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NEW YORK CITY TEACHERS' RETIREMENT SYSTEM
INVESTMENT MEETING
held on Thursday, November 3, 2011
at
55 Water Street
New York, New York

ATTENDEES:

MELVYN AARONSON, Chairperson, Trustee
SANDRA MARCH, Trustee
MONA ROMAIN, Trustee
NELSON SERRANO, Executive Director, TRS
LARRY SCHLOSS, Trustee, Comptroller's Office
RANJI NAGASWAMI, Trustee, Finance
CAROL EGLOW, Comptroller's Office
THADDEUS McTIGUE, Comptroller's Office
MARTIN GANTZ, Comptroller's Office
JOEL GILLER, Comptroller's Office
SEEMA HINGORANI, Comptroller's Office
BARRY MILLER, Comptroller's Office
YVONNE NELSON, Comptroller's Office
MARC KATZ, TRS
ROBERT RAUCCI, TRS
SUSAN STANG, TRS
ROBERT C. NORTH, JR., Actuary
JAMIE SMARR
CHRIS LYON, Rocaton
ROBIN PELISH, Rocaton
ROBERTA UFFORD, Counsel
STEVE BYRNES, Townsend
SARAH CACHAT, Townsend
MARTIN ROSENBERG, Townsend
MICHAEL KOENIG, Hamilton Lane
CORINA SYLVIA, Hamilton Lane

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P R O C E E D I N G S

(Time noted: 10:10 a.m.)

MR. SERRANO: Good morning. I'll begin the November 3 investment meeting by calling the role.

MR. SERRANO: Melvyn Aaronson?

CHAIRPERSON AARONSON: Here.

MR. SERRANO: Sandra March?

MS. MARCH: Here.

MR. SERRANO: Mona Romain?

MS. ROMAIN: Here.

MR. SERRANO: Larry Schloss?

MR. SCHLOSS: Present.

MR. SERRANO: Lisette Nieves is out of town.

We have a quorum.

I'll turn it over to the chairman.

CHAIRPERSON AARONSON: Welcome to the investment meeting of November 3, of the TRS Board. And we are going to follow the following order:

We will do the public agenda of the Passport funds first, and then we will do the public agenda of the pension fund. And then we will do the executive agenda of the Passport funds, and we will then do the executive report agenda for the pension fund.

So we will start by calling on Rocaton to talk to us about the Passport funds.

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MR. LYON: Good morning.

I will review the information by first starting with November. I'd like to make a remark before that, which is that it's gotten better since then. When you see this, keep that in mind.

We'll first start with the diversified equity fund, Variable A. And as you may know from the report last month, August 31, there were $9.3 billion of assets in the fund, market value, as well as the regular outflows we have due to participant distributions and transfers, which brought the value down to about $8.6 billion.

So you can tell that September has been a relatively rough month, for reasons in the markets. When you look across the asset allocation on the first page, you can see that the major composites continue to track the movement within 1 percent of their targets.

Of course, that's a function of the regular revaluation program that's done monthly to bring things closer to targets, and the process of also raising necessary liquidity for beneficiary payments.

So, no major concerns from an asset allocation perspective.

You can also see, of course, a few more recent changes that have now started to flow through,

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such as indexing, as part of the portfolio.

If you flip ahead to page 3, you can see the total performance for the month of September on a net of fee basis. The Diversified Equity Fund had a negative 7 and a half percent return. Small consolation, but a little better than the broad U.S. equity market, a little worse behind the benchmark for each of the underlying composites of the fund.

In terms of looking at that absolute return, it's again, the total fund is down negative 7 and a half. The international allocation hurt in that sense. A lot of the developed markets had problems here. We have many more problems in some of the developed markets, countries in Europe, and that weighted that part of the portfolio down 9 and a half percent.

And we did have some help, to help discussion of the defensive strategy composite. It's not guaranteed to always do better in down markets, but certainly in September. You can see on page 2 the defensive strategy composite was down just under 4 percent, with the RTAA manager being a large portion of those assets, down only 3 percent, rounding liberally.

And our two local volatility equity managers continue to look very good relative to the broader equity markets. So those strategies are generally

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working; not always outperforming their respective benchmarks, but they are performing the way we would hope in the market environments.

In fact, since an inception basis, low volatility equity managers are very significantly ahead of their benchmarks, and that of course is a relatively short time period. Their performance record started in March, but it is off to a very strong start.

So, if you look at the year to date column, the year to date, therefore, the 7 and a half percent back on page 3, for the month, year to date, it's in further negative territory, down 9.6 percent.

MR. SCHLOSS: That's the calendar year, right?

MR. LYON: Calendar to date; correct.

Then, I'll flip to other Passport funds. We reviewed Variable B in a different format quartile report, but for this purpose we have Variable C, D and E, the International Equity Fund, the Socially Responsive Equity Fund. You can see the asset levels at $64 million, $23 million and $26 million, respectively, continue to be similar to prior reports.

You can see the performance of each of the options, the International Equity Fund performance. Similarly, the international composite of diversified

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equity fund because, in fact, the assets are unified under a similar manager structure and performed in line with the EAFE for the month and year to date basis, also a handful of basis points ahead of the benchmark, down 14.4 percent on a since-inception basis. This investment option, annualized since July 2008, is still 4 and a half percent ahead of the benchmark.

The next fund is the Inflation Protection Fund. That fund, we hope, over longer time periods outpaces inflation and other benchmarks that are shown.

Over short time periods, we don't expect to track very closely, because it has a tactical allocation component, a fund of funds that invests in a variety of strategies. And each is an underlying PIMCO brand of mutual funds, and the fund was down about 5 and a half percent for the month, bringing year to date into slight negative territory; and therefore one of the few times it was reported behind the benchmark.

Also, the amount of tracking this particular month versus the benchmark, it did take since inception into slightly negative territory. So since inception, the investment option just shows slightly behind, 11 basis points behind the benchmark. This is a pretty active fund, and hopefully will do better in the next few months. It's reversible.

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And finally, the Socially Responsible Equity Fund. That's investment option Variable E, returned negative 8.3 percent, a little behind the S&P 500 index, about 1.3 percent. So it is a year to date number similarly behind since inception. This investment option is still about 3 percent annualized ahead of its benchmark.

So all in all, a disappointing month of September for anything but long term Treasuries, pretty much. And those are the results past the end of September. And everything but long Treasuries pretty much has been a better month.

Before I preview October 31, any questions on these reports so far?

I'm glad I previewed first, to soften the blow. October was a strong month on this report. The U.S. Equity market was up 11 and a half percent. Long Treasuries were down a bit, but they still have a calendar year return of over 20 percent.

The regular Barclays aggregate fixed income market was slightly positive. International stocks rebounded, but not to the same extent as U.S. based investors in U.S. markets. And so, the hybrid benchmark for the Diversified Equity Fund is up 10.3 percent for the month of October; so that the October 31 flash, when

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all the data becomes available, will look a lot better on a year to date basis than I just presented.

The PIMCO All Asset Fund returned a positive almost 6 percent return; so compared to its benchmark of 1.4 percent, a lot of ground has already been recovered in October. And although it didn't outperform the Newberger Socially Responsive Equity Fund, the primary underlying investment in Variable E, it was up almost 10 percent, so the returns of that option have also been similar. So October's flash will be more pleasant to present. Of course, we'll have to talk about whatever's going on in November.

In any case, those are the items for the Passport funds, for the public agenda.

I'll pause one more time if there are any questions.

CHAIRPERSON AARONSON: Do any Board people have questions?

MR. LYON: Thanks.

CHAIRPERSON AARONSON: Thank you very much for that report. And thank you very much for the October results.

Mr. Schloss?

MR. SCHLOSS: Ideally, I was going to start, but the economist from Barclays is stuck at the security

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desk. We can skip them and get to the September results if you want.

CHAIRPERSON AARONSON: Yes.

MR. SCHLOSS: Does everyone have this package?

(Indicating.)

Again, I'll skip the economics because I'm sure he will cover it all. So, let's go to page 212, and this will parallel a little bit what was just said on the variable. Since August, you may recall -- in August we had a debt ceiling problem and issues on the federal budget, and we had euro issues.

Basically, since August, if you look at the markets, the volatility, page 21 -- there are all sorts of ramifications. We discussed that September was a lousy month, October was a good month; lots of volatility in our portfolio.

In response to that, on page 22, the Fed announced a new program. The new program will hopefully induce people to borrow longer term. It's designed to ultimately help mortgage lenders. So if you recall, the Fed's QE 2 pushed down the shorter end of the curve, now they're after the longer end of the curve.

So if you look on page 22, the current yield curve is the white line, and in the Halloween spirit,

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the pumpkin color is where we were at the beginning of the year. You can see they made good progress, but they're going to keep working pushing this down, dropping their risk, getting people to refinance mortgages, basically trying to get people more comfortable with risk, even though there's lots of things going. Ultimately we need other parties to pay attention and do their bit.

Page 23, again, you can see the panic that went on in September. And now things have bounced back. Of course, the Greeks announced they'd like to vote one more time. A Greek drama, Greek tragedy, more volatility and uncertainty, not good for long term investors like us; although it does create certain buying opportunities at some point, which we'll get to in a second.

On page 24, what's happened is, the risk has come off. You may recall we sold high yield bonds in the spring when spreads were compressed; now they're blown out again. So we are actually in the process of buying high yield bonds now. We'll get back to that in a second.

You can see the risk premium is up almost 300 basis points high in the yield market; and it's also up again, the spread widened again in investment grade.

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Again, fear is on one day, off another day. It's quite a treacherous investment environment.

If you go to page 25, what you see is, PEs are coming down, because earnings of corporations are doing quite well through cost cuts. The bad news about the cost cuts is its people, so unemployment is staying high while earnings are going up.

You see earnings on the next page, 26. We are the blue line, which compares this recession, coming out of this recession. These are orders, and how they compare to the last 30 years worth of coming out of recessions. Basically, this is the second best from a corporate profit standpoint, not a GDP standpoint, however. Again, I'll let the Barclays guys talk about that, how profits are up.

If you look on the next page, 27, these are the PE multiples, trailing and projected, for the Russell 3000 EAFE and emerging markets. If you look at the green color, you see prices are starting to be pretty reasonable. Equities, by and large, are cheap. People are still worried if the euro blows apart. Fear is what's keeping things down. As soon as that calms down -- It calmed down last week, there was a big rally. The Greeks decided they'd like to vote and it went down again. It's really something of a yo-yo. We'll get

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back to that in a second. We dealt with that.

On 28, large cap, mid-cap and small cap, again, multiples coming down, earnings coming up, good value in the stock market.

And then, page 29, you can see again, the white line is the U.S. stock market. You can see it fall off a cliff after the downgrade and through the debt ceiling discussions. And then basically up and down, a sawtooth pattern. It rebounded back down a little bit; difficult markets.

If you skip to page 31, this is the ten year asset value for Teachers. If you look at the fiscal year 2011, July 1 to now, being September 30, it's down to 38.7. We estimate that at the end of October it will be back up to about 40.5. October was better than September; but again, extreme volatility.

In fact, if you glance at 37 -- before I go further -- page 37, we will talk about September results. If you look at the top of the first column on the left, the U.S. markets, they were down 8 to 11 percent in the month. And the international markets were down 10 to 15 percent in the month. A terrible month.

On the other hand, I'm happy to tell you that the October numbers, which you'll see next month,

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U.S. Equities are up 11, International was up 10 to 13 percent again. So this will be a bad month to go through. We'll spend much more time on it next month, which will be a better month. I say that partly in jest; but again, high volatility in the markets.

If you go to the next page, 32, again this is the monthly progression. If you pencil in 40.5, up about 5 percent -- 32 of our numbers -- up to about 40.5 at the end of October.

So, if you look at page 33, this is the old asset allocation. You'll recall, basically page 33 to page 34, which is the asset allocation, would typically take us 12 plus months to move old asset allocations to new asset allocations.

You may recall that we've been building cash in anticipation of the asset allocation, as well as the risk mitigation. This cash number is the highest it ever got to, 8.7, down to 6.7.

Page 34 of this book, the September 30 book -- remember we're going from page 33, which is the old allocation, to the new allocation. This is the peak cash, we had 8.7 percent down to about 6.8. In the interim, we added half a percent to REITs, half to equities, a half percent to high yield bonds, trying to get us into the range, slowly with choppy markets.

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On page 34 we'll talk more about the ranges next. Probably after the Barclays thing.

Having said that, one of the big discrepancies is opportunistic fixed income, hot pink -- at another board meeting I called it chartreuse -- down 3.9 percent in allocation.

As you know, at the last possibly four board meetings we approved a half dozen managers for the space. We're in the process of negotiating documents. And so we probably committed 2 and a half percent of this 3.9 percent. So once we finish the documents, the managers will then slowly, or not so slowly -- now is a good time to invest in opportunistic fixed income. This should take care of itself over time. I'm confident this is sort of self-correcting.

I'm also pretty sure from now to the end of the year, plus or minus, depending on the markets, we'll basically reinvest all the cash; unless, of course, the euro completely blows apart, in which case it would be good not to invest in cash. So again, in process. I think the U.S. basically is in balance. In emerging markets we added to high yield, added to REITs, we've added to all, which are slowly working their way into new ranges.

MS. NAGASWAMI: EMD, the light blue, is

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invested? Or is it zero?

MR. SCHLOSS: We haven't done trustee education; remember, EMD is a new asset class.

MS. NAGASWAMI: You had it a minus 3 in August.

MR. SCHLOSS: It should be minus 3.

At some point we'll have trustee education on emerging market debt, and have an RFP. It will be the last thing to get filled most likely, because of the timing of the RFP process more than anything else.

If you look on page 36, in the month of September we were down 5 percent, mostly equities. And the fiscal year to date was down about 9 and a half percent. I think it made about 5 percent in the month of October. So we're probably down less than 5 percent fiscal year to date. Again, cash is usually better than the stock market. If the stock market goes down, we don't lose money on that.

If you go through most of the managers, there's a lot of volatility, more green than red bouncing around. Because of volatility, a lot of managers were getting caught one month and would make it back the next month. We're not that focused unless someone's a very, very big outlier on month to month performance. I think, over all, they've done all right,

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given the markets.
Seema, do you want to say anything about the equities?
MS. HINGORANI: No.
MR. GANTZ: I'll have specific comments in executive session.
MR. SCHLOSS: Barry?
MR. MILLER: No.
MR. SCHLOSS: Yvonne?
MS. NELSON: No.
MR. SCHLOSS: Basically, it was a volatile month. The asset allocation caught some of it; cash caught some of it. A better month next, than October. I think it's actually reasonable, given all the volatility in the markets.
So, any questions on this?
CHAIRPERSON AARONSON: Thank you.
MR. SCHLOSS: The Barclays people are here now. I'd like to have them come in to talk about what's going on in Europe, and the U.S. economy backdrop of making investments.
(The Barclays people entered the room.)
CHAIRPERSON AARONSON: Welcome. When you make your remarks, make them in this direction where we have the Board people and the stenographer.
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MS. DUNLAP: Thank you.
My name is Kathleen Dunlap, and I'm with Barclays Capital. My job is to look after and be the relationship manager for large pension funds. On behalf of the bank, I'm delighted to be here to talk to you about the crisis in Europe and the implications for investors.
And with me is my esteemed colleague, Michael Gapen. I'm going to read Michael's bio, because it's illustrious and I don't want to miss anything. Michael joined Barclays in 2009, and he is head of our International Macro Strategy Group.
Prior to Barclays Capital, he was with Citadel, as their emerging markets economist. Prior to Citadel he was with UBS, head of Latin America. And prior to UBS, he worked with the Inter-American Development Bank. We worked at the Fed. He was a consultant to the IMF, and also to the World Bank.
Michael works with G10 as an emerging markets economist and strategist to identify trends and international asset flows, evaluations of policy and currency and investment opportunities, and implications for global asset management.
He's also an associate professor of Economics at Columbia, and received his Ph.D. in

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Economics from MIT.

So, I think you are in good hands with an expert to talk about this gnarly subject. It's my understanding we've been asked for Michael to talk for about 20 minutes, and then 10 minutes Q and A.

MR. SCHLOSS: Perfect.

MS. DUNLAP: Over to you, Michael.

MR. GAPEN: Thank you for your time. Let me know if my voice trails off a bit. When I was teaching at Columbia the faculty Ph.D. students would make fun of the faculty, and I was always "the mute."

(Laughter.)

I'll do my best.

The attention of the headlines these days are about Greece. I have relatively little to speak about Greece. If the problem were only Greece, it wouldn't be a problem that need concern you, it would not be a global problem, even a small European problem.

The problem is that Greece is the tip of the iceberg, much bigger, and now includes Italy. Up until about July of this year the crisis countries were Greece, Portugal and Ireland. I'm not allowed to say them in the order of Portugal, Ireland, Greece, or use the acronym.

(Laughter.)

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It was an eminently manageable problem, even if all three of those were to be forced into acting like adults, to restructure. It had to be managed well. It hasn't been; it's been managed with mediocrity. It was a manageable problem until July of this year, when this situation took a significant turn for the worse. Market attention focused on Italy, now the battleground that matters.

A couple of weeks ago the situation turned even worse, when market attention started to focus on France. Let me begin with the French connection. It's not impossible that there could be another run or attack on the French public debt; but that's not a downside risk or the negative reality that needs to concern us here.

What needs to concern us here is the market focus on the French public financial limits, to the extent to which the stronger countries of Europe, meaning Germany, France, and a couple of smaller countries, can lend support to Southern Europe. It's part of the reality we now face, that we didn't even three weeks ago. The conditions I will talk about, recent policy announcements from the euro zone.

Bear in mind that the entire euro zone is at least under the threat of a loss of confidence, and that

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does condition the magnitude of the support that the North can offer to the South, not only the local politics, but the fiscal reality piece, as well.

The underlying problem in Italy is not really a government that is widely out of balance, public finances that are widely out of balance. In fact, if you look at the Italian public finances, you'd be led to ask, what is the problem? Compare them with the U.K., compare them with U.S., compare them with Japan, three countries whose debt is not under attack at the moment.

The Italian public finances look in most respects much more comfortable. I have a note here, I thought I would leave behind a couple of background notes for anybody who cares.

One is, exactly what is the difference between Italy and Japan? That's a question we started to get, kind of around July of this year. What is the difference? Not the deficit, it's not related to public debt. Japan has public debt, even higher than Italy, considerably so. Certainly the public deficit is much bigger.

The difference is, in our view, first, that the U.K., the U.S. and Japan all have central banks that are ultimately under the control of the government that

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issue the currency, that the government has as its obligation. In a last resort, Japan, the U.S. and the U.K. central banks can print the money the government needs to redeem its debt. It might be inflationary, but it doesn't mean a default.

Italy -- in fact, all of the euro zone countries are in a fundamentally more precarious situation because they issued their debt currency; which is, for all intents and purposes, the national government can't issue to cover their own liabilities in the local currency. This is the problem in emerging markets, sovereigns, and up until fairly recently, where at least international finance, sometimes domestically generated public debt as well, was dollars or Deutsche or marks or yen, currencies they couldn't print. And that is very closely related to the debt crisis countries have.

It's been resolved in some countries. Let me step back for a second and continue the thought. What Italy lacks and the U.S. and the U.K. and Japan have, is the lender of last resort who can print unlimited amounts of money in extremis. What it has instead is fiscal support mechanisms from the core European or European fiscal structure. But these are first, ad hoc; and secondly, come with conditions that

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have turned support mechanisms into what we call the default machine.

What's the default machine? A default machine is a country that goes into an EU program; it tries to comply with the conditions of the EU program. It typically fails because, almost inevitably, politically generated programs are generated on the basis of economic assumptions that are unrealistically optimistic.

And after the failure becomes apparent, a new round of support is necessary, and the creditor countries condition that support on private sector involvement. In Greece, a country where this has played out so far, private sector involvement is inevitable. That is to say, a default on at least obligations owed to the private sector is inevitable, because there is simply no way the government under any realistic circumstances can repay all the debt accumulated in the past 30 years of its profligate existence.

But that is not how private sector involvement was sold politically in Europe. It was sold on the grounds of political fairness. If the public sector and taxpayers of Europe make X contribution to a Greek rescue effort, then the private sector creditors ought to be making wide contributions understandable.

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My German wife, born and raised in Germany, is angry that her parents have to actually pay the bill. And her brothers will have to pay, rightly so.

But that means that the next time a country where the credit story is a little less cut and dry than the one in Greece, creditors, private creditors, cannot assume there won't be a default restructuring of obligations owed to them, even if the credit fundamentals look okay, because of the political element in the decisions whether or not to demand private sector involvement; default machine.

The U.K. doesn't have it, the U.S. doesn't have it, Japan doesn't have it. Italy has it, Spain has it, the process is endemic within the European system.

What this means is, a country like Italy is solvent if the market thinks it is solvent. If the market thinks it's solvent, it will charge interest rates that are at levels the Italian state can afford to pay.

But, if the private sector thinks that there's a haircut coming, for political or underlying debt reasons, the risk premium doesn't have to get too high before it declares a bankruptcy rate of interest. In a country where the gross public debt is 120 percent of GDP, it can't afford even a 6 percent interest rate.

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That leaves you with a multiple equilibrium problem. We believe Italy can make it. And deep in our hearts we think ultimately Italy will be rescued from the bad equilibrium in which it's forced into the default consequences of an Italian restructuring. Even a full scale attack on the Italian public debt, which we have not yet seen, are too horrible to contemplate; and for you, let me say.

The U.S. is entirely exposed, directly and indirectly, to a downdraft of major proportions in the Italian debt market. Again, it's not an issue if Greece restructures, it's not an issue if Ireland restructures, if Portugal restructures. But Italy the world cannot afford. The banking systems around the world, not just Europe, are holding debt, and the risk would be a Lehman-like event.

As the European authorities try to manage the smaller debt problems, in particular the Greek debt problem, are they managing to do to that in a way that reduces or increases the risk of a destabilizing outbreak of anxiety about Italy or maybe even a credit event? Is this sometime down the road in Italy?

I'd love to say the answer is yes; but the answer, I think, is no. The euro zone summit was a step forward, and we have adopted the view that the glass is

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half full, and that's true, that compared with what existed, the policy vacuum that existed before the announcement of last week, the recent policy framework is sketchy and gets an incomplete as a step forward.

This morning, I'd like to focus on the part of the glass that's half empty; the risks to the Italian story, in particular, created by the policy decisions that were made last week.

First, what needs to be done with the management of Greece and probably Portugal and maybe Ireland, in the months to come, is first: The restructuring has to be definitively behind the market. It can't be perceived to linger for another five months, never mind five years.

Second, the restructuring has to be done in a way that insulates the precarious sovereigns and the banking system in Europe, in particular, infrastructure, the consequences, direct and indirect, of restructuring itself; and it has a plan to rebuild the banking system of defaulting countries that will certainly be broken by restructuring.

In three dimensions, seems to me, all of the opposing last week's announcements were dangerously in step. First, the Greek restructuring is not deep enough to put the Greek public finances on a sound footing.

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Fifty percent sounds like a lot. But they've carved out all of the EU obligations, both ECB and government to government obligations, and refused to restructure those.

Of course, the IMF is considering that, supposing that the rest of the stuff can be restructured. But in that, there's debt which is owned by other central banks and institutions. If the ECB is not willing to take a haircut, it's unlikely those guys will take a haircut, as well.

And it's likely that the banks, who are under the regulatory -- are subject to regulatory pressures from European sovereigns, will participate in the restructuring. They own half of the privately held debt out there. It's easily understandable and easily predictable that other investors will not. We're not done with Greece, even that if this restructuring goes forward. That's bad.

Second, because the public sector purchases of Greek public debt were decided not to be restructured, it has become clear to the market that the default risk will be concentrated in other stories as well upon the private sector holding the bonds, more concentrated as the aggregate shifting of bonds, the holding of bonds, move from the public sector to the

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private sector.

So it's one thing for you to be the subject of debt restructures, all of the debt to be restructured. But if you own debt, which is 30 percent of the total and it has to be cut by enough to make the sovereigns credit-worthy again, that's when it becomes astronomical and the credit risk becomes enormous.

Second, the banking initiatives to try to strengthen the core European banking system were two. First, sensibly, they have agreed on a program, the details are not yet available, to make sure bank funding is maintained throughout the crisis, some sort of public guarantee of European bank obligations, seems to be in the offing. And that's very important to prevent a credit crunch in Europe. It's happening now -- to get worse and create a deeper recession than is already in the cards for core Europe.

Bank recapitalization received a lot of attention. It's completely wrong-headed and actually the wrong thing to do, and much more likely counterproductive than productive. It was way too small to make any difference whatsoever if the important countries of Europe fall into default or even are subject to full-fledged attack, and way too big if they don't.

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Because the only problem, the only capital deficiency in the European banking system occurs because the sovereign debt the banks own are in question. There's no protection for European banks from an Italian default, no such thing; certainly a hundred billion euros of capital will do no such thing.

The allocation of the capital raised was determined because, in the event Spain and Italy do go down, the least problems would be the direct exposure of the banking system to those sovereigns. The bigger story will be the economic chaos that ensues from the credit losses associated with the financial mayhem, and the economic catastrophe.

And finally, along with the very unfriendly treatment of banks in general, in particular Greek restructuring, it encourages banks to delever and to reduce ownership of Greek public debt, European public debt, to the maximum permissible. It has happened to big banks all over Europe, reducing their holdings of Italian, Spanish, Portuguese, Greek and Irish debt as quickly as it can get away with.

The last thing that Europe needs is to contaminate the confidence of the most important class or group of owners of the European public debt. This they have done. The EFSF, which was created or

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conceived as a lender of last resort for distressed sovereigns among other things, was very poorly equipped and ultimately inadequate for the task of supporting Italy or Spain if either one of the countries comes under a really serious market attack. It is simply too small and poorly structured for that purpose.

I have a note here on the structure of the EFSF, the European Financial Stability Fund. It explains why we think the headline number of a trillion euro is completely -- won't have significant impact on the actual debt service costs and problems that face the distressed European sovereigns. Again, Italy is the one that matters the most.

So, for the time being, it looks to us like this story is very, very far from over. It's no surprise, to me at least, that the market reaction to the summit decisions, after a day or two of euphoria, returned to a position of pretty significant skepticism. The Italian bond yields a little bit softer today, a little bit better today because the ECB cut rates this long.

Nevertheless, unsustainable levels, and very close to the previous peaks. Ominously, no evidence whatsoever of any relief in the banking system, created by the banking component.

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I don't know if you guys follow this, but one measure of stress in the banking system is the spread, the Libor overnight interest rate, that's noncredit intensive, reflects nervousness with which the major banks of Europe treat each other in the overnight lending rate. And that is close to, in fact, at the (unclear) was certainly higher in the 2008 financial crisis, now unsustainable.

You can't have that continue for another year or two and not have a liquidity/lending crunch that will do serious damage to the European banking system.

What is needed?

First, again, Italy is the story. All of the other stories really matter, almost only to you, insofar as Spain and, above all, Italy is perceived to proceed. Greece matters more for precedent to Italy than anything else.

First, Italy needs to do its homework, and it can't under the present government. We need a new government of Italy. The government doesn't have the traction in Rome needed to get a relatively modest important set of reforms through that both markets and, more importantly, the euro zone policy needs to see.

And the prime minister has zero credibility. Nobody in Europe's policy circles have confidence in

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him, and there's very unlikely to be full-fledged policy support for Italy under the Berlusconi government; which means that, in a matter of days if not weeks, maybe a couple of months away, what needs to happen for Europe and what needs to be done is, first, as Italy does its homework, to offer essentially unlimited financial support to stabilize the Italian debt markets so that investors know there's a backstop if they and other investors retreat from their holdings of Italian debt, which is inevitable; inevitable because of its treatment of the banking system of Greece and for other reasons, as well.

The only way is to prevent the vicious circle dynamics in which high interest rates lead to high estimated default probabilities, which lead to reduced demand for the debt, which leads to yet higher interest rates. That's a vicious circle that has to be cut, and EFSF won't do it.

The SNP, which is the Secondary Market Purchases program, on EBCB, cannot do it unless it's made clear to market participants that they mean business; they mean business like Ben Bernanke means it when he says the QE2 is $800 billion dollars. When EBCD starts to signal they're willing to intervene on that sort of scale, then one can rest easier with the Italian

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situation.

This will not be over even if these preconditions for preventing a collapse are in place for at least a year. We still have to get through Portugal. There's a very good chance that we'll have to manage the Portugese, as well. Another direct consequence of that, not too devastating, but it needs to be needs managed intelligently. So far it's been managed abominably.

My background is in emerging markets. I have to tell you, the kind of sanctimonious lectures that the countries I cover got in the IMF from the Europeans made me want to (unclear) at this point because, compared with the way this is being managed, they make it look like Argentina did good.

So first, we've got other policy, big policy bumps in the road to get over. Secondly, we have a recession coming that could be pretty bad, will be pretty bad if we don't get the banking system back on track. And no investor is going to feel comfortable in the European public financials until they can see light at the of the end macro economic tunnel. And that is sometime to come. We're just going into the beginnings of the European recession.

Look for this to be a key driver of asset markets in the months to come. What would I do? Be

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aware. Whatever you do, don't be tempted -- there seems to be -- to write catastrophe insurance on the European collapse, which is what is holding Italian public debt. Yes, you win if they avoid a public collapse. But if you lose, everything else in your portfolio goes down at the same time, and big. That is a horrible trade.

Look for things that are located as a result of anxiety attacks, like we periodically will have in the future, that you can feel comfortable holding through market to market volatility associated with debt assets, where the kind of distressed that is, ought to be reflected in situations is price.

You can make a case that German equities are a case where such bad news in price (unclear) public debt. And look for opportunities in European bank deleveraging; that is coming. I was speaking with another big pension system not long ago, and they let us know that they are already starting to see things from European banks, governments, disposing related assets, appealing prices, as long as the cosmetics transaction are priced acceptably.

I've probably overspoken. Let me leave it open for comments, complaints, questions.

(Laughter.)

MR. SCHLOSS: Depressing.

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THE SPEAKER: Can you comment on implications for the U.S. markets?

MR. GAPEN: I think, first, what I said about the economics, it all needs to be said about the markets. This is, if Italy goes down, maybe even if Spain goes down. Spain is a much smaller story, a less meaningful smaller story and less risk, less distributed around the world as Italian risk is.

But if Italy -- if the probability of Italy going into a real debt crisis becomes a real one, there are secondary ramifications that will hit the U.S., as well.

What's our view on China? China will be fine in 2012, as long as it doesn't import a recession along the lines of the 2008 external demand implosion. It's very poorly equipped at the moment, compared to 2008, to manage an external shock that size. The reasons we'd have to schedule another meeting to discuss.

It's not just the U.S. at risk. It's also not just the economics, but also U.S. banks are not at risk to a Greek restructuring, an Irish restructuring, a Portugese restructuring; but an Italian restructuring, directly, yes. Indirectly even more, because the interlinkages between the U.S. financing system and the

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European financial system are like Siamese twins, and there's no one unraveling those connections.

So first, to the extent that there's a market anxiety about something that doesn't seem to threaten Italy -- you may not think tactically about investments, but if you read newspapers and try filter the news, you can psychologically filter market anxiety about now.

But, if Italy begins to come into more serious questions than it already has, get out of the way. Get out of the way. The S&P 500 is not priced for consequences of anything like that. So there's real risk in this story if it plays out poorly; we think it could. I painted a very dire picture.

MR. SCHLOSS: You were just kidding.

(Laughter.)

MR. GAPEN: This is a manageable problem. It is both astonishing and shocking that it's come to this pass. There's no reason for Italy to be in the kind of policy straits that it is at risk of being in. It may actually be resolved quickly. We think if in December, or the earliest January, we have a new Italian government that is technocratic in nature and trusted by the core European policy makers...

And although I deeply respect his

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intervention, this has been puzzling and unbelievably damaging to the management of the crisis. If there's one single person has complicated the European policy response, above all it would have to be Trachet [sic]. He hung on for longer than anybody in the world, never mind in Europe, to the fiction that Greece didn't need to restructure its public debt.

As an economist, it's deeply baffling to me how he could have maintained that fancy for as long as -- and resisted the Greek restructuring for as long as he did. It's tremendously damaging, and his very grudging half-hearted support for European public debt stabilization was damaging. That's easy to remember, easy to understand.

But nevertheless, with the benefit of hindsight, it can be seen to be tremendously damaging (unclear) an equally competent trusted technocrat. I think (unclear) because of the fact he's Italian. He's not Italian, he went to MIT just like me. He is an economist's economist, a Ben Bernanke-like figure with political stature to do what needs to be done.

Even from an Italian that might be received negatively in some circles. They proved that today to some extent. That was an easy decision. It's not impossible with a political transition in Italy, offer

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the lender of last resort the facility... to what Italy needs, long policy efforts to turn the threat of Italian debt in the event of a true fail risk.

Second, you can afford to put Italy off to the side when making core investment decisions. It's not there yet. It's not likely to get there. I just think we'll see worse before we see an ultimate resolution of the problem.

MS. NAGASWAMI: You talked about a management and leadership crisis. That's what got us into this mess. Inherently the economy's structure is deeply flawed. And you talk about a recession. I just don't see where the growth is going to come to even make the three cents on the dollar, seem like it might move?

MR. GAPEN: I think the two economies where you can say that are Greece -- and I don't think that's the case in Italy. Italy has a demographic problem that compounds the problem going forward. And they have what we used to call "Remember Italy." (Unclear) They have it, clearly. They also have the ingredients to come back, I think, along the lines of Ireland. I see Italy as obviously bigger, older and a more complicated story than Ireland.

One potential actual surprise upside, demographics aside, is the private sector. If you think

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about it, it does comprise a large number -- doesn't mean that they don't have a recession coming. That doesn't mean they don't they a long grinding period of rebalancing coming. They do.

But I see it a little more like -- I don't want to sound overly optimistic, more like the 5 to 10 years of difficulty that Germany had absorbing East Germany. It took enormous policy efforts and it took enormous sacrifice from the private sector in the form of slow to negative wage growth and so forth. But they came out of it with a stronger economy than they went into it.

I don't think that's impossible for Italy. Many things can be done. It might not be so obvious to guys who haven't lived in Sicily or --

MS. NAGASWAMI: Have been for ten years and nothing happened.

MR. GAPEN: It's a leadership problem. It's two things. First, let's step back. Italy has been through something like this in the past under more favorable circumstances. In the early 1990s, the debt burden may have been almost identical to the one it faces now. What brought it down, if I remember, about 25 percent point GDP to get Italy out of the danger zone, if it were actually to materialize. Now, those

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were much more buoyant years in terms of global growth. Italy didn't have the competitiveness problem but developed a competitiveness problem in the last ten years. It didn't have quite the demographic problem that it will have in the next ten years.

So I think it will be harder and a little over-optimistic to say that (unclear) repeat those ten years is not easy, but I personally think doable.

If you talk about Greece, it's much more difficult to envision Portugal, too; much more difficult to envision. I don't think we should be overly-pessimistic about Italy with the leadership and the kind of policy initiatives.

Last point; the debt consolidation we had in the 1990s didn't happen, because (unclear) slowed, better growth than you can expect in the next ten years, but it's still a fairly slow growth economy. It has been a slow growth economy the last twenty years, not just the past five or ten.

It means that we have to be much more careful and much more thorough in the manager attitude to fiscal consolidation. But they can start with a much healthier position. The Italian public finances are probably out of whack by 3 to 5 percent, I'm not sure, compared with the United States or Japan, more 10 to 12

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percentage points of GDP, an unsustainable fiscal structure. It's a much more manageable situation. It definitely needs attention and work and support, but we're not pessimistic.

MS. ROMAIN: Given the dysfunction, what is your view of the euro zone expanding, contracting?

MR. GAPEN: I think it's not my call, but we think there is a negligible risk the euro zone will lose a subset of Portugal, Greece and Ireland. It would be devastating if any of those countries leave the euro zone. It would be equally devastating for them to stay in the euro zone. It's a very tough situation they've gotten themselves into.

That, to me, can only increase the integrity -- by the way, I think Ireland is the least likely to leave and the most likely to come out of this actually with high public debt, without a debt restructuring, a pretty good bet; and with a growth story to tell. Why? Partly because of two reasons.

First, the markets and endowments, endowments in human capital and international trade; and in the stubbornness of the Irish people and their experience. They approach this problem like the Baltics did, and their crisis, Lithuania and those countries, fell into an unbelievably deep crisis, and nobody really

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thought they would be able to make it with their heads intact.

Until our economists went there and looked them in the eye, "Show me the arithmetic." They said, "You don't understand, we went through the Soviet Union, we know what pain is. You haven't even seen the beginning of what we can tolerate."

The Italian public sector (unclear) that is benefiting them, because internationally they're exposed to competitors. It's hard to see that in Greece, hard to see in Portugal and Italy. Luckily the problem is much smaller... euro zone systemic in nature, little countries but a core country. I think you would have to identify Italy as the country most at risk. There are elements within Italy that would -- I would assign zero to low probability, five to ten years, no more than five percent probability that Italy leaves the euro zone.

Scenarios in which the strong countries decide to break up euro zone, not even worth thinking about. If they had to vote on it now, Germany would vote overwhelmingly against the euro. They weren't asked.

(Laughter.)

The politicians ignore them.

MR. SMARR: Can you describe the debt, some

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of which was restructured, some was not? All the money Greece borrowed, was that restructured public debt? You said it was restructured?

MR. GAPEN: Make a distinction between debt -- debt owed to or borrowed by?

MR. SMARR: Borrowed by.

MR. GAPEN: All borrowed private sector debt, the problem was non-existent, not entirely (unclear).

MR. SCHLOSS: One guesstimation, you're handicapping, the Greeks say, let's have a nice referendum, because they're going to ask question they don't want to ask the people: What happens?

MR. GAPEN: The reason this question is being asked is because if we ever get to a referendum, there's almost no risk, the answer would be no. The Greek public is overwhelmingly in favor of staying within the euro zone with the euro. Not unanimously; 70 to 75 percent of survey respondents have said that.

The risk comes from the fact that the referendum might turn into a referendum on the government, as opposed to an actual answer to the question being asked. And it's a stupid risk to run. A new government would almost certainly abandon this plan to run a referendum. It can't afford referendum that

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has nothing to do with the policy questions at stake, I think.

MR. SCHLOSS: You think there's no referendum?

MR. GAPEN: It's not impossible.

MR. SCHLOSS: You're a betting man.

MR. GAPEN: I think it's very likely to wind up being no referendum. I'd say my own view, not the house view, I'm not sure what the house would say, what a European team would say. My own view probably is there's a 15 to 20 percent probability of a referendum. I could be wrong. Politicians are very hard to predict. They may survive. Weirder things have happened, with Greek politicians especially.

I think the base case is a government is elected tomorrow. A government of national unity is constructed, a temporary government is constructed, and they stagger into 2012 and try to implement the most recent program as best they can. There's uncertainty, not to say we know.

MR. SCHLOSS: Last question.

A Hail Mary from the Fed or China, don't worry?

MR. GAPEN: One of the scariest things to me is to hear Sarkozy (unclear) Chinese realization, he

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doesn't seem to understand the nature of the problem where Europe is in the international scheme, the Chinese would provide cash. But Europe doesn't need cash. Cash is everywhere. You have cash, I have cash. The Fed has a fire hose.

It's not a liquidity problem in that sense. Europe needs credit, an investor or set of investors willing to take a bet on the European, in particular Italian, credit. That's not the Chinese game. They invest in cash reserve managers. Certainly not to make stupid credit bets; right? They don't. Enough to know.

So, approach China? To me, no. This may wind up, if it grinds on long enough, bad enough, becoming a problem obviously too big for Europeans to handle on their own. In that case, you can expect the U.S. -- the IMF, of course, to spearhead a G20 type of response, which would possibly be financed substantially by Chinese money.

For example, in the past we've seen Asian and Middle East money. That will not be credit. Credit will remain concentrated in the private sector, because all those lenders will demand the private sector not be subject to restructuring risk. There aren't many investors out there right now willing to be subject to that restructuring risk.

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CHAIRPERSON AARONSON: Anybody else?

Thank you very much. The only thing that saves this day is my granddaughter. She raises my spirits.

(Laughter.)

MS. DUNLAP: Thank you very much for having us here today. We have a number of publications here that we'll leave for you, research reports.

(The Barclays people left the room.)

(Recess taken.)

CHAIRPERSON AARONSON: We would like to get started again.

MR. SCHLOSS: Next on the agenda is a continued discussion about rebalancing ranges for the new asset allocation. I'll hand it over to Robin.

MS. PELISH: Thank you. This is really intended to be a follow-up to a discussion held at a prior meeting about rebalancing the target allocations and rebalancing ranges. And this is on page number 58, and starts in the big book.

So, the difference between the prior presentation and this presentation really is that we've aggregated the allocations to public equity and public fixed income, and developed ranges, rebalancing ranges for those asset classes.

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And let me call your attention to the details on page 60, where you see that the long term target allocation to public equity is 51 percent. The aggregate U.S. Equity and non-U.S. Equities, Emerging Markets and REITS, each one of the individual asset classes has a range around the target allocation that allows for some movement within that asset class.

But once you get outside of that range, it's expected that you rebalance back to a point within the rebalancing range. The ranges are developed as a combination of our end science, but they're developed considering using algorithms to produce transaction cost, volatility of the asset class, as well as the correlation to that asset class and other asset classes in the portfolio.

As I just noted, if you add up those four sub-asset classes, public market equity for the target allocation to 51 percent, what we're proposing here is that rebalancing range for aggregate number be plus or minus 5 percent.

So, in other words, you could underweight non-U.S. Equity, overweight U.S. Equities, but it's aggregate. The aggregate of public market equities is not expected to go beyond 46 percent or 56 percent.

Now we don't have rebalancing ranges for

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private asset classes, although those allocations should be monitored. Rebalancing is really intended to be carried out with liquid asset classes. So we're excluding private equity and real estate.

If you move down to the fixed income asset classes, you'll see, if you add up all the sub strategies, Core+5, TIPS, high yield and emerging market debt, the total target allocation to public market fixed income is 32 percent. We're suggesting here that there be a range of plus or minus 4 percent with regard to the aggregate strategies within public markets.

So that's really the major change from the numbers you've seen previously.

Any questions on that set of numbers?

MS. NAGASWAMI: The trigger points all appear reasonable in terms of changes to the volatility assumptions that Rocaton made, which reflects that. The only question I still have, Robin, is that our current equity in fixed income, what you have as plus or minus 5 and plus or minus 4, actually include the illiquid. Today in our investment policy statement we are plus or minus 5 for equities, private and private.

If you added the 51 plus 63 and 3, is that 63? And the plus or minus 5 would apply to that? I'm not sure why we would change that.

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The same with fixed income, we've added up opportunistic fixed income to that category, with a plus or minus 4, would be relative to 37, not 32. And that goes with the whole way that the Actuary thinks about it, the 70/30 is the risk today and that moves to 63/37; and then the bands are set around that, rather than just the public.

MS. ROMAIN: The balance of liquid in the categories, then are you saying let it be included anyway, and therefore wouldn't rebalance?

MS. NAGASWAMI: Included now, so it's already part of how we thought about it for years and years. But we don't -- Robin makes a very interesting point, which is that you don't rebalance illiquids, but the weights changes. So when we think about our total equity weight -- let's say we have a market drop by 20 percent of the total equity, shouldn't we include the private equity weight in terms of saying what's plus or minus 5 percent of the total equity weight, including private equity, because we have that exposure to private equity?

MS. PELISH: There is a logic to doing that. I understand the logic; I guess the counter-argument, I do think the way it's being done is defensible. The counter-argument to the way it's currently being done

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and the suggestion you are making is that rebalancing is really a response to mark to market. And the private asset classes don't really mark to market very efficiently. So you're including numbers that may be very lag, either on the upside or downside.

MS. MARCH: You can't figure out what they are worth?

MS. NAGASWAMI: I agree with Robin.

MS. PELISH: If you're including them in the total around which -- what you're saying is, consider those beta exposures.

MS. NAGASWAMI: Ignore means don't include them. We already have them. Suddenly we could add 5 percent to public equities, but in fact we have private equity stuff.

MS. PELISH: Right.

MR. NORTH: I think what the issue is here is, right now there's a rebalancing on 82 percent of the assets. To the extent you want to get fully invested in the other 18, you could be in a situation -- I'll make it extreme to make a point -- assume none of the private equity elements are in place at all. You would end up with a portfolio of 56 percent public equity, the maximum -- because the private equity is still being advised.

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So I think the question is, Do you want to allow in terms of characteristics either a wider band to account for the investment into the other processes? Or do you want to make a specific allocation to the place-holder or illiquids?

MR. SCHLOSS: Bob, I don't think that is right. It looks like that, the way the math works. I think the reality is buried in the footnotes 1, 2, 3, 4. Because what these footnotes do is give you a public proxy for illiquids. So if you added these footnotes in, with sort of a pro forma number.

In fact, if you wanted you could come up with another pro forma number, add the invested amounts, and say let's use that as a proxy. But I think it's dangerous if you -- you're going to have privates pushing out your publics in big market dislocations, which might not be at all what you want to do, given the inability to value these privates correctly.

MS. NAGASWAMI: I feel that ignoring that beta is absolutely painting a picture in terms of ranges I wouldn't want. I wouldn't want to ignore the denominator effect on the alternatives. We want to do more of these. We talked about adding even more, so that we could have a lot of beta exposure that's not accounted for when we think about our weights.

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MS. PELISH: It is accounted for. I think your point applies if we've gotten very much out of whack versus our targets to privates. But if we're anywhere near these targets it is included, we are saying.

MS. NAGASWAMI: It could be off, right? For two or three years, pretty off.

MR. NORTH: I think another way of describing the issue is, when the reports come back every quarter and they say how much is in, say, uninvested EMD; it's supposed to be 50 percent in foreign and 50 percent in high yield. Unless it's recognized in a separate bucket as, this is part of what will be EMD someday, the reports that are going to come back are going to show you either a little overweight in Core+5 and overweight in high yield. And you don't want to rebalance back, because they're both illiquid. It's a proxy.

So one can set up the numbers on the whole portfolio or the other portfolio because you're trying to get the risk balance and the betas in the right place. But then when it's reported, you've got to make sure you don't accidentally trigger a rebalancing --

MR. SCHLOSS: Right.

MR. GANTZ: What we've done in the past is

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adjust for just what you're describing, have the adjusted policy to account for the uninvested amounts going into the other holding place; and then apply ranges on that adjusted --

MS. NAGASWAMI: That's in the policy.

MR. SCHLOSS: There's two parts to this. Let's break it into two. The part that's not invested, EMD, that just gets you a pro forma policy, which is easy to take care of. Ranji's is a little different question. You guys are only 82 percent of the portfolio. What about the rest?

I can take care of yours, Bob, by these footnotes.

MS. PELISH: And appropriate reporting.

MR. SCHLOSS: Yes.

MS. PELISH: I think what the answer is, you can approach it -- not adding in private asset classes does leave out beta exposure, absolutely. Adding increases the problem, the evaluations at any moment in time, and we're rebalancing monthly; very suspect. But so it's weighing those two issues.

If however, we worked to include the private asset classes in either equity or fixed income, because we have also left out opportunistic fixed income -- I think we would have to raise the 5 percent either way.

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Keep it the way it is or raise it 3 percent.

MR. SCHLOSS: Bigger bands --

MS. MARCH: But what you're doing is, you are including in your range, including in your results, assets that we don't have the value of, for six months after they are valued. And this is not an exact science. And if we account for it in other ways, I don't really think we should make the changes being asked for.

MS. NAGASWAMI: I'm not sure why we're changing our policy. What we have today is being changed. I'm not sure why we are doing that. We've had this policy for years, where we've included it. I'm not sure why we're changing something. Because the beta has mattered historically. I'm not sure why the beta doesn't matter anymore. We've moved all the other trigger points for volatility, let's move this one.

I'm surprised we've excluded something that has always been included, and it's now 18 percent of the portfolio. And everywhere else we have widened the bands, because vol [sic] has gone up. Sure that makes sense.

MS. PELISH: I think we can approach it either way. I think this is sort of neither -- I think rebalancing is really an operational process. If you

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want to include the beta from private asset classes, that's fine. It's harder to calculate the range because it then becomes --

MS. NAGASWAMI: But the bands are there to manage the beta. That is what bands are for. If we ignore 20 percent of the portfolio -- I'm not sure why -- the point of the exercise is to keep beta at a target level.

MS. MARCH: That's fine. So let's not change our bands until we know the results of the private equity. Let's not deal on a short term basis. Let's wait until we have the results. We'll wait until those results come in.

CHAIRPERSON AARONSON: We've heard arguments on several sides. The Board has made its recommendation with respect to your application, to accept this recommendation at this time, and that we move ahead. And then, as we do this, if we see any problems arising, review it. Right now my suggestion is to accept this and move --

MS. NAGASWAMI: I'm not comfortable. We are changing the way we think about beta. I'm not comfortable with that. It's very easy to just widen the bands. We just did it for non-U.S. in our policy portfolio, plus or minus 2 to plus or minus 4. That

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makes sense. I'm not sure why this is difficult.

MS. PELISH: I'd suggest one other solution. One other solution is to -- balancing the problems with valuations. All we know the numbers are off the mark any time we rebalance. We know the private numbers are not exact, they lag so much. But recognizing that, at the same time, recognizing that they do provide beta exposure. Another way to potentially handle it is to look at this either on a monthly or quarterly basis, take weightings, either over or under targets, the private asset classes, and adjust the numbers. I'm not sure of the best way.

MS. MARCH: If you are not sure that it's the best, why should we accept the recommendations?

MR. SCHLOSS: How about we do not decide today and come back to it next month? I'm okay with that.

MS. MARCH: Fine. Come back next month.

MS. PELISH: I'd mention one other point. If you're not approving this today either, I'd mention one other point that needs to be addressed and approved at some point; which is this concept of cash allocations. In none of the asset allocations is cash considered as a strategic allocation. Cash is only accumulated for frictional reasons, you're awaiting

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distributions, awaiting investments, manager terminations that are proceeding. Or, the third reason is cash -- today the largest, I think, source of cash is extreme market conditions that led to holding cash for a limited period of time.

MR. SCHLOSS: And rebalancing.

MS. PELISH: An rebalancing falls into the cash category.

So, we are not suggesting that cash be considered a strategic allocation; it never has been. But one of the decisions that has to be made is the maximum allocation to cash that can be held for any of the reasons, any administrative or tactical reasons.

Here we have a suggestion that allocation to cash not exceed 5 percent of the planned assets without prior notification and approval of the Board of Trustees. I'm not sure the board wants to discuss this at this time, but this is another important element to go into IPS.

CHAIRPERSON AARONSON: All right?

MS. MARCH: All right.

CHAIRPERSON AARONSON: Does that conclude your report?

MS. PELISH: Yes, it does.

MR. SCHLOSS: We'll come back on this one

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next month and wrap it up.

That concludes the public session for the Comptroller's Office.

CHAIRPERSON AARONSON: Do I hear a motion?

MS. MARCH: I move, pursuant to public session law, Section 105, to go into executive section to discuss the proposed acquisition, sale or exchange of securities held by the Teachers' Retirement System; and to discuss proposed pending or current litigation.

CHAIRPERSON AARONSON: Any discussion?

All in favor say "Aye."

(A chorus of "Ayes.")

Any opposed?

(At this time, the meeting was conducted in executive session.)

MS. MARCH: Motion to go out of executive session.

MR. SCHLOSS: Second.

CHAIRPERSON AARONSON: Any discussion?

All in favor say "Aye."

(A chorus of "Ayes.")

Opposed?

We're now out of executive session. And we would like, for the record, a report on what was done in executive session.

MS. STANG: In executive session of the variable funds, three manager updates were presented.

In the executive session of the pension funds, several manager updates were presented.

A private equity investment was discussed, consensus was reached, which will be announced at the appropriate time.

Presentations from two real estate consultants was received, and a consensus developed, which will be announced at the appropriate time.

There was a session of attorney client privilege to discuss a policy issue. No consensus was reached.

CHAIRPERSON AARONSON: Okay.

Any other business before the board?

Do I hear a motion to adjourn?

MS. MARCH: Moved.

MS. NAGASWAMI: Second.

CHAIRPERSON AARONSON: Therefore, seeing no objections, we are adjourned.

(Time noted: 3:28 p.m.)

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C E R T I F I C A T I O N

I, Jeffrey Shapiro, a Shorthand Reporter and Notary Public, within and for the State of New York, do hereby certify that I reported the proceedings in the within-entitled matter, on Thursday, November 3, 2011, at the offices of the NYC TEACHERS RETIREMENT SYSTEM, 55 Water Street, New York, New York, and that this is an accurate transcription of these proceedings.

IN WITNESS WHEREOF, I have hereunto set my hand this _____ day of _____________, 2011.

____
JEFFREY SHAPIRO