7 the variable A, B, C, D and E funds. And just
8 as a reminder, the June flashes are in this
9 report and were distributed on the e-mail.
10 The July 31st flashes were also distributed in
11 advance and passed out today.
12 The first one is variable A. It's at
13 July 31st. The total value of variable A was
14 $9.01 billion and you can see the asset
15 allocation on the first page. I mentioned
16 earlier that we continue to be overweight 50
17 percent index target, given some money that's
18 been allocated there on an interim basis. And
19 for the most part, that largely explains any
20 over and underweights of significance.
21 If you flip ahead, please, to page 3,
22 you can see in the middle of page 3 where it
23 says "Teachers Total" the performance for the
24 month of the July. The good news is July was
25 a much better month and the total variable A

1 fund was up 6.81 percent net of fees. This is
2 just 13 basis points shy of the Russell 3000
3 and, similar, shy of the hybrid benchmark
4 listed a few lines below for the calendar
5 year-to-date period that brings us up to
6 benchmark. But, nonetheless, we are at
7 negative 1 basis points net of fees
8 performance for the year to date for July
9 31st.
10 And when we look over the course of the
11 month, first of all, you can see that the
12 international composite had the strongest
13 performance during the course of the month, so
14 that did help total returns. And over the
15 course of the year, however, international
16 equities have been more negative and that was
17 their worst performing composite, down a
18 little over 4 percent for the year-to-date
19 period.
20 Pausing for questions.
21 Not hearing any.
22 So the next fund out, we have the
23 variable B, C, D and E flash. Again, the
24 structure for these rolling it forward through
25 July 31st, you can see the asset value at the

1 top haven't changed that much. The
2 performance, the options for month, you can
3 see the international equity fund in the
4 middle of the first set of boxes of
5 performance numbers 8.61 percent, a little bit
6 behind EAFE. For the year to date we are
7 still marginally ahead of EAFE, 4.42 versus
8 4.67 percent negative returns. And then
9 variable D, the inflation protection option
10 for the month. Want to go with the bolded
11 line 32.91 percent meaningfully ahead of its
12 benchmark, which all had zero-point- something
13 percent positive return and for the year to
14 date were up 7.4 percent through July 31st.
15 And the next highest of the benchmark was up
16 3.6, so we are still way ahead.
17 And, lastly, the socially-responsive
18 fund up 4.8 percent. It was behind the S&P
19 for this year, but for the year to date we are
20 up. So the benchmark basically was flat, so 4
21 percent roughly of outperformance.
22 And since inception, all of the
23 performance of all these funds is way ahead.
24 These funds, as everyone recalls, were added
25 25 months ago. And on page 2 you can see that

1 the international option was 6.65 percent
2 ahead, the inflation protection option was 6,
3 the socially-responsive equity fund 4.7
4 percent ahead. So the fund is off to a great
5 start of the past 25 months relative to the
6 benchmarks. We would like to see stronger
7 positive numbers but, nonetheless, off to a
8 good, strong start relative to objectives,
9 anyway.
10 Questions?
11 And the last handout, real quickly, to
12 tell you about the August performance. Some
13 of July is in the bottom line and you can see
14 that equity benchmarks were down, down again
15 for the month of August. In the middle of
16 this handout you can see down 3.86 percent is
17 the hybrid benchmark for the month, so we
18 could expect the variable A return to be
19 something somewhat similar to that, given its
20 low exhibited tracking error. You can see
21 that the all asset fund that your inflation
22 protection option invests in was positive for
23 the month and how your socially-response
24 equity fund did in variable E investment, was
25 down about 5 percent for the month.

1 And I will just pause again and see if
2 there are any questions.
3 Hearing none, that concludes the
4 variable funds public session.
5 MR. AARONSON: Okay, and now we move to
6 the pension fund public report.
7 MR. SCHLOSS: Thanks. Let me hand it
8 over to Martin.
9 MR. GANTZ: So everyone should have a
10 copy of the flash report in front of you. We
11 certainly have extra copies by Larry over
12 there.
13 Before we begin, I want to go through
14 some of the changes and improvements we made
15 to help make this report more informative.
16 First, you will see the column on the
17 left is new. That is a column that shows what
18 we estimate the market values to be as of the
19 date of the flash report, which in this case
20 is September 9th. And that coincides with
21 fiscal year to date, which we are now in 2011
22 of the returns.
23 You will also notice the red and green
24 numbers on the page, and that kind of takes me
25 out of the business of actually doing the math

1 for you and that's simply an easy, handy way
2 to see how we have done fiscal year to date.
3 The two columns on the right have been
4 updated and those are now the fiscal year 2010
5 return results, which we will also go through
6 in a moment in the quarterly report.
7 So I just want to let you know about
8 some of the differences that we made recently
9 for you. So just looking at the numbers, you
10 will see that on the right the fiscal year
11 2010 ended with 14.45 percent return and after
12 fees 14.35, behind the adjusted policy
13 benchmark of 14.92. We will go through that
14 in just a moment, but I do want to point to
15 fiscal year 2011, which is the second column
16 of the numbers on the left, and we have gotten
17 off to a pretty strong start. It's been -- as
18 Chris just went through, July was a good
19 month, August was a poor month and then
20 September, starting on September 1st, the
21 market started rallying again.
22 And the fact that equities had a strong
23 run fiscal year to date and fixed income has a
24 decent run, which for the US fixed income
25 portfolio was 2 basis points behind the

1 Russell 3000 returning 7.28. Non-US equity
2 reversed the underperformance we saw earlier
3 due to the Euro and Greek debt crisis. And
4 non-US equity has outperformed the US equity
5 sector 10 percent. REITS continued strong
6 return, performing 9 basis points ahead.
7 I want to point out that the private
8 equity and private real estate numbers here
9 we're now showing, those are the most recent
10 numbers that we had. And if you look at the
11 footnote, they reflect the numbers ending for
12 the quarter March which you also see in the
13 quarterly report soon. That brings the total
14 equity to 7.78. Fixed income had positive
15 numbers as well. Not quite as good as equity.
16 Fixed income for the core plus 5 was, we
17 estimate, 12 basis points ahead. TIPS did
18 well at 1.30 and enhanced yield was strong and
19 equity-sensitive convertible bonds, but behind
20 the benchmark by 67 basis points.
21 Opportunistic is at 2.12, bringing the total
22 to 2.26.
23 When you bring it all together, we
24 estimate the total teacher fund as of
25 September 9th for the new fiscal year is up

1 5.92. And backing out public market fees, we
2 have an adjusted policy benchmark of 6.71 and
3 we estimate the market value has increased
4 from 34.7 billion to 36.9 billion as of
5 September 9th.
6 Are there any questions?
7 MR. AARONSON: Any questions?
8 Thank you, Martin.
9 Now we are going to do --
10 MR. SCHLOSS: Do the quarterlies.
11 MR. GANTZ: If you don't have the
12 quarterlies, we should have some extras here.
13 I think they are by Larry. Oh, David has
14 them.
15 Volatility in the financial markets as
16 Chris mentioned before and as I mentioned
17 before, it was -- if you remember back in the
18 June quarter, that's when the Euro crisis and
19 specifically the Greek debt crisis came to
20 markets and there was definitely a flight to
21 quality trade into risk notably treasury. As
22 you will go see later on, that lower treasury
23 yields helped fixed income returns. At the
24 same time, economic indicators pointed to a
25 slower growth and we still had stubbornly high

1 unemployment. However, the year ending June
2 30th, the fiscal year, was still a strong year
3 on an absolute basis.
4 So if you turn to page 9, you will see
5 the returns for the funds as a whole and the
6 returns for the quarter were negative at minus
7 5.87, but that was 120 basis points ahead of
8 the benchmark. Returns for the year were
9 strong at 14.38 and that was behind by 5 basis
10 points. But if you take a look at the longer
11 term numbers, they are roughly 30 basis points
12 consistently ahead of the policy benchmark
13 going out all the way out to 15 years.
14 Next page shows on top of the page the
15 pie chart where we summarize where the assets
16 are actually invested. And here we have the
17 largest slice, the red slice, which represents
18 domestic equity, which is mostly Russell 3000.
19 The bottom part shows where we are
20 underweight, overweight versus policy. And
21 you will see, for the most part, we were
22 within rebalancing ranges. You will see the
23 green bar, that represents the uninvested
24 portion in private real estate and that is
25 invested in US equity. Core plus 5 and high

1 yield are slightly overweight and non-US
2 equity was slightly underweight. Overall
3 total equity at the end of the fiscal year was
4 at about 67 percent.
5 Next few pages shows the attribution of
6 returns. First page, which is on page 11,
7 shows the returns for the quarter ending June
8 30th and that was a negative quarter, as you
9 see. We break it down with the allocation
10 effect and the management effect, which shows
11 the allocation effect is how the fund did due
12 to overweights or underweights versus policy
13 and the management effect is how the managers
14 themselves did versus the benchmark. The
15 allocation was a very slight 3 basis points
16 positive and the management effect, the
17 managers did well versus the benchmark in a
18 down market. So while the numbers were
19 negative, the policy benchmark was a steeper
20 negative.
21 Page 12 shows the one-year numbers,
22 meaning now positive numbers, and you see the
23 allocation effect is negative. That's
24 primarily due to overweight for most of the
25 period in fixed income and some cash.

1 However, the management effect continues to be
2 positive at 40 basis points and we will go
3 through that in more specific detail in a
4 moment.
5 Finally, the three-year numbers are on
6 the following page. Again, these are negative
7 numbers overall, but the allocation effect and
8 management effect -- in other words, managers
9 beat their benchmarks overall and the
10 overweight to fixed income helped in a down
11 market.
12 Next page is a summary of the management
13 effect, and there are a couple of numbers I
14 want to point out. What really drove returns
15 here was EAFE markets really doing well, and
16 you will see that on the slide later, adding
17 value. And also the domestic fixed, which is
18 the core plus 5. You will see the private
19 equity and private real estate showing
20 negative numbers, but those are really due to
21 lag effects of returns. But they are smoothed
22 out over time, as you will see in the
23 three-year column.
24 Next two pages show how teachers did
25 versus other large public funds. For if you

1 look at the middle of the page under the June
2 10th column, you will see the return 14.39
3 placed you in the 22 percentile. That's top
4 quartile. However, for the quarter ending
5 June, results of minus 5.87 placed you in the
6 81 percentile. So for the years ending '09
7 and 2010 you will see during the year you are
8 in the top quartile and not -- that obviously
9 is good compared to other large funds. Longer
10 term results are on page 16, as you will see.
11 Primarily the differences that you will see
12 here relate to asset allocation differences
13 and the single biggest difference is a large
14 exposure to US equity, so we are really tied
15 to the US equity market unless we have more
16 diversification in other asset classes.
17 Turn to page 18, we start the equity
18 discussion. And that pie chart shows clearly
19 the red slice is the largest allocation.
20 That's US equity, that's 63.5 percent. As I
21 mentioned, your total fund is at 67 percent,
22 total equity 23.4 billion.
23 The next page shows where the domestic
24 equities were allocated. And as you see by
25 far in the chart on the top and also the table

1 on the bottom, the assets here in US equity
2 side are clearly driven by the passive Russell
3 3000 results, which represent over 90 percent
4 of the allocation. If you happen to look
5 under the index return column on the table,
6 you will see that small cap did better than
7 large cap, although both numbers were
8 negative. Small cap minus 9.92 and large cap
9 was minus 11.44.
10 Next page, page 20, shows how the small
11 cap manager results fared for the periods.
12 And, again, the numbers were negative/minus
13 7.59, but that was over 200 basis points ahead
14 of the Russell 2000 index. For the one-year
15 record that the manager has, the results are
16 stronger on an absolute basis. Over 20
17 percent, but behind the benchmark by 96 basis
18 points.
19 The large cap returns are shown on the
20 next page and here the management trailed the
21 benchmark for the quarter and the year. And
22 similar to the small cap story, returns for
23 the year were good on an absolute basis but we
24 are behind by 107 basis points. Managers also
25 underperformed by 85 basis points. Again,

1 these are active managers in large cap space.
2 Page 22 shows the emerging manager of
3 managers program that is shown versus the
4 Russell 3000 index. Similar thing here,
5 negative results for the quarter, strong
6 positive results for the year. You will see
7 versus the benchmark, the managers
8 outperformed. But I do want to point out
9 there are a number of managers who are
10 benchmarked to small cap and mid cap. And as
11 you saw on the previous page, small cap and
12 mid cap outperformed large cap. Russell 3000
13 is mostly large cap and that primarily
14 explains the outperformance that you see here.
15 We will go over more of that in detail later
16 in the executive session.
17 Next page is probably one of the more
18 important pages. Page 23 shows how the
19 passive results did versus the Russell 3000.
20 This is 40 percent of the overall fund for
21 13.8 billion. And as you would expect, as we
22 had hoped, the managers did well. Tracking
23 the benchmark very closely, within just a few
24 basis points for the quarter and for the year,
25 as well as going out to the 15-year period

1 that we have. The returns were 15.76 for the
2 year and minus 11.29 for the quarter.
3 The next page is total domestic equity,
4 but those numbers look very similar to the
5 page before since over 90 percent of this is
6 driven by passive results. So those numbers
7 are very, very similar. Strong absolute
8 results and relative results for the year and
9 a large negative, over 11 percent for the
10 quarter.
11 Non-US equity starts on page 25 and here
12 on the top pie chart, it's really simple.
13 It's all red, that's because it's all actively
14 managed. And the bottom part of the pie chart
15 shows you the assets are diversified between
16 value growth and core in the developed market
17 space.
18 As far as returns for the EAFE markets,
19 that is on page 26. And here as I mentioned
20 before, because of the Euro crisis during the
21 quarter, EAFE markets, developed markets did
22 worse than the Russell 3000 or US markets.
23 And the results were minus 12.05, but that was
24 significantly ahead of the EAFE index of
25 13.97. That's almost 200 basis points ahead.

1 And for the year it was actually very strong
2 results of 8.89, which is almost 300 basis
3 points ahead of the EAFE index. If you go out
4 in time over the long-time periods, the
5 program has consistently been ahead of the
6 EAFE index. Now, for some, strong one-year
7 results. These are the strongest one-year
8 results.
9 You will see here on page 27 this is
10 from the REITS portfolio. The REITS market,
11 as you know, rebounded strongly almost
12 doubling from their March lows. But for the
13 period year ending June, the results was 55.73
14 for the year. That was 38 basis points behind
15 the benchmark. The quarter, while negative,
16 was a much smaller negative and it did beat
17 the benchmark by 153. I also want to point
18 out because of the scale of the chart to
19 accommodate, the 55 percent doesn't quite
20 stand out. But if you look at the second year
21 result since we have had the program, it's
22 returned 9.67 percent and was over 180 basis
23 points ahead of the benchmark.
24 And, finally, for equities we have the
25 activist and environmental sustainable

1 strategies and we show those on page 28.
2 Fixed income starts on page 30 and we have the
3 pie chart that shows where the assets are
4 invested. Largest slice belongs to the core
5 plus 5 structured programs at over 56 percent
6 and the fixed income assets were over about 33
7 percent of the total fund, off 11.6 billion as
8 of June 30th.
9 Now for something different. On page 31
10 you will see some positive quarter results.
11 If you look at the index return and actual
12 return column on the page, you will see the
13 government sector did extremely well returning
14 over 8 percent. The mortgage and credit
15 sectors also did well returning over 3
16 percent. This is clearly due to flight in the
17 quarter. Certainly the treasury, the 10-year
18 treasury as you will see later on, went from 4
19 percent to below 3 percent. The 2-year note
20 went to, I believe, a historic low of 0.6
21 percent during this time. This is, again, in
22 the flight to quality trade when people were
23 trading out of risky assets.
24 As far as the sectors, the government
25 sector slightly outperformed mortgage sector

1 outperformed. Credit sector was behind by 4
2 basis points. We were underweight in the
3 government sector and overweight in credit and
4 mortgage, this slightly detracted from returns
5 since the government sector did so well. But
6 overall the returns were very strong, as you
7 will see on the next page where we show the
8 returns for the program as a whole. And all
9 the returns going out in time are positive,
10 above the zero percent line. It was strong
11 for the quarter and for the year. The quarter
12 was 4.13 percent, 6 basis points behind the
13 benchmark. And for the year 12.33, 184 basis
14 points ahead.
15 As you will recall with the poor results
16 we had in 2008 and with the strong results we
17 have seen over the last year and a half, we
18 are now very close to being back on track in
19 our program. In particular, you can take a
20 look in the appendix. The government
21 sector -- I know we had this discussion
22 probably about a year ago when we did the RFP.
23 The government sector actually had -- in
24 addition to outperforming on an absolute
25 basis, the managers themselves have done very

1 well versus the benchmark.
2 TIPS returns are shown on page 33. The
3 managers here are very similar to the page you
4 saw before. The results were good. For the
5 year, just shy of 10 percent. And for the
6 quarter, a little over 4 percent. Across the
7 board since inception, the managers have
8 beaten the benchmark by about 20 to 30 basis
9 points. These returns were primarily driven
10 by lower rates. TIPS has an inflation
11 component. There is inflation component, but
12 there is also a component that's related to
13 interest rates and real rates declined and,
14 thus, the strong returns.
15 High-yield results are on page 34 and
16 for the quarter the results were flat, 5 basis
17 points behind the benchmark. But for the year
18 it was very strong, 19.65. That was 27 basis
19 points ahead of the benchmark. And you will
20 see going out ten years, which is the year of
21 the inception of the program, the results are
22 strongly positive versus the benchmark.
23 Convertible bonds is on page 35. This
24 is a relatively new program. These are more
25 aligned or have attribution that would show

1 that their sensitivities are closely aligned
2 with equities in certain markets and that's
3 why you see the negative minus 4.73, but that
4 was 62 basis points ahead of the benchmark.
5 Now, for the year you see the returns, the
6 blue bar, are 17.18, but that was almost 500
7 basis points behind the benchmark. But we now
8 have a two-year record as of June 30th and I
9 want to point out that the two-year record at
10 2.03, which now encompasses the down market
11 and now the rebounding upmarket, is the 129
12 basis points ahead. What we have seen so far
13 since inception of this program, it seems that
14 the managers have been doing very well in flat
15 and down markets and less well in upmarkets.
16 Again, we will see how the program evolves,
17 but since inception they are nicely ahead of
18 over 129 basis points.
19 Last chart I am going to go through, the
20 opportunistic fixed incomes. And those are
21 not misprints, these results were very, very
22 strong. Over 30 percent ahead of the
23 benchmark. Stronger on an absolute basis
24 returning over 43 percent. This is as the
25 market recovered. The quarterly numbers that

1 you see are behind the benchmark. The
2 numbers -- we have a revised number that came
3 out after this book was printed and that
4 number was also over the benchmark. We will
5 send everybody a revised copy as soon as we
6 are able to. That changes/affects the bottom
7 line very slightly, but it makes the quarter a
8 positive number.
9 And, lastly, on page 37 we have ETI
10 results. And Cathy Martino is going to take
11 you through that in a little bit more detail.
12 MS. MARTINO: Good morning.
13 Just a reminder that the returns are
14 shown net of fees, which average about 27
15 basis points on an annual basis. The
16 portfolio, it mostly starts to look at the
17 custom benchmark. It was behind in the first
18 quarter and pretty close for year to date and
19 12 months and outperformed both benchmarks
20 over the longer period, which is what we
21 expect from this portfolio.
22 If you would now turn to page 7 in your
23 board package, just look quickly at some
24 collateral benefits. The first page is your
25 public private apartment rehabilitation

1 program and we saw new commitments from three
2 of your newer lenders and almost 9 million of
3 commitments from CPC, one of your oldest
4 lenders, and we saw big deliveries from CPC of
5 $6 million. And the charts on the bottom
6 shows you the boroughs in which those
7 investments have been made on the left, and
8 where they are committed on the right.
9 The next page 8 is your AFL-CIO housing
10 investment trust. You know they continue to
11 invest in New York City. On the right what I
12 have charted is the --
13 MS. MARCH: Can we take our other real
14 estate money and give it to them? Because
15 they seem to know what they are doing.
16 Hi, Yvonne.
17 MS. NELSON: Hi.
18 MS. MARTINO: They do really well and I
19 agree.
20 MR. SCHLOSS: Lending consultant.
21 MS. MARTINO: They are doing really
22 well, but what I charted on the right is HIT
23 Home loans to teachers in the city. And
24 although we only tried phase II, since they
25 began investing and started this HIT Home

1 program over 1,044 teachers have received home
2 loans through that program, which is great.
3 They get lower fees and, you know, aren't
4 getting abusive lending terms.
5 Page 9 is workforce housing initiative.
6 Nothing changed in this quarter from last, but
7 I do know in the current quarter they made a
8 big investment in student and teacher housing,
9 and that's very exciting.
10 Page 10 is your CPC revolver's
11 construction line of credit and the chart
12 shows you where construction is taking place
13 in the city's low/moderate income neighborhood
14 via this vehicle.
15 The next page is access capital, page
16 11. Again, that's a stable portfolio, not a
17 lot of activity at this point. And the chart
18 shows you where investments have been made
19 since the beginning of this investment in
20 multifamily and single family, all five
21 boroughs.
22 And the last page, page 12, is a
23 breakdown of returns by investment managers.
24 Are there any questions?
25 Thank you.

1 MR. AARONSON: Thank you Cathy.
2 MS. NELSON: This is a tough act to
3 follow, but if you turn to page 16 we will
4 talk about some of the highlights of the first
5 quarter, 2010, in the teachers real estate
6 portfolio. The good news is it's positive.
7 MS. MARCH: Hurray.
8 MS. NELSON: The return for the quarter
9 is 3.3 percent for the teachers portfolio,
10 whereas the industry benchmark that we have
11 been using, which is the NPI, is closer to 4.8
12 percent return for the quarter. After fees
13 the portfolio return is 2.4 percent for
14 teachers. The portfolio at this point has a
15 market value of about $366 million, there is
16 about $387 million that's unfunded, and
17 together that's $753 million.
18 Now, here is a commentary from Townsend
19 that follows below. And they will be here in
20 executive session to talk about the markets
21 more in depth and some funds in particular,
22 but specifically they noted that they believe
23 that real estate has kind of seen its worst.
24 And I kind of looked around at other indices
25 that indicate that same trend. The Moody's

1 index for real estate commercial property
2 index has turned positive as well. And if you
3 kind of look at what the worst was, that
4 particular index which tracks real estate
5 values went down 43.7 percent from the
6 beginning of '08 to first quarter '09 and that
7 index has also turned positive for the next
8 quarter. The NPI itself suffered a loss of
9 about 30 percent during that same time period.
10 So across the board investors in the asset
11 class have experienced some severe declines,
12 but real estate is turning the corner.
13 The thing about real estate that we have
14 to keep in mind is that it does lag other
15 asset classes. It really does need employment
16 in order to really get things going. So even
17 though we have turned the corner, we expect
18 the recovery to be somewhat slower gradually.
19 If you kind of look at the graph down at the
20 bottom, you will see that our portfolio
21 performance has been a bit uneven. Thank
22 goodness we do have a positive quarter for the
23 near term. And then as you can see for the
24 one year and the three year, this represents,
25 you know, what we have just been talking about

1 in terms of the severe downturn, but in later
2 periods the program has performed against this
3 benchmark. And just to kind of keep in mind,
4 that's what real estate is all about. It is a
5 long-term play. And so in terms of our
6 long-term performance, we are on track.
7 On page 17 is just a graphical depiction
8 of, you know, the performance versus the NPI.
9 The bottom, if you have a magnifying glass,
10 you can see the gross and net returns over
11 several periods.
12 On the following page, page 18, we are
13 going to take a closer look at the composition
14 of the portfolio to see whether or not we are
15 operating within the policy guidelines that we
16 set forth when we established real estate as
17 an asset class.
18 You recall that originally the program
19 had a 3 percent allocation that was increased
20 to 5 percent in December, 2007. The program
21 based on current assets, this is first
22 quarter. But second -- but it wasn't changed
23 that month, so the program size potentially is
24 $1.8 billion. We kind of break that out in
25 accordance to what the investment policy

1 statement says. There is a 40 percent
2 component set aside for core, core plus
3 strategies. These are the low-risk strategies
4 where properties are supposed to be
5 significantly -- need very little leverage.
6 And the noncore space, that's a little bit
7 more along the risk curve of some new
8 developments, some development. And it also
9 contains our emerging manager program, which
10 we know has a permit set aside of 5 percent of
11 the real estate allocation, that we do have
12 three managers in that space today.
13 So in terms of what the program looks
14 like today in terms of funded and committed
15 basis, we are 35 percent core. We are 65
16 percent noncore. Another 35 percent, of
17 course, is slightly under the 40 percent that
18 we just talked about but, as you know, over
19 several years we have been tracking real
20 estate as best we could. One thing we did
21 recognize a couple of years ago is that in the
22 core space, the prices were really just white
23 hot and we kind of refrained from making
24 different commitments in that space. And so
25 we have a temporary overweight based on what

1 we are seeing in the markets today and what
2 Townsend put in the annual plan. We are going
3 to look back at core and look at some
4 distressed strategies in terms of the
5 strategies that we are going to be looking at
6 as the market recovers.
7 Down at the bottom just talks about a
8 summary of the cash flow between managers and
9 teachers. You know, we have 32 investments,
10 we have 25 managers and for the quarter there
11 were contributions sent to about 17 managers,
12 and we had about 5 managers that distributed
13 some cash to us in terms of either profits or
14 just property operations.
15 The following page, on page 19, is just
16 an important metric box to kind of checkoff
17 the boxes in terms of where we are in terms of
18 risk. We talked about the fact that the
19 portfolio on the long-term basis is tracking
20 its benchmark, although we do have some, you
21 know, one year and two year turbulence in
22 terms of portfolio composition. We just
23 talked about the fact that, you know, we are
24 slightly underweight in core. We think that
25 we would be bringing you some things shortly

1 to kind of bring us back to that 40 percent
2 core. We are committed, 2 percent of the
3 program is committed at this point and 1
4 percent is invested at this point, but we are
5 really working hard to grow the program and
6 bring you some returns.
7 In terms of leverage, the policy is 50
8 percent and we are currently at 62 percent.
9 Here, again, is definitely the impact of the
10 valuations that you have been seeing, the
11 lower valuations, that kind of push up that
12 leverage point within the program. Here,
13 again, we think that is core and we certainly
14 do not have any exposures to any particular
15 manager greater than 25 percent.
16 Lastly, on page 20 the portfolio is
17 depicted for you in terms of property type and
18 geography. And I just wanted to point out on
19 property type, there is something called
20 student housing here. Some of the things that
21 you have been hearing a lot in real estate,
22 folks are trying to identify recession-proof
23 strategies and student housing is one.
24 MS. MARCH: I know how we avoid
25 recession-proof strategy.

1 MS. NELSON: And some of the managers
2 are starting to explore student housing,
3 senior housing, medical office. And pro and
4 con on that is that, you know, programs
5 perhaps they do exhibit those characteristics,
6 but it's a very specialized area and you have
7 to kind of make sure that you are teamed up
8 with the right partner.
9 Lastly, down below it shows the
10 diversification of the portfolio by geography.
11 And we will take on more questions now
12 or later on when in executive session.
13 MR. SCHLOSS: Thank you, Yvonne.
14 Liz, you want to do private equity for
15 the quarterly?
16 MS. CALDES: So I am starting on page 25
17 of your booklets. This is the quarterly
18 report for the first quarter 2010. This
19 year's performance, we will start off there,
20 since inception for IRR was 6.6 percent and it
21 actually underperformed against the Russell
22 3000 plus 500 basis points. It came out at
23 8.3 percent but still performed against the
24 venture capital median, which was negative 0.4
25 percent. Your policy target is 4 percent and

1 you continue to stay a little over-allocated
2 at 4.4 percent private equity.
3 Turn the page, you will see that your
4 allocation is as such. 70.3 percent in
5 corporate finance, 11 percent in venture
6 capital, distressed and mezzanine remain at 6
7 percent. Secondary fund of funds and
8 co-investments at 12 percent. And here you
9 are underweight in distressed particularly,
10 and those are some areas we are looking for
11 across all the systems for new opportunities
12 as well as secondary.
13 In terms of your portfolio summary, a
14 couple of things I would like to point out
15 which are on page 27 at the table. One is
16 that you will see your contributions pick up
17 from the first quarter of 2009, so it's a
18 small percentage increase. However, you will
19 see the contributions were coming up between
20 the second quarter, third quarter and fourth
21 quarter 2010 and started coming back down at
22 66.5 percent.
23 You will see also, which is good news,
24 that your distributions did have a slight
25 increase from the first quarter of 2009, so

1 clearly a huge improvement from a year ago.
2 And you will see that your portfolio
3 appreciated by 67.1 percent, and that's really
4 reflective of 48 funds that had write-downs of
5 70 million in value and 71 funds that had
6 write-ups of 74 million in value. So the
7 valuations started to pick up in the industry.
8 You will also see that your IRR since
9 inceptions has gradually been coming back up
10 again and it's actually increased by -- since
11 the fourth quarter of 2010 at 5.7 to the first
12 quarter 2010 at 6.6 percent.
13 Turn to the next page, you will see the
14 program summary. You still have 125 funds in
15 your portfolio and that's representative of 87
16 relationships altogether. Of your 3.3 or 3.4
17 billion of commitments, 63 percent has been
18 drawn down so far. Then you will see that the
19 total distribution is 781 million plus 1.6
20 billion of fair market value, gives you a
21 total value of 2.4 billion. And you will see
22 the IRR of 6.6 percent of a net value multiple
23 1.14 times.
24 There is a couple of things we would
25 like to point out. Take a look at page 33.

1 It's hard to see in black and white, but you
2 get to see a little bit more about the
3 diversification of the portfolio. The bigger
4 chunks are consumer discretionary at 22
5 percent, which probably continue to be hurt
6 with this economy. But funds are having some
7 level of activity in terms of assets, so we
8 will see that improve. You will see also
9 distributions, we would like to pick up the
10 energy exposure which is at 11 percent. And
11 there is also health care at 15 percent and
12 industrial at 18 percent and IT at 14 percent,
13 so some of your bigger exposure in terms of
14 industry.
15 We have more on the funds individually
16 that we would like to cover in the public
17 session, but if there are any questions right
18 now, I can answer them for you.
19 MR. AARONSON: Any questions on the
20 fiscal year end and the quarter before we get
21 to -- did you have a head shake there, Martin?
22 Something you want to say?
23 MR. GANTZ: No.
24 MR. SCHLOSS: So now J.P. Morgan will
25 come in, we will have some handouts.

1 MS. MARCH: This is in executive
2 session.
3 MR. SCHLOSS: No, we are in public
4 session.
5 MS. DUSEY: Hi, everyone. Thank you for
6 having us. We are excited to be here.
7 I am Lauren Dusey. I am in J.P. Morgan
8 Institutional Asset Management. I support the
9 client service business development area.
10 I am here to introduce Dr. David Kelly.
11 He is J.P. Morgan's chief market strategist,
12 20 years of experience, author of our
13 quarterly guide to the markets publication
14 which some of you may have seen. He will be
15 working from a similar presentation today and
16 if you are interested, after the fact I can
17 take contact information. It comes out every
18 quarter. He will be talking to macroeconomic
19 and market themes. He has had some recent
20 appearances on CNBC and other financial media
21 outlets, and it's my pleasure to introduce
22 him. Thanks so much again.
23 DR. KELLY: Thanks, Lauren and thank
24 you, all, for this opportunity.
25 What I want to do is you should have a

1 presentation in front of you here. What I did
2 is I used some of our slides, some of the
3 slides out of our most recent guide to the
4 markets, to address some issues.
5 And when I think about the overall
6 environment, right now we have an environment
7 in which there is profound pessimism all over
8 the investment landscape, pretty much all over
9 the economic landscape. And we believe very
10 strongly the people need to look not just at
11 what could possibly go wrong, but also look at
12 what could probably go right. And when we
13 look at the positioning of markets, it seems
14 that people are simply banking on the
15 worst-case scenario in a lot of places. Now,
16 there are things that can go wrong and we do
17 believe certainly in diversification, but we
18 don't think this is the time to throw in the
19 towel on risk assets. In fact, we see plenty
20 of opportunity there.
21 So what I did in this presentation I
22 went through, these are the five questions
23 that I wanted to address which relate to this
24 whole issue of what's possible and what's
25 probable. I would like to go through each of

1 those in turn, and then I want to open it up
2 to all of you for any questions. I will be
3 happy to try to take some questions at that
4 point.
5 First question is this whole question of
6 a double-dip recession. We believe, and we
7 believed throughout this year, that a
8 double-dip recession is possible but it's not
9 probable. And there are two basic reasons for
10 saying that. The first of them you can see in
11 this chart here, it's page 2 of this
12 presentation, actually has a big 10 up on the
13 right-hand side because that's where it is in
14 our guide to markets. But you see this chart
15 here with all the bars, that's the length of
16 expansions and the length of recessions in the
17 United States going back to the year 1900.
18 When we talk about a double-dip
19 recession, what do we mean. There is no
20 official definition, but we believe it
21 basically means you fall back into recession
22 before you are really out of the last one.
23 That has happened exactly once since World War
24 II. That happened in the recession of 1982,
25 which followed after the recession of 1980 by

1 just 12 months. The economy expanded from
2 July of 1980 to June of 1981 and that was only
3 a 12-month expansion. But the point I want to
4 make in this chart here is, that is the only
5 example of a double-dip recession since World
6 War II. Every other expansion has lasted at
7 least 24 months. And, in fact, that's
8 actually true if you go back. You have to go
9 all the way back to the 1920s to find an
10 expansion that lasted less than two years.
11 So, first of all, in terms of pure
12 frequency, are we going to see a double-dip
13 recession? Based on the numbers, probably
14 not. But why?
15 Why are double-dip recessions so rare?
16 Well, the reason is this: If you look at the
17 next page, we look at what causes recessions
18 in America and recessions are overwhelmingly
19 caused by four-cyclical sectors in the
20 economy. Sometimes I call these the four
21 horsemen of recession. Orders, home building,
22 business equipment spending and inventories.
23 Those four areas together account for less
24 than 20 percent of economic growth in the long
25 run, but they account for a 140 percent. You

1 can see this down at the bottom half of this
2 chart here in the gray bar, they account for
3 139.9 percent of the output lost in recession.
4 They account for about or over 100 percent of
5 the output gained in the first year of
6 recovery in the most recent recovery. And the
7 point is, that's where recessions reside.
8 But if these areas are already in the
9 basement, it's very hard for them to fall
10 further. That's what's giving us some
11 double-dip protection. I know it doesn't feel
12 like it. It's kind of like if you get a
13 virus, then the week after, after you meet
14 somebody with the same virus, you don't catch
15 it because you have a certain immunity. We
16 actually have a certain immunity to things
17 that normally cause recession immediately
18 after recession because those areas are so
19 low. If you look, we actually show this
20 graphically on the next page.
21 MR. SCHLOSS: Can I just ask something
22 on this chart?
23 DR. KELLY: Yes.
24 MR. SCHLOSS: You just said these caused
25 the recession. None of these factors caused

1 this particular recession, did they?

2 DR. KELLY: Well, in terms of the GDP,

3 these are the areas that sink to give you

4 negative GDP growth. What caused this

5 recession, of course, had a lot to do

6 with -- I mean, obviously the financial crisis

7 and financing of housing actually triggered

8 the recession. The collapse in housing itself

9 was part of the recession. But maybe you are

10 right, cause is too deep a word for what

11 happened.

12 The recession resides in these areas.

13 These are the areas where you see a decline in

14 output, which actually causes a decline in

15 employment and amounts to a recession. But

16 you are right, what triggered this was the

17 financial crisis itself and the credit

18 detraction and confidential detraction that

19 occurred as the financial crisis exploded.

20 That's absolutely right.

21 MS. MARCH: And still exists.

22 DR. KELLY: Well, yes, the credit crutch

23 is still there. We think it is easing a

24 little bit, but not much. The confidence

25 level is still very low.

1 But the real point I would make is that
2 we are at the level where we are -- you know,
3 the level of auto spending, purchasing new
4 cars, the level of home building, the level of
5 business investment spending are really all
6 pretty much in the basement still. So the
7 question is not whether things are lousy.
8 They are. But the question is, could we have
9 a further ratcheting down of confidence
10 equivalent to what we saw back in 2008 or
11 further ratcheting down in vehicle sales
12 equivalent to what we saw in 2009 from this
13 point, and that I think is unlikely. And if
14 you look at the next page, we sort of address
15 this graphically.
16 MS. NAGASWAMI: Can I take the other
17 side, though? The two factors that you
18 mentioned were consumer related, but the
19 consumer equipment and change in inventory
20 which appear to be bigger swing factors, isn't
21 there a forecast that could be made that
22 massively swings that back down?
23 DR. KELLY: Yes. Well, let me talk
24 about them. They are actually on the next
25 page. I have the four pieces here.

1 So let's leave the consumer side, as you
2 say, for the moment. I will just say with
3 regard to the consumer side that we are still
4 very far below average levels of vehicle sales
5 and very far below average of housing sales,
6 but we have seen a recovery in business
7 investment spending to some extent. These
8 numbers go up in real terms over time. They
9 are still pretty flat and we have seen
10 inventory grow for two quarters in a row.
11 Let me talk about inventories, first of
12 all. Inventories are still about 6-1/2
13 percent lower than what they were before we
14 went into the recession. What happened is
15 inventories fell, fell, fell, plunged and then
16 businesses stopped cutting inventories. And
17 then just in a little bit of the last two
18 quarters, you have seen inventory grow. But
19 if you look at inventory sales ratio, they are
20 generally very low even at the low level of
21 sales. Across all of GDP the inventory, the
22 final sales numbers, are generally pretty low.
23 Also if you look at the monthly data on
24 inventories, we think inventories are actually
25 accumulating faster in the third quarter of

1 this year than in the second. You are right
2 there is more potential for an inventory
3 class, but there is nothing out of whack about
4 inventory right now. They are actually pretty
5 low because we have had -- I think it's six or
6 eight quarters of declining inventories and
7 only two of rebuilding inventories.
8 MS. MARCH: I am not an economist, but
9 they are not creating inventories because
10 those individuals or those corporations that
11 would produce inventories are, instead, taking
12 the profits and banking it?
13 DR. KELLY: Well, there is no doubt that
14 businesses would rather increase corporate
15 profits right now than expand for the future.
16 But the issue, though, is from an investment
17 perspective, where is the status going from
18 here. I mean, if companies are being lean on
19 inventories, you may be right about that but.
20 If you are right about that, then you have
21 less to worry about in terms of inventory
22 collapsing because we are already at very low
23 levels. You know, companies have not
24 over-hired, they have not overspent on
25 technology, they have not over built

1 inventories. What I am saying is that all
2 these things mean, we are very lean, we may be
3 very mean.
4 MS. MARCH: Very, very mean.
5 DR. KELLY: That may be true. But both
6 of those amount to the same thing, a certain
7 degree of double-dip protection.
8 Economic growth is about 1.6 percent in
9 the second quarter. Right now my models are
10 telling me somewhere between 1-1/2 to 2-1/2
11 percent in the third quarter. That's fast
12 enough to produce a few jobs. It's not fast
13 enough to bring the unemployment rate down.
14 We are somewhat stuck in the doldrums right
15 now. I hope as we go into 2011, we pick up
16 out of this.
17 There are things going on that are
18 important here. There is a huge improvement
19 in consumer balance sheets. We have seen we
20 have got a lot, have got 75 percent of
21 household debt is mortgage debt. It's being
22 refinanced into the lowest mortgage rates
23 since Eisenhower, that has reduced the burden
24 of debt. We see some increase in savings
25 rates. We see some pent-up demand because

1 people are driving older and older cars, so I
2 think there are reasons we think why things
3 might pick up in 2011.
4 But for the moment, all I would say is I
5 don't think we are going to hit a double-dip
6 recession unless we get shot by something
7 else, even though the economy feels pretty
8 lousy.
9 The second issue somewhat related is on
10 the next page, which looks at political stuff.
11 MR. SCHLOSS: We don't ever look at that
12 in this room.
13 MS. MARCH: You will be sorry.
14 MS. STANG: Moving along to page 18.
15 MS. MARCH: Trust me, you will be sorry.
16 MR. AARONSON: Why don't you skip to
17 page 21.
18 DR. KELLY: I have been warned.
19 MS. MARCH: You have been warned.
20 DR. KELLY: There is one thing, though,
21 I have to say in fairness given what we are
22 talking about here.
23 Over the last week, the president in his
24 press conference talked about not holding some
25 extension of which tax cuts hostage, to having

1 them all extended. That was a maybe economic
2 calculation, maybe a political calculation.
3 For whatever reason, if you listened to John
4 Bayner over the weekend, the republicans
5 appear to have actually decided that
6 politically or economically -- I am not going
7 to make a decision, not going to make a
8 judgment as to which, but for whatever reason
9 they have decided they might as well call the
10 president's bluff and support any tax cuts
11 that there are, any extension of tax cuts that
12 the democrats actually want to try to push
13 through the house, in any event. I don't know
14 how much he has coordinated with the Senate of
15 this, but it does reduce the risk of all these
16 tax cuts expiring on January 1st because we
17 are now in the situation if the democrats in
18 Congress push this thing through, the
19 republicans are basically saying, Go ahead, we
20 will sign on; we just think you should extend
21 them all.
22 And that's important from an economic
23 perspective because one of the risks
24 was -- and there is still a risk, but one of
25 the risks is political infighting causes all

1 of them to expire on January 1st, which is
2 something I don't think this economy can quite
3 handle.
4 MS. MARCH: I have to say, and then I
5 will be good: I am not an economist. I am a
6 first grade teacher. But I do understand one
7 thing, in 1970 1 percent of the population had
8 9 percent of the income. In 2007, that same 1
9 percent had 23.5 percent of the income. And
10 until all of you get the message until the
11 little guy has money again, the big guys
12 hoarding their capital are not going to
13 resolve and bring this country back. That's
14 the bottom line. Simplistic, but that's where
15 it's at.
16 DR. KELLY: I have written stuff on the
17 income gap in the past and, actually, the
18 importance of education to closing the income
19 gap. But it's not -- I actually agree with
20 your view, but on the inequity of it. But the
21 real issue is the short-term macroeconomics,
22 which I am trying to address. And I think the
23 risk from politics has been somewhat
24 diminished by what happened over the last
25 week.

1 The next thing I want to mention is
2 corporate profits. I don't think that we
3 should allow -- I say this to a lot of
4 individual investors, I think it's important
5 not to allow strongly-held political views to
6 get in the way of prudent investment
7 decisions. And even though people feel
8 strongly politically both ways about what's
9 going on, this is a very strong rebound in
10 corporate profits going on. This chart here
11 shows the rebound in corporate profits which
12 are almost back to their old peak, which was
13 in the second quarter 2007 at 24.06 and S&P
14 500 operating earnings are almost back there.
15 What happened is we have this lousy
16 economic climate. What that climate is doing
17 is it means wages can't go up because people
18 are happy just to have a job. Nobody is
19 bashing the boss's door saying, Give me a
20 raise or I quit. And because of that, that's
21 holding down wage growth.
22 Meanwhile, you have got very low
23 interest rates, very low depreciation expense,
24 you have got some tax cuts, carry-forwards and
25 you have got good productivity gains at least

1 in a year-over- year basis. And all that is
2 what's allowing margins to rise. So even
3 though we have got a very lackluster recovery
4 in the economic overall, we actually do have a
5 V-shaped recovery. I think that's very
6 important from an investment perspective.
7 And because of that, if you flip one
8 more page over, we think stocks are cheap.
9 Stocks are selling at about 12 times earnings
10 over the next 12 months and that is cheap by
11 historical standards. It may stay cheap for
12 as long as people feel so worried about the
13 economy itself. One of the things we found in
14 our analysis is that PE ratios are very
15 related to consumer confidence. If people
16 feel lousy about the economy, they won't buy
17 stock. So they will pay lower multiples and
18 we are, to some extent, stuck in the doldrums
19 here waiting for this to clear. But at the
20 same time, profits are going on up and also
21 government debt is going up. But that makes
22 stocks, both in absolute terms and relative
23 terms, cheaper.
24 Next thing I want to mention was this
25 whole deflation issue. We have this chart

1 here which looks at inflation rates going back
2 to the 1960s. I always I tend to look at core
3 inflation which takes out the swing from
4 energy crisis. So you see the solid dark line
5 is the core inflation rate. The orange line
6 is the overall inflation rate.
7 A few years ago or even last year,
8 people were talking about how this economy
9 could see an inflation problem. We never
10 bought that. We didn't think this economy was
11 going to have inflation. We have got too many
12 people unemployed, too many empty apartments,
13 too much unused industrial capacity. Now the
14 great worry is about deflation. Provided we
15 avoid a double-dip recession, we think we will
16 avoid deflation.
17 If you think about inflation, inflation
18 is a little bit like cholesterol. If you
19 think about cholesterol, your body makes some
20 cholesterol and then you also bring in
21 cholesterol from what you eat. Well,
22 inflation is a little bit like that. You make
23 some inflation internally by the workers of
24 your own economy and you also import inflation
25 from overseas.

1 And what's going on is, for various
2 reasons, the inflation imported from overseas
3 might actually go up. There is a boom in
4 emerging markets still that is pushing the
5 worldwide economy crisis. We have got, I
6 think, still a long-term lack of capacity in
7 oil markets and that can push oil prices to go
8 up. The US is not growing as fast as other
9 countries, so we think that can push the
10 dollar down. All these things are increasing
11 just a little bit importer inflation.
12 Meanwhile, we have got a lot of slack in the
13 US economy at least in terms of industrial
14 capacity and also in terms of the apartment
15 sector. We think we will gradually take that
16 up.
17 So we are not saying we are going to
18 have high inflation, I think we will have very
19 low inflation. But right now looks to us we
20 are going to stay positive somewhere between
21 1/2 percent and 1 percent as a running rate
22 for core inflation for a while until the
23 economy picks up. Even with that,
24 though -- the next few pages, and I will skip
25 over them, are on fixed income. But the main

1 point I would make is even with that, we have
2 we think a --
3 MR. SCHLOSS: One last thing on
4 inflation. I buy everything you said, but
5 what do you do with this big deficit that's
6 got to get financed? How will it play out?
7 DR. KELLY: Yes, that does have an
8 impact. It could have an impact long term on
9 inflation. It can also have an impact on
10 interest rates in general. And I am very
11 worried about it, particularly short term,
12 worried about the interest rate effect.
13 Today I think we are getting numbers on
14 the treasury budget for August. Overall this
15 year looks like a deficit 1.3 trillion, next
16 year 1.1 trillion. We are adding to the debt.
17 And long term that much debt over the next
18 decade, our debt shared GPD will probably be
19 average around 70 to 80 percent. And over the
20 last four years it's averaged 35 percent.
21 Without much call on capital markets, we think
22 the treasury rates will go up once this bubble
23 breaks here. Will it cause inflation? No.
24 The only time big deficits cause inflation is
25 when there is no slack in the economy.

1 Back in the 1960s when we were fighting
2 the Vietnam War and running an economy of 4
3 percent unemployment, at the same time you are
4 running a big budget deficit. That means the
5 government is buying all this stuff from the
6 economy, the economy can't supply it; it's
7 running at full tilt. But if we have this
8 much capacity, we do not believe nor does the
9 Federal Reserve believe that big deficits at
10 this time will cause inflation.
11 Now, down the road if that compromises
12 the choices made by the federal government and
13 Federal Reserve, if we at the end monetize the
14 debt, that might be a different story. But I
15 think that's many years away. We think
16 inflation is going to be low. We think the
17 economy is going to grow -- well, relatively
18 slowly local, but still we think there is a
19 bubble in the bond market.
20 Now, a bubble in the bond market is not
21 the same thing as a bubble in the stock
22 market. You are going not to lose 50 percent
23 or 75 percent of your money if things crash
24 unless you are incredibly leveraged into it.
25 But it makes no sense, for example, 10-year

1 TIP yields right now to be at 1.1 percent if
2 the government is going to be borrowing this
3 much money. That is way below real normal
4 interest rates.
5 We show that actually in one of our
6 charts here, we show the real TIPS. On
7 average, over the last 20 years -- if you look
8 over in the right-hand side of this, on
9 average over the last 20 years the real yield
10 in10-year treasury bonds will be 2.8 percent
11 and it's way below that right now. In the
12 long run we think it will be well above that,
13 as we try to digest all this government debt.
14 On page 36, if you flip forward a few
15 pages more to the sovereign debt issue, this
16 table here, we have various G7 countries with
17 some of the distressed sovereigns, including
18 my native land of Ireland and also Greece. If
19 you look at this page here, Greece is clearly
20 the worst of the sinners. But there are no
21 saints on this page.
22 And that really is the most important
23 thing to recognize about the Europe debt
24 situation. The Europeans could not let Greece
25 go because they were all too close in terms of

1 their own fiscal situation. If they let
2 Greece go, then the bond market vigilantes
3 would have been chasing after Italy and
4 Portugal and Spain. That's why it's very
5 important to the Europeans that every
6 sovereign nation that is a member of the
7 European union pay on its debt on time and in
8 full. A few years down the road maybe some
9 compromises will be made. I think in the end,
10 Greece may actually need a grant rather than a
11 loan, and I think Ireland in some ways is in a
12 similar situation.
13 But over the next year or two, the
14 Europeans dare not let any of these countries
15 default. And that's why I think they were so
16 aggressive in putting together this enormous
17 fund to finance public debt. If called on by
18 the ECB, is willing to buy government debt.
19 So I think the risk was a little overblown
20 once we realized that the Europeans golished.
21 And if there is one small silver lining
22 to Lehman Brothers, it is that we have seen
23 what happens when we try and draw a line in
24 the sand in the wrong place. There is plenty
25 of moral hazard involved here. But they don't

1 want to deal with moral hazard, they want to
2 make sure nobody defaults. And once you make
3 that assumption, then the rest of the world
4 looks very good.
5 If you look at the next page here, looks
6 at world economic growth versus US economic
7 growth. The world trounces domestic growth,
8 we think they will continue to do so. The
9 reason for that is that the emerging markets
10 continue to grow faster than we possibly can,
11 so we think there is plenty of investment
12 opportunity in emerging markets. We
13 also -- I'm sorry, in international in
14 general.
15 On the next page we still have a big
16 trade deficit. That could push the dollar
17 down over the next few years.
18 And then last thing is we have a chart
19 on valuations and that shows that, in relative
20 terms, developed countries do look cheaper.
21 But both US and international-developed
22 countries, but even emerging markets, they
23 don't look cheap relative to history. They
24 look about average. But they used to say it's
25 not your father's Oldsmobile but -- well, it's

1 not your father's emerging markets either.
2 These countries, both from a macroeconomic
3 perspective and also from a corporate
4 governance perspective, must be better than
5 they used to be. We believe there is plenty
6 of opportunity here, also.
7 The last thing I want to mention is
8 volatility. And I have this chart here, which
9 up here the VIX index and the volatility of
10 the Dow going back a 100 years. We have been
11 through two huge bouts of volatility. We have
12 been through a terrible decade in terms of
13 investment returns on equities and that has
14 scared a lot of individual investors away.
15 One of the reasons the stock market is having
16 such a hard time recovering right now is that
17 month after month after month people are
18 taking money out of equity and mutual funds
19 and putting it into bond funds. That's why we
20 have got this valuation disparity.
21 But at least when I talk to individual
22 investors, I try to point out that if this
23 chart here shows the range of returns on
24 equity and also on balance portfolios and
25 bonds over the last 60 years, over the last 60

1 years' worth of 5-year rolling averages,
2 10-year rolling averages, 20-year rolling
3 averages. Everybody hates volatility. After
4 what happened on May 6th with the flash crash,
5 people hate volatility even more. But the
6 average investor has time on their hands. The
7 zigs -- over time the zigs offset the zags.
8 So you get less if you look at the height of
9 these or the range of returns. These green
10 bars, you go out over 5-year rolling averages
11 or 10-year rolling averages or 20-year rolling
12 averages, the range of returns diminishes. So
13 it's less volatile in the long run.
14 In addition, if you simply diversify,
15 what we did in the third bar here is that you
16 have got 50 percent of your money in stocks,
17 50 percent of your money in bonds.
18 Immediately you compress the range of returns
19 and over time you compress them further. So
20 for long-term investors, it's very important
21 to recognize that as scary as all these
22 markets are in the short run, over time
23 volatility diminishes and with diversification
24 volatility diminishes. And one if the economy
25 can get through the doldrums here, if things

1 do pick up next year as I think they probably
2 will, over time individual investors will get
3 a little bit more balanced here and
4 institutional investors will get more balanced
5 here.
6 I think it's important for investors to
7 recognize the possibilities of what could go
8 wrong, but also the probabilities of what can
9 go right and don't shortchange risky assets
10 just because we feel -- all feel lousy about
11 the state of the economy right now.
12 Those are the main points I wanted to
13 make and open up for some other questions, if
14 there are other questions.
15 MR. SCHLOSS: Do you think the incidence
16 of an exogenous variable will run things up
17 higher or lower than usual?
18 DR. KELLY: The incidence of an
19 exogenous variable is that higher or lower
20 than usual, a truly exogenous variable is no
21 higher than usual. I always worry, for
22 example, about oil prices. I worry about the
23 Iranians and Saudis and the amount of oil that
24 comes out of the Persian Gulf. That's also
25 always a vulnerability to the United States.

1 Are we vulnerable to black swans,
2 something like what happened in 2008? To some
3 extent we are, because we have actually been
4 hatching black swans ourselves in our
5 financial markets over the last 25 years. The
6 faster we make our markets work, the more we
7 push down trading levels, the more leverage we
8 use, the more we set up these vicious cycles
9 which actually cause normal distributions to
10 go away and you end up with these horrific
11 events. We actually have been building that
12 because of the growth in derivatives, because
13 of the speed of trading.
14 Right now, honestly, I think we are less
15 exposed to than normal because everybody is so
16 worried about it. If you look at what was
17 coming out of the Basil 3 over the weekend,
18 everybody is trying to reduce risk taking and
19 increase capital. And that's going on in the
20 government sector, it's been doubled up in the
21 private sector, so I think the risk of a big
22 financial crisis right is now is actually very
23 low. The downside of it is it's slowing the
24 pace of economic growth.
25 So I don't think that the risk of a

1 shock to the system is any greater than
2 normal. I think it's actually probably
3 smaller than normal in terms of something
4 that's going to be generated by behavior
5 participants in the financial markets in the
6 United States, but it's always there in terms
7 of geopolitics, environmental stuff. There is
8 always some risk.
9 MR. NORTH: If I might ask long-term
10 projections for the future. You have shown
11 the historical and diversification benefits
12 and so forth, but do you feel that going
13 forward the prospect of taxation regulation
14 and various other events around the world,
15 high debt levels, will produce the same or
16 lower expected returns in the risky asset
17 classes?
18 DR. KELLY: I think, first of all, high
19 debt levels around the world must mean high
20 asset levels around the world too. We do
21 owe -- the money is owed to somebody in the
22 world, so I am not sure that it slows down
23 world economic growth. I think that we are in
24 an era of lower inflation, so I expect to see
25 lower nominal returns going forward.

1 I also think that we would have lower
2 than average returns coming from bonds over
3 the next decade because of the interest rates
4 at which we start. If we avoid outright
5 deflation around the world, then starting from
6 the miserably low interest rates the best you
7 can get on the bond as those bonds
8 mature -- coupon bond yield is very low.
9 Conversely, I think above average
10 yield -- ignoring taxes for the moment, the
11 above average real return on stocks. And so
12 if your investments are in some way
13 tax-exempt, I think the returns in stocks will
14 be really very good in real terms over the
15 next decade just to make up for how lousy they
16 have been over the last decade. I don't think
17 anything happened to slow down long-term
18 productivity growth.
19 I don't even think, though, the debt in
20 the United States is unmanageable. I just
21 think in the end we will be required to make
22 some choices that, at the moment, our
23 political system is not capable of making.
24 But in the long term, I think we will figure
25 it out and make those choices. I am pretty

1 optimistic about long-term real returns,
2 although I do expect higher taxation in the
3 United States. So if you are tax-exposed,
4 that's going to be a problem. And I also
5 accept inflation rates will be lower than
6 normal.
7 MS. ROMAIN: Can you talk a little bit
8 more about -- you commented, it's not your
9 grandfather's emerging markets -- some of the
10 factors that make the emerging market growth
11 more sustainable going forward?
12 I mean, we look at the chart and we can
13 see that the US market and the developed
14 markets are pretty much in lock step and
15 totally out of sync with the emerging markets.
16 Can you talk about that.
17 DR. KELLY: It really has to do with
18 economic growth. If you go to this page,
19 which I showed earlier, about page 13 of the
20 bottom here of this presentation. If you look
21 at world economic growth and US economic
22 growth, it was pretty close for 30 years.
23 And in the year 2000 it began -- the
24 world started growing faster than us and they
25 haven't stopped growing faster than us. And

1 the reason is in the year 2000, developing
2 countries were about 15 percent of the world
3 GDP and now up to 50 percent of world GDP.
4 Part of this is political. We have the
5 collapse of communism in the Eastern Bloc and
6 Russia, but most importantly in China. And
7 that allowed China to get going, but
8 also -- and also we have seen the spread of
9 more democratic governments in Latin America,
10 which also I think has helped their growth.
11 But the other thing that's really
12 happened is technology has meant that you
13 don't have to make it here. The home country
14 advantage that the United States and developed
15 countries had for many years has gone. And so
16 it is because of communications technology,
17 it's very easy to make it in India with
18 particularly goods, but even services as well.
19 Good capital can easily flow across the world
20 if you have got more stable political systems.
21 All of that I think is allowing the rest to
22 play catchup.
23 They are still way behind us in terms of
24 productivity. There are still like 300
25 million Chinese nominally on the land in terms

1 of agricultural sector. I don't see anything
2 that's going to stop that gap from closing.
3 You can have certain political shocks in
4 certain areas, but I think what's happened,
5 really, is the technological change, which
6 allows countries around the world to use labor
7 from developing countries. That genie is out
8 of the bottle, and I think that is really
9 what's undercutting manufacturing wages in the
10 United States and will continue to allow
11 developing countries to outpace us in growth
12 for many years.
13 MR. AARONSON: We have 9.6 percent
14 unemployment now. What does J.P. Morgan think
15 about how that's going to continue and what's
16 going to happen to the unemployment rate?
17 DR. KELLY: To the question on
18 unemployment, I just want to turn forward to a
19 page, which let me see if I can find it here
20 in my guide. It's in the 30s. Almost there.
21 Yes, at the bottom of the page you can
22 see it says "page 38," and that shows -- you
23 have to go up the numbers, but on the bottom
24 left-hand side, page 38, and it shows the
25 civilian unemployment rate going back over the

1 last 50 years.

2 Historically unemployment, the

3 unemployment rate, looks a little bit like a

4 playground slide. It goes up more steeply

5 than it comes down. In fact, traditionally

6 when the unemployment rate is going up, it

7 goes up about 2 percent per year. When it

8 comes down, it comes down about 1 percent per

9 year. Generally we expect that's probably

10 going to happen this time around too, with one

11 small caveat. By the way, that means that if

12 we end this year, let's say, 10 percent on the

13 unemployment rate, it will take us five years

14 to get down to 5 percent.

15 The problem this time around is that,

16 first of all, we do have very small economic

17 growth for early stages of recovery. 1-1/2

18 percent growth is what's necessary to create

19 payroll jobs, we are doing that. We need

20 about 3 percent growth or 2.9 percent growth

21 to cut the employment rate. We are not doing

22 that right now, and so that's stalling this

23 whole process out.

24 In addition, millions of people left the

25 labor force in this current recession and as

1 things brighten, we expect them to move back
2 into the labor force and that's going to slow
3 the initial stage of any decline of
4 unemployment. So I wouldn't be surprised if a
5 year from now, we are still at 9.6 percent
6 unemployment. Economists won't be worried
7 about it, everybody else will, because
8 economists will see that's what's happening is
9 we are creating payroll jobs. It's just more
10 and more people are coming back into the labor
11 force and so it's going to take a while before
12 we actually begin that projection moving
13 downwards. But thereafter, I think provided
14 we don't have any shocks, the economy will
15 grow by about 4 percent per year. That's
16 enough to bring the unemployment rate down by
17 about 1 percent per year.
18 So the history of it, I am not
19 optimistic in the short run, but I don't want
20 to be too gloomy in the long run. Every
21 single recession, if you look at this chart,
22 has been followed by a gradual decline in the
23 unemployment rate. Unemployment is a
24 disequilibrium position. It means there are
25 people who want to work who aren't working.

1 It means there are businesses that aren't
2 exploiting opportunities they could. It means
3 consumers aren't buying stuff they really
4 want. It just takes a while for us to move
5 back to that disequilibrium, but there is no
6 reason why this economy can't do that.
7 I think once we get out of the doldrums
8 here, I expect the economy will borrow about 4
9 percent per year over the next few years and
10 this will bring the unemployment rate down
11 slowly.
12 MR. AARONSON: So you think by 2016 we
13 will be back to 5 percent?
14 DR. KELLY: Yes, unless we get hit by a
15 shock.
16 MR. AARONSON: Does that include all of
17 the people on the sidelines now coming back?
18 DR. KELLY: Yes, the idea is
19 this -- well, yes, it does. I think what's
20 going to happen is over the next year, we are
21 going to be treading water as we get to sort
22 of more normal labor force participation
23 rates. So the jobs we create over the next
24 year are just going to be kind of dealing with
25 that sideline issue. Thereafter, we think the

1 economy will grow about 4 percent. We get
2 about 2 percent productivity growth and we get
3 about 2 percent growth in the working age
4 population every year, so the first 3 percent
5 of growth is just needed to hold the
6 unemployment rate constant. And the extra 1
7 percent of growth, that's what brings the
8 unemployment rate down by 1 percent per year.
9 That's the most likely scenario.
10 MR. AARONSON: And your prediction is
11 that the economy will grow by about 4 percent
12 a year beginning when?
13 DR. KELLY: Well, I think it's there is
14 so much uncertainty around this, but I believe
15 as we move up to into next year, we will
16 ratchet it to about 4 percent. What's
17 happening is we have got a lot of uncertainty,
18 which is holding everybody back right now.
19 When we get back past the turn of year, when
20 we know what tax rates are next year, we have
21 seen so much improvement in household balance
22 sheets, we have so much build in pent-up
23 demand in autos and houses and potentially got
24 so much cash on the books of corporations,
25 that I think all of that could actually cause

1 the economy to grow a bit faster than average.
2 It's very rough to say 4 percent exactly, but
3 that's what we think is going to happen.
4 MR. AARONSON: The long-term employment,
5 what we call the 99ers, does J.P. Morgan have
6 a position on what should happen with those
7 people as they still continue not to be able
8 to get --
9 DR. KELLY: I am sure there are people
10 in J.P. Morgan who think about that a lot
11 and -- but it doesn't -- the sad thing is, you
12 know, the economy is like a force of nature.
13 Nature can be very cruel while ecosystems
14 grow, and there are a lot of people who are
15 getting plowed under by this economy. Nothing
16 in this forecast says that's going to change.
17 The people without a good college education in
18 this country are really in trouble because
19 they are competing in the end with workers in
20 India. And that's why I think it's -- I don't
21 see that -- I see that as a very worrying
22 problem. But it doesn't stop the overall
23 economy from growing, even if it causes a lot
24 of people to get left behind.
25 MR. AARONSON: You are talking about the

1 manufacturing sector of people who aren't
2 educated. But how about the service sector of
3 people without --
4 DR. KELLY: What's happening in the
5 manufacturing sector, people are competing
6 with people from developing worlds. In the
7 services sector, people are competing with a
8 lot of illegal immigrants. If they don't have
9 education, they are in the same space as a lot
10 of illegal immigrants who can't get good jobs
11 because they don't have the papers, but they
12 will beat down wages at the service sector
13 level. So, either way, without education in
14 America, it's a very tough environment and it
15 will be even in an expansion.
16 MS. MARCH: It's people like myself who
17 refinance their mortgage because the people
18 who really need to refinance their mortgage
19 can't do it, and so what's keeping the economy
20 going is the fact that I was able to refinance
21 the mortgage, save $600,000 on my mortgage a
22 month that I am putting back into the economy
23 because I am helping support people who don't
24 have a job anymore.
25 DR. KELLY: That's right. And to the

1 point you were making earlier, I
2 absolutely -- one of the aspects of this
3 economy is the inequality.
4 But I think probably from the same
5 studies you are quoting, if you look at the
6 income, at the top 10 percent of income
7 Americans, they control 50 percent of the
8 household income, of the taxable income at any
9 rate. If you think about that, what that
10 means is it's -- I agree that it is an
11 unpleasant reality and it's very tough for the
12 people at the bottom, but also in terms of
13 trying to forecast the economy what it means
14 is if 10 people walk into a 7-11, one of those
15 people has got the same income as the other
16 nine combined. And if the top two or three or
17 four of those people are spending because the
18 some market goes up and they are doing okay,
19 the economy can trade up demand to growth.
20 So there is a big difference between
21 predicting economic growth and predicting
22 better welfare for people in general.
23 MS. MARCH: If you talk to my jeweller,
24 he will tell you that those people in the
25 upper income bracket who used to come in and

1 drop the $10,000 and $20,000 are not doing it.
2 They are not.
3 DR. KELLY: That's why.
4 MS. MARCH: They are hoarding their
5 income.
6 DR. KELLY: But the real issue from
7 here -- I agree with where they are. The real
8 issue from here is the next step, a step down
9 or step up.
10 MS. NAGASWAMI: David, is the economy in
11 the next ten years structurally very different
12 in terms of where the jobs are going to be
13 created or where the growth is going to come
14 from?
15 DR. KELLY: No, I think it's going to be
16 a continuation of the trends we saw in the
17 1990s and some extent the 2000s, but just
18 interrupted. In other words, we will see
19 continuing decline in manufacturing. Right
20 now manufacturing counts for less than 1 job
21 in 10 in the United States. Back in the 1950s
22 it was 35 percent of employment, it's now 9
23 percent of employment.
24 One difference from the last decade, I
25 don't think we will see a big increase in

1 construction jobs. But, generally speaking,
2 it's going to be services sectors that create
3 jobs. It isn't just in low-paid services.
4 We will see a lot of growth in technical
5 services, legal services, financial services,
6 educational services. That tends to be where
7 the growth has been. I think that's where the
8 growth will be.
9 MR. AARONSON: Anybody else with a
10 question? I thank you very much for your thoughtful
11 presentation. I appreciate it very much.
12
13
14 (At this time the meeting went into executive session.)
15
16
17 MR. AARONSON: Okay, any objection? We are now in public
18 session and we are going to give a summary of
19 everything that we did to the stenographer.
20 MS. STANG: Okay. During the executive session, the
21 investment committee discussed issues concerning
22 potential change in investment strategy for the
23 variable program and agreed to continue work,
24 which could lead
25 to or change the strategy.

1 The board received presentations from
2 several managers related to variable
3 international equity program and made
4 decisions regarding selection of managers
5 subject to board ratification and completion
6 of the contracting process.
7 The committee heard presentations from
8 the comptroller's office regarding the
9 manager. The committee accepted the
10 recommendation of the comptroller's office to
11 terminate the manager, details to be made
12 public upon completion of the transition. The
13 committee also received a report from the
14 comptroller concerning RFPs conducted for the
15 U.S. and non-U.S. and or global equity
16 multi-cap passive index managers. Results of
17 the RFPs were reviewed. The comptroller
18 recommended that the board add products from
19 certain managers to the pool for future
20 potential use. The investment committee
21 agreed that these firms would be added to the
22 appropriate pools. The names of the
23 successful bidders will be released through
24 the comptroller.
25 The committee also met with a real

1 estate manager. The committee concurred with
2 the recommendation of its consultant and the
3 comptroller's office and agreed to make a
4 commitment to the fund. Details to be made
5 public pending the completion of the LP
6 agreement.
7 An attorney-client privileged session
8 was held discussing matters pertaining to
9 Freedom of Information Law, quarterly reviews
10 of the real estate, and private equity
11 portfolios were presented.
12 MR. AARONSON: Okay. Do I hear a motion
13 to adjourn?
14 MS. MARCH: So moved.
15 MS. NAGASWAMI: Second.
16 MR. AARONSON: Any objections?
17 We are adjourned.
18 MR. SCHLOSS: Next meeting, we go
19 through the watch list in detail.
20 [Time noted: 4:08 p.m.]
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22
23
24
25

1 C E R T I F I C A T E

2

3 STATE OF NEW YORK)

4) ss.

5 COUNTY OF QUEENS)

6

7 I, YAFFA KAPLAN, a Notary Public within

8 and for the State of New York, do hereby

9 certify that the within is a true and accurate

10 transcript of the proceedings taken on

11 December 3, 2009.

12 I further certify that I am not related

13 to any of the parties to this action by blood

14 or marriage and that I am in no way interested

15 in the outcome of this matter.

16 IN WITNESS WHEREOF, I have hereunto set

17 my hand this _____ day of ______________, 2010.

18

19

20 _____________________________

21 YAFFA KAPLAN

22

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