MINUTES

Members Present:  Ms Lori Roediger, Trustee, Chairperson
Mr. Tim Dunne, Trustee
Ms. Randie Stein, Trustee (joined at 10:34)

Others Present:  Mr. Jeff McHenry, Trustee
Mr. Ryan Parham, Chief Investment Officer
Mr. Martin Anderson, Deputy Chief Investment Officer
Mr. Paul Corens, Alternatives Investment Analyst
Mr. Mark Steed, Senior Analyst
Mr. Mark Selfridge, Investment Analyst
Mr. Shan Chen, Investment Analyst
Ms Michele Weigand, Investment Contracts Paralegal
Mr. Allan Martin, Managing Partner, New England Pension Consultants (“NEPC”) 
Mr. Don Stracke, Sr. Consultant, NEPC
Mr. John Shearman, Partner, Albourne America, LLC
Mr. Marc Lieberman, Partner, Kutak Rock

1. Call to Order

Chairperson Lori Roediger called the meeting to order at 10:02 a.m.

2. Review, discussion and possible approval of Investment Committee Minutes from November 17, 2010.

   Recommendation 01-15-11
   Recommendation: At 10:02 a.m. Motion to approve the Investment Committee Minutes from November 17, 2010.
   Moved by: Tim Dunne
   Seconded by: Lori Roediger
   Discussion: In favor - Roediger and Dunne; Stein – Not present
   Motion Passes: Passes

3. Clarification by Chief Investment Officer Ryan Parham and discussion among the Trustees and staff, concerning the Board’s authorization for an investment in the Bridgewater All Weather Portfolio II(authorized by the Board of Trustees on November 17, 2010 and request by Mr. Parham (and possible appropriate Action) that the Board of Trustees authorize an investment of up to $70 million in the Bridgewater All Weather Portfolio, LLC managed by
Bridgewater Associates in lieu of the previously authorized investment of up to $70 million in the Bridgewater All Weather Portfolio II, Ltd.

Mr. Parham explained that the Board authorized Staff to invest up to $70 million in the Bridgewater All Weather Portfolio II, Ltd. He said that as Staff moved forward with negotiations, it was determined that there were distinct advantages to investing in the All Weather Portfolio LLC, which is an onshore fund. He said this determination was based on structural issues and not exposure issues. Mr. Martin added that the All Weather portfolio is a risk-parody portfolio and is not designed to take advantage of market opportunities. He characterized it as a “risk spreading” portfolio where Bridgewater would have the right, in certain circumstances, to make a market call. He said NEPC supports this but just wanted to be sure the Board was aware of this provision.

Ms. Stein asked for a clarification as to what happens when there is an All Weather Portfolio III. Mr. Parham responded that an All Weather Portfolio III would be considered to be a completely new investment because it is not in existence under the All Weather umbrella at this point and if Staff had a desire to move into an All Weather Portfolio III, that would have to be brought to the Board for approval at that time.

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<th>Recommendation 01-16-11</th>
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**Recommendation:** Motion to approve a recommendation to the full Board to switch from an authorization to invest up to $70 million in the Bridgewater All Weather Portfolio II, Ltd. and authorize an investment of the same amount in the Bridgewater All Weather Portfolio LLC.

**Moved by:** Tim Dunne

**Seconded by:** Randie Stein

**Discussion:** Unanimous

**Motion Passes:** Passes

4. Report by Investment Department Staff and discussion regarding the Month Ended and Fiscal Year-to-Date performance/portfolio update.

Mr. Anderson distributed the Performance as of 12/31/2010. He said that Staff just got the most recent NCREIF update which comes out on a lagging quarterly basis. Consequently, the final report was not available for inclusion in the mailing. He said December was a good month on an absolute basis; but on a relative basis, we lost a little ground due to the write-down in the values of the real estate in the Troon portfolio. On a relative basis, the Total Fund ended the month -65 basis points; however, the real estate value write-down cost 77 basis points; so net of the real estate write-down, the portfolio was positive for the month. The GTAA portfolio has been strongly diversifying and positive in return. He said year-to-date the total portfolio is up 21 basis points.

Mr. Dunne asked if more write-downs are expected in real estate. Mr. Anderson responded that at this point there is nothing pending, but as things move forward there is a chance we may have more write-downs.
5. Presentation by Investment Department Staff, Albourne America LLC and representatives of West Face Capital Inc. or their affiliates (who may attend by phone), and discussion and possible Recommendation regarding a possible investment of up to $40 million in the West Face Long Term Opportunities Global Master Limited Partnership or appropriate feeders, blockers, or associated or parallel funds of same.

Mr. Anderson described the West Face Long Term Opportunities fund. He said West Face is a hedge fund structure investing in corporate distressed opportunities that Investment Staff recommends for the Credit Opportunities asset class. He said that the asset class is slightly over allocated at this point; but Staff is anticipating some significant realizations coming in. The cash should be coming from some of the structured product and RMBS managers. He said the Staff is looking to take that cash and shift to more emphasis in the corporate side of distressed debt and credit opportunities. He said West Face is unique relative to the current holdings in this asset class as they are based in Toronto and have a Canadian focused strategy. He said they are “the” player in Canadian stressed markets and Staff is looking to them to provide a different opportunity set for the portfolio and increase the emphasis in the corporate distressed debt area but in a different geographical location.

Mr. Shearman, Albourne America LLC said that Albourne thinks highly of this manager and described West Face’s strategy as a concentrated, high conviction opportunistic approach to event driven investing. He said that this opportunity will not overlap current positions as the focus is predominantly Canadian with a significant bias towards natural resources. He said the portfolio is long biased with some hedging and quite concentrated and that it is catalyst driven. He said that while this is a portfolio that might bounce around a bit in the markets, in reality all the positions in it will have very well defined catalysts and focused on a real margin of safety in the investment. He said Albourne has done full due diligence on this manager and they rate them very highly. He added that there are no material due diligence issues. He said this will be a very diversifying addition to the portfolio. He said West Face has an experienced team that knows all the participants and has been doing this for all long time. He said this gives them an edge and something a bit idiosyncratic in comparison to other managers.

Mr. Anderson introduced Greg Bowland, CEO, Co-CIO and one of the founding principles of West Face Capital Inc. who was participating via telephone conference. He said they focus on applying a very stringent set of investment principles to varying circumstances. They indentify favorable return profiles across the capital structures and seek securities with a tight factor set where few variables have high explanatory power. They identify the dominant factors that are highly idiosyncratic and produce the potential for Alpha and then they spend a lot of time focusing on the scenarios and deeply understanding these factors. Then, where possible, they isolate these dominate sources of Alpha by hedging the undesirable sources of risk. He said if they are unable to isolate Alpha factor, they focus on downside and potential for random volatility and portfolio effects. They identify any boundary conditions that can create convexity and asymmetry. He said they believe it is very value added to act proactively wherever possible because this foreshortens the time horizon and improves the result. Regardless of what the investment attributes are,
risk amplifies with the progress of time so they try to foreshorten that and tighten the range of outcomes wherever possible.

Mr. Dunne asked if this was the only fund that West Face is currently working. Mr. Bowland responded that they have the global master feeder and occasionally have investments to large to make a full portfolio allocation. He said they will offer those as co-invest opportunities to their investors. West Face just closed a co-investment opportunity in December on a control through distress transaction on an oil and gas company so they have a $200 million single purpose vehicle which their investors invested in directly to take the overages beyond what they felt was prudent to hold in the portfolio. He said their goal in Canada is to try to keep the Fund size at a reasonable level so that they are not ever over capitalized and deal with the overages by offering them to their investors.

Mr. Bowland reviewed a couple of case studies. He discussed the background of the opportunities and discussed the dominant factors which made each opportunity attractive. Ms. Roediger asked for the examples that identify process risk. Mr. Bowland said that a good example would be during 2007 to 2009 where the fulcrum debt security of most restructurings moved around. He said it used to be that a second lien creditor was in a powerful position because you could almost always refinance a first lien and therefore the second lien creditor became the fulcrum security; but when there was no first lien market, as was the case during that time frame, the first lien creditors had the ax and the second lien creditors got “smoked” because the first lien creditors could put them in a position where they couldn’t refinance. Consequently, the path dependency can be like a trip wire and it is something that can surprise investors.

Mr. Dunne asked if there would be currency risk. Mr. Bowland responded that they hedge everything to U.S. dollars but they could hedge to another dollar if we preferred. He said their funds are denominated in U.S. dollars.

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<tr>
<th>Recommendation 01-17-11</th>
<th>Motion to recommend to the full Board approval of an investment of up to $40 million in the West Face Long Term Opportunities Global Master Limited Partnership or appropriate feeders, blockers, or associated or parallel funds of same.</th>
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<tr>
<td>Moved by:</td>
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6. Presentation by Investment Department Staff, Albourne America LLC and representatives of EIF Management LLC or their affiliates, and discussion and possible Recommendation regarding a possible investment of up to $40 million in the EIF United States Power Fund IV L.P. or appropriate feeders, blockers, or associated or parallel funds of same.

Mr. Corens gave a brief overview of the power generation market. He discussed EIF’s track
record and strategy and said that they buy existing power generation assets and they develop and construct Greenfield new generation assets and transmission lines. He said they have a realized track record of 22 percent net IRR and a 2.7 equity multiple.

Mr. Shearman said Albourne thinks this is a really interesting opportunity, given the state of the industry in the U.S. and the fragmentation that exists. He said what Albourne likes about EIF is their split between Brownfield and Greenfield and from a structure perspective they feel there is more value to be added from Greenfield than Brownfield and also more complexity. He said EIF is an established market player that has been around for a long time; it has invested in 33 states over 20 years. He said the opportunity will build PSPRS’ real assets exposure, specifically in the U.S. power and electric-utility market and the return drivers are expected to have a medium to low correlation with the wider PSPRS portfolio.

John Buehler, Managing Partner and Herbert Magid, Managing Partner and co-founder both of EIF Management described the EIF United States Power Fund IV L.P. He said they started what they believe to be the first private equity power fund in 1987. He said they are focused on power generation and transmission and their principle relationship is with the Utility. He said the strength of this marketplace, in addition to the technical strength of it, is in the strength and enforceability of the long term contracts. They execute them on behalf of equity owners in projects and the contracts specify the spread that will be paid for producing capacity when asked to pay it. The contracts specify the type of fuel that will be used to generate electricity, so the details are all in the long term contracts. He said they now have about 5000 operating assets under long term contracts and as far as they can tell by their research, not a single one of those contracts has been abrogated by either party. He said one of the reasons they focus on the U.S. is because of the enforceability of contracts. He said to date they have raised about $3.5 billion of equity capital from a diverse group of institutional investors both inside and outside the U.S.

Mr. Magid gave an overview of the market that they invest in and described how they developed their strategy. He said they focus on the wholesale market, contracting with regulated, typically “off-taker”, good credit, long term entities. He said their funds typically average on an operating project 5% to 10% current yield in the first few years going to 10% to 15% in the later years; so they have a mix of yield and capital appreciation. He discussed the foundation of their strategy and said a blend of 40% to 50% construction and 40% to 50% in operating assets makes the best sense with good current yield and risk diversification. He summarized the results of their previous three funds and said they were comfortable with their goal of 20% net and they believe it is supported by the marketplace.

Mr. Dunne asked if any of their funds purchase assets from their previous funds. Mr. Magid responded that by virtue of the long life assets and the development cycle, they often have some deals that crossover between two funds but in their history they have never had one fund purchase an asset from another fund. There have been some co-investment and some development opportunities which have taken a longer time; but if a fund is out of capital, the next fund comes in and provides further funding and equity opportunity but never any actual purchase. He said that even in those cases were they are co-investing, they have investor advisory boards which have to give their approval for anything that has that kind of overlap.

Mr. Dunne asked what the average time is for their debt financing. Mr. Magid said typically
lenders will go out about to the term of the power purchase agreement; so if you have a 20 year power purchase agreement, you can put in place 15 to 18 year debt and even longer on longer contracts.

Mr. Buehler discussed the U.S. market and said that it is still about as dysfunctional as it has always been in a lot of way. He briefly described how that translates into opportunities for them and their limited partners over the next 20 years and described the terms of the partnership agreement.

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<th>Recommendation 01-18-11</th>
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7. Presentation by Investment Department and discussion and possible **Recommendation** regarding a possible additional allocation of up to $20 million in the DTRI C pool of assets managed by Desert Troon.

Mr. Parham explained that the DTR1C pool is a pool of assets that is owned 100% by the Trust. These assets are legacy real estate assets with a concentration in the Southwest and particularly Arizona. He said these assets are part of the pools of assets that continue to struggle; but the Investment Staff expects the local markets, depending on sector, to recover in the future. Staff does see signs of recovery in various portions of these assets; but one of the critical components to achieve a risk adjusted return that justifies maintaining and moving forward with the assets is the cost of maintaining the debt on these assets. He said Troon is recommending that $10 million worth of full recourse debt be paid off because, by removing the cost of carrying the debt, the forecast for return on these assets should improve. In addition, that would help to preposition them for ultimate prudent disposition down the road. He said Staff expects $10 million to be used within the next couple of weeks and that Staff expects to pay-off an additional $10 million around September.

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<th>Recommendation 01-19-11</th>
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Mr. Martin referred to the presentation which was distributed with the meeting material and described how securities lending works. Ms. Stein asked why the borrower would want to participate. Mr. Martin said that the borrower has essentially three reasons why they would want to borrow. When you lend a security, you lend the ownership of rights in that security; so the borrower receives the dividend which by contract is returned to the lender and the borrower receives the voting right. That gives the borrower voting power leverage to effect a merger action. A primary reason is operational for brokers to cover shorts as it is cheaper to borrow the security than to pay the sale fail associated with it. A third type of borrower is hedge funds that borrow securities and sell them short with a view to buying them back at a lower price. He said there are also some tax arbitrage opportunities in some foreign markets.

Mr. Martin next went on to describe the risks in lending securities. One is counter-party risk where the borrower does not return the security; however, that risk has largely been mitigated as the borrowers indemnify the lender in the event of default. Another risk is operational where the manager has sold the security and the lender does not have time to recall it and there is a sale fail but again this risk can be mitigated through indemnification. The risk that brought this to everyone’s attention is the cash collateral reinvestment risk which occurs when the security defaults and there is insufficient collateral to assure the return of the securities. He said the risk can be mitigated by the standards by which the custodian is held accountable for the risk they take in the collateral pool.

Mr. Parham discussed some of the particulars with regard to the Trust’s securities lending program that is in place with the System’s custodian. He said that over the past seven to eight years, the earnings have outpaced the losses. The program continues to earn basis points. The Staff acknowledged that the risk associated with these investments was understated in the past but it is more clearly understood now. There is a significantly smaller portion of assets available in the securities lending program now because of the new asset allocation; but the Staff thinks the program is worth continuing at least for the next couple of years as we see how the markets continue to shape up. He said Staff does not feel the Trust is overexposed and Mellon has made structural changes in the way they manage the program. Because Mellon is the custodian, Mellon tends to be more conservative than other providers of securities lending services.

Mr. Lieberman stated that the System has always looked at the income from securities lending as a source for paying or at least defraying the administrative costs of running the System and historically that has been the case, with the exception of FY 2008/2009. Out of the 30 years or more that the System has been participating in securities lending, that time period was the only one in which a loss was sustained.


There was no report.
10. Report by Investment Department Staff and/or legal counsel and discussion regarding recent developments and legal issues (including settlement discussions) involving the Trust’s custodians, lenders, securities lending agents, vendors, advisors, investments or investment managers or partners (as well as any investments managed by the Trust’s investment managers or partners). The Board of Trustees may vote to discuss this matter in Executive Session pursuant to A.R.S. §§ 38-431.03(A)(3),(4) and (7), as set forth in item 11.

11. Executive Session for Legal Matters. Discussion with legal counsel for legal advice, and discussion with and instruction to legal counsel regarding (i) ongoing or threatened legal action involving the Arizona PSPRS Trust, the System or the System’s sister plans (EORP or CORP) (the “Plans”); (ii) legal issues affecting the Plans and the Trust, and any issues regarding the Trust’s or Plans' vendors, advisors, contracts, legal rights, personnel, or investments. The Investment Committee may vote to discuss these matters, wholly or in part, in Executive Session pursuant to A.R.S. §§ 38-431.03(A)(2),(3),(4) and (7).

a. Discussion with and instruction to legal counsel regarding legal issues, and settlement discussions, if any, arising in connection with the Arizona PSPRS Trust’s real estate, private equity, hedge and other investments, including those managed (or formerly managed) by the Pivotal Group, ApexCapital Management, and Desert Troon Limited, pursuant to A.R.S. §§ 38-431.03(A)(3), (4) and (7), and including claims raised by Millard and Scott Seldin with respect to an indirect investment in Anthology.

An Executive Session was not convened.

12. Call to the Public

No members of the public came forward to speak.

13. Schedule next meeting

The next Investment Committee meeting was scheduled for February 23, 2011.

14. Adjournment

The meeting was adjourned at 11:59 a.m.

Ms. Lori Roediger, Trustee, Chairperson                 Mr. Tim Dunne, Trustee
Ms. Randie Stein, Trustee