NEW YORK CITY TEACHERS' RETIREMENT SYSTEM
INVESTMENT MEETING
held on Thursday, April 7, 2011
at
55 Water Street
New York, New York

ATTENDEES:

MELVYN AARONSON, Chairperson, Trustee
SANDRA MARCH, Trustee
MONA ROMAIN, Trustee
LARRY SCHLOSS, Trustee, Comptroller's Office
RANJI NAGASWAMI, Trustee, Finance
MR. MILLER MILLER, Comptroller's Office
LIZ CALDAS, Comptroller's Office
MARTIN GANTZ, Comptroller's Office
JOEL GILLER, Comptroller's Office
MARC GROSS, Comptroller's Office
SEEMA HINGORANI, Comptroller's Office
MARC KATZ, TRS
KATHY MARTINO, Comptroller's Office
JOHN MERSEBURG, Comptroller's Office
YVONNE NELSON, Comptroller's Office
ROBERT C. NORTH, JR., Actuary
CHRIS LYON, Rocaton
ROBIN PELISH, Rocaton
KAREN SEEMEN, Corporation Counsel
ROBERTA UFFORD
STEVE BURNS, Townsend
SARAH CACHAT, Townsend
MARTIN ROSENBERG, Townsend

P R O C E E D I N G S

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

MR. KATZ: Good morning. Welcome to the April 7, 2011 investment meeting of the Teachers' Retirement Board. We will start by calling the roll.

Melvyn Aaronson?

MR. AARONSON: Here.

MR. KATZ: Kathleen Grimm.

(No response.)

Not here.

Sandra March?

MS. MARCH: Present.

MR. KATZ: Ranji Nagaswami?

MS. NAGASWAMI: Here.

MR. KATZ: Lisette Nieves?

(No response.)

Not here.

MR. KATZ: Mona Romain?

MS. ROMAIN: Here.

MR. KATZ: Larry Schloss.

MR. SCHLOSS: Here.

MR. KATZ: We have a quorum.

So, the first order of business is a motion to elect a chairperson for the meeting.

(Short pause.)

MR. AARONSON: I declare the meeting closed.

(Laughter.)

MS. MARCH: I nominate Melvyn Aaronson.

MR. AARONSON: Is there a second?

MS. NAGASAWI: There is.

MR. AARONSON: Any discussion?

All in favor, say "Aye."

(A chorus of "Ayes.")

All opposed?

Motion carries.

MR. KATZ: Mr. Aaronson is the chair. Before we turn it over to Mr. Aaronson, there is a resolution that's required this morning regarding the webcasting of the meeting. I will read the entire resolution and then we're going to seek consensus on it.

"Whereas, public officers law Section 103 was amended by Chapter 43 of the laws of 2010, Chapter 43, to provide that any meeting of a public body is open to the public, shall be open to be photographed, broadcast, webcast or otherwise, be recorded and/or transmitted by audio and visual means.

"And whereas Chapter 43 provides that a public body may adopt rules consistent with recommendations from the committee on open government reasonably governing the matter by with such recordings are made, to insure that the body's meeting can be conducted in an orderly manner.

"And whereas the board seeks to promote transparency at public meetings in accordance with Chapter 43, while insuring that meetings continue to be conducted in an orderly manner:

"Therefore being resolved that board meetings, to the extent open to the public, shall be webcast by staff assigned by the board to perform this task.

"And be it further resolved that the webcast of such public board meeting shall be available at an internet site made available by the board.

"And be it further resolved that the board directs staff to draft proposed rules in accordance with the requirements of Chapter 43 and this resolution for review, and possible adoption by the board at it's next regularly scheduled board meeting."

CHAIRPERSON AARONSON:  Is there any discussion of this resolution?

Seeing none, we will act on this resolution.

MR. KATZ:  We seek consensus before we proceed.  Do we have consent?

MS. MARCH:  We have consent.

MR. KATZ: Okay.

CHAIRPERSON AARONSON: Welcome to the April investment meeting of the New York City Teachers' Retirement System. I am Mel Aaronson. I will be chairperson of the meeting. As this is the first webcast of the board proceedings, I would like to welcome you.

And first order of business today is going to be a report on the variable programs.

MR. LYON: Good morning. Chris Lyon, Rocaton Investment Advisors. I'd like to start by reviewing the diversified equity fund performance. This information was previously distributed to the board and also handed out this morning. And all the information I'm going to present through the end of February. This is my standard monthly update. We have more detailed quarterly review discussions.

So, I focus mostly on kind of the incremental information that is new since the last update. If you start on the first page, you can see the total assets in the diversified equity fund, also formerly known as Variable A, where there's approximately $10.4 billion.

At the bottom of the first page, you can see all that was divided between the different investment plans. When we look at the overall asset allocation, the total allocation by broad grouping are relatively close to their targets, will fluctuate due to market performance and rebalancing a cash flow needed, of course. But it has also fluctuated from the target midterm allocation that were still in effect at this time. But the largest deviations from the target were less than 4 percent of assets.

Turning to performance submitted, we have -- flip ahead two pages to page 3 -- and in the middle of the page, still focusing on the diversified equity funds, which is totally considered total performance for this investment option. And all this information is shown on a net of fees basis.

For the month of February, you can see that the returns were, approximately, 3.4 percent. And this was pretty close to but less than behind the 3.6 percent returns of the broad U.S. equity market, measured by the Russell 3000 right below it. And closer proxy for the fund allocation is a hybrid benchmark, which is 3.46 percent. We're very close to that.

For the month in particular, the strongest performance in absolute terms came from the index composite, which comprises both of the assets and followed by the active U.S. managers composite, while the defense and international composites had slightly lower returns. But nonetheless, it's pretty reasonable absolute returns for one month period.

If you move two columns to the right on page 3, in the middle of the page, you can see that the year-to-date returns for the calendar year-to-date was 5.6 percent, approximately; and that this compared favorably to the hybrid benchmark, which is 5.5 percent and slightly trailed before our U.S. equity market.

Again, the two U.S. equity composites, although, in the reverse order, the active composite first, then the index composite, have a strong absolute performance during this time period.

And then, that was followed by the other two major composites; the international and the defensive. But again, all were still positive in terms of their contribution during the year-to-date period.

You can see certainly on this report the longer term report rebuilt as well, and we specifically review those in more detail in the quarterly reports.

So, before I move on to other reports, are there any questions?

CHAIRPERSON AARONSON: Seeing none, go ahead.

MR. LYON: The remaining three options that we plan to review today are the international equity funds, also known as Variable C; the inflation protection fund, also known as Variable B; and the socially responsive equity fund, known as Variable D. And just to note that this table of value fund, known as Variable B, is reviewed as part of the quarterly reporting process.

At the top of this other handout that has Variables B, D and E, you could see the market values, approximately, $77 million in Variable B, $18 1/2 million in Variable D, and almost $19 million in variable E.

And turning to the performance, you can see that the international equity fund for the month of February returned 3.1 percent, about 20 basis points or two-tenths of percent behind the EPA benchmark, which is a good proxy for the international equity market broadly.

And for the year-to-date period of funds returned 5.2 percent, which is about a half of a percent behind of a still strong absolute return for a two-month period.

Despite being slightly behind for at least the very short time period, this investment option since the inception on any annualized basis net of fees has outperformed by over 5 1/2 percent.

The next investment option is Variable D, and you can see that the investment option return 1.4 percent, this is almost 1 percent ahead of it's benchmark for the month of February. The year-to-date return is about four-tenths of a percent, ahead of the benchmark is 1.9 versus one and a half, roughly. And since inception -- this option on annualized net of fees returned almost 3 1/2 percent more than the benchmark.

And lastly, the Variable E fund, socially responsive equity fund as it is formally known, this option returned 4.7 percent versus 3.4 percent with the benchmark for the month of February, and outperforming the S&P 500 index. For the year-to-date period, it also outperformed by lesser 6.4 percent roughly versus 5.9 percent. And since inception, it's outperformed by over 4 1/2 percent net of fees on an annualized basis.

So, those are the results through the end of February.

Any questions?

And the last thing I have to present is a performance -- benchmark report, which brings the board more up-to-date -- this information through the end of March. And what you can see, as everyone knows, March was quite a bad the month for the world in general for markets as well. And despite that, the U.S. markets ended up basically flat in terms of the major indices that we worked out before. It's quitely positive with respect to the U.S. Equities. International equities were down about 2 percent.

An estimate of what the Variable A performance is likely to be like is found by looking at a preliminary version of the Variable A hybrid benchmark, which is essentially flat positive 3 basis points, or 300... for the month of March that we would expect, typically, the Variable A fund results track that closely when all that information becomes available.

The other variable options, to the extent that they invested primarily in mutual funds, have shown the mutual funds performance -- the underlying funds that are surprising the bulk of investment options and you can see that with respect to the funds used by Variable D, that that fund had a modest positive month in March. And the same is true with respect to the funds used in Variable E.

Any other questions?

CHAIRPERSON AARONSON: That concludes your report?

MR. LYON: Yes; thank you.

CHAIRPERSON AARONSON: Thank you very much. And now, we will move to Mr. Schloss and the pension fund.

MR. SCHLOSS: Thanks, Mel.

Does anybody need a performance report?

Since we have PIMCO coming later today, after I'm done, I'm going to through the economics and the markets very fast. We can do this in half an hour with the economist.

So, just quickly running through the slides, let's start on page 3. You can see that the utilization in the economy leveled off a little bit but in general, it continued to trend upward.

Page 4, you can see the manufacturing index continues as well to trend forward.

Page 5, nice increasing accelerating rate of unemployment claims going down. So, again, it might spike up every now and then as we talked about previously but the trend is clearly going down.

You can see on page 6, unemployment rate is now 8.8 percent, still too high. But again, the trend is starting to come down.

On page 7, consumer sentiment bounces around -- the last picture here went down as a result of the tsunami in March. But again, it might be recovered by now.

Going to page 8, architectural billing, the same thing, trending up. Companies starting to increase their capital expenditure, which is the indicator of that.

Page 9, existing home sales bounced around down. In March, home sales in the housing industry continues to be extremely depressed, as you can see on page 10. New home construction and the construction industry stay that way, weak.

For the future retail sales on page 11 are essentially flat. Auto sales. On the other hand. Are increasing which is very, very good. Particularly, since coming out of a recession, General Motors, in particular, has restructured itself. And now, with what's happened in Japan, it's good for the U.S. manufacturers, all of them are going to be affected by the supply chain again, as a result of the tsunami in Japan.

On page 13, continued strength in leading economic indicators. Again, a big chunk of that is the stock market. Stock markets reflect that in a second, it continues to go up, the U.S. stock market.

And then, page 14, something to keep our eye on is the CPI. The CPI's moved up a little bit with drops of commodity inflation going on. Instead, it's not seemed to be overly worried about it. However -- even though, clearly it's going to move up a little but they're not overly concerned about it, yet. But it will work through the economy, particularly the price of oil, as well as other industrial raw materials.

If you look on page 16, you can see the euro is going to strengthen relative to the dollar.

If you go on 17, you can see the dollar weighted index or a weighted index of dollar of other currencies against the dollar. The dollar continues to decline. That's clearly a function of the safekeeping interest rate, extremely low. A couple of other people think they're increasing it, particularly in Europe -- and again, a weak dollar is a good change for U.S. manufacturers. On one hand -- turning on the other hand, it's sort of what the economy needs right about now.

Skip page 18.

On page 19, the spike in March -- again, it was the tsunami. It's come and gone with little red tag issued on Japan. But from the stock market's perspective, the Vicks has calmed down. I'd tell you, personally, that the Vicks is too calm. For all of the noise going on in the North Africa and the Middle East.

For some markets, it seems to ignore almost everything that's bad news for -- at least get over it extremely and quickly. That's what we think about that.

Page 20, you can see that the Treasury yield curve, the white line in the occurring curve. If I show you a schematic of this over the last two months, it was a flight to quality after the tsunami. Treasury rates went down and continued in about 320, it's back up to 350. It had been up to 380. So, expect it to sort of drift up over the foreseeable future, but not dramatically.

The Deficit ten year rates on page 21.

Page 22, again, is a result of the safekeeping interest rates very low, spreads continue to narrow. The debt for yield, if it can't get yield, they'll put the excess cash in the stock market. Again, that's why stock market's going up. The Fed is determined to create wealth so the consumer feels better, and therefore spends money.

On pages 23 and 24, you can see equity multiples. On the first page is the major industries, the Russell versus EPA versus emerging markets. They were all sort of flat. In the last period of time, it bounced right a little but in general sense, they're not very high on an absolute basis, relative to historic norms as well as historic highs. Consequently, you could find value in the stock market.

The next page, it's similarly faced the U.S. market split into large cap, mid cap, then, small cap. You might comment on that in case we talk about our equity managers.

On page 25, again, you can see the indices since the beginning of the year, they trended up. You can see the crack in March -- again, tsunami-related, and has now come back and is seen to continue to go back up.

Page 26, MNA activity; corporations are very flush with cash. The bigger guys are starting acquisitions. That's good for the stock market, which shows that CEOs are confident again. Again, leading indicator, that's a good thing when MNA activity picks up.

On page 27, you can see the history of the market value, the Teachers' Pension Fund is at an all time high at $42 billion. Congratulations.

And again, it shows it's completely rebounded from the market collapse of fiscal 2008 when it hit about $35 billion. So, highest ever, very good.

And similarly, on page 28, you can see the trail is 12 months and it's basically gone up, straight up. If you look on page 29, you can see the asset mix of the $42 billion. Subsequent to February 28, we have sold about 2 percent of U.S. Equity so it looks over here, we sold it. We sold the 2 percent, basically, to de-risk the portfolio. It is in cash. We're deciding what to do with it. What the portfolio's strategic cash relative that acts as allocation for now.

Partly because -- you can see, if I jump to page 31, you can see in the third column in the middle, our fiscal year-to-date returns or plus 21 percent. We're extremely anxious about the political situation in the Middle East and North Africa. All the regime change going on there as much as the stock market seems to ignore it, the Fed is at zero interest rates, short term with great gains and we like to protect the gains.

They go over the profit off the table which is what we did by selling Russell 3000 indices last month. Moving over to the left, to the one month return in February was 2.4 percent.

And again, the fiscal year started July 1, the returns are just spectacular. If you look at the far right column, the 3-year return, the 3.74 percent, that includes the dip in '08 so we made up for that. And again, the positive territory trended up. We think the stock market will continue to go up even though that the glitches, ups and downs and lots of volatility. And again, they try to be a little bit defensive but we're making as much as money as possible which is why we reduced our equity exposure.

The fear is as much as the market is accepting as much risk is inflate takes right now, there is -- an event can happen any minute of any day. Everybody will three is our fear are you sure our profits little profit off the table good conservative way to do things in you look on page 32 you can see the February indices -- again, as Chris mentioned all the markets go up very, very well, there was volatility in March, just a glimpse ahead.

If you look at the market value today, the volatility came and went and we're above where we are. As of yesterday, we were above where we were at the end of February. So, all things considered, we're north of $42 billion. Now, everything is looking good.

Again, if you look on 33, you can see where the profits came from, where the assets are allocated. We're smack on 70/30 equities versus debt. With that, let me turn over to Seema to make a few comments about equities.

Seema?

MS. HINGORANI: Thanks, Larry.

So, just a few updates. As Larry mentioned already, the Russell 3000, in particular, has had a strong run year-to-date through just yesterday. The Russell 3000 has been up close to 7 percent. During that time, we did have it close in March, where the Russell 3000 was down 5 percent in a short term direction, with all the events going on in the Middle East and what happened in Japan. But it actually ended in the month of March up about 45 basis points.

So, it's not that strongly until we did take some profits off the table, as Larry mentioned.

I wanted to point to one thing on page 35, which is to compare how the Russell 3000 has been doing versus the S&P MidCap as we might remember. Whatever strategies have we implemented a couple of months ago was to take money out of the Russell 3000 and put it into the S&P MidCap to focus on the fact that, historically, the MidCap passive index outperformed the LargeCap piece of the Russell 3000 for long periods of time.

And so, if you look on page 35, you can see the differential continues. Russell 3000 being up in the month of February, 3.4 percent. And if you scroll down more -- towards the bottom of page 35, our S&P for Midcap index is up 4.65 percent. So, 10 point difference in there in year-to-date. And through yesterday, the S&P MidCap is up 10.3 percent and the Russell 3000 is up 6.82 percent, so we're doing well on that transitioning of equities that we did a couple of months ago.

And then, I just ask you to flip to page 37, towards the bottom of the page -- it's actually at the bottom of the page, you'll see emerging markets there close to a billion dollars to BlackRock. It will show up in returns next month. But I wanted to give you an update there that we put that money to work in towards the latter part of February into part of March.

And just to let you know, again, year-to-date through yesterday, the MSCI emerging markets index is up close to 4 percent. We actually have execution on our piece up more than that because we actually caught the dip. But it's lucky timing, I would say. So, we're doing well on that piece of emerging markets, equities that we put in place for the last couple of months. And that's it for us.

MR. SCHLOSS: Thanks, Seema.

There's really nothing to report in fixed income for the month, since we have a big quarterly report next month. So, we're going to skip fixed income similarly in private equity and real estate, not very much to report that happened the last month. We're going to talk about some new investments in the executive session. I'd like to point you, however, in your books to page 59.

If you look on page 59, on the far right hand corner, you can see the quarter ending December. The system made 6.63 percent. It was in the 20th percentile, top quartile. And if you roll your eyes over to the 6th column for the year ending December, 2010, again, 20th percentile -- so, you're in the top quartile for the year. I think that's the first time the fund is in the top quartile in the last ten years. So, congratulations.

CHAIRPERSON AARONSON: Congratulations to the staff at BAM.

MR. SCHLOSS: Are there any questions on the month? Things are working too good?

(Laughter.)

End the year now, would be the right time, but we'll see.

MS. NAGASWAMI: My one question is with the tactical shift out of equities: Is cash the best place to be defensive, or should we think about commodities? In other words, find something that might go up if equity goes down, rather than something that does nothing if equities go down?

MR. SCHLOSS: The shift to cash is temporary, A. B, we have no commodity managers -- can't shift to commodities other than through a manager that would direct only invested commodity and publicly traded. We don't have such a manager. So, we can't tell somebody to do that.

MS. NAGASWAMI: Would you need an RFP for something like that?

MR. SCHLOSS: Yes. So, we're a little strange in what we can do. So, the answer was, take the profits out, throw on the sideline. We've picked around, putting in convertibles or we talked to our managers, REITs are fairly valued. Reverse potentially, fixed income was not. We took our money at a high yield, spot on. So, our list of options are a little tight.

We are about to have an RFP for emerging market equities against equities, but if you believe a longer term, that might have been placed or put it but it's not getting at directly.

MS. NAGASWAMI: There's no way to use an opportunistic bucket and just work with the manager on the design?

MR. SCHLOSS: We're about to have -- as you know, we're working on this fixed income bucket. And if we had such a bucket and we had managers, we would give it to them, absolutely. So, that's where it goes. But again, we're totally strained as to how to make money whether we try to be a little defensive, and we have no one that's on the other side of equities that aggressively positions.

So, the office in fixed income bucket, with our strategic partners who used to work in Rocaton, I'd like to think we'll be done with it in 60 days. Come to the board with a selection of managers and we'll have some very, very interesting place to put it. So, come in process.

CHAIRPERSON AARONSON: Anybody else with a question?

MR. SCHLOSS: The next thing on the agenda is PIMCO. You know, once a quarter, we bring in one of our managers, economists to come and talk about the economy in general so they have a good foundation and make investment decisions. Martin will bring in the people from PIMCO. PIMCO has done a great job for us as a manager of several allocations of fixed income.

(The PIMCO people entered room.)

The presentation books are going around.

CHAIRPERSON AARONSON: Can we ask, if you can introduce yourself. The board is on this direction and so we can have it recorded and the board members are sitting in this direction, too. So, when you make the remarks, they can write them down here.

MS. PHILLIPS: Great; will do. Well, thank you as always for the opportunity to speak with you this morning and provide you with an economic update, our view of the world. I'm Louise Phillips. I have worked with the New York City retirement plan now for about two years. I have been with PIMCO for roughly 14, most of it from the West Coast, the last four and a half in New York.

To my left, I'm proud to introduce my colleague, Chuck Water, who is a portfolio manager on our equity team. As you may recall, we launched our active equity platform in December of 2009, integrating our equity teams into our process; and Chuck was one of the members of the inaugural team and is now the portfolio manager for the PIMCO Pathfinder Fund, a global deep value equity fund which we can talk about.

As I've mentioned to all of you before, at PIMCO, we do not have a chief economist. We formulate our economic forecast and views by way of very a democratic process where we meet with all investment professionals from around the globe to debate the world providing our secular long term view, three to five years. And we couple that with our view over the next several quarters which we kind of market the next three to four. As such, we do not have one person to penalize if things don't go well and one person -- we don't have one person that gets to share the glory when things do.

So, again, we call that both a burden and glory sharing but it's a result. Chuck and I both participate in that process as I mentioned earlier as we have expanded our platform, both across fixed income sectors and into active equity. Again, that process has served us very well and again, we all participate.

In terms of today's agenda, and again, this is your meeting and as always, we encourage you to ask questions along the way. We thought we would do is sort of start with kind of state of affairs and how we got here. And then, importantly, our view going forward. And Chuck's going to start with that and, then, we can end up with some of the most current views given what's going on in the markets on a day-to-day basis both with geopolitical as well as the situation in Japan.

So, again, we ask you to please interrupt us as you wish along the way to ask questions and we look forward to making this a dialog.

MR. WATER: Thank you, Louise. And thank

you everyone, for your attention. Let me just kick off slide number 3, which is really a graphical representing where we are today. After coming through a relatively globally economic financial crisis in 2008, there has been a strong cyclical recovery around the world but in two different speeds -- multi-speed world where, essentially, developed markets are lagging emerging markets.

But nevertheless, there has been a relatively strong rebound from a crisis on a cyclical standpoint. A lot of the options, however, that were available to policy makers and just at overall economy through the last recession at an earlier part of the 2000's aren't available this time around.

Specifically, the consumers stepped in rather strongly back in 2001 and 2002, consumer balance sheets and developed markets are stretched where we are today. Again, and most developed markets -- emerging markets are a bit different story and that's a debating point on how much the emerging market consumer can actually grow demand in the future. But nevertheless, I think the theme here is that even though we've seen a substantial decline on the chart on the rights followed by a substantial rebound, the future is somewhat uncertain and the decisions the policy makers actually make will be key in dictating how the economy continues to progress.

So, slide 4 -- and again, talking about emerging economies, this is really been a substantial change in the trend, is that emerging markets are leading the multi-speed recovery that we're seeing in the world today.

Upper left hand corner, we see that emerging economies are doing better in employment. Upper right hand corner, better industrial production. Lower right hand corner, better in terms of retail sales in terms of growth. All of these things are engines actually driving the global economy at this point and it's a market departure from the economy of the past.

Slide 5, however, with growth, sometime comes particular risks. As the growth has rebounded, inflation has emerged into the vernacular, not only in developed markets we're hearing and discussed here, but in emerging markets in particular. For those following emerging markets equities, you've seen our substantial sell-off over the last few months. Predominantly, on the concerns about inflation, capital controls, risks to those economies that they're overheating.

It is becoming more and more an issue in developed markets, as well. The Fed minutes that were released earlier this week -- we do a lot of things at PIMCO but one of the things is actually watching what central banks do. And there is an extensive internal dialog about going through these minutes. And you actually look at the times that inflation was mentioned in this series of Fed minutes is escalating quite rapidly. So, inflation is a risk that we see and we'll have to deal with in terms of the future and in investment decision.

Slide 6, this is a slide where, I think, perhaps, we best capture the details about where we were and where we are today because looking at economic growth is one item. But really, what created almost the moment of no return in the last crisis was the breakdown in the financial transmission system in our mediation system.

And this is where programs like TARP and other tools used by policy makers and governments. I think we can say, in hindsights, successfully brought us back from the brink. Taking a look at some of the charts here, you can see the market changes in financial markets. Upper left hand corner, the two-year interest rates swap spread.

MS. MARCH: Would you say that government saved the market?

MR. WATER: I think lots of actors were involved but the government actions, certainly, they were the lender of last resort in this crisis.

MS. MARCH: I guess, it is important to keep government functioning.

MR. WATER: I can't disagree. Certainly in a crisis.

MS. MARCH: They shouldn't close it down. Do you think PIMCO could send a message?

(Laughter.)

MS. NAGASWAMI: They don't own many these days.

(Laughter.)

MR. WATER: We do have a view on the government shutdown. The human cost aside, as an equity portfolio manager, I'd tell, if you look back to the last shutdown in 1995 and '96, from an investment standpoint, it actually presents interesting opportunities in the equity market.

The government will reopen. They don't get sorted out. And again, hopefully, at minimum human cost but as an equity manager, we focus on individual situations. There are some stocks that are going to be sold for the wrong reasons. And I have a shopping list that whenever the market goes on sale, it can be a good opportunity to buy some good investments for the long term so --

MR. SCHLOSS: Like a Wall Streeter.

(Laughter.)

MR. WATE: Cost and benefits with the shutdown. Other charts here, again, you can say, the actions by government and the actions by central banks -- we'll talk a little bit more about the central bank actions in particular, have really led the way into recovery because these -- again, are the actors of last resort when private industry didn't have the resources to resolve the issues.

MS. MARCH: I have a question and it is a political question. If that's what a firm like yourself believes, why isn't the message out there? What you just said was that it is government that saved the market. And I know I made my statements before. Someone or somebody has got to start doing that.

MR. WATER: I'd say that PIMCO has. In PIMCO's defense. For example, we hired Neil Josharry [sic] who was the assistant Treasury secretary that actually developed the TARP program. Bill Mohammed worked intimately with the Treasury department during the crisis, actually, proposing solutions for the financial crisis. Some were accepted, some weren't.

So, PIMCO for many years, it's not a revolving door, but many individuals that come from government had come to PIMCO. Rich Clairedelf [sic] who is also a former assistant treasury secretary. I'd say that PIMCO, perhaps, has been at the forefront of actually working with the government and certainly in the crisis in moving things forward.

MS. MARCH: Thank you.

MR. WATER: Slide 7. This will actually give us a view of, again, where we've been and where we are today and a little bit about where we are going. So, we have a series here of all the central banks around the world. And you can see, again, back in 2008, substantial cuts and rates from central banks around the world as the financial crisis escalated.

Now, interestingly, as we come out of this crisis, you can know the few things. First, we have the European Central Bank hiking rates today. A number of central banks around the world, Canada, as well as Sweden, other countries have actually hiked their rates, Australia as inflation pressures have emerged.

The Federal Reserve hasn't done so yet nor has the Bank of Japan. Now, when we talk about rates and rate policy, this is often what we talk about as Plan A. This is the primary instrument, the primary tool that central banks used to stimulate the economy. It is interesting to think about what the response will be from here but our core position is that the fed, at some point, will hike rates.

But it is entirely premature to say it's going to happen into a near turn, even despite the debate. So, on slide 8, what you see here is actually what happened correspondingly to central bank balance sheets.

MR. SCHLOSS: Can we go back to 7 percent? Why do you think that they'd keep their rate where it is? Because I don't agree with it. Everyone else's raise's raised. Where does the dollar go?

MR. WATER: I think our core view on the dollar is the non-secular time frame. It continues to weaken and you see it in many different asset classes, gold, for instance, commodities, they are all denominated in dollars and you see ongoing strength in those commodities. Our long term view is that the dollar is in a state of decline because of all the money printing that's been done by the Federal Reserve.

Again, with the ECB tightening today, this is given us the euro, that I think on the technical basis is a bit over done, $1.42 or $1.43. So, perhaps you can expect a correction. I think purchasing power parities around $1.15. I wouldn't expect that much of retrenchment. But we think the long term path for the dollar is one of decline.

MS. PHILLIPS: In mostly against some of the emerging economy currencies, because when we start looking -- when the dust settles here -- and when we get beyond, sort of, monetary policy is, checks going to talk about, there has to be the view toward what deficits look like. Not just ours, but developed economy deficits.

And as such it's hard to find who takes the place of the dollar as the reserve currency. But from a depreciation perspective, where we feel the greatest movement is, is relative to the emerging currencies.

MR. WATER: So, Slide 8, we can just spend very little time on this. But this is a graph that's actually showing you how much central bank balance sheets have expanded. And what this slide shows you is, again, the amount of money that has been injected into the system. And one of the key tools that the federal reserve in the U.S. has used is something called "quantitative easing" -- QE. QE2 is what we talked about right now, because there was a QE1.

So, on Slide 9 -- and when it comes to QE, when I talk about rates being cut as Plan A, QE is what we would call Plan B. QE2 in particular is a program that was announced by the Federal Reserve to actually use open market operations and other transactions to actually buy various instruments in the fixed income market.

And since we had the implementation of QE2 last fall, a number of things have happened. In particular, equity markets responded very positively to this. And you can say that also the economy has followed in tandem or perhaps trailing behind the equity market, somewhat. So, you see a number of different expansions here and actual reinvesting of proceeds with QE2.

And slide 10. So, marrying Plan A and Plan B, where are we at right now -- and let me talk first about the title here. What we have in the graph is actual fed funds rate in the U.S. and then what we call "the Taylor rule."

And just a few quick words on that. It's a formula created by an economist, John Taylor, who uses different variables to actually forecast where the fed funds rate should be. And what you see is something very interesting here. In the crisis, the Taylor rule would have advocated negative fed funds rates and it's currently between zero and 25 basis points, hence, the notion of Plan B or the QE Programs as an additional tool.

What we have right now, if we see current trends continuing, an optimistic scenario is that, in fact, the Taylor rule -- and that's on the far right-hand side of the chart with the dashed line -- is showing that there should be a substantial hike in the fed funds rate in the near future.

Again, that's not our core view because there are other things that have to happen still -- and that's on the slide 11. First QE2 has to end -- starting on the far right-hand side.

And then really steps two and three would be the action of draining this excess liquidity from the economy through a number of open market operations, reverse repurchased operations, different tools that the federal reserve uses to pull money out of the system. Only after that point, and that's really targeted around June of this year, do we expect after that and after actually seeing how the economy reacts, will the federal reserve actually go about hiking rates.

Now, you may have seen some of the research coming out of PIMCO but we think the second quarter and the end of the second quarter, in particular, will be a very interesting time for asset markets. Because just as the markets and equities, in particular, went up with implementation of QE2, what happens when you withdraw all this liquidity? Not only in equity markets, the fixed income markets, perhaps, in the economy as well because the economic recovery over the last six months is coincided with QE2 quite a bit.

So, we expect the Fed to kind of go on pause and take a wait-and-see attitude towards -- once this withdrawal is done, is there a QE3 -- I would say probably so, if things worsen substantially. If not, then I would expect an eventual gradual hiking of the fed funds rate, perhaps, in early 2012.

And then Slide 12 -- actually, slides 12 and 13. I'll talk about really what the consensus view is for economic growth and inflation.

MS. NAGASWAMI: Can we go back to the Feds for a minute. So, a lot of the stability of the economy, then, depends on a very short term on a very disciplined withdrawal of liquidity. How are you handicapping the odds that we'll actually get this right or if the Feds will get this right and the market growth?

MR. WATER: I tend to think that in terms of the economy, the short term cyclical recovery is relatively self-sustaining, in terms of different investment markets, I expect substantial volatility. So, I think, after an adjustment period -- because all these money will be pulled out and that adjustment period will coincide with -- which isn't an anomaly and "the summer blues" and different asset markets, I would expect pretty robust debate at the fed but ultimately a continuation on the glide path moving into the third and fourth quarters.

MS. NAGASWAMI: Can you please elaborate a little bit on, where is the draining happening? Who is it affecting? Who's on the other side of that drain? Who now has left liquidity? Is it the financial system? Is it mortgage backed securities investors? The central bank?

MR. WATER: So, when the fed actually implemented QE2 and injected liquidity into the market, there are number of the key money central banks, as well as foreign central banks and foreign players that actually transact in these fixed income markets. PIMCO as well is a player in these fixed income markets. And when the fed injects liquidity, actually bidding up the securities to that much changes hands to the players.

I expect that, actually, how the Fed actually goes about exiting this, will be in terms of, actually, withdrawing those funds in the fashion of securities in the different repurchase transactions that repose, term deposits, increasing the reserve rate that the federal reserve actually pays to banks for depositing cash at the fed would be another key tool used.

That's actually an interesting economic series to look at, is that the banks aren't lending yet, they're lending a little bit when it comes to different types of C&I Loans, business loans. But many banks are depositing a lot of this liquidity that they've got at -- they're keeping it on their balance sheet.

So, by actually paying more, the hope is, first of all, that, that money will be injected into the economy in the form of loans but by paying more at the federal reserve, that would be an incentive. So again, the Feds hope that this works and the banks start lending and the excess liquidity will get mopped up by paying a higher rate at the Federal Reserve.

So, slides 12 and 13. The key point here, I think, looking at the real GDP growth outlook chart on the right-hand side, you see an optimistic scenario or consensus scenario and a pessimistic scenario. The point is, there's a significant amount of disparity and debate over where the economy goes from here. Again, on cyclical basis, when I say "cyclical," let's call it 12 months. I think were very supportive, perhaps, a little bit biased to the optimistic scenario.

On the secular basis, we, again, go back to the fact that there are real pressures in terms of fiscal balance sheets, the debt ceiling, difficulties and, actually, borrowing to grow your way out of the issues, difficulties in municipal budgets. Difficulties in many parts of the world that make a clear case for a continuation of the optimistic trend beyond 12 months, would be entirely unlikely, and that's what we often call the new "normal" at PIMCO, a volatile path in terms of growth in the future.

And then on slide 13, inflation as well. Again, a very volatile series here and I'd probably say there is even more than upward bias to this than there was when this analysis was first done, a little bit less than a month ago. Because inflation really is creeping into our world much more so than I think originally expected. If you look at rents and housing related items in the CPI basket, that is a substantial part of it.

Again, different ways of reporting inflation, excluding food and energy is one way of doing it but typically over a 12-month period, that increase in commodity markets, that's actually in the core CPI tends to leak into the rest of the CPI basket as well. So, when we look at this inflation outlook, there's a probably an upward bias to it.

And so, let me turn it over to Louise.

MR. SCHLOSS: It's really, the trend is up but not really cataclysmic. Is it?

MR. WATER: No, we don't think so. And again, from an equity standpoint, the equity market, when we look at the long term series, really begins to care at level about 4 percent, so -- we're a ways off from that. We would -- I think, generally consider equities amongst the number of different options.

Maybe the least challenging option, in terms of the fact they have an economic recovery, you have some inflation that isn't too severe yet, but the trend is up. The question is if the Federal Reserve can actually manage this and prevent it from getting out of control.

MR. SCHLOSS: But these are not what the Fed likes? I like a little bit of inflation.

MR. WATER: A little bit, yes. Because it wasn't too long ago when you're talking about deflation and that's less of a threat that's very difficult to deal with. Japan has learned that and dealt with it. So, you can say that this is almost a benevolent outcome for now, but too much escalation would, in fact, be a risk.

MS. PHILLIPS: Again, picking up on page 14 and continuing where Chuck left off. And, as he mentioned, we sort of changed our view away from more of the pessimistic camp to the optimistic camp at the end of 2010, on the heels of what was really continued view toward the positive elements of the stimulus effect, as well as some positive surprises to that end with some of the passages at the end of 2010.

And that's really the biggest driver in terms of where we are, in terms of our current or cyclical forecast for GDP, in the U.S. in particular, relative to what we view as the negative or headwind, if you will, on the secular basis in terms of growth. And we'll talk about both of those.

But, in aggregate, at this point -- and we've been here before -- we do have some different reviews on the short term versus the long term. We mentioned the positive cyclical tailwind and certainly on the heels of government stimulus both on the monetary, as well as the fiscal side, being really the biggest driver.

Now, certainly, we've seen some strength in some of the personal consumption numbers, expansion across the manufacturing and the service sector predominantly manufacturing so far, and then industrial production and some improvement in that capacity utilization number. So, certainly, it'll show that there is still some slack in the system.

On the secular basis, the longer term where we find the headwinds -- and, again, this is the element that we described previously as the new normal, the U.S. fiscal deficit, not just the U.S. but the developed market in terms of where deficits have risen to, as these governments have been "all in," if you will, to stimulate their economy.

A negative savings rate, still savings rate improving but negative, if you will, and then leverage that going to be the continue place too rely on for growth, which we will talk about, is still to be hindered, given whether it has occurred in the former shadow banking system as well as lending standards and still the tightness of credit currently.

We circled here on the bottom, then, the forecast, again, closer to the optimistic scenario, 3 to 3 1/2 percent over the cyclical time frame. Can you see muted growth throughout the developed world Japan? Again, these are updated though we would probably shave some of that forecast number just given the disaster and tragedy there over the cyclical time frame. China and the rim countries are where we see areas of growth, likewise, where we see the biggest drivers of inflation. And now, China, a provider of inflation, instead of a provider of disinflation, where we were nearly a decade ago.

We love charts. I won't go through every one of them, but on the next couple of pages, you see the fiscal and monetary stimulus side has been the big driver of growth in the economy and we are, again, really what hinged our view more to the positive side, as we look out at the next couple of quarters.

We talked about this, and as you mentioned, we felt that stimulus has and will continue to be necessary to achieve growth in the economy and certainly has prevented us from falling into a further brink. The question is, what happens when that starts to be pulled away or dissipated in terms to this effect?

Let's talk about the headwinds to a self-sustaining rebound. Number one, not surprising unemployment rate. Nobody is happy with 8 1/2, 8 -- 8.7, 8.9 percent. And more importantly, structural element of unemployment, as we see the duration of that increasing and the number of unemployed, marginally employed, underemployed and aggregate really twice that headline number -- the biggest concern for us in terms of where the headwinds are.

On housing, we started to see now the prices, home price levels turn south, again. Really on the heels of despite low mortgage rates and inability to get financing and reeling inventory story. One that we still feel, takes another year or two to correct as we wind these down and together, these provide pretty strong impediments to sharply higher interest rates going forward.

And then the second piece of core -- third piece rather is that continued deleveraging. Again, not of a bank-friendly -- lending-friendly market on behalf of banks in this environment, not only the desire for consumers to clean up and continue to clean up their balance sheets, but likewise, the ability to re lever and to continue to support the economy in the way that it was done in the previous decade is really where we see the biggest hurdles.

We talked about inflation -- commodity inflation not necessarily feeding yet into that CPI number both -- because it is a small percentage of the headline number, but what you see on the bottom there is that the CPI numbers have risen pretty significantly up to 5.8 percent from where we were year ago, at

4.4 percent.

Again, where we would become concerned is that there is the ability to pass on those higher input prices into higher output prices and where we would see that CPI number increase.

MS. NAGASWAMI: So, right now, they're just being absorbed in margins which are very high anyway?

MS. PHILLIPS: They're being absorbed in margins but also some of the commodity impact it's just notably not a big story in the number and the calculation of the number itself.

So, it is into margins. It provides a tax on consumers importantly and so we expected to feed into some of the consumption number, though the CPI number may not capture it to the greatest degree that is present. We mentioned early, Plan B. The government all-in, in terms of how that impact balance sheets. And we're walking through here on the bottom chart of 18, what occurred across the crisis.

We're now at the level in terms of developed market, debt levels and deficit levels that provide more of a concern where many of these economies and their debt really was more of an interest rate story. We now fear that it's now more of a credit story, given where these levels are. We saw -- announced today that

Portugal has now raised their hand for rescue packages to add to what has been provided to Greece and Ireland. And the size of that, while still yet to be determined, is still concerning in terms of what is both required, given their current deficit levels, as well as what austerity will be required in return for that and what that means for European growth.

So, let's look, then, on page 19, and this is where we provide a little bit of our status report card on the basis of the things that Chuck has talked about. Quantitative Easing 2, ending at the end of June. Big question mark, then, will QE3 be on the horizon?

And, again, given the headwinds, we suspect that there maybe something in the cards. Fiscal stimulus are waning, not a lot of appetite, of course, and we see that very much evidence as we speak in terms of continued fiscal stimulus going forward. Austerity, again, increasing but the requirement there, as we look to get a handle on debt, is also one that hinders growth and the ability to pay for it going forward.

This idea of "escape velocity" and this is the word that we talked about a lot of PIMCO. When do we stop relying on the hand of the government where things sort of take off and we achieve a sustainable growth rate? And that's where really the biggest question mark is right now. As we see much of the stimulus on the horizon to go away, with not a lot of appetite for additional stimulus, again, the ability to sustain that growth rate going forward is where we think over the longer term, we move more into that new normal scenario and growth becomes muted.

Looking at the framework then, and I'll sort of summarize here, on the secular basis, again, we would circle that grading the economy, the global economy and on ABC or D level, on a secular basis looking out three to five years given the headwinds that I've talked about, we probably put things in the camp of around, sort of "D grade," a partial recovery where we move into a scenario of -- of new normal growth, growth that is very different from where we have been this last decade.

Again, on the cyclical basis, the next several quarter still being driven by growth that's driven from stimulus in the economy, both by way on monetary and fiscal policy.

Page 21, we've talked about by way of process. We will be revisiting our longer term view in another month or so. I don't anticipate the things will change too significantly but this idea of what's left and how do we stimulate the global economy, particularly in the developed world becomes the question and where we turn our eyes from a growth perspective, from a demographic perspective and more to the emerging economy to prop-up things globally.

We again, define the new normal the leveraging, desynchronized growth, this multi-speed world that we talked about, and re regulation while required and likely necessary as an impediment to growth going forward.

And simply what that means from the investment perspective, looking at the things graphically on page 23, is that, the tail risk in this environment, whether it's inflation, whether it's a downturn in the market more broadly, the risk on the tail, we think become wider. The old normal where that tail risk was muted and a rising tide had the ability to lift all both, we think becomes a little more dispersed on the going forward basis.

Investment implication just -- then finally, and I do promise I'll end here on page 26. In this new normal environment, again, being forward-looking is required. Looking at things more on a global basis, taking into account demographics that in the developed world we know where in an aging economy and the U.S. is hardly in the worst position relative to Japan and

Germany and a number of others, but how that will impact with corresponding in consumption?

Maintaining liquidity and looking at risk factors really across asset allocations to determine where the big drivers are and, of course, looking at where some of the systemic issues may come from in terms of inflation, shocks, re regulation and as we speak from the geopolitical environment as well.

We talked for a while. I will stop there. In terms of questions, as I mentioned at the outset -- certainly the environment, as always but in particular to speak remains fluid and we're happy to talk about things that may be we didn't address on the pages if -- if, in fact, you have questions.

CHAIRPERSON AARONSON: Can you tell me, have you guys developed an opinion on the Ryan proposed budget for the next ten years? And whether you think that's going to be good?

MR. WATER: As of yet, that there is no formal opinion coming out, I think, as we go through the analysis and, actually, go through the work of thinking about it and modeling it out, I can almost lead with the conclusion that we find it politically almost unfeasible for it to be adopted, obviously.

I know internally, there were number of

discussions about the president's debt commission and their proposal from some months ago being relatively positive and that had a number of things -- really a complete overhaul of the U.S. tax code, reducing the mortgage interest, deduction of number of other things but again it was viewed positively.

The Ryan proposal has some elements of that, but some elements, otherwise, that don't necessarily fit with that. So, we haven't completed the analysis yet but, again, I think the conclusion is that is political unfeasible.

CHAIRPERSON AARONSON: And you haven't decide yet whether or not it's economically feasible or not feasible. When you have completed that study, do you think you can share it with us, please?

MR. WATER: Sure. We'll come back with that, yes.

CHAIRPERSON AARONSON: Thank you very much.

THE SPEAKER: I'm just wondering what level -- in your opinion, what level of real GDP growth would actually reverse the unemployment number if it's not 3 to 3 1/2 percent and --

I was just asking what level of real GDP growth would actually reverse the unemployment numbers, if it's not 3 to 3 1/2 percent. And your analysis also talks about bank recapitalizing and that process of recapitalizing may be being a potential source of -- or not a potential source of stimulus for the economy.

I think we also read about companies not hoarding cash. And how does that also -- if they stop doing that -- is that factored into this or could that be a potential way to also decrease unemployment?

MS. PHILLIPS: Your first questions, in terms of what levels do we see, kind of reversing the unemployment and we certainly see the unemployment rate kick down on the heels of -- in a stimulus and the economy and this 3 to 3 1/2 percent number which is for us, was up nearly a percent from where we started.

So, we have seen improvement. In order for that, though, to be sustainable and it -- this goes, then, to your questions two and three -- is we have to see both corporations in particular stop sitting on cash and to see return on investment, so the horizon for the return on investment positive enough such that they are willing to spend on what we would call sort of productivity-enhancing activity, which would involve, of course, hiring workers and bringing that unemployment rate down.

With respect to bank balance sheets, there has been a lot of discussion both in the U.S. and Europe in particular. And the emerging markets really didn't have this problem because they didn't get them the type of trouble. Well, we see that as an opportunity from an investment side. As this bank look to rid some of those assets that are still on their books. It also has the ability from a capital requirement perspective that until they do -- there somewhat saddled in terms of the type of lending activity that they can undertake.

And so, the environment that we were in the growth is very much reliant on the formal banking economy as well as that outside of it, again, what we call the shadow banks in terms of the mortgage lenders. It is still going through the process of cleaning things up and until they do, we don't see this spurt of lending that's going to either allow consumers to relever to spend.

And what has changed is that there are still the desire on the personal side to clean up personal balance sheets. So, again, it's something that's still being worked through the system.

MR. WATER: Let me just add, on GDP side, it literally is a multivariable question because GDP is the sum of consumption and the investment of what the government spends and then net exports. If we think back to the days when we had 4 or 5 percent unemployment rates, housing was booming. You had a lot of jobs in construction. You had that sector creating to a substantial amount of jobs.

So, kind of part of the new normal, I think, is that we've had this huge structural shift as housing has declined and those jobs, they don't look like they are coming back any time soon. So, for me the hazard, I guess, 3, 4, 5 percent of the GDP side. I still don't think, I could say with any conviction that, that's the number that will really give us tangible improvements the way it used to be.

It's really more of a structural question of what industry steps in to create jobs. And that's the type of thing where the policy on the dollar, the policy with our trade with China, number of different factors that need to be addressed to actually come to a conclusion on what can be that next engine for job growth. Those are very difficult questions that we don't see any answers forthcoming anytime soon on.

MS. MARCH: What goal do you think income disparity plays in our United States of America, in terms of what is happening in the economy today?

MR. WATER: You certainly see it by going to the stock market. When we think of equity that had been done particularly well, the high end consumers have been in very robust shape. For instance, the Swiss watch industry almost suffered its death in 2008 and early 2009. It was always thought that items like that would always sell, but the severity of the crisis was such that many of those businesses almost went under. Then, it came back with quite a bit of strength; you see a lot of luxury buying. On the lower end, obviously, there is a challenge there. That's where the unemployment issue actually resides.

MS. MARCH: You started your presentation by saying that "the emerging market will do much better in time." Well, my prediction -- and I'm not an economist -- is that, we're not going to have to worry, because over the course of the next 20 or 30 years, we are going to become an emerging market and we will do very well. Could you comment on what I just said?

MR. WATER: Well, you don't have to be economist to make prediction so --

MS MARCH: Well, then, I predict that. I do predict that.

MR. WATER: Almost anyone can be an economist too but, specifically, in Europe -- I would say, talking with people internally and how we were approaching Europe in terms of Greece, Ireland, Portugal is the emerging market's playbook. For instance, when I look at the banks in those countries, I could come up with a compelling case to say "you should buy today because they are very cheap." But in reality is, this is a completely different paradigm, what's happening in Europe, and it goes back to former emerging market crisis and the playbook is to wait for the default.

Now, the U.S. has certain advantages that Europe doesn't, specifically, it can print it's own currency. Use of change over the last -- certainly over the last 36 months -- 24 months the strength of the current cyclical recovery, I think is leading us away from the belief that we'll be in the emerging market, 20 to 30 years from now.

But for certain -- I can say it with certainty, the set of other emerging markets implies that 20 or 30 years from now there will be a relative wealth shift away from the U.S. into the emerging markets.

MS. MARCH: Is this "relative wealth shift" happening right here in our country? And I think it is time for some of the individuals to take a look at the economy to realize that. A person cannot purchase what they need every day if they are earning less and things will costs more.

The reason why we became what we are today in this country, is because there was a huge development of middle class. It is disappearing. Go out into the world and away from the textbooks and maybe then we will come up with how we will moved the country in the direction of lowering unemployment.

MR. WATER: Absolutely.

CHAIRPERSON AARONSON: Any board member want to ask a question?

MS. NAGASWAMI: I just had one question, I will get this quick. With inflation in China, policy mistakes, global impact, any worries from a certain perspective that the surprise does not come from the developed world? It comes structurally but it actually comes from the emerging market.

We're starting to look, I think, more from -- with respect to China, specifically, on that story, if you will, and the inflation impact -- we look to China right now. And, again, going back to this question, as to growth in the middle class and the emerging economy, is more broadly to see that there are hundreds of millions of people moving into that particular realm as the big driver where we see growth going forward.

So, again, they've always had better demographics but for quite some time we have had better demographics than we had. They didn't have the financial system or the income to put that to work. And what we are seeing now is we're now seeing that's put to work. With respect to -- it's more of a policy mistakes or a surprise impact -- again, what we are seeing from the emerging economy is that inflation is also a big part of that story.

And so, from a policy perspective, cutting that off or hoarding that or focusing on that, could provide a damper to the other side of that growth equation. The way that we view things now though is that most of that is still coming online and it's less in up here.

CHAIRPERSON AARONSON: Any other questions?

May I thank you very much for your thoughtful presentation. We look forward to hearing from you again and when you form that study on the budget. Thank you.

MR. SCHLOSS: Thank you.

Next, we have a presentation from the GMO. It talks about asset allocation, which is the process we're going through. We've been doing it for six months.

(The PIMCO people left the room.)

(Recess taken.)

(The GMO people entered the room.)

MR. SCHLOSS: Now, as part of our continually asset allocation dialog, we brought the GMO, which are experts in asset allocation, to tell us their perspective on how it works and what we should think about.

CHAIRPERSON AARONSON: And may I ask you to address your remarks down here to the stenographer and the board members are also on this side. Thank you.

MS. FERRARA: Thank you very much. My name is Lisa Ferrara. I'm the relationship manager for the Teacher Retirement System of the City of New York. I have been working with the investment staff since we began investing with GMO in 2005. Thank you very much for inviting us in today.

With me, to my left is Mark Mayer -- and you should all have his photo in front of you -- he's the Chief Executive Officer of GMO. And to my left also is James Montier. James is a senior member of our asset allocation team, GMO. He is well known widely regarded figure in the behavioral investing. He's the author of a book entitled "Value Investing" as well as the little book of "Behavioral Investing."

So, our agenda and our objectives today are very straightforward. One, is to talk to you about how we take a valuation and long term approach to asset allocation. And the second objective we have is for all of you to walk away with feeling today that your time here was well spend. So, I'm going to ask you, as we go through the material, to please interrupt and ask questions because this is your time and we want you to feel that it is very productive.

So, at this time, I'll turn things over to James.

MR. MONTIER: Thank you very much and good morning everybody. I'm also slightly nervous now in presenting in front of teachers.

(Laughter.)

I happened to be doing jury service a few years ago. And it so happened that one of my former teachers was on the same jury panel as myself. And when I was at school, whenever a master entered the room, we had to stand up and say "Good morning" and so at the jury service, I stood up and said, "Good morning, sir."

He said, "James, it's been 25 years since I taught you. You don't have to stand up and say 'good morning.'" So, if I suddenly stand up and say "good morning, everybody" you'll understand why.

(Laughter.)

MS. MARCH: But I wanted to warn you, there are only three teachers in the room.

(Laughter.)

MR. MONTIER: I feel much more relaxed now.

MS. MARCH: But we are three formidable.

(Laughter.)

MR. MONTIER: Very formidable.

MS. MARCH: Very formidable. I figured someone else should say that.

MR. MONTIER: I wish could promise to you that today's presentation is going to be full of happiness and joy. Unfortunately, I can't. We are GMO.

(Laughter.)

And we don't have to do happiness in dealing. Personally, I suspected that GMO stands for "Generally Miserable Observers." The one good news is there is a study in psychology which shows that there is one group of people who generally see the world the way it really it is, and that is the clinically depressed. The reason, of course, they are clinically depressed is they know they are pretty useless at everything, which is why they're clinically depressed.

The rest of the world is unfortunately happy and deluded. So, I think there is unfortunately a tradeoff one is forced to make -- and I reckon being clinically depressed at work and happy and deluded at home is probably the right balance. So, forgive me in my own coming to clinical depression.

Now, let's start you on page 3, if I may, because this talks about the way that we feel the market works. And that's a pretty important place to start.

Right at the top of that diagram that is the circle, around which is probably the biggest single impediment to sense of investing -- which is career risk. That is the fact that people do not like taking on risk that leaves them out on their own. John Maynard Keynes say, "it is better for reputation to fail conventionally than to succeed unconventionally."

Unfortunately, the vast majority of the investment management industry is driven by that image. Nobody wants to take on risk. Once funds are gathered, the easiest way of avoiding being fired is to look very close to a benchmark. So, there are huge amount of career risk. That career risk leads to herding and momentum -- a non-willingness to be different. Everybody is doing exactly the same thing.

Allied with that is a tendency to extrapolate, projects the recent past into the foreseeable future. That itself creates a market inefficiency and that inefficiency, of course, represented by prices deviating from fair value.

The good news is that there is an anchor to the market's behavior and that is replacement cost. There is a points that which you say -- actually it is easier to go on building a new plant than it is to go and buy one in the stock market.

So, you have an anchor to valuation. The existence of that anchor means the main reversion of cost. Prices eventually get dragged back to some degree of sanity check. The problem with that, of course, is timing uncertainty. We never know how long it will take for a price deviation away from fair value to come back to normal. And that's times back into clients patience. They're not particularly able to take long-horizon decisions and, of course, that takes as all the way back to career risk. And so, the merry-go-round continues ad nauseam.

So, the challenge I think for anyone thinking about investing is how you break the stages of that path of disaster in terms of investment performance. On page 4, I tried to provide what I think are the seven immutable laws of investing. These are things that one should always try and seek to do. Every time investment is made, I think, this is a check list of the one that should run through. I do spend a fair bit of the time today by taking you through the various elements of this, trying to make sure that everybody understand what they entail and the difficulties that exist in, actually, implementing them.

So, start with the first one, always insist with the margin of safety. Valuation is the closest thing that we had in finance to a law of gravity. It is the one thing that we know works. And it seems madness not to want to put that at the very heart of your investment approach. And yet, time and time again, that is exactly what we witness, people ignoring the margin of safety, reaching for return, doing silly things in order to squeeze out another few percent of return.

So, having a margin was safety and absolute standard of value is critical to sensible investing.

When we send -- when we look at that today -- well, page 5, begins to answer that by showing you what happens if you ignore the margin of safety. And the answer is you expose yourself to the probability of a permanent impairment of capital.

Now, the exhibit on page 5 -- I've been waiting over a decade to use, it's torn from a magazine article that is written in August 2000, Fortune Magazine. Publisher listed stocks that they described as ten to last of the decade, a "buy-and-forget portfolio." Well, had you bought this stocks, you almost certainly would have wished you've forgotten about them.

(Laughter.)

Tragically, this group of ten stocks: Nokia, Nortel, Enron, Oracle, Broadcom, Viacom, Univision, Schwab, Morgan Stanley and Genentech, have you put a $100 in those ten and you waited. Today, you would be left with just $30. That's a compound annual loss of 11 percent per annum for a decade. That is the permanent impairment of capital.

And the reason, of course, the capital became so impaired was the fact that those ten stocks were trading on an average fee per purchase of 347 times. So, enormously expensive equities.

That is the risk you run when you invest in no margin of safety. These stocks have discounted not only over the possible life to come but pretty much the here after as well. They were priced for absolute an utter perfection. Now, how does that look today when we look at markets.

Well, page 6 is one way of doing that kind of very simple, valuation-based approach. This is what we call the Grayman-built PA [sic]. So, this takes the current price and divides it by ten year moving average of earnings. Now, the reason for doing that is a ten year moving average of earnings smooths out the business cycles. So, we just taking out a cyclically adjusted look at valuations. On what you can see, is actually U.S. equities are really real expensive on this measure. If you can imagine this chart without the Dot-Com Bubble, which is enormous spike up to 50 times, we are almost of expensive as we have been anytime since 1929.

And you don't hear too many people telling to buy it because it's just like 1929. They worked out that wouldn't be a remarkably good sales pitch. But that is the realty. We are investing with a very, very small margin of safety, in fact, almost no margin safety at all.

Now, one of the tools that we used inside to evaluate markets , it's what we call our seven year forecasts. And they are constructed on a very similar way to that kind of grind and dog measure of valuation.

On page 7, lays out an example. We say there are several components, in fact, four components that make up your return when you invest in an equity. The first is any changed in valuation that occurs. The second is any change in profit margin, so, where the earnings are in the business cycle. Real growth and the dividend deal.

Now, if everything was in equilibrium and the world is a very happy, nice place, the first two elements would effectively be zero because -- that the earnings would be normal and the P on those earnings would be normal. So, the return you would get would be growth plus yield.

But when we run those numbers today, what we find is, unfortunately, both the multiples of above average and the margins are above average. So, we are the pretty high point in the business cycle which sounds very strange, given the bounce back that we've seen in the wake of the global financial crisis. Not only those margins high, but within putting -- putting high multiples on those margins and those two factors drag down over your return. Hence, those two negative bars. And you end up with the statements that U.S. equities -- at least in terms of the S&P 500 -- unlikely to generate a return of effectively zero, per annum in real terms for the next seven years.

MR. SCHLOSS: All right. You got me depressed.

(Laughter.)

MR. MONTIER: Oh this is the good news. Depressing stuff, it comes later. So, at the moment, owning the S&P 500 is pretty much entertainment business. You're doing it for fun, not for return.

That's never-stop-music, great rationale for investment.

Now the challenge for us allocators is -- unfortunately this isn't just true of the S&P 500. It's true in a much broader context as well. And I feel that this is a buy products of the federal reserve current policies.

Ben Bernanke is quite possibly the world's worst economist -- a very fiercely contested title.

One of the things he has done is set the cash rates to zero. Now, when the cash rates is at zero, you have a choice. You can either go out and spend or you can save an assets that have a higher return than zero. Now, presumably the fed would like you to go out and spend, which means they have to encourage the return on all other assets down toward zero. So, part of the process of quantitative easing involves driving the future returns on all assets down to zero. Perfectly, consistent in what we are currently see on page 7 of the S&P 500.

One of the tools of quantitative easing is the fed outright buying government bonds. That historically has been a very dangerous thing to do. But even to a very simple valuation perspective, we can say that is no margin of safety in government bonds either. Page 8 shows the way we're trying to think about this asset class. We say that bonds really have three elements to their return. There is a real yield, some expected inflation and then a risk premium. The compensation for the fact that inflation may well turn out to be different from expected inflation.

Now, you could use the real yield from the market. There are real bonds were we can buy effectively CPI-protected yields. I have a hard time doing that in some countries. The U.S. isn't too bad. The real yield on ten-year bonds in U.S. is about 1 percent. But in the U.K., we have unfortunately an obsession with liability driven investing and that is distorting of real yield market; such that there is, in fact, a 45-year maturity bond. That is real. That is yielding 0.67 percent per annum.

Now, I wouldn't led U.K. government to 600 basis points real per annum for 45 years. Let alone 60 basis points per annum. So, instead of taking the market yield, I'd imposed an assumption, an equilibrium yield. To that, I need to add inflation. Now, we are not in the business of macro forecasting. Anyone who has had a misfortune to read any of the books I have written, who discovered the liability that macro forecasting is an exercise in absolute futility. Nobody has any ability to predict that economic cycles. We just can't do it.

So, I used the consensus number here. The consensus says "Inflation is likely to be 2 1/2 percent per annum for the next ten years." Now, I don't believe the consensus because we know that the consensus is useless of forecasting. Because of that, I'm going to need that risk premium. I'm given the uncertainty over the fed's behavior. I think you need a, probably, larger than average risk premium right now. When you sum those elements up, you get a fair value bond yield for ten years of somewhere around 5 percent. We can compare that with the yield that's available from the U.S. government bond market today. It's somewhere around about 3 1/2 percent. So, there is no margin of safety in government fixed income, as well as equities.

So, we are struggling. This is not a nice world to live in as asset allocates these. Two of the very biggest assets, frankly, suck. This is not compelling opportunity set for you.

MS. MARCH: Are you making a case for me to put it in my mattress?

MR. MONTIER: I will happily say within the fund that I'm responsible for, we have 50 percent in cash; which is pretty much like putting it in your mattress.

MS. MARCH: Only half.

MR. MONTIER: I will suggest some things you might be able to do, that it's slightly more attractive than mattresses.

MS. MARCH: Twenty and a half billion in my mattress.

MR. MONTIER: It's a very, very comfortable mattress.

Page 9 just shows you the kind of risk you run in terms of permanent impairment of capital if you invest in bonds when they have very low yields. The last time bonds were down of these kind of levels for any sustained period was actually the 1940s. And the 1940s ushered in a 40-year bond market in real government bond returns, such as you loss nearly 2 percent real per annum for 40 years in so called "safe securities."

I did tell you this would be a depressing presentation.

So, let's turn your attention to the second rule of the seven immutable for the time being, which is a reminder that this time is never different. So, John Templeton, one of the legendary investors of all time, once said that this time is different on the four most dangerous words in the entire English language.

And evidence is born him out. History is littered with the corpuses and those who had proclaimed new eras and new normals. The one thing we know to be true is so far, none of them have ever had any validity. It's never been different this time.

Every extraordinary bubble we have witnessed has been far more than it should have been according to believers in efficient markets. Every one of our bubbles has inflated and then deflated. Now, we define the bubble on page 10 as a two standard deviation moved away from a trend line.

Are there any math teachers in the room?

MS. ROMAIN: Me.

MR. MONTIER: Excellent. You can tell me if statistics is wrong here. I'm really hoping it's not.

A two standard deviation event on a normal distribution should occur once every 44 years. Now, not only did we see a two standard deviation event up, but every one of those two standard deviation event up has been followed by two standard deviation event down. Now, the chances you have seen a two standard deviation event followed by another two standard deviation event or, roughly, one every 1,600 years.

So, it just shouldn't happened. And yet, history gives us a plethora of examples of exactly this problem.

How can we react to this kind of environment? Well, page 11 is effectively Rule No. 3 of our 7, which is one has to be patient and wait for the fat pitch. That's my attempt to convince you that I speak American. There is no analogy I could use in that attempt. So, when I'm England, I have to explain what a fat pitch is. Here, I'm going to take it as read, but everybody who follows baseball is in love with the concept.

The basic argument here is because of that uncertainty, because we don't know when bubbles burst, we have to be patient. We can tell when assets mispriced, but we don't know when they're going to correct. So, one has to be patient drag one's feet and wait for the very, very prime opportunities and when they come along, swing hard. Be prepared to take big bets at the point in time when the opportunities set is greatest.

Page 11 shows you a variety of all seven-year forecasts. I showed you the one we did for U.S. equities. This is a variety --

MR. SCHLOSS: Let's go back to 11. How are we supposed to read page 11?

MR. MONTIER: What page 11 does is give you a variety of forecast as they were in December, 1999. Now, in the interest of full disclosure, this is the best forecast series we have ever made. But it shows the power of this framework. So, we have estimated rank. That was the rank based on our forecast, which is the next column.

So, these were our return numbers. Looking in December, what we thought you would achieve over the next, in this case, ten years, I believe still doing ten-year forecasting in '99, we moved to a 7-year forecast a few years ago.

The third column that actually shows you the real return, you actually achieved over that decade. And then the final column shows you the rank ordering. And there were a couple of things that stand out. The first is -- actually, all rank ordering was pretty good. The chances of picking a rank ordering better or the same as ours by pure chance or one in 550,000, which tells you this isn't chance.

And there was some interesting features to this range of forecasts. Things that many people had finance with regard is impossible. For instance, if we look at the very last asset, the S&P 500, December, '99 we thought this would generate a negative return of 2 percent per annum over the next decade. Simply based on that framework that I showed you earlier. The valuations were extraordinarily high. We knew they would mean revert and that would create a drag on returns.

But simultaneously, with that very negative forecast on the S&P, we have a very positive forecast on emerging markets. And anyone in finance would tell you that's impossible. These are two very highly correlated markets. These are both global equity markets and yet we have a nearly 10-point differential between the two.

And the good news is the valuation, because that was -- this what was driving this, the emerging markets are extraordinarily cheap draws correlation. So, the obsession with all of these things move together, just leads you down the wrong path. Valuation is a much more important decision input when it comes to making your asset allocations.

And you can see we thought you get just about 8 percent and you actually got just about 8 percent from emerging markets. In the S&P, we thought you get minus 2, you actually got minus 3 1/2.

So, we were actually a little bit kind, a little bit too optimistic. Hard that is to imagine. That is the power of having a valuation discipline. Having the ability to stick with it. And frankly, like an idiot, because that's what we look like in '99. Everybody was saying this is a new era. Tech stocks rule the world. We were saying tech stock is incredibly expensive. This is madness. And we were losing business. People were firing us, because they bought into the new story, the new era. But as I mentioned earlier, it's never different. The same realities keep reasserting themselves.

Page 12 gives you the fourth, I think it is, rule of the 7, which is one has to be contrarian. I'm going to give you another quote from Sir John Templeton, which is, "If you buy the same securities as everybody else, you will end up with the same returns as everybody else. So, if you want to get different returns, you're going to have to do something different."

And right now, everybody loves equities. The chart on page 12 is the Merrill Lynch survey or Bank of America and Merrill Lynch survey of global funding managers. Now, I have only one caveat to this chart which is I never met anyone who feels out this survey. But apparently, somewhere, somebody is filling it out. We are not; somebody is. Whoever is filling it out has never been more bullish about equities. They simply love them. That itself raises red flags to me. That degree of homogeneity of view, when everyone is thinking the same, no one is thinking effectively.

When you couple that to a degree of extreme optimism with the valuation framework that I showed you earlier, one has became to get really quite cautious. Now, the corollary of everybody loving equities is that chart on page 13, which is everybody hates cash. And it is not hard to see why people hate cash, who has a zero yield. Particularly here. In our home in Europe, I can get a little bit higher than zero, not much. So, there is a universal loathing of cash.

But I think this misunderstands the nature of cash in a portfolio. Cash isn't just there to give you a yield. It's there as dry powder. It's there to serve as a reserve when the opportunity set changes, so that you have the ability to take advantage when you get much higher returns on our valuation-based models. So, cash is what connects today's opportunity sets to tomorrow's opportunity sets. And I have no reason to believe those two things were being the same. Markets remain volatile. And as long as they are driven from the debts of disparity of irrational exuberant, we will see shifts in the opportunity set.

And therefore, one should hold cash when assets get expensive. It should be a residual decision. One doesn't need to be proactive and say, "I'm going to hold extra cash." It should just be, "Hey, look, nothing is effective. Therefore, I will hold cash." So, cash to me is always a residual, but it's very much a by-product valuation driven framework.

MS. HINGORANI: You mentioned that in 1999, you were telling folks, "This is crazy, don't believe in it." So, at the depths of 2008 into early 2009, when you're saying "this is crazy," to whom are you saying that?

MR. MONTIER: Absolutely. But Jeremy and myself published in March, 2009, my miscalled, "Buy When It's Cheap; If Not Then, When?" And Jeremy's was entitled, "Reinvesting When Terrified."

(Laughter.)

So, it was terrifying in '08 and '09. It was totally unprecedented miserable existence. The world was telling us that no scenario was too bad. And the valuations were incredibly appealing. In fact, I think in here I quote, yes.

(Indicating.)

Page 21, if I may just move you forward, shows you the evolution of our equity valuation. So, you can see what we were saying in realtime.

So, in September of 2007, the yellow bars, we faced a very weird situation. A situation where people actually willing to pay for the pleasure of holding risk.  So, the higher the risk asset, the lower the return of this forecast.  Makes absolutely no sense. A complete anomaly.  By the end of February, 2009, you can see the blue bars, they are all significantly above the equilibrium expected return.  And so, our valuation methodology was saying, fine, great, go out there and buy equities.

And the green bars effectively represent where we are today somewhere in between.  More akin to, unfortunately, the yellow bars than the blue bars.  But it shows you the way in which the opportunity set can move and the value that the cash has in that environment.

We were able to deploy capital into 2009 because the opportunity set was just -- frankly, it's evaluating investor's idea -- we are very perverse.  But I have to say, we're generally happy when the world is falling apart which is slightly a weird thing to say.

It's interesting that social pain, which is pain going against everybody else.  So, that willingness to contrarian is felt in the brain in the same place as real genuine physical pain.  So, being a contrarian, being a value guy is a little like having your arm broken on a regular basis.  It's really not a tremendous fun. We are essentially pacifists. What we do over the weekends is probably best left outside of this meeting.

(Laughter.)

Being dungeons and whips, that kind of thing. So, that kind of real investment equipment of that world. We like pain.

Page 14 takes you on to Rule No. 6, which is about an appreciation of the nature, the genuine real nature of risk. Finance has, at its very heart, a fluid definition of risk. That's where finance says, "Volatility or standard deviation is the correct measure of risk."

And that stems from some work that Harry Markowitz wrote in 1954. And in fairness to Harry, when he was writing in 1954, he actually said the deviation was what he was going to use and he used it not because it was correct, but because it was computationally easy. And that's a pretty reasonable constraint to have to worry about in 1954, because in 1954 we were still using punch card computers which were really nasty. I used some of them, not fun. Not in 1954; afterwards.

Today, we have more computing power in the average mobile phone and Harry had, at his entire disposal, when he was trying to do his analysis of risk. So, I think computational ease is a very poor reason for a fluid definition of risk today.

So, I think risk is really the permanent loss of capital. It is the fact that you can invest and never get your money back. And that is what we, as investors, should be worried about. And there are effectively three paths you can take to the permanent impairment of your capital. You can run valuation risk. You can invest in assets when there is no margin of safety.

As I have shown you, with both bonds and equities, that results in very low and indeed generally negative low long run returns. So, you have that route to the permanent impairment. You can also run what's called fundamental risk. That is the idea that the assets you buy has some general flow. As Ben Bryant quotes there, "It's the danger or loss of quality or earnings power through economic change or deterioration of management. It's business risk."

And the third route is financing risk, which really means leverage. Leverage is an incredibly dangerous to its -- particularly if you're going to follow a valuation-driven approach. Because leverage can never turn a bad investment into a good one. But it can unfortunately turn a good investment into a bad one. It can force you to sell at just the wrong point in time. So, it can cripple your ability to withstand those periods of time when the market is moving against you. So, as a value investor, you really want to avoid leverage.

In fact, I would argue leverage generally be avoided in pretty much all basis. And the reason for that is the chart on page 16, which is the experience of a company called Long-Term Capital Management. No less than two noble laureates worked at this firm, which tells you something about the work of a noble laureate. One dollar invested in LTCM back in 1994 which was worth $4 by March of 1998. That's a very impressive return.

Unfortunately, by March, 1998, LTCM were using 254 times leverage. And when markets went wrong for them, they ended up sitting on just 30 cents. That's your $1 now worth 30 cents by the fall of '98. That is the impact of leverage. It's why you should always think twice before using leverage in a portfolio.

Now, the final rule gets the page all to itself because I couldn't think of pretty pictures go with it. But it is probably second only to always having a margin of safety, which is simply the statement, "You should never invest in something you don't understand." Einstein said, "If you cannot explain it to a 5-year-old, you don't understand it." I pretty much live by that rule... the average intellect to the 5-year-old.

So, if somebody tries to explain something to me and I don't get it, I simply won't touch it. And I put it down to their failure, not mine. It's not that I'm stupid, they just badly explained it. But it is a very important rule. Because finance is full of people who have wonderfully complexed sounding instruments, wonderfully complexed sounding funds. But if you don't truly understand what was funds are doing, you really shouldn't be investing in them because ultimately you are accountable.

So, what can we do to try and improve returns in a world where we get a pretty unappealing picture?

And I think there are three things that one has to be prepared to do, assuming you're willing to adopt a valuation-driven approach. The first is to have the broadest possible opportunity set. I have shown you the very big major asset classes, U.S. equities, U.S. bonds, are both unattractive. So, if you want to try to get returns, you're going to have to step outside of those particular defined areas.

So, you're going to need it. But you're also going to need a willingness to have concentration.

Because those great opportunities, those fat pitches, they don't come along that often. So, when they do happen, you want to swing aggressively at them. So, you want to lug a portfolio in those fat pitches. So, you're going to have to be prepared to have an odd issue-looking portfolio. And probably above and beyond all else, you're going to need the ability to hold cash. Because when all assets all went unattractive, that is the best place to protect capital. And the preservation of capital avoiding the permanent impairment loss, that is something that all investors should take very seriously.

Somebody asked me, one of the clients, in fact, asked me the other day, why would they pay me to look after portfolio that is 50 percent cash. And I said to them, "To be honest, you're not paying me to sit on cash. You're paying me not to do something stupid and investing in pretty much anything else right now would be doing something stupid. And investors have a bad habit of wanting to swing at everything.

Active managers want to be seem to be active. Now, I have been reading Winnie the Pooh to my two-year-old daughter, and I'm pretty sure she has not understood what I've been saying. But I've enjoyed it. And one of the lines I enjoyed most in Winnie the Pooh was, Pooh there saying, "Never underestimate the value of doing nothing." And right now, with a horrible looking opportunity set, the value of doing nothing is really relatively high.

So, let me try to round out before I continue too much of your time by telling you how you see the world currently. And I've already given you some depressing phases of this. Page 20 gives you the seven-year forecast for a pretty broad universe of potential assets.

Unfortunately, none of them look appealing. There are some places where one can seek relative protection, high quality stands out as an area where one can see some degree of relative protection right now. Again, it's not absolutely cheap. 4.3 real return is not compelling. It's not me jumping up and down saying, You should have all of your portfolio in U.S. high quality.

But if you have to own some equities, U.S. high quality looks like a place to hide. Bonds truly look appalling. And that's based on conservative estimates of inflation. If we want to get scary, you can start thinking what happens if the fed lose its control over inflation and then bond returns starts to look really, really bad. So, there isn't a very compelling opportunity set here.

MS. HINGORANI: How do you define "high quality"?

MR. MONTIER: High quality consist of three characteristics to us. It is companies that have stable earnings, high earnings and low leverage, so low debt to equity ratios. When you look at high quality, it really consists of three sectors of the moment. It is consumer staples, healthcare or pharmaceuticals and large cap technology stocks.

Boring, dull, defenses, the Johnson&Johnson, the Coca-Cola's, the Microsoft's really boring companies. But once that will provide armor plating in event of the crisis, because those are the stocks that will not go bust. The very nature of high quality, it offers you some degree downside protection.

Now, if the equity market falls, high quality will fall as well. This is not an absolutely a compelling opportunity. But in relative performance space, high quality looks like a very sensible place to actually try and protect whatever equities you are forced to on.

MS. NAGASWAMI: This chart has looked this way for some time.

MR. MONTIER: Yes.

MS. NAGASWAMI: Can you comment on that?

MR. MONTIER: I wish I could tell you I this guaranteed it's going to change tomorrow. Unfortunately, it has to look like this for some time because of the nature of the fed policies. And as long as you get a fed for this, telling you to go out and speculate, this chart is going to have unappealing returns on it.

The good news is, as I showed you earlier, that opportunity set does shift. It wasn't that long ago. It was only 2009 when we faced a really, really attractive opportunity set. Two years on. We're now facing an unattractive opportunity set. So, we've had two years, or at least a year of this kind of environment. And that is why you need to be able to be patient.

Because the realty is, I think it would be negligent for me to swing these kind of opportunities very hard, because I'd be running the risk of impairing your capital permanently, which I wouldn't be able to sleep at night. And I would hope you wouldn't be able to sleep at night either, if I was doing that.

MS. ROMAIN: Then what is the relatively high optimistic forecast of timber?

MR. MONTIER: Timber, yes, we love timber.

Timber is a really interesting asset class. It's the one growth asset that we actually like. Timber is a very attractive asset class because it is very stable. If I had timber on that previous chart where the other levels are going up and down, timber just stays flat at 6. Timber generally gives you 6 real through most cycles.

It is the one asset that we can find that didn't lose value in the Great Depression. It just stayed flat. Incredible performance. When we think about how to forecast timber, there are two elements that go into it. One is called the cap right which is basically the yield on the land on buying.

So, how much per acre are trees am I able to collect. And the other is real, genuine biological growth. The nice thing about timber is it grows while you sleep. At least it does if you're on the forests on the other side of the world, which is generally where we currently own forests. Most current timber investments in southern hemisphere, Australia, New Zealand, Uruguay.

Simply because they're getting the best value. We are finding deals that we can do at very reasonable prices. Now, the problem with timber is it is a very illiquid asset class. The average life span for timber fund is somewhere between 15 and 20 years.

So, the capital into timber means you have to be prepared to be incredibly patient.

MS. ROMAIN: Is it easy to value it?

MR. MONTIER: It is not hugely easy to value. In one sense, it's so much the truth like to exercise the value because we can work out how many logs we can get from each acre of forest and what their worth would be if we sold them. But the value of the underlying land, it can change, as well.

The nice thing about land over time is, it's very stable. Real estate goes up and down. So, the buildings, that goes all over the show. The land values are actually very, very constant in most places. So, we have a constant value of land and then we have a -- if you like the mark-to-market impact from the value of the timber at any given point. The nice thing about the timber is if you don't like today's price, hell, you leave it, come back next year. It will be worth more because trees are bigger.

So, that is one of the nice things about timber. But it is a very, very long-term, illiquid asset. So, in my role, I worked in a kind of liquid market side of our business. I can't put money into timber in my funds. It's just not an asset I can invest in. We have an operation that does exactly that.

But unfortunately, it's not one that I can invest in, because I can't make it liquid enough to most investors to be able to deal with. The pension funds, with long-term horizons absolutely should look at timber. It's the one commodity area where we think you can get good returns and you can value it. Generally, we're pretty skeptic about people's ability to actually value commodities. But timber stands out as the one that we think we can actually value. I probably move to round out by just visiting page 22 which is the portfolio that we currently run for you.

And I'm relatively glad to say that it is pretty much entirely consistent with what I've been telling you. The equities we own in the U.S. are high quality. So, they are all in the more plated blue chip kind of companies. We are overweight internationally which is relative to the U.S. because the returns on the international forecast market are better than those in the U.S.

Fixed income obviously in a world in which I didn't have to own any, I wouldn't. But this is a benchmark. But also I have limit to the amount that I can move here. We have to own some fixed income. For the fixed income, we have is almost entirely real bonds. So, we're not taking nominal risk. We're trying to remove the inflation component here. So, the exposure we have here is almost entirely real bonds plus an international bonds but we can buy them at fair value which is Australia, New Zealand at the moment. So, unfortunately, the opportunity set is tough, it is not an environment in which it is easy to find good opportunities to invest.

We will try to be as patient as our clients allow us to be and wait for the best opportunities knowing that at some point in the future, they will re-emerge, but sadly not knowing when.

And if there are any other questions, I would be delighted to take them.

MR. MAYER: So, we'll close here with the formal remarks. I want to express gratitude again for entrusting us with the assets for which you are responsible. Know that we take that fiduciary responsibility very, very seriously. We're grateful that we had chance to talk a little bit about what we do in asset allocation and want to make sure we make it as useful as possible.

If there are questions from James' presentation, if there sort of angles about asset allocation that we haven't touched on properly, we'd like to take the remaining time and make this productive for you.

MR. SCHLOSS: Can you talk about page 31?

MR. MONTIER: Page 31 is a true horrific chance. It's why it doesn't get into the main book.

This shows the way in which our positions have evolved over time. So, this is how the opportunity set has realized, if you like. So, all of the allocation we made and this is in a portfolio that is similar to the one that we run for you, a typical benchmarked, balanced asset allocation fund. This is how we have altered the asset mixed within that from over time depending on the environment in which we find ourselves.

So, at various points in time, we have owned an enormous amount of bonds when they were very, very attractive. Down to the sage now what we hold just about a smaller bond allocation as we can. You can see the arrival of quality into our universe of investable assets and the allocation to that. As it became a more and more attractive asset class. So, yes, that is very much the pattern of distribution of our decisions over time, which generally have been reasonable. And certainly consistent more importantly with our seven-year forecasts.

MR. SCHLOSS: So, you have no private equity in here and no real estate.

MR. MONTIER: Not in a fund like this, for this fund is a typical 65/35 or 60/40 benchmark fund. Actually in none of our funds do we own infrastructure or private equity. We struggle with how the value of those asset classes, again, exposed to. Private equity often looks very much like public equity. So, it just gives you a very similar return profile.

Infrastructure, very difficult to value because it's always -- as an asset class, this is specific on the infrastructure projects you're involved in. But for a publicly traded fund like this one, a balanced portfolio, we couldn't access those even if we could value them.

MS. NAGASWAMI: But other than currency, no commodity, that those are liquid?

MR. MONTIER: No; commodities for us probably not really an asset class in that they have no cash flow attached to. So, that's very, very hard to value. The majority of commodity investment is done via futures and futures have their own terrible, terrible problems. When you invest in a commodity future, you get three elements to return.

You get spot returns that change in the underlying price of the thing you're actually interested in; a collateral return which is this is a futures contract. So, it is not fully collateralized. You can put the excess cash into an interest rate vehicle. And then the role return, because what you're doing is buying a futures contract so you have a term structure out into the future.

Now, historically, that term "structure" was in back relation which means it was downward sloping. So, if you bought a futures contract and it rolled back towards the current, you made money. And the idea was that backward sloping futures curve was that the people who produced the commodities were willing to accept lower future prices because they'd be out of place of their product.

When you look at commodity markets today, in 29 commodity markets, I looked at 24 of them, are now what's called "contango," they have upward sloping futures curves. Unfortunately, you only have an upward sloping futures curve. As you roll back down towards the current point in time, you have a negative return.

And when we look at the history that negative role return, that contango shape, has more than offset the spot return gains you've made. So, the only benefit people has from investing in commodities in the last decade is bond returns with enormous volatility.

So, not an appearing asset class to last. You can ask why the curve went from... to contango, why it have been put down with the upward sloping. And the answer, I think, is that -- and commodities became seen as an asset class.

So, if you go back to the early 1990s and you look at the futures market and you ask what percentage of the market was accounted for by people with no commercial interest in underlying asset? It's about 25 percent. So, one in four. Today, it's 50 percent. So, roughly half of all commodity futures market participants have no interest in the underlying commodity. They're just speculators. They're investors in the birth of commerce.

So, for us, commodities are generally a difficult asset class to value among where we have trouble funding a way of implementing it that doesn't unfortunately damage the returns still further.

MS. NAGASWAMI: I read that your forecast is for seven years. As trustees, we think in decades. It is hard to move 110 billion, as well. So, we just can't be as nimble as you are.

MR. MONTIER: Sure.

MS. NAGASWAMI: And then we have a very high hurdled rate of return which doesn't -- it's not volatile but our assets are volatile.

So, are there asset classes you would broaden to? Would you look beyond the seven-year period and say this is 30-year horizon and returns are different from a cyclical --

MR. MONTIER: Generally, you can see the kind of equilibrium returns that we think are fair on page 21, at least for equities. Bear in mind these are all real numbers. So, we need to add inflation to get to your target rate. If we were able to ignore valuation and if you had a exceedingly long time horizon, you can ignore valuation. But that time horizon need to be probably somewhere like 30 years to truly ignore valuation.

Then the equilibrium returns are a better guide than our current seven-year numbers. I think what one can do for broadening asset classes -- it's difficult if you just own that many asset classes. It's tricky. People keep inventing new ones, but they don't actually really fulfill the criteria of asset class.

Volatility is the latest one. Volatility is not an asset. It's a by-product, yet everybody is raving about volatility. So, I think it's very difficult to just solve this by expanding the mix. That was very much the kind of... that Harvard and Yale pioneered. But there were also some problems with that, as they discovered in that a lot of that some so called diversification was really just returns chasing. They were chasing after stock that had done well. And it turned out the diversification was in name only.

So, suddenly, all of these assets -- a quotation, it's an asset. Hedge funds aren't asset, they are a vehicle. But hedge funds just ended up, unfortunately, giving you exactly the same return in the market as did private equity, as did just about everything else they were invested in.

So, diversification, I struggled to believe, is genuinely the answer to the problems that we face. I think the best solution that we have is to say you have to be more dynamic. You have to -- I agree you can't be nimble over some of the things you are dealing with. It's just impossible.

But I think one has to be willing to, at the margin, alter the distribution of your assets based on a shorter time horizon, maybe a decade, which is not so dissimilar from the seven-year forecast here. Because if you don't, you can end up owning equities when they are expensive and then you just get zero return. It's what we've seen over the last decade.

So, I think the only viable alternative is to say, we have to follow a more dynamic path. Couple that with breadth, if your manager has the best opportunity that they can, don't constrain them too tightly so that they have the best chance of adding value to your portfolios. That's to me seems to have the best hope of meeting the high hurdles that a lot of pension funds faces these days.

CHAIRPERSON AARONSON: Anybody else with a question?

Then let me thank you very much for your presentation.

MR. MONTIER: Thank you.

(The GMO people left the room.)

MR. SCHLOSS: We have another agenda item, Review of Corpus. It should be in your book. If anybody wants -- it's not a Treasury handout.

(Indicating.)

And it should be pretty straightforward if you're on a corpus, it's how we fund your asset management. So, let's start with a little history. In 2004, the board approved corpus funding to take care of the investment-related results in the investment-related staff in the Bureau of Asset Management of the Comptroller's Office.

And if you look on page 3, you can see the organizational chart of BAM. When I arrived last January, corpus had approved 37 positions. When I arrived, there were 18 people in their seats and there were eight vacancies. The vacancies, we have the people in green. So, clearly, we were understaffed at the time. On initial review, we needed to add 17 people.

If you look on page 5, you can see up to 17 that we decided we needed. At the time, seven have been filled. We met all of these people, Seema, MR. MILLER, Catherine, Amira, Adi, Neil and... all of which have substantial investment experience, I'm happy to point out.

On the next page, page 6, you can see that we had about ten open positions. Hopefully, the next short-term, we'll hire two real estate people with lots of investment experience. It would be great. Currently, five open posted positions including some very important positions like director of risk management and we decided not to fill the manager of risk or the two compliance positions until we had head of risk because that would be their boss. And we may change that if we can't fill head of risks in the near term. But, again, these are five posted on the Comptroller's website, open positions.

In addition, we've identified ten additional positions that we need to create. Those are listed on page 8 and it go very much with the investment changes that we've been making in the last 14 months. Three of the other boards have approved hedge fund. So, we're building out the hedge fund team, the hedge fund team works for Seema. Ultimately, an additional senior investment officer and additional analyst. We're building out Martin's team.

In addition to Adi, who has arrived, we need another person like Adi as well as a junior person building out the private equity teams. Ultimately, we need co-investment people because we have $12 billion of commitments. We have co-investment rights, but we have no one to analyze these co-investments. And perhaps the infrastructure, as well. We need a junior person in real estate to go with the two senior people that we're hiring.

And then ultimately, we go to our asset allocation, which we're in the process of finalizing in the next 30 or 60 days. To the extent that we decided to get into real asset commodities, we need a team. And that's three additional people. So, this page has ten additional hires to come.

So, if you look on page 9, it's a recap of where we start and where we're ending. Again, the first column -- this is by asset class. In the first column, there's 18 people when I arrived. The next column is the six that we've hired, the ten that are open. And then you can see the ten new hires which will take us up when you add all across the 44 people. The 44 people manage $117 billion of assets. If I look back to the beginning, the 117 which at the time was only $99 billion, 99 billion managed by 18 people would make us the most assets under management per person of any public pension fund. About $6 billion per person, which is on average is about $3 billion per person.

So, we're just understaffed. This again is a much better position. But, again, if we build out new asset class to get diversified, we need new teams for that.

So, page 10 is how the organizational chart might look. If we build this out a little further and you can see basically there are teams now under the heads of all the groups. As head of fixed income run by Martin. As the head of public equities and hedge funds run by Seema, it's a bonds team and real estate. If Barry's team is private equity, ultimately, it's a real asset team and he's the head of risk and a team of people under risk and compliance. This was much more like a team that can handle these assets.

Once you have the front office, you need to add the back of the house, as well, as on page 12. We need four accountants. We need additional person contracting. Some reporting person as well as, ultimately, two clerical people who handle all of these new people.

Page 13 shows the back of the house which is run by David Jeter. This is only the corpus people. There's another group of people that are on the city payroll. They also report to David. These are not here. They're just the corpus-funded people.

If we go to the last page, page 14, you can see how this work its way through the city budget. Again, starting at the top, there are 25 corpus approved positions when I arrived that cost $2.3 million. And, again, these three columns here, these employees, its total cost and then the Teachers' share and then the share is proportionate to your AUM versus total system AUM.

Again, going down the page, there were $2.3 million of cost when I arrived. We've added six or $644,000. The total as of now is about 31 people for about $2.9 million. The posted hires of six people or another $650,000. So, approved to date, the corpus funding is 37 people for $3.6 million. The addition to that, I just walked through, is 24 additional spots for $2 million. So, ultimately, corpus funding is 61 people per $5.6 million.

So, if I go through exactly what we're really talking about here, it is realty the third from the bottom line, which is the current 1.3 that you pay now would be increased to about $2 million. And that will be your share of basically 24 new hires which is building out the team. To a more acceptable size and structure to go with these assets.

So, we're going to all the boards -- with just the numbers, we're going to all the boards with all of the budget process that you're all familiar with from the City and get the boards to approve it, put to this process, get the job postings up and then hopefully continue and interview people so we can build the team and manage these assets.

MS. NAGASWAMI: So, few comments. First, good job filling out the positions that you have open when you came.

MR. SCHLOSS: Thank you.

MS. NAGASWAMI: I think all of us know the reality and how difficult that is to compete for the kind of talent that you have assembled around this table. So, I think for all of us, glad you're able to attract people like Seema and MR. MILLER and understand that you need more. And if we are to agree on an asset allocation, the people must come before the strategy. Totally respect that and agree with that. I think that makes a lot of sense.

I guess one question I have, Larry, is dollars and people. This is a lot of people and it keeps the rate per person way of thinking about salary. But in your view, is there more that you would like that the realty of the current environment doesn't let you do in terms of attracting people?

Again, you've been able to attract people, but are there structural issues that we should be thinking about even more boldly than we have in this plan?

MR. SCHLOSS: This plan is put together within the budget constraints of the City. Now, you're walking into the City and you inherit a structure and a pay scale. And it's difficult to attract talent of investment professionals with this pay scale. We had 17 postings, as you have 17 openings, which is ten still out there. It's taken us six months to hire six people.

You are correct, it's an ongoing battle. And we'll see what clears the market, and I'll come back to everybody if we can't clear the market with the acceptable team.

MS. MARCH: In reference to what you just said in terms of the salary scale. When you look at other public funds that are also working in an environment that is, quote/unquote, their city or their state, or just New York State, are they in the same situation in terms of salary guidelines?

MR. SCHLOSS: It is a complicated question.

MS. MARCH: How do they handle it right?

MR. SCHLOSS: How do they handle it? There's a couple of different ways. I would tell you, in general, all public pension funds have a compensation issue relative to competition in the free market. If I look at the money that the City spends on its staff versus the money which was spent on outside managers, we spent over 99 percent of our money outside on outside managers and less than 1 percent on our expenses for managing money is on inside staff. I would say that's probably not the correct balance, if you spend a little more on the home team.

How others public funds have handled it is very dependent of where they live. So, for instance, you can pay your people less if you're in Iowa than if you're in Manhattan. So, I don't really compare us to Iowa, on the one hand. On the other hand, we're blessed that we're in Manhattan, because this is where Wall Street is. That's the good news. The good news is there are lots of investment professionals on this island that live in New York City, in the five boroughs. Problem is they're fiercely competitive for the best talent. So, a simple benchmark would be an entering MBA from a good business school, goes to a large training program, makes 250- to $300,000.

I'm the highest paid investment professional in the City. You know, I make $224,000. I'd like to hire people that are more well-trained than the first entry job MBA. So, I would look at that and say I think we're not going to be as competitive as we need to be. I don't know how to solve that.

CHAIRPERSON AARONSON: You would say we have $41 billion in assets at this point?

MR. SCHLOSS: Teachers, yes; 42.

CHAIRPERSON AARONSON: And your projected expenses for us is $2 million that comes out of the corpus of the fund?

MR. SCHLOSS: Yes.

CHAIRPERSON AARONSON: I don't know. I'm not a mathematician, but that seems to me like a tiny, tiny percent of what we have.

And is there any way of -- because of the needs and the competition for quality employees that, since this does not come out of the general City's payroll, that it might be something we should look at and get some kind of a waiver on some of these things because of the way we are funding?

MR. SCHLOSS: I'm just happy to continue the conversation.

THE SPEAKER: I'd like to be fair. That is eventually paid back with interest; the corpus expense. So, it's paid back the next year as part of the employer contribution. It's not like it just comes from nowhere.

CHAIRPERSON AARONSON: The employer pays back about 1/10 of what the expenses are each year, is my understanding.

Robert?

MR. NORTH: First of all, that's just not my understanding of how expenses are. In the appropriations paid each year, there is a line called Investment Expenses. It's the investment expenses extended to preceding fiscal years prior, brought up with two years interest.

THE SPEAKER: It is coming from the City, so that's -- I think that's not what we got.

MR. SCHLOSS: We can argue about funding mechanics. It's a fact that's how it works. The reality is if I look at the total budget to what you point out, your $42 billion paying $2 million to your team I would say is a little short.

CHAIRPERSON AARONSON: Yes. I believe that also.

MS. MARCH: It is short. And I don't think that we need to develop a plan that matches what happened on Wall Street.

MR. SCHLOSS: Right. I totally agree.

MS. MARCH: But there is a way of developing a plan that might be different than the normal pay plan in the City is, because it is a specialized field. This city has hired individuals out of the pay scale of the city because they have believed that these individuals will only be able to be part of the city structure if they offered them a greater compensation.

Now, the compensation is not outlandish, but it is more than the average commissioner makes in the City. So, why can't we just take a look at what we could possibly do and see if we could come up with a plan that might be somewhat different than the normal city pay scale in terms of the titles that we need and see if we can do anything.

MS. NAGASWAMI: I would probably endorse that, anything that we might do to help you, very happy to do that. And also I ask if we have ever considered incentive compensation where, again, we pay people for doing a good job as a reward? As part same of the same structural --

MR. SCHLOSS: It's part of the same question.

MS. NAGASWAMI: Has it every come up, is my question?

MS. MARCH: I don't know that we should rule it out. We can look at it and see how it fits in to the plan. I just would not want to fit into the category of having the public say that what we are doing is creating a mirror image to what we have criticized going on Wall Street.

MR. SCHLOSS: Fair enough.

MS. NAGASWAMI: Structuring the right way.

MS. MARCH: Exactly.

MS. NAGASWAMI: But, as you know, other public funds have gone in that direction.

MS. MARCH: Yes, they have.

MR. SCHLOSS: That's right.

MS. MARCH: They have, and it is limited.

MS. NAGASWAMI: It is limited. It's not Wall Street.

MS. MARCH: Could we just look at that.

MR. SCHLOSS: Fair enough.

MS. MARCH: And we may or may not be able to accomplish it, but I think we should really try to take a look at it and see.

MR. SCHLOSS: I will come back with something.

MS. MARCH: And we thank you for what you have added to the staff at BAM, because it really is important that we have people working for the City in the investment area who have the knowledge that we so much need.

MS. NAGASWAMI: My last comment, if I may, is to ask you a little bit more about your thinking on adding someone, an expert on strategic issues. So, we have a very good plan for people who invest individual asset classes. In almost every day, they work with the consultants outside. So, we sort of outsource part of it, I understand.

But it seems to me that we don't have someone very focused on asset allocation. And one idea that is around is possibly broadening the risk management mandate to include strategic policy setting. Again, working very closely to our consultants as to all of our heads and all of our asset classes.

MR. SCHLOSS: Again, we were in the process of doing an asset allocation. The City had done one for four or five years that we're doing that. Again, Teachers have been working with Rocaton and a lot is outsourced. But we would spend a lot of time on it. We have an in-house in BAM asset allocation team, it's me and Seema and John Mersburg and Martin. So, we have a team.

I would think in the future, again, it's to build out risk components in asset allocation because they're were measuring where you are. That will be a normal place to build it out, but it is a little unclear right now in trying to... get the parts of the body that go with the head.

But ultimately, again, for a pool of assets this size, it should have more than a passing interest in asset allocation. It should be a full-time thing. It should be in your -- it's in a monthly reports now, but it should be actively managed, actively discussed. And, again, to your point, it's sort of outsourced to Rocaton, and the other funds have all have their own consultants that's been outsourced.

So, ultimately, you'd like to bring as much knowledge in-house full-time as you have and this plan is sort of next step. There's multiple steps thereafter to get it so that we've got the right talent with this large amount of assets. Right? Agree?

MS. NAGASWAMI: Yes. 90 percent of our returns comes from that. And so, not to have someone on staff that is thinking about the research, obsessing about where we should invest in the future, not just executing on a plan within an asset class, is I think a huge source. And typically, plans have such a person and that tends to be the deputy CIO... from my own experience, a very senior role.

I would just urge you -- I would do whatever I can to support one more. Because I just think it is a vital role, and that is what drives the performance.

MS. MARCH: What I'd like to add to that is, we can have all the staff even if the area of asset allocation, but we're not being able to move our assets as quickly as we would like to. The person would give us their information and we will take that to the next time we change asset allocation to do it. So, I would hope we continue to look at how we can become a little bit more nimble.

MR. SCHLOSS: While working on the RFP process, as you know, that will help.

MS. MARCH: Well, I think we have to take also a look at the PPB rules.

MR. SCHLOSS: Yes. So, I need a vote or a consensus to move through this.

CHAIRPERSON AARONSON: My colleagues --

MS. NAGASWAMI: The consensus we have asked for -- a lot of support for even more boldness. And so, just, I think, absolute consensus for this, but we urge you to really -- we will work with you to help give you what you need.

MR. SCHLOSS: Perfect.

CHAIRPERSON AARONSON: I agree with this so far as far as it goes, and hopefully we do more in the future.

MR. SCHLOSS: Okay. Thanks for the support.

That ends the public agenda that we have.

CHAIRPERSON AARONSON: Is there a motion?

MS. MARCH: Yes. I'll make a motion that we move pursuant to public officer law, Section 105, to go into executive session to discuss the proposed acquisition or exchange of securities held by the Teachers' Retirement System and to discuss the, quote, pending current litigation.

CHAIRPERSON AARONSON: Is there a second to that?

MR. SCHLOSS: Second.

CHAIRPERSON AARONSON: Any discussion?

All in favor, say "Aye."

(A chorus of "Ayes.")
Opposed?
Abstentions?
Motion carries.

(At this time the meeting went into executive session.)

CHAIRPERSON AARONSON: So, we're now back in public session. And, Susan, can you give us a summary of what we did in the executive session?

MS. STANG: In the executive session for the pension fund update, several investment managers were provided; and an overview of the real estate portfolio was received.

There were presentations of three investment opportunities, and consensus developed, which will be announced at the appropriate time.

MS. MARCH: Motion to adjourn.

CHAIRPERSON AARONSON: All in favor?

(A chorus of "Ayes.")

Opposed?

We're adjourned.

(Time noted: 3:45 p.m.)

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, April 7, 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