The Education Trust Board of New Mexico

THE HONORABLE SUSANA MARTINEZ
GOVERNOR OF NEW MEXICO

DR. JOSÉ Z. GARCIA, CABINET SECRETARY
NEW MEXICO HIGHER EDUCATION DEPARTMENT

This is the APPROVED October 2, 2013 ETB meeting minutes and are the official minutes.

Meeting Minutes of October 2, 2013 1:00 p.m.

APPROVED

New Mexico Higher Education Department
5201 Eagle Rock NE, Suite 1A
Albuquerque, NM 87113

Board Members in Attendance

Dr. José Garcia, Chairman
Robert Desiderio, Vice-Chairman
Trevor Serrao, Member
Robbie Heyman, Member (via Telephone)

Other Individuals in Attendance

Kevin Deiters - Executive Director
Angela Gallegos - Board Secretary
David Mathews - HED Attorney
Bill Raynor - OppenheimerFunds
Ken Henry - OppenheimerFunds
Steve Dombrower - OppenheimerFunds
Jeremy Thiessen - Pension Consulting Alliance
Jonathan Hall, BNY Mellon Investment Management (via Webcast)
Michael Quinn, OppenheimerFunds (via Webcast)
Elizabeth Slover, The Boston Company (via Webcast)
Matthew Griffin, The Boston Company (via Webcast)

AGENDA

1) **CALL TO ORDER**

Chairman Garcia called the meeting to order at 1:05 p.m. Board Secretary Angela Gallegos called the roll and announced that four of four Board members were present and that a quorum existed.

2) **PUBLIC COMMENT**

Chairman Garcia called for public comment. There was no public comment.

3) **APPROVAL OF AGENDA**

Chairman Garcia stated that the primary objective of the meeting was to select a replacement fund(s) for the Oppenheimer Capital Appreciation Fund (OTCYX). He called for a motion to approve the agenda after the removal of Agenda Item 4, Executive Session to Discuss Litigation, from the agenda.

Mr. Heyman made a motion to approve the agenda and to eliminate Agenda Item 4. Mr. Serrao seconded the motion. The Board unanimously approved the agenda as amended.

Chairman Garcia called on Mr. Deiters to give the Board an update on the September 9, 2013 presentation to the Investment and Pension Oversight Committee.

Mr. Deiters informed the Board that he, Chairman Garcia, Jeremy Thiessen, and Joe Goldberg attended the September 9, 2013 meeting of the Investment and Pension Oversight Committee and provided the Committee with a presentation about the Board's activities. Chairman Garcia gave an overview of the Board's investment oversight activities; Mr. Thiessen reported on investment monitoring and performance; and Mr. Deiters reported on plan marketing.

Chairman Garcia reported that the Committee was very pleased with the presentation.

4) **EXECUTIVE SESSION TO DISCUSS LITIGATION** – Eliminated from the agenda

5) **OVERVIEW OF DREYFUS RESEARCH GROWTH FUND** – Jonathan R. Hall, BNY Mellon Investment Management

Chairman Garcia called on Mr. Hall, Senior Relationship Manager for BNY Mellon Investment Management, to provide the Board with an overview of the Dreyfus Research Growth Fund (DWOIX) via webcast from New York City.

Mr. Hall presented from his handout entitled *Dreyfus Research Growth Fund (June 30, 2013)* which summarized the DWOIX and the investment philosophy and practices of The Boston Company. Mr. Hall introduced Elizabeth Slover, Director of The Boston Company's Global Research Team and Matthew D. Griffin, Global Research Analyst and Portfolio Manager of Technology Strategy for The Boston Company.

Mr. Hall advised that The Boston Company Asset Management was established in 1970 and that it currently manages $42 billion in assets. The core of the firm is composed of independent teams that focus on fundamental research in their approach to global equity management. He also summarized annualized and calendar year returns as reported on pages 5-6 of his handout.

Ms. Slover provided an overview of pages 7-15 covering the investment team, investment philosophy, investment process, and portfolio construction and Mr. Griffin described the investment process for technology stock selection.

Mr. Hall concluded the presentation by outlining the reasons the Board should select DWOIX. He stated that they are a team of seasoned investment professionals with an average of 15 years of experience; disciplined investment process that delivers consistent results; and decisions are made by those closest to the information. As a result, the fund has consistently been in the top-third of performance among its peer-group.

Chairman Garcia asked the Board if there were any questions.

Mr. Serrao directed Mr. Hall's attention to the description on page 15 of his handout that all stocks must have a "Buy" rating before being recommended for inclusion. He asked who was responsible for rating stocks. Ms. Slover responded that the fund's analyst is responsible for rating stocks and recommending them for inclusion.

Mr. Serrao asked why an analyst would ever not rate their own recommendation with a "Buy." Ms. Slover responded that they are asking their analysts to weight their entire universe of stocks and this enables the firm to measure the performance of the analyst.

Mr. Serrao asked Ms. Slover to explain derivative use in the fund. Ms. Slover responded that they do not use derivatives in the fund.

Mr. Thiessen asked Ms. Slover to describe the process for sector weightings and to explain their severely underweighting of Apple when compared to their peers. Ms. Slover explained that this is when they like to use their "risk budget" because this is the type of decision they feel their people are good at making. They sold Apple last October because their analysts did not see new products coming out and determined that Apple was not a good stock to own at this point when compared to other options. Ms. Slover concluded that this was a good example of the process and how they attempt to drive returns in a low-risk way.

Mr. Thiessen asked Ms. Slover if they ever over-ride a recommendation made by an analyst. Ms. Slover replied that it was very rare and that it was more of a "moral suasion" discussion with the analyst about the recommendation. In the end, they have confidence in the analysts.

Mr. Deiters asked Ms. Slover to explain the term "forced conviction." Ms. Slover responded that analysts could be "wishy-washy" when left to their own devices. She gave the decision regarding Apple as an example of how they could have simply under-weighted the holding instead of having the conviction to get out of the stock.

6) **OVERVIEW OF OPPENHEIMER GLOBAL FUND –** Michael Quinn, OppenheimerFunds

Chairman Garcia called on Mr. Michael Quinn, Client Portfolio Manager for OppenheimerFunds, to provide the Board with an overview of the Oppenheimer Global Fund (OGLIX) via webcast from New York City.

Mr. Quinn presented from his handout entitled *Oppenheimer Global Fund (October 2, 2013)*. He said that the OGLIX has an investment strategy that has been around for over four decades and has consistently produced above-average results for their shareholders and clients.

Mr. Quinn explained that the OGLIX attempts to make investments in great companies. He explained that the OGLIX seeks to identify superior investment opportunities with a minimal focus on the benchmark with respect to region/country, sector, or security.

Mr. Quinn discussed how the OGLIX utilizes a contrarian growth investment style to search for high-quality companies. He cited an example of their purchase of Google in 2010-2011 following a controversy about the ability of mobile search engines to adopt advertising in mobile platforms. At the time, Google was growing at 20 percent per year and OGLIX was able to purchase the stock at six times earnings. Google has since proven to be a significant performer.

Mr. Quinn described the OGLIX as a pioneer in growth investing and only the second mutual fund of its type when introduced in 1969. It has since relied upon a consistent philosophy and process. Rajeev Bhaman, the current portfolio manager, is only the third portfolio manager in the OGLIX's history. He also pointed out the cultural diversity of the team and the advantages that it provides in understanding and making international investments.

Mr. Quinn explained that OGLIX portfolio managers believe that long-term outperformance can be achieved by investing in quality companies with sustainable revenue growth. They also believe that a contrarian approach to growth investing should deliver outperformance and that structural growth themes (mass affluence, new technology, restructuring, and aging) help drive long-term opportunities.

Mr. Quinn described how the OGLIX remains primarily a developed market strategy. OGLIX typically consists of 75-125 securities based upon bottom-up selection. Their portfolio managers use fundamental analysis to identify quality companies with sustainable earnings growth, durable competitive advantages, and attractive valuations. They are long-term investors hoping to own a security for three-to-five years.

Mr. Quinn reported the performance returns for the OGLIX by pointing out that the average annual total return for the past five years was 5.88 percent (which exceeded the MSCI AC World Index return of 2.30 percent). He explained that the OGLIX underperforms during periods when more-cyclical lower quality businesses have strong returns.

Mr. Serrao asked Mr. Quinn if he could expand a little more about the interactions that his portfolio managers have with OppenheimerFunds' risk management team. Mr. Quinn responded that the risk management team provides a very formal framework that provides limits for each fund.

Mr. Quinn also described how the OppenheimerFunds' risk managers are very effective at helping portfolio managers understand how they may be allocating risk and where risk is coming from in the portfolio. This gives a portfolio manager the opportunity to consider another position that would have lower-risk characteristics.

Mr. Deiters asked if there were any currency hedging in the portfolio. Mr. Quinn responded it did not employ currency hedging and did not use derivatives.

7) **PLAN MANAGER RECOMMENDATION REGARDING CHANGES IN UNDERLYING INVESTMENTS** – Ken Henry, OppenheimerFunds

Chairman Garcia called on Mr. Henry of Oppenheimer Funds to provide an overview of his recommendation to the Board for the replacement funds for the Oppenheimer Capital Appreciation Fund (OTCYX).

Mr. Henry presented from his handout entitled *Oppenheimer Capital Appreciation Fund Replacement Review (October 2, 2013)* which summarized OppenheimerFunds' recommendation to the Board for the replacement of OTCYX.

Mr. Henry advised the Board that OppenheimerFunds, in conjunction with Pension Consulting Alliance (PCA), had identified the Dreyfus Research Growth Fund (DWOIX) and the Oppenheimer Global Fund (OGLIX) as potential replacement funds. The handout included three investment options for the Board to consider.

Mr. Henry stated that OppenheimerFunds believed that these investment options are good options and will improve the performance of the investment portfolios while having similar risk characteristics. However, considering both investment and overall fee outcomes, Mr. Henry stated that OppenheimerFunds believes that replacing the OTCYX with the OGLIX in certain Age Based and Custom Choice Portfolios in Scholar's Edge and The Education Plan, and adjusting the underlying equity fund target allocations in such Portfolios, is in the best interest of the Plans. Additionally, for the Capital Appreciation individual fund portfolio in Scholar's Edge, OppenheimerFunds believes replacing the OTCYX with the DWOIX is in the best interest of that Plan.

Mr. Henry gave a brief summary of each of the three investment options.

Option One would replace the OTCYX with the DWOIX. The DWOIX is a better performing large-cap growth fund, but the fund has significantly higher fees (which negates the proposed fee decrease from the "Y" share class to "I" share class conversion in Scholar's Edge). Option One would be sector neutral and would not require a reallocation of equity stocks (as proposed in Option Three) Mr. Henry stated that Option One would result in higher returns, lower volatility, and greater return per unit of risk.

Option Two would remove the OTCYX and add the OGLIX. The OGLIX is a better performing global fund with significantly lower fees (which retains the proposed fee decrease from the "Y" share class to "I" share class conversion in Scholar's Edge). This Option would result in a greater allocation to international stocks because the OGLIX has an allocation of approximately 60 percent to non-U.S. stock. Mr. Henry stated that this option would result in higher returns, slightly higher volatility, and greater return per unit of risk.

Option Three would remove the OTCYX, add the OGLIX and adjust the underlying equity fund target allocations for certain Age Based and Custom Choice Portfolios in Scholar's Edge to retain their existing international exposures. This Option would also remove the OTCYX and the Thornburg International Value Fund, add the OGLIX and adjust the underlying equity fund target allocations for certain Age Based and Custom Choice Portfolios in The Education Plan to retain their existing international exposures. As a result, the Board would need to adjust target allocations to reduce the exposure to the other international funds in such Age Based and Custom Choice Portfolios to make up for the higher international allocation in the OGLIX.

Mr. Henry pointed out that the Thornburg International Value Fund, one of the existing international funds in The Education Plan Age Based and Custom Choice Portfolios, was under-performing and subject to inclusion on the Watch List. Option Three would reduce The Education Plan's exposure to this fund by removing it and adding the higher performing OGLIX. In general, Mr. Henry reported that Option Three would result in lower fees, higher returns, slightly higher volatility, and greater return for unit of risk.

Vice-Chairman Desiderio asked if the reported returns are before or after fees. Mr. Henry responded that returns were calculated after fees.

Mr. Henry concluded his presentation on Option Three by describing the third component of this Option - OppenheimerFunds' recommendation to replace the OTCYX with the DWOIX in the Scholar's Edge Capital Appreciation Portfolio. Unlike the Age Based and Custom Choice Portfolios, this individual fund portfolio is marketed in Scholar's Edge as invested in a large-cap growth fund. He advised the Board that OppenheimerFunds was recommending the DWOIX for the Capital Appreciation Portfolio because it would be inappropriate to use a global fund for a large-cap growth fund portfolio. Mr. Henry stated that the DWOIX would result in higher fees, but that the fees for the Capital Appreciation Portfolio will remain within the industry average for large-cap growth fund portfolios.

Vice-Chairman Desiderio asked Mr. Henry to explain the impact of the fee change in Option One after the replacement of the OTCYX and the conversion to the "I" shares. Mr. Henry explained that, if the OTCYX remained in the Newborn to 5 Year Age Based Portfolio for Scholar's Edge, fees would go down from 98 bps to 87 bps. If Option One were selected, most of that benefit of the conversion would be lost because addition of the DWOIX would result in fees of 95 bps.

Vice-Chairman Desiderio asked Mr. Henry to confirm his understanding that Option One produces the largest returns. Mr. Henry agreed that Option One would have produced greater returns over the past five years than Option Three.

Vice-Chairman Desiderio asked Mr. Henry why he is recommending Option Three if Option One has a better return, a better standard deviation, and a better Alpha. Mr. Henry responded these are historical numbers and that it was OppenheimerFunds' opinion that both the DWOIX and the OGLIX were good going forward, but that fees were lower in Option Three. Mr. Thiessen said that it was because of the higher fees associated with another large-cap growth fund that they started to consider the use of a lower-fee global fund.

Chairman Garcia asked Mr. Henry to describe the process they used in developing their recommendation of these funds. Mr. Henry responded that they looked at all of the fund families that OppenheimerFunds currently uses in their 529 programs and narrowed it down to three or four choices for Pension Consulting Alliance to consider. One of the funds being considered had to be dropped from consideration because of recent under-performance.

Chairman Garcia asked Mr. Henry to explain the financial consequences of using a fund outside of the OppenheimerFunds family. Mr. Henry explained that the OTCYX currently has an expense ratio of 82 bps and approximately 75 bps is revenue to OppenheimerFunds. He explained that OppenheimerFunds loses all of this revenue when a program selects a fund unaffiliated with OppenheimerFunds. As a result, OppenheimerFunds introduced an administrative fee or "wrapper" to be paid to OppenheimerFunds for unaffiliated funds with all of the five 529 plans that they manage to capture some of the lost revenue and to maintain the financial stability of program.

Mr. Henry directed the Board's attention to page three of his handout for an example of the administrative fee to OppenheimerFunds associated with the DWOIX. The underlying expense ratio of DWOIX is 88 bps and the fee payable to OppenheimerFunds is 30 bps, resulting in a total expense ratio of 1.18 bps. OppenheimerFunds is able to recapture some of the lost revenue while keeping the total expense ratio below the industry average.

Chairman Garcia asked Mr. Thiessen if he agreed that the fees were reasonable. Mr. Thiessen responded that the fees were reasonable and they reflect the reality in the 529 business when a plan chooses to include a fund outside of its plan manager's fund family.

8) **INVESTMENT CONSULTANT REVIEW AND RECOMMENDATION** – Jeremy Thiessen, Pension Consulting Alliance, Inc.

Chairman Garcia called on Mr. Thiessen to provide an overview of OppenheimerFunds' recommendation to the Board for the replacement of the Oppenheimer Capital Appreciation Fund and PCA's recommendation to the Board.

Mr. Thiessen presented from his handout entitled *Oppenheimer's Proposed Capital Appreciation Fund Replacement (October 2, 2013).* He began his presentation by stating that, from PCA's perspective, the DWOIX and the OGLIX were good funds and the Board would be improving the Plans by selecting any of the options presented today.

Mr. Thiessen said that he wanted the Board to understand how OppenheimerFunds developed its recommendation for Option Three and that the selection of a global fund was not a new concept because we currently have a global fund portfolio. He described, as another advantage of using a global fund, that the fund manager is given more flexibility in making investments.

Mr. Thiessen reminded the Board that it completed an asset allocation review at its meeting in August and that OppenheimerFunds and PCA recommended no changes to the existing asset allocations of the Age Based and Custom Choice Portfolios in the Plans. Accordingly, he said that it was important to determine how to position a global fund such as OGLIX in the portfolios while keeping the U.S. – Non U.S. asset allocation the same.

Chairman Garcia asked Mr. Thiessen if that was the basis for the recommendation to select Option Three.

Mr. Thiessen confirmed this and said that the Board needs to look at all of the numbers. Performance is improved. Although volatility (standard deviation) will be increased, the return per unit of risk (information ratio) will be increased more than volatility. Mr. Thiessen discussed how international stocks have underperformed U.S. stocks recently and that the Board is now able to add a global fund to the Portfolios and improve performance.

In his summary of the benefits of Option Three, Mr. Thiessen concluded that the Board could add a global fund; have a fund manager with more flexibility; maintain its international exposure; and have all of the indicators improve.

Mr. Thiessen pointed out the *Holdings-Based Style* chart on page 4 of his handout that indicated the fund currently has a "growth" bias. He explained that you end up with more core equity portfolios once you introduce the OGLIX and make the reallocations among the existing equity funds.

Chairman Garcia asked Mr. Thiessen if he had any reason to change his mind about the asset allocation. Mr. Thiessen responded "no" and said that we would determine the impact of the OGLIX on the sector allocation of the Portfolios when we complete the annual asset allocation review.

Chairman Garcia asked Mr. Thiessen to describe the process that PCA followed in reviewing the recommendation of OppenheimerFunds for replacement funds. Mr. Thiessen said there was significant amount of discussion and analysis by PCA of the options proposed by OppenheimerFunds. PCA reviewed the options using its own processes and provided feedback to OppenheimerFunds and the Executive Director.

Vice-Chairman Desiderio asked about the total dollar amount of the transition. Mr. Henry replied that approximately $175-$180 million of Portfolio assets in the Plans are invested in the OTCYX.

Mr. Deiters asked if the OTCYX performance has improved in the last 60 days. Mr. Thiessen responded that it has underperformed for every month of this year.

Mr. Deiters pointed out the substantially higher fees for the DWOIX and he asked Mr. Thiessen if it was his opinion that its performance should negate this increase in the fees. Mr. Thiessen acknowledged that the fees do increase and he explained that it is difficult for large-cap growth funds to out-perform their benchmarks. He pointed out that the DWOIX was in the top quartile among its peers for three-year-and-five-year periods despite being right around the benchmark.

Mr. Deiters asked OppenheimerFunds when it would recommend that the transition be implemented. Mr. Henry indicated they did not have an exact date, but he estimated the middle of December.

9) **SELECTION OF REPLACEMENT INVESTMENT FUND(S)** – discussion and possible action

Chairman Garcia called for a motion to approve the recommendation of the Plan Manager and Board's Investment Consultant to remove the Oppenheimer Capital Appreciation Funds in the Plans and add the Oppenheimer Global Fund in certain Age Based and Custom Choice Portfolios in Scholar's Edge, to remove the Oppenheimer Capital Appreciation Fund and Thornburg International Value Fund and add the Oppenheimer Global Fund in certain Age Based and Custom Choice Portfolios in The Education Plan, and to reallocate the equity funds in the Plans to maintain the current regional allocation (U.S. versus Non-U.S. equity) as present today.

The motion was made by Vice-Chairman Desiderio and seconded by Mr. Serrao. A roll call vote was taken and the motion was approved unanimously.

Chairman Garcia called for a second motion to replace the Oppenheimer Capital Appreciation Fund with the Dreyfus Research Growth Fund in the Capital Appreciation Portfolio of Scholar's Edge and to approve an administrative fee of 30 bps to be paid to OppenheimerFunds as Plan Manager.

The motion was made by Mr. Heyman and seconded by Mr. Serrao. A roll call vote was taken and the motion was approved unanimously.

Chairman Garcia called for a third motion, with the adoption of the previous two motions, authorizing the staff and advisors to update the Board's investment policy statement, monitoring guidelines, and plan disclosure documents to reflect the actions today.

The motion was made by Vice-Chairman Desiderio and seconded by Mr. Serrao. The motion was approved unanimously.

10) **FY 2013 AUDIT CONTRACT AMENDMENT** – discussion and possible action – Kevin Deiters, Executive Director

Chairman Garcia called on Mr. Deiters to provide a review of the request by REDW to increase the total amount of their FY 2013 audit contract with the Board.

Mr. Deiters explained that REDW requested a contract amendment to increase the amount of their FY 2013 audit contract by $12,000, from $62,060 to $74,060. He informed the Board that due to the expansion of the number of portfolios offered by the Plans, REDW will need to establish and monitor new investment accounts as a part of the audit.

Mr. Serrao asked Mr. Deiters if REDW provided a detailed estimate of the additional scope. Mr. Deiters stated that the auditors estimated that each new Portfolio would result in approximately eight hours of additional work.

Vice-Chairman Desiderio stated that he would like to see a formal request and he asked what the consequences would be if we denied their request.

In response, Mr. Deiters requested the Board to table the item so that REDW could attend the November meeting and answer the Board's questions.

No further action was taken.

11) **AUTHORITY TO ISSUE REQUEST FOR PROPOSAL FOR A 529 PLAN CONSULTANT** – discussion and possible action – Kevin Deiters, Executive Director

Mr. Deiters provided a September 30, 2013, memorandum requesting authority to issue a request for proposal for 529 consultant services. Mr. Deiters explained that the Program Management Contract with OppenheimerFunds ends in May 2015 and that he would like to assemble a team to prepare an RFP for the Board by the February or March meeting.

Mr. Deiters reminded the Board that Andrea Feirstein provides 529 services as a subcontractor under the Board's investment consultant contract with PCA and that she provides annual 529 industry updates to the Board. Mr. Deiters explained that his understanding of the 529 services under the investment consultant contract were limited and would not include the type of services needed to support the RFP process. He asked Mr. Thiessen to discuss the PCA contract.

Mr. Thiessen agreed with Mr. Deiters' understanding of the contract. He stated that PCA and AKF (Ms. Feirstein) bid the contract together, but that PCA was relying upon Ms. Feirstein to report on non-investment issues related to the 529 industry. Mr. Thiessen stated his opinion that, as the Board moves forward with the development of the RFP, more items would fall under the purview of a 529 consultant.

At the request of Mr. Thiessen, Mr. Deiters discussed the issues associated with the PCA contract. He advised the Board that the contracts for both PCA and Hogan Lovells would expire in June 2015, which is just after the May 2015 start-date of the new plan manager contract. He expressed his concern that the contracts for the Board's primary advisors would expire at the time it was implementing a new plan manager contract. Mr. Deiters advised his intention to seek Board authority to extend the terms of the PCA and Hogan Lovells contract at the next meeting.

Vice-Chairman Desiderio asked Mr. Thiessen about amending his contract and asked him if he were talking about the extension. Mr. Thiessen advised that if the Board issued an RFP for 529-industry services consultant, that PCA would agree to remove the 529 consultant provisions from the existing PCA contract.

Mr. Thiessen gave an example of how PCA and Ms. Feirstein continue to bid on investment consulting contracts around the country and how several of those states have separate engagements with Ms. Feirstein for 529 consulting services. As a result, these states had direct access to Ms. Feirstein without going through PCA.

Mr. Heyman said he was under the impression that, when the Board hired PCA, Ms. Feirstein was going to be available to the Board during the plan manager RFP process. Mr. Heyman asked Vice-Chairman Desiderio what his recollection was of the original intent of the contract.

Mr. Thiessen responded to Mr. Heyman's question by stating it was the difference in having Ms. Feirstein opine on the RFP or having Ms. Feirstein as a critical part in developing the RFP and evaluating the responses. He concluded that it would require a significant number of hours.

Mr. Deiters asked the Board if his request should be tabled until the next meeting so that the Board could have more information on the PCA proposal and contract.

In response to Mr. Heyman's question, Vice-Chairman Desiderio stated that he did not remember the details and thought the issue should be tabled to the next meeting so that the Board could receive more information. Mr. Heyman agreed that the issue should be brought back to the Board.

No further action was taken.

12) **ADJOURNMENT**

Chairman Garcia called for a motion to adjourn the meeting.

Mr. Serrao moved to adjourn the meeting. Vice-Chairman Desiderio seconded the motion. The motion was approved unanimously.

Chairman Garcia adjourned the meeting at 3:24 p.m.

Approved by the Education Trust Board

December 11, *2013 Meeting*

Angela M. Gallegos

Angela M. Gallegos, Board Secretary