CITY OF PHILADELPHIA

SINKING FUND COMMISSION

In Re: January Meeting

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Wednesday, January 11, 2017

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This Meeting of the Sinking Fund Commission, held pursuant to notice in the above mentioned cause, before Angela M. King, RPR, Court Reporter - Notary Public there being present, held at Two Penn Center, 16th Floor Conference Room on the above date, commencing at approximately 10:06 a.m., pursuant to the State of Pennsylvania General Court Rules

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STREHLOW & ASSOCIATES
FULL SERVICE COURT REPORTING AGENCY
54 FRIENDS LANE, SUITE 116
NEWTOWN, PENNSYLVANIA 18940

(215) 504-4622

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A P P E A R A N C E S

COMMISSION MEMBERS:

Donn Scott, Chairman

Rasheia Johnson, Treasurer

Bill Rubin

ALSO PRESENT:

Christopher R. DiFusco, CIO, PGW

Alex Goldsmith, PFM Asset Management

Ellen Berkowitz

Christian Dunbar

PGW Representatives

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CHAIRMAN SCOTT: I'm delighted to call this meeting to order. Thank you all for coming out and joining us.

First official business is the approval of the transcript of the meeting on December 2.

Is there a motion?

MS. JOHNSON: Motion.

(Duly seconded.)

CHAIRMAN SCOTT: All those in favor?

(Ayes.)

CHAIRMAN SCOTT: Okay. The third item on the Agenda is the PGW Pension Plan Investment Consultant Plan.

MR. GOLDSMITH: Thank you. And wasn't too long ago that we were here last. We do have updated performance as of -- and the market value as of December 31. I will do a brief summary of the markets and economy as of the end of the year.

In general, it was a good year for market performance on an absolute basis. U.S. equity markets were up broadly in the 12 to 15 percent range with small caps outperforming.

Despite challenges, international equities were general -- were broadly up for the year. And despite increase in interest rates during the year, fixed income returns were positive. On an absolute basis, returns were good in the face of mounting uncertainty.

Again from a return basis, the total fund, and you all have the performance, return to positive 7.93 percent for the year. That exceeds the targeted discount rates, so that is a positive. Again, this is on calendar year basis. The plan's fiscal year is different. But you know, I think that's a good sign.

I will step back and talk -- again, for the year, I mentioned returns. Some key economic indicators: GDP growth for the year, the U.S., 1.7 percent and, I would say, squarely in the middle of what's typical over the last ten years. Developed international economy slightly below at 1.5 percent, smack dab in the middle of their typical range. And emerging markets, 4.6 percent, towards the lower end of their range.

GDP growth expectations for emerging economies have come down. And they will face a number of challenges and certainly looking less favorable relative to the U.S. developed economies than they have been.

The unemployment rate is at its lowest over the last, let's call it, ten years at 4.7 percent. Developed international economies, unemployment is below their ten-year range. And emerging economies towards the lower end, as well. So, positive job market here.

And inflation has started to tick up. It was previously at its lower end. And so, I will get into how these things both positively and negatively effect the economy.

Year-to-date, let's just look at some returns. It's -- I think we -- the Press has been tracking the DOW 20,000 push. That's indicator of -- we talked the last meeting about strong equity markets here since the election. Possibly, you know, diverging from fundamentals, though. Certain corporate earnings have been resilient. Corporate stock buybacks are actually lower, which is a good indication of applying that companies are reinvesting in their -- growing their business, not just buying stock back. That being said, I think stocks generally moved sideways up slightly about 1 to 1 and a half percent for the U.S. market year to date. International markets is doing slightly better.

On a fixed income basis, rates have -- from the election, rates rose all about, you know, a percent to half a percent pretty rapidly. The ten-year treasury bill sits at 2 and a half percent. We expect rates to rise over the long term. One year from now, I think the yield curve is showing rates at about 2.7 percent, a modest increase. And I think that reflects the rate or the speed of which rates have risen. So I think, you know, we expect them to go up over the long term. They perhaps have got a little ahead of themselves now. Fixed income in the last quarter exhibited a negative return. That is what occurs when rates go up quickly as they have.

And then I mention an outlook for the equity market. So, there is a number of positives, certainly corporate earnings, an increase in trade and its contribution to U.S. GDP. I think we talked last meeting about some of the President-Elect's policy, certainly regulation, tax policies, infrastructure spending, how that would benefit, I think, U.S. corporations.

On the flip side, I mentioned inflation. The dollar is stronger. And while unemployment has fallen, real wages haven't fallen. And so, the stronger dollar is, the flag in wages could prevent headwinds. Internationally, tailwinds are central bank activities. While I think our central bank is wrapping up, certainly wrapped up their asset purchases and looking to increase rates in 2017, the opposite is happening overseas. On the flip side --

MR. RUBIN: Alex, can you back that up. How much of that is overvaluation of corporations? We expected there to be a decline when the President-Elect was elected, the thought was there going to be a huge drop. And nobody knew where it was going to go. Kind of uncertainty. So, how much of this is actual growth and how much of it is overvaluation?

MR. GOLDSMITH: Let's take a step back. I don't think -- we weren't predicting a huge drop. The correction in the market is 10 percent. I don't think we're looking at a 10 percent correction.

MR. RUBIN: Going forward for how long?

MR. GOLDSMITH: I don't think I can put a time period on that. There won't be a catalyst event, I don't think, would cause a 10 percent drop in the market.

I think value -- the fundamentals are strong. Trade is increased in the U.S. Unemployment is down, you know, despite wages. Corporate earnings have generally met expectations and they're positive. I want to say the outlook keeps getting reduced, but that's what corporate CFOs tend to do so that it can beat their expectations.

MR. RUBIN: You don't see where people are going to take money off the table and it's going to cause --

MR. GOLDSMITH: I think when you look at -- this is what I was getting at with the international risk. I think a lot of -- despite what we have here in the U.S., a lot of the political risk lies overseas. I mentioned the Italian election that happened before our last meeting. There is still another one to come. There is an upcoming election in France and the Netherlands, as well.

Indications are that there will be a move right there, positive based on change in demographics, immigration and terrorism concerns. But it's also, I think, possible reaction to what Europe didn't do right coming out of the Great Recession, which was austerity. They did the total wrong thing. So, I think they want a little bit more pro-business initiatives there. These elections create uncertainty.

Despite the uncertainties from Donald Trump, there is less uncertainty in our -- in the corporate financial markets. We are generally confident in corporate earnings. I don't think that they -- the information is being hit in that. I think we may run up a little quicker than expected. But again, the tailwinds here in the U.S. are stronger. And so, I think that supports generally valuations here. I think -- I'll address uncertainty in the U.S.

Personally, I watched the President's speech last night, and I thought it was very good. And I think that that -- it strengthens, I think, some of the democratic institutions here in the U.S. That despite what happens with our President, and a lot of news came out yesterday that could precipitate potentially moderate sell off, I don't think 10 percent, that despite what happens there, I think Congress, the Supreme Court, these other institutions will, I think, safeguard the U.S. economy. Which again, is healthier than it was eight years ago, ten years ago.

MR. RUBIN: So, you don't think we should trim our sales?

MR. GOLDSMITH: No. And again, this gets back I think to a question you asked last meeting, too. Which is what can we do?

I don't think we can favor going more to fixed income. Rates have gone up a little too sharply. But over the long -- over the next year, we expect them to rise. Over the next five years and thirty years, expect them to rise. I don't think bonds are a safe haven.

We have selectively trimmed again from small cap, which so far that's been a good decision. So far in 2017, large caps have outperformed. The small cap which, you know, about 25 percent for 2016. We elected to take some of that back as we can. But we really can't make any significant, you know, dramatic shift into the allocation of this plan. We are not advocating going 5 to 10 percent over weighed equities either.

Some of the other positions -- we can get into performance, as well. I think these thinks persist. You know, being underweight international has helped through the year. That's a relative tradeoff that we are not looking to switch right now. I think we favor the U.S. So slight underweight to international equity has benefitted. And we think it will benefit over the next six months to the next year.

MS. JOHNSON: So just quick question. Even with all the rumblings and the talk with the President-Elect and what's coming next Friday, you would say stay the course with the strategy that is currently now?

MR. GOLDSMITH: Yes. Yes. And

that's -- I call it equal weight to equities as a whole, overweight to the U.S., overweight to small caps. And then adding -- adding yield to fixed income. We can't avoid, you know, what will come to fixed income market when the rates go up meaningfully. But again, we can add managers like Logan Circle to enhance yield.

So, are there any other questions on the economy markets?

I will move onto actual performance of the Plan for the quarter for the year. I talked about it earlier, but 7.93 percent for 2016. Ahead of the actuarial rate return, lags by about a half percent the benchmark. And just want to point out, that is the new benchmark which is, I believe, 45 percent Russell 3000, 20 percent MSCI ACWI U.S., and 35 percent Barclays aggregate. So, simplified benchmark that doesn't have separate small large cap. It doesn't have value growth. And so again, it will be -- potentially be challenging during some quarters to beat. Other quarters, you can see significant out-performance. The asset allocation either addition to subtractions will shine through more so with this new benchmark.

In terms of, you know, what happened, I think, for the year, some things go into the slight underperformance. Selection within equities as a whole detracted despite the positive absolute performance. A lot of the active managers missed their benchmarks slightly to, again, in some, particularly Fred Alger, larger misses. We continue, I think, to favor indexing where it makes sense in the large cap sector.

We also, and this is a theme we will get to later, favor core approaches as opposed to value growth. It seemed that every quarter this year, value and growth sectors alternated which outperformed. I don't -- it doesn't make sense to try to time those by overweighting or under-weighting. What that tends to do to active managers is they will get defensive. And so, they will get defensive in a slow quarter for growth. And the next quarter when growth takes off, they will be in position to more defensive stocks. The market as a whole rises. And index funds tends to outperform active managers. Then they get caught up in sort of a timing game. so, we will talk about that theme later. But you know, active management as a whole detracted from domestic equity returns for the year. It actually contributed to international returns. They are all active and they outperform for the year. But for the most recent quarter, active international detracted.

I mentioned there's an overweight to small caps that contributed on the margins. The underweight to international contributed on the margins. Equal weights to fixed income is generally -- a drag -- cash was a drag. For the year, it actually helped 2 percent cash position this quarter. But generally, lower duration and enhanced yield over the benchmarks of that fixed income manager.

So you know, I can go into specifics on some of the managers. O'Shaughnessy had a good quarter and a good year. They continued to demonstrate good selection. And that was one where they actually -- it's a value manager. They performed in a strong value market. In the third quarter, they actually outperform in a weak value market. That is an instance of one manager that didn't sort of drop the boat -- drop the ball trying to time market environments.

Alger demonstrated poor selection. They are -- they maintained their overweight to Pharma, IT. Their picks did not play out. They hold those positions. So, swings quarter to quarter. But maybe this quarter, again, with growth back on top, maybe some of those positions will play out.

The small cap side, I think some of the managers missed a rally in the small cap market. Absolute returns were pretty good both for the quarter and for the year. Vaughan Nelson, I think, and Chris and I spoke about this. They mentioned a cash drag hurt them. So, cash was redeemed from them several times over the quarter. So, we are working with them to improve how we can help them a little better.

So, those are my comments on manager specifics.

MR. RUBIN: So if we look at large cap and small cap on your sheet, it looks like they did well, but they didn't outperform the index?

MR. GOLDSMITH: They're benchmarks, yes. Specific manager benchmarks.

MR. RUBIN: At what point do we look at and say we should index?

MR. GOLDSMITH: Well, I think that's -- we do that on the large cap side. Small -- Chris, we have talked about this, too. The small cap index has been approved, I believe, right? That was done. And you know, conventional wisdom is that small cap is historically not the place to use index funds. There is more companies, less of an informational advantage because you have to do a lot of leg work and research to identify there is less information out there.

That being said, in a strong year like this, index funds will be the bulk of active managers.

MR. RUBIN: This is gross of fees, right?

MR. GOLDSMITH: This is net of fees.

MR. RUBIN: Okay.

MR. GOLDSMITH: Now, I would be in favor of using a small cap index as a gateway to a core approach. I think a lot of the struggles from these active managers have come from, as I mentioned a couple times so far today, the value growth dichotomy. How one will outperform one quarter, one will underperform. And it's really switched every single quarter this year in 2016.

And so, I think by going with a core approach, you will capture the whole market. You won't -- you avoid any underperformance. But going forward, I would prefer to see active management in the small cap sleeve. And we get to the, sort of, forward looking agenda. It includes a discussion of whether we go with the core approach in small cap, issue an RFP. I think we can see some strong managers that respond to that RFP. We have several in mind. So -- at least that we like. I would like to issue a small cap RFP and see what we get.

But to get to your question, an index fund could be used as a tool to get to core in the mean time.

MR. RUBIN: How long do we stay with Fred Alger?

MR. GOLDSMITH: That's another decision. We will make our formal rank --

CHAIRMAN SCOTT: What was that question?

MR. RUBIN: How long do we stay with Fred Alger?

CHAIRMAN SCOTT: That was the same question I had. Can I just -- let me build on what he just asked.

When you see such a variance, how do you evaluate that? I'm looking -- if you look all the way over since inception, right, it's 12.18. That's what, three years or what?

MR. GOLDSMITH: It's April 2012, I believe. Almost five years.

MR. DIFUSCO: Almost five years.

CHAIRMAN SCOTT: Okay. That's what I'm trying to understand. How do you evaluate the performance of a manager when they have had one pretty bad year. But I guess, if you look at it over five years, it's just -- has it been above?

MR. DIFUSCO: Just below.

CHAIRMAN SCOTT: Just below.

MR. DIFUSCO: Just below.

MR. GOLDSMITH: And prior to this year was doing better obviously, but as you mentioned, they had a slow year. I think we certainly evaluate it over shorter periods. But more importantly, I think you look at longer periods. I think you have to look at it in context of what they are doing and why as we get the story from the manager. And the story we have is that they maintain several concentrated positions in fundamental names that, again, small cap versus large cap. But in fundamental names that they for specific reasons like to -- want to hold for the long term.

This year, those names didn't work out. They are sticking with those names. So, I don't have a problem with that story. Now, how long do you allow that to go?

And I think, you know, for -- you look at performance, five years is a good -- you are look at performance in a vacuum. Five year underperformance even slightly, not ideal. When you are looking at the performance of specific names, ideas in their portfolio, we typically look at that at 18 month to 24 or 36 month. You expect a Pharma company, you look at their drug -- this is what they do. They are overweight to Pharma. They have a pipeline of drugs that come to market. What happened specifically to them this quarter and this year, a number of those drugs the trials were set back, approval dates were delayed. They may still work out. You know, drug processes take a long time.

But you know, they -- Alger can fundamentally look at this and decide they want to hold these Pharma companies because of this drug portfolio. And that's what they're doing. I think we -- you know, that -- what I'm trying to get at, is that -- you give them about 24 months, give or take, 18 to 36, for them to let that thesis play out. Because I think if you were to maybe risk pulling them now and then suddenly a backlog of these pipeline goes through and, you know, I mentioned the value growth dichotomy. The value growth is already up this quarter. May have been a bump in the road for a lot of the names that Alger holds. They suddenly see a glut of good news and good performance.

So, I don't think you react by pulling them or yanking them this quarter. We don't -- we're still very early. Don't have a full holding list. We will do a full attribution.

And that will be in the packet for the next meeting. We also have our formal ranking where we will rank Alger not just for this portfolio but all of our clients. It's our independent viewpoint of them. That will impact the decision, again, that's fundamentally based.

Do we like their process, the team and the story? Right now, we generally do.

I think getting back to what you originally asked, Bill, what do we do with Alger? This discussion goes back to, I think, last summer and early last year of our desire to want to move away from value growth. And so, there has been an RFP issued. I think looking like we will be on track to invite those candidates in in March with large cap core strategy. And I think at that time, even if, you know, say Alger recovers and we still generally like their process as a growth manager, we would prefer core. And so, that's a change to the structure of this portfolio. That will precipitate the removal of Alger. And I think -- that's a better decision, better structure for the long term. We're talking, you know, five years to thirty years.

MR. RUBIN: But there's no change in leadership. There's no change in their process?

MR. GOLDSMITH: No.

MR. RUBIN: There's no change in any of their fundamentals from when we hired them?

MR. GOLDSMITH: No. I don't want to go back -- my knowledge of the manager, no. And that would go over the last five years. I actually just met with him yesterday. And I can say that, yes.

MR. DIFUSCO: The only thing I would add to that, Bill, I think obviously this goes back, you know, prior to, you know, even last year when we introduced or two years ago introduced indexing in the large cap space. Clearly, I think the underperformance there if you go back to inception, you know -- a little over 9 percent ot a little over 10 percent going back to the '80s, I mean, that's clearly in my mind the most obvious reason as to why the overall since inception performance is just lagging. It's close, but it's just lagging. I think obviously makes up 40, 45 percent of the overall assets. I think even as part of the discussion in March when we bring these other core candidates in. I think we should be thinking about is, you know, core the approach. We should be contrasting that to index.

Should it be -- because look, we have all talked about this. Large cap space, domestic equity, it's going to be the hardest place to outperform. It just is, right? What's your information hedge in capital? What's your information hedge in Google? What's -- it's very hard for, I think, any of us fundamentally to think as opposed to small cap.

If you look at -- yes, they have had a rough quarter. I think we should look at options, as I said you know, the email I sent out a couple days ago. But this since inception performance for small cap combined for this Plan, this is significant out-performance over 10 percent versus 9 percent. So I think when we bring these managers in in March, we should be thinking of them not just compared to Alger and not just compared to O'Shaughnessy. But in the back of our minds, is this strategy better than just going a hundred percent index. Do we say yes, we like Manager A, do we think core is the way to go? Or do we say, look, these guys are good; but you know what, at the end of the day beating in this space is going to be tough. And I think as good as these folks are --

MR. GOLDSMITH: I think you will see it in the responses, as well. When it comes to core managers, there are two types. Those that hug the index and don't want to take large bets, or those that will say, look, we have to demonstrate our value somehow. And they do take larger bets. That can cause volatility when they are more concentrated and those positions may not work out.

So certainly, I think we will look at active managers relative to indices. I think the value growth story persists in small cap. Active managers historically do protect on the downside. So a rally in small caps, I don't think they are totally out of whack, small cap valuations are lower than large cap. But it's been a strong year. I think you would help to have some downside protection in the form of active management in small caps.

Any other questions? I think a lot of this we can address when looking forward at plans.

CHAIRMAN SCOTT: There being no other questions, let's move forward to the Logan Circle Investment Rate Funding.

MR. GOLDSMITH: The last plan for Logan Circle was approved to fill an investment grade credit mandate. They proposed a strategy that was heavily invested in investment grade corporate securities with some government and some other agency in mortgage back sectors. But predominantly corporates, that strategy was approved. And I think via negotiations, we have expense ratio of 20 basis points, which is pretty low for an active corporate strategy like this.

The next step was to come up with an implementation weight as well as the guideline for the strategy given the change, the overall investment policy statement. If you recall, we simplified that document to apply to the total plan. These individual investment management agreements will govern the manager. So, the benchmark has been set as the Bloomberg Barclays five to ten year, so it's not the full duration spectrum. It's not intermediate, which is a little shorter. I think we want it sort of in this nice five to ten year sort of spot as well as a cap on high yield securities at 5 percent.

I think, again, looking for a higher yield is important in this environment. But again, this is an investment grade strategy. We want to limit their ability to really, you know, beat the benchmark by going into junk bonds. We want them to pick the best investment grade corporates. We are recommending a 3 percent allocation, which reflects the asset allocation study that we performed when I went over with you last summer. And we are recommending that that gets sourced from the core fixed income managers in the plan.

I don't know if the Staff has anything to add. I believe the contract is still underway. Once that's gets finalized, we will be -- we plan to move ahead at this point here.

MR. DIFUSCO: Yeah. We are pretty far along. We already have multiple contracts across both pension plans with Logan Circle as Alex mentioned. You guys approved them at the last meeting as the manager. So, would be about $15 million initial allocation to that which we will source from the existing core income managers as soon as the contract is finalized, which I expect pretty soon given where we are. We would rebalance the portfolio accordingly.

CHAIRMAN SCOTT: Thank you.

Next item on the Agenda is a 2017 Planning Outline.

MR. GOLDSMITH: Yes. This is sort of what I was alluding to, the forward looking agenda. I don't know if agenda is the best word. There's a lot to accomplish for the plan. A lot of these themes go back to what we discussed when we were first brought on last March, predominantly the diversification of a fixed income from a simple core, an intermediate core approach to a more diversified higher yielding portfolio, adding in some international fixed income and emerging markets fixed income, adding in, again, investment grade credit, former corporates which we have done, and then adding in dedicated high yield.

When I mentioned I want to limit Logan Circle's ability but we also want to hire a dedicated high yield manager that can do almost all high yield. But that's what they go out and do in the portfolio. So, you will see that the January meeting, Fund Logan Circle. That is what we just addressed. You will see in February, it's issue the high yield RFP. We would like to get that out there. That's -- the international emerging debt RFP has already been issued, so the next one to issue would be the high yield related to emerging markets debt you can see in April.

We have the responses. Between now and April, we work with Staff to get a list together, conduct our calls and then interview them in April. And then you can see down in June, conduct high yield manager calls with an interview with the July meeting. So, it takes about six months to move through two additional RFPs. So, that's why we wanted to lay it out, out here.

So those are -- that plan is underway. It's been approved. Was approved last year. The other RFP that's out in the market, it was approved, it's release, the large cap core. We discussed that earlier today, as well. So, our plan is later this week and next week to meet with Staff and get on the same page with our -- the managers we like to further review, and then bring those in for the March meeting.

I think, you know, after that, those are the projects that are currently underway, the active RFPs. Some of the other themes involve discussions you can see in April. And I have this as a between meetings agenda item. But it's consider core approach to small cap equity. And that would be discussions we would have with Staff, potentially with any of you offline. But it's do we want to do the same thing that we're doing -- potentially doing in large cap to small cap? You know, I already expressed that our preference would be, yes. At least, let's do the RFP, see what managers we can respond and those that we like.

Another discussion would be at the May meeting. And that's sort of a preliminary discussion, maybe can be done with Staff outside.

But that's a discussion of alternatives. The addition of alternatives like private real estate -- any real estate public or private. But private real estate predominantly, private equity, perhaps private debt or infrastructure investments was not approved when we addressed the new asset allocation last year with the caveat that we will focus on it at a later date. And so, maybe I think that May meeting is a discussion, a chance we bring some educational materials. I can flush this out with Staff, but however we approach that. I think we would like to get that discussion moving because we will go through it in whatever form we do, there is some opportunities both for yield and appreciation return for some of those asset classes.

A number of the other items are -- this continues to be -- you have to go through several steps for an RFP. It's timing when we issue, timing when we call, timing when we interview with these meetings. So that's -- you will see the small cap core, if proceeding, if proceeding. The high yield interview in July. I mentioned that.

So, the only other item that I would say is not on here that might be worth discussing is do we apply the core approach to international equity. There are also value growth strategies within international. Perhaps an international index has been approved. No index saying aside from the DFA Fund, which is sort of a hybrid index, has been used in international. Perhaps we move to an index core approach in international equity. That would, I think, require, you know, at least would recommend issuing RFP, doing the work and seeing what we can find in the respondents.

So, I will take comments and thoughts now on any of those initiatives. Or I know this is a lot of stuff in here. But with a lot of -- lot of plans for this portfolio, we thought it would be a good idea to schedule at least the first half of next year out this year.

MR. RUBIN: What's the approximate funding level?

MR. GOLDSMITH: Funded ratio of the Plan, I don't have that on the top of my head.

MR. DIFUSCO: It hadn't changed from the

mid 60s or high 60s from last year. In fact, probably -- again, I'm guessing, not an actuary -- may have gone up slightly. As I noted yesterday, just in the last week the assets AUM has gone up about $11 million just since the -- in the week. I can reach out to Tom, have him ballpark it back in the envelope if it's changed. But I would not anticipate it's changed markedly from the last market report.

MR. RUBIN: You wouldn't be giving us another report until --

MR. DIFUSCO: August/September.

MR. RUBIN: Right. I guess my question is, if we are looking at private markets and other real estate and those kind of decisions that you are asking us do we want to look in that direction, I would think that it would be predicated on the funding level, right?

MR. GOLDSMITH: Yes.

MR. RUBIN: So, how do we make those decisions prior to knowing if we are going in a -- if we are going in a positive direction when the funding levels --

MR. GOLDSMITH: Right.

MR. RUBIN: -- are going to be, say, 80 percent in ten years or twelve years is probably the projected, is that fair?

So why would we take more risk and go into alternatives if we're going on the right trajectory? Is there a bigger gain for us? Can we shorten that window? Does it matter? How can we answer those questions?

MR. GOLDSMITH: Yeah. I think you have to sort of define what risk means to you. So, it can -- I think what people typically view in alternatives, the risk being liquidity risk. And so, funded ratio is certainly important because that means whether you will need more money for benefit payments, need more money, let's say, contributions will be coming from outside. But it -- looking at least at participant data.

If you are locked up in a liquid fund and you need to be pulling assets to make your benefit payments, that's a risk. Now a lot of the private funds have a lot lower volatility than public funds. To a lot of people, the prime definition of risk is volatility. I don't necessarily fully agree with that either. I look at risk as missing public market benchmarks. Historically, private market returns have been higher, but there is also leverage. Leverage is a risk, too.

Sometimes I think one way to look at it is when you are better funded, the plan is a little more sound. You can move money to private markets because there is a less of a risk that you will be needing some of this money to make immediate benefit payments, so you can afford to lock it up for a little bit. You get a liquidity premium. That is why private funds, return to higher -- they call it higher average returns. They call it liquidity premium. Then you have lower volatility. You have, you know, more insight into the -- a smoother return stream.

So I -- it makes a lot of sense to look at whether you add them or not in the context of your actuarial data. It's been data benefit payments and then just general funded status. I think what we can do ahead of time is provide some education on what sub-asset classes we would recommend. Because not all -- we're not going to be in here recommending venture capital, which you lock up your assets for ten years, 90 percent of the investment at the fund base go to $0 but the other 10 percent go up, multiply themselves by 15 times over. We will not be recommending that, especially not for a plan like this. But there are private real estate which returns income, quarter in, quarter after quarter; or private debt funds, which much like traditional fixed income, they invest in corporate bonds, corporate loans, direct loans to corporations with significantly higher yields and locked in negotiated return screens. You are getting a coupon quarter after quarter.

I think a lot of that would make sense for a strategy like -- a fund like this. Early on in spring, we bring in, you know, educational presentation or we can do it offline about what would make sense and what other -- maybe what other public pensions have done, what they are -- their private market allocations look like. So when we get the data in August, we are ready or you're ready to, you know, decide one way or the other. And we can look -- we can conduct several searches, show potential managers at that point.

And then would approve, would require, I think, an amendment to the investment policy statement. But you know, I am fine with that. We didn't want to put that in what was approved.

MR. RUBIN: So you are not looking at private equity?

MR. GOLDSMITH: I mean, private equity is a broad definition. So real estate, private real estate is -- you know, possibly broad buyouts. Maybe, you know, in a slightly reduced allocation, might be worthwhile for a plan like this. I don't want to single -- I don't want to say dedicated allocation to venture capital, probably not. I can go as far as to say that right now. There also funds of funds which have a little bit of everything rolled in. They reduce that venture capital risk by diversifying amongst ten to fifteen venture capital funds. They also have private debt, they have -- you get a little bit of everything in one fund. The problem is you are paying two layers of fees.

So, those are the things that we can look at in spring and explain, you know, the role they would play in the portfolio. Income, diversification, lower volatility, specifically in each sub-asset class.

CHAIRMAN SCOTT: So, we would consider -- I'm looking at the former plan to add additional asset classes. We would consider those options because we would anticipate a greater return? Why would we consider these options?

MR. GOLDSMITH: Greater risk, adjusted return.

CHAIRMAN SCOTT: Greater risk and --

MR. GOLDSMITH: Risk adjusted return. In that instance, I am using volatility as adjustment of risk. But yes, better return for each measure of risk that you are taking. That's ultimately, I think, what the goal of investment manager, goal of fiduciaries should be. Again, that's why we are doing the education.

Let's keep in mind the level of risk we want. Is it venture capital risk? You could just shoot the lights out with venture capital. You could also end up with empty pockets. So it's -- the risk adjusted return for venture capital is high. Is it too much risk for this plan. We would cover all that in an educational way.

But yes, the ultimate goal is to increase return for the amount of risk we want or you all would want.

CHAIRMAN SCOTT: Any other questions on that? All right.

Is there a motion to adjourn? Is there anything else?

MR. RUBIN: Do we have to address Matt not being here? Put something on the record?

MS. JOHNSON: May make sense to put it on the record.

MR. DIFUSCO: Just to Bill's point, I think many of the folks in this room know, but Matt Mazza, who was the Executive Director of the Sinking Fund, resigned effective December 23. I know discussions are ongoing amongst Rasheia, Rob, Controller. I am sure Don will be looped into those about the structure and who will be the Executive Director and how those duties will work going forward.

I would anticipate both offline and, if necessary, Executive Session if it has to go into that at the next meeting in March, we would address that.

In the interim, you know, Rasheia's office, Christian who is here as Deputy Treasurer has been very helpful in terms of coordinating a lot of the contractual issues through ASIS. He's been a big help. I appreciate that. He and I are working through those things with the Law Department to keep the contracts on pace, keep all the things going that need to be done.

But again, both offline and then, as necessary, I think the March meeting we can address any personnel changes or anything going forward.

MR. RUBIN: Yeah. That's fine.

MR. DIFUSCO: Does that address your --

MR. RUBIN: It does. I just wanted to have something on the record so people know.

MR. DIFUSCO: Yeah.

CHAIRMAN SCOTT: This meeting is hereby adjourned. Thank you.

(Sinking Fund January Meeting adjourned at 10:48 a.m.)

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

I, hereby certify that the proceedings and evidence noted are contained fully and accurately in the stenographic notes taken by me in the foregoing matter, and that this is a correct transcript of the same.

ANGELA M. KING, RPR
Court Reporter - Notary Public

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