CITY OF PHILADELPHIA

SINKING FUND COMMISSION

In Re: Quarterly Meeting

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Wednesday, November 18, 2015

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This Meeting of the Sinking Fund Commission, held pursuant to notice in the above mentioned cause, before Serena A. Spotts, Professional Court Reporter and Notary Public in and for the Commonwealth of Pennsylvania, held at Two Penn Center, 16th Floor Conference Room, on the above date, commencing at approximately 11:00 a.m., pursuant to the State of Pennsylvania General Court Rules.

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APPEARANCES:

COMMISSION MEMBERS:

Benjamin Gilbert, Chairman

Alan Butkovitz, Commissioner

Nancy Winkler, Alternate for Mr. Dubow

ALSO PRESENT:

Charles Jones, Executive Director

Matthew Mazza, Assistant Treasurer

Christopher DiFusco, Chief Investment Officer, PGWPP

Frank Gomiesen, Gallagher Fiduciary Advisors

Marvin Devers, Gallagher Fiduciary Advisors

Adam Colman, City Law Department

Jeff Hornstein, Controller

ALSO PRESENT:

Dan Leonard, PGW

Janet Werner, Wells Fargo

Jo Rosenberger Altman, City Law Department

P R O C E E D I N G S

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MR. GILBERT: The minutes of the last meeting were circulated by way of email. Are there any questions, corrections and/or additions to those minutes?

Hearing none, may I have a motion to accept the minutes from September 9th?

MR. BUTKOVITZ: I've move.

MR. GILBERT: Any questions on the motion? All in favor?

MS. WINKLER: I didn't have the minutes. I'm apologize.

MR. GILBERT: Motion carries. The quarterly Sinking Fund statements were also circulated, also in the packet for Sinking Fund for September 30, 2015. Any questions on those statements?

MS. WINKLER: I have a comment to make about them, which is they continue to be labeled in a manner in which I, as city treasurer, cannot understand them.

Just before the start of the meeting, the new Sinking Fund executive director, who apparently doesn't fully understand them either. I don't mean -- It's just a statement. It's not a value judgment. I want to continue to raise the concerns I've raised in the past that they are not clearly labeled, and I don't understand why we have these particular statements organized the way they have in the past. I've been told that's the way we always do it. That's never been a very good answer to me.

I propose that the treasurer's office sit down with the Sinking Fund and the accounting department and talk about what -- I don't understand what we're even approving here. I'm uncomfortable voting on them. So I won't be voting on it. And I would suggest that there be a meeting to discuss revising these reports so that they have some value to the people reading them so that they understand what they say.

MR. BUTKOVITZ: I won't vote on

them either.

MR. GILBERT: Is there a motion to table this statement?

MS. WINKLER: I'll make a motion.

MR. BUTKOVITZ: I second it.

MR. GILBERT: Any questions on the motion? All those in favor?

MS. WINKLER: Aye.

MR. BUTKOVITZ: Aye.

MR. GILBERT: The statements are tabled. The PGW pension fund statement for September 30, 2015 also in the packet. Any questions on those statements?

Hearing none, may I have a motion to accept the PGW pension plan statement for September 30, 2015?

MS. WINKLER: Make a motion.

MR. GILBERT: Second?

MR. BUTKOVITZ: Second.

MR. GILBERT: Any questions on the motion? All those in favor?

MS. WINKLER: Aye.

MR. BUTKOVITZ: Aye.

MR. GILBERT: Motion carries. Thank you. The PGW pension plan investment. Frank, you're on.

MR. DOMIESEN: Good morning. I'm joined today with Marvin Devers. Marvin's a colleague, and we work together on several accounts. And he's here today to be with us and to look at the market background. Marvin and I are on your account together.

So, with that, I've asked Marvin just to touch on the market background. We have two reports. We have the September 30 ending report, and we also have October. We'll talk briefly about the third quarter and then update you for October.

MR. DEVERS: Third quarter was a challenging period for all risk assets as they sold off in late August into September. This was predominantly driven by fears of global growth that extended out for emerging markets. The quarter also continued to be tampered by weak commodity prices, which dented emerging market economies across the globe.

This benefited risk offset, such as high quality fixed income. As we get into the report, you'll notice that the high quality managers, those that aren't core plus, had stronger performance in the fixed income side. Across the board, it was a challenging market environment.

As we move into the October report, which Frank will touch on, we did see a very strong V shaped recovery in equity markets. Nothing significantly changed from a fundamental story. There was no new economic news that went from the third quarter to October. It just demonstrated that, given where evaluations are in the market, equities as a whole are going to be very sensitive to fluctuations in investor sentiment. And as a result, you're going to see volatility, both good and bad, across markets.

MR. DOMIESEN: Several others points I would like to share, is that if you look at page 3 -- page numbers are in the lower left. If you look at sector performance in the lower -- the chart in the lower right -- the green bar represents one year. The blue bars represent for the quarter. Again, if the SOP was off 6.4 percent in the quarter, and in October, it was up 8.4 percent.

If you look at the sectors, in particular energy sold off, continued pressure there while price was falling. You see that for the quarter. It was down 17.4 percent. Also, healthcare was down about 11 percent, unlike the first quarter and over the trailing last year where the higher quality healthcare sector had done well.

The other area that did perform well, again, with respect to higher quality, if you look at consumer staples, it was flat for the quarter and positive over the last year of 7.1 percent. That's also demonstrating the bias towards higher quality with consumer staples doing better --

MR. BUTKOVITZ: Why was healthcare down?

MR. DEVERS: Healthcare was down predominantly based on comments made by political figures that impacted pharmaceutical markets. It has been --

MR. BUTKOVITZ: Are people objecting to the ten thousand percent price increases in certain drugs? That's what drove it down?

MR. DEVERS: That's what drove down a lot of selling in space. That's correct. Because people viewed the comments as expectations that there is going to be more controls, more regulation in the space, which is going to hurt profit growth. These segments of the market do have evaluation that exceeds the current market. Given that overevaluation and the expectation of high growth continuing, when you see that type of comment, you're going to see investors fleet.

MR. DOMIESEN: I also point out at the bottom of this chart you see utilities, which was favorable for the quarter, being up 5.4 percent. Again, here, investors looking for yield as opposed to bond prices -- bond segment of the market where yields have continued to drop during the quarter. We'll touch on October when we have the October performance.

MR. BUTKOVITZ: What's the anticipated impact of this potential Chinese bubble on the outlook?

MR. DEVERS: The Chinese market, there is varying degrees. I think the more interesting thing that it's potentially going to play out in China outside of the equity markets is, right now, given they are pegged the U.S. dollar, they are in a position where they are actually selling about $150 to $300 billion of U.S. treasuries a month, to then come back and purchase their wong [ph] to essentially hold that peg. Defacto as a pegged currency, you're tied to U.S. monetary policy.

With the potential rise in U.S. rates coming, the strengthening U.S. dollar, capitals fleeing the Chinese market, what's interesting here is that China has about -- I'm sorry -- about 3 trillion, a little less than that in liquid reserves. As they continue to sell off their treasury holdings, their currency could become under pressure in the future.

Based on some conversations of other individuals, China could be put in a scenario where they are faced with either supporting their economy by essentially launching a fiscal stimulus or supporting their currency and holding the peg to the U.S. dollar. You can't have both in this scenario. It's more likely that they are going to devalue their currently more and support their economy with more stimulus across the board.

MR. BUTKOVITZ: Who are they selling the U.S. treasuries to?

MR. DEVERS: Broad market. You hold the reserves, and those are held in treasuries. You sell that on the open market. By selling that, they turn around and repurchase wong, which adds the strength to the wong.

MR. BUTKOVITZ: What about the slow down and their demand for raw materials?

MR. DEVERS: Certainly that's the play of the argument that they are going to have to drop their support for their currency and actually support their domestic economy with fiscal stimulus and monetary stimulus. Their defacto held to U.S. monetary policy.

MR. BUTKOVITZ: So the conclusion is they are not going to cut back on their consumption of raw materials and all that?

MR. DEVERS: Yes.

MR. BUTKOVITZ: Is that the consensus view?

MR. DEVERS: That's what a lot of people see in the market. I certainly don't think there is a consensus out there

on what the Chinese are going to do to
support their economy.
MR. BUTKOVITZ: Okay. There had been a lot of discussion about us having gotten to a maximum point in the maturation of the bull market. Is that still --
MR. DEVERS: We're certainly in the latter stages of it. What I would say is looking out the next one to three years, there is no signs of a recession pending on the U.S. economy. If you want to tie equity market strength to U.S. GDP growth, which, over long terms, is shown to be no relationship. In the short term, they can be higher correlated, and that would suggest that the equity market still has room to move higher.
The bigger question though is can U.S. companies actually grow their earnings. What we're seeing in the third quarter is the first decline in U.S. earnings on a market basis. So as U.S. earnings decline, your price per earnings or PE value goes up, and your stocks become

more expensive.

If we can correct that and actually see growth from an earnings basis on companies, then you still additionally see higher moves in the equity markets. We're certainly in the later stages. That's demonstrated by the volatility that we're seeing.

MR. BUTKOVITZ: So does it make sense to stay in pact with our equity positions?

MR. DEVERS: We certainly had conversations with Chris and Matt about looking at strategies that could de-risk or take a little equity risk off the table that are strategies that aren't just fixed income.

MR. MAZZA: We also on international space wanted to propose to the commissioners if we could go to an index based -- put an RPF for an index based management in international space to save some money on feeds and chase overturn that way. So we wanted to see if we could get your approval.

This is going to be a six-month process nonetheless. It seems our international equity managers have been getting hit especially hard with the whole downturn. And if we could save money on fees where these managers are falling. It's quite very closely. Might as well go to an index based platform.

MS. WINKLER: You're talking about a reallocation of the portfolio to reduce risk?

MR. MAZZA: I think personally for what has happened to us in the international equity markets, it would be foolish for us to change our asset allocation right now, and that's based to get out of the markets while it's at the bottom. If we've already gotten hit so far with the markets taking a beating --

MR. BUTKOVITZ: That's the issue. I mean, I've been reading articles that say we're going to lose a lot of value and that there has been a retreat to cash in the market. And are we just going to sit there passively and watch value fall through the --

MR. DOMIESEN: We talked with staff, as well, on moving cash each month for payment -- benefit payments. We're harvesting, we're talking with staff, we're harvesting that from the equities as -- to bring down the allocation. There is -- it's pretty much in line, slightly overweighted, versus the target waiting by bringing that down through those monthly --

MR. BUTKOVITZ: Two or three times a week I see 200 point drops in the Dow Jones. My heart is in my mouth. Then it comes back again and goes up by eight dollars or something. I don't really -- don't like that. And I don't know. My instinct is that we should kind of hide out for a while until it becomes less volatile.

MR. MAZZA: I think we've got to have patience in this aspect for -- with the equity markets. It's the fixed income markets that I'm mostly worried about with the rising rate environment. For lower asset allocation right now, it would be the lower asset allocation towards fixed income managers whose current holdings are only going to go down as rates are known to have risen or rise in December and possibly March. That's what I would do.

MR. BUTKOVITZ: You expect to decline in bond holdings?

MR. DEVERS: It's highly likely. Currently investors are pricing these at 70 percent probability that the Fed will move in December to raise rates. It's going to be in the short end of the curve, 25 basis points. It's most likely not going to move the back end of the curve up very much as our stronger dollar and higher rates look more attractive to international money.

That's going to flow back into the U.S. If they do move in December, they will most likely -- if the economy stays on track to the move in March, and then they'll delay because the Fed tends not to move during a political year -- during an election year as not to be viewed as a political source.

MS. WINKLER: That's interesting. For the treasurers office, we just did our round of meetings with our short term cash managers. That's the space they focus on the most. And pretty much to a firm that came in, Black Rock, Wells, PFM came in last week and presented.

They were all looking -- they said the market consensus on the number of Fed moves next year is either four or five, counting this December. So for accumulative increase over -- so every other Fed meeting between now to December 2016 is looking for 100 basis point aggregate total move. But the shape of the yield curve just shifting to being more flat, and so, we wouldn't -- I think to your point that you made a moment ago that the back end -- I don't remember where our duration is in our bond portfolios, but this is more likely to effect short duration, which of course, if you keep your

money really short, it has very little
effect.
Only upside in earnings
potential, you know, if you have cash but
less on the back end where, maybe no impact
on the back end --
MR. MAZZA: That problem is
though with that fixed income managers,
they've been keeping that duration in the
three to five year range, which is where
everything is going to be severely effected
during a great rise, especially if there is
going to be four to five -- I think that,
you know, a significant amount of rises in
rates in next year, during election year,
is highly unlikely. That's my opinion. I
don't know why the Fed would do that in
this election year.
MS. WINKLER: They did it to
Bush. And he didn't get reelected;
remember? That was the last time the Fed
did a bunch of moves --
MR. DEVERS: In the early 90s --
MS. WINKLER: In the year

leading into the election.
MR. MAZZA: It's also partly noted in our fixed income managers, Logan Circle or Garcia Hamilton, sitting on a lot of cash. Folks are very, very aware of what to do right now, especially since their duration is in that three to five year range. They know they are going to get hit --
MS. WINKLER: Is that where we see ourselves to be most vulnerable?
MR. DIFUSCO: Yeah. Matt's exactly right.
MR. MAZZA: Fixed income is definitely where our vulnerability is.
MS. WINKLER: I'm talking about the three to five --
MR. DIFUSCO: To Al, two points I'd make to Al's questions. I think some of the other things we're doing in terms of being more defensive, we're obviously increasing our cash position. That's where Matt's talking about the fixed income managers doing it. But staff has been

proactively in conjunction with this change to the benefit payments structure where we're now funding to the payments directly. We've also been putting more cash on the side lines. We have two or three months of benefit payments. We have a larger cash position than we have --

MS. WINKLER: How's that invested, the cash?

MR. DIFUSCO: It's just in cash, money market. It's in the money market. The other thing, Al, I think you'll see not only from Frank at the next meeting but from others who would be coming into to present, there are going to be suggestions not only from Frank but from other consultant candidates directly to address your point.

Does this continue to be the asset allocation that we should be in, or should we be looking at making changes whether it's out of -- having too high an allocation to equities and maybe putting things in other spaces. This is not something where I think you're out of an island or asking the incorrect question.

MR. BUTKOVITZ: Are we -- we have too much exposure in equities or too much exposure in fixed income?

MR. MAZZA: I think in fixed income 100 percent. If we lower our exposure in fixed income from, you know, the 35 percent bogey that we have down to the 25, 20 percent area, especially since our duration with a majority of the fixed income managers is in the three to five year range, and we add in a 10 percent, 15 percent exposure to alternatives or some other asset allocation, that will give us a better shot at hitting our 765 bogey going forward.

MS. WINKLER: This seems -- I'd like to ask that we all be very deliberative and thoughtful about this and have -- really hear from people about it because these are fairly complicated decisions.

MR. MAZZA: When we say

alternatives, we mean everything from hedge funds to bonds to high yield bonds. We're not talking about anything that's crazy in terms of feed. We want to make sure we have the ability to hit our return bogey in terms of 765 based on our actuary assumptions to make sure that we can get this thing fully funded by the year 2035. We need to hit 765, and we're not going to hit that at our current asset allocation. You are right. By lowering our asset allocation to fixed income and adding a certain percentage to alternatives, whether that's high yield bonds --

MS. WINKLER: Right. That may be another option. Another option to think about would be further lowering the return assumptions. I don't know that you -- as staff, you should necessarily think of that as a given that's in-mootable and unchangeable. It's possible that another way to think about it would be that -- we really need to start with what's the risk profile and what's the probability of us getting to our goal with different portfolio compositions given the goal.

And if we can't get there, we've all seen those kinds of analyzes. And we maybe -- if we want more assurance and confidence, bringing down the return is another possible avenue of consideration.

MR. DIFUSCO: Yes. I didn't mean to interrupt. I think that's part of what you'll here at the next meeting, is it's a possibility when you see where the current -- the likely expected return based on the current models could get us. That is another viable option, would be to lower the --

MS. WINKLER: That's what you're talking about as well, Alan?

MR. BUTKOVITZ: Yes.

MR. DIFUSCO: The questions are good questions, and they are exactly on point. I think you will hear a lot of that when you see the presentations at the next meeting in terms of possible asset allocations.

MR. MAZZA: Every investment solely met with, including our calendar, has said that based on our current asset allocation at 765 --

MS. WINKLER: Based on our current --

MR. MAZZA: Yes.

-- can be very difficult to come by.

MR. BUTKOVITZ: How close do they think we'll come? What do they think?

MR. MAZZA: The highest folks said in terms of total return that we're going to get in our current asset allocation, based on their capital market assumptions, it was in the high sixs.

Is that correct?

MR. DOMIESEN: Correct. That's correct.

MR. BUTKOVITZ: That's the most optimistic. What's the midpoint?

MR. MAZZA: Low fives.

MS. WINKLER: Midpoint is the low fives?

MR. MAZZA: You never know. These -- once again, these are capital market assumptions. No one wants the fact that their capital market assumptions of probabilities because, at the end of the year, they are always almost all wrong, you know. People come up with their capital market projections and say, hey, this is what we think is going to happen to the market, and then it's completely opposite. These guys know. You're never going to stand by your assumptions at the beginning of the year.

MR. DEVERS: Anymore questions on the market, or should Frank get into the portfolio?

MR. BUTKOVITZ: No. That's not as bad as I thought. I thought we were in a position for absolute loss.

MR. MAZZA: No.

MR. BUTKOVITZ: Okay.

MR. DOMIESEN: Okay. I'm going to touch on page 9. As of September 30th still, we're looking at the total portfolio, and it shows the number valuation. We'll get into detail in a moment. 478,9 and 117,000. And the distribution across the major asset classes, within the domestic equity, you're at 53 percent with the target of 50. So three percent overweighting. Again, we mentioned that we worked with staff, and we're saying harvest the profits as we take out and put them aside for cash for benefit payments, take those out of the domestic equities.

MS. WINKLER: Am I crazy? Am -- what was that? What was the value of the portfolio in the end of the year 20 -- fiscal '14, end of the fiscal year?

MR. MAZZA: 514 million maybe.

MS. WINKLER: Okay.

MR. MAZZA: Something like that. We had a downturn in the markets that effected us. We also had the contributions that we're now paying out of the pension fund for the pensioners, and we put a little extra cash in there. That would show there was a higher rate of contribution --

MS. WINKLER: Does this 478 include the cash?

MR. MAZZA: It should, yes.

MR. DEVERS: It includes --

MR. DOMIESEN: No. There is -- it goes to detail on page 20.

MR. MAZZA: There another two and a half million in cash.

MR. DIFUSCO: As of this morning, it's just under 493. It's like 492.9, 492.7.

MR. JONES: 492.7.

MR. DIFUSCO: Thank you.

MR. DOMIESEN: The overall allocation back on page 9, again, for domestic equities is 53 percent, international 13, slight underweighted versus a target of 15 percent target. And then fixed income is about 34 percent with a target of 35 percent. So fairly close to the target weightings. Again, we had talked about the staff -- about harvesting some of that on monthly cash needs from the equity model.

All right. So page -- go right to the performance page. I think that would be best. That's on page 12 and 13. If we start with page 13, which shows the very bottom line, the plan quarter column, which is the second from the left quarter column, it was off 5.7 percent, and the benchmark that we looked at was off 5.4 percent. It did underperform by approximately 35 basis points.

Where did that come from? If we start on the fixed income, which is right above it, you have four managers. Two are measured against the Barclays Aggregate Index, which is the broad market, and this Barclays Logan Circle. You can see here, for the quarter, Barksdale slightly outperformed benchmark. Logan Circle underperformed.

A lot of that was due to two things I mentioned already. I heard a comment about the cash level that they have. They tend to be very short. Shorter maturities hurt them on the quarter and the cash level as well. On the two other managers, Lazard and Garcia, Lazard is more of a tilt towards credit bonds. And, again, the exposure to credit being higher risk than government and treasuries underperform higher quality.

MR. BUTKOVITZ: What do you mean exactly? That's pretty traumatic. There were defaults, nonpayments?

MR. DEVERS: No. The high yield that -- as spreads widen across the board, high yelled was down about 4.3 percent. So allocation to lower credit securities was at the detractor in returns overall.

MR. DOMIESEN: They tend to have.

MR. DEVERS: It's not defaults. It's just bonds prices are going down as a result of pricing in additional risk.

MR. DOMIESEN: It was the sell off of corporate bonds in favor of treasuries, risk off, investor risk off.

The demands drove those prices.

MS. WINKLER: What's the yield on the Lazard portfolio?

MR. DOMIESEN: I don't have that with me right now.

MS. WINKLER: We were into that for income; right?

MR. DEVERS: Yes. Correct. And the higher income from the credit.

MR. DIFUSCO: I'll get you the most up-to-date numbers. We'll send it to you.

MS. WINKLER: Yeah.

MR. DIFUSCO: We'll send it to her.

MR. DOMIESEN: The -- s the fixed income in aggregate was, for the quarter, up 1 percent, and the benchmark was up 1.1. That's component one, part of the performance issue for the overall funds.

Right above that, the top of the panel of this page is the international managers. Mondrian is the defense of value strategy, and Harding Loevner is the growth manager. We've spoken, again, with staff about Harding Loevner, as well as the overall exposure here in the developed markets. Mondrian has added value, which is at the benchmark. And that's measured against the international value benchmark.

Harding Loevner has not. They have underperformed. One of the elements here is on the trailing year to date and one year number. They have about 13 percent exposure to emerging markets. The benchmark does not. One of the issues here is they've creeped up on their emerging market, and that's hurt them.

In the month of October, they actually out performed in a rebound of the international markets. However, in reviewing this again with staff, we think that there is room at the end of the day when you put the two pieces together we're not coming close enough to the benchmarks, such that recommend would consider indexing part of these two strategies. At the end of the day, net-a-fees, there's not a lot of value added. You can see that in the longer run.

MS. WINKLER: Sorry. Net-a-fees, there is not a lot of value added with Harding Loevner?

MR. DOMIESEN: Correct.

MR. BUTKOVITZ: You're basing it on the one year track record?

MR. MAZZA: Yeah.

MR. BUTKOVITZ: Where is the longer --

MR. DOMIESEN: You just added point 71 versus 3.35.

MS. WINKLER: Harding Loevner was added in February of 2013; correct?

MR. DOMIESEN: Correct.

MR. DEVERS: So the fund over five years is up 3.7 percent versus the benchmark of 4.83. Over five years, it's underperformed by 1.1 percent.

MR. DIFUSCO: How much of that is due to the fee drag? What's the composite on that?

MR. DOMIESEN: That's net-a-fees.

MS. WINKLER: What was the rational for recommending them to begin with?

MR. DEVERS: Prior to the last two calendar quarters -- calendar years, I think it was 2013 --

MS. WINKLER: When we made the decision to hire them, what was the recommendation?

MR. DEVERS: Coming into this period, they had strong performance, strong track records. Since bringing them in, they had two rough years that has contracted from their performance.

MS. WINKLER: What's caused that?

MR. DEVERS: It was stock selection and positioning around countries, country allocation.

MR. DOMIESEN: Coming into the time period, they had better downside protection.

MS. WINKLER: I thought that's what I remembered. It was the downside protection. Right.

MR. DIFUSCO: I probably didn't articulate my question. I get that it's a net-a-fee number. I guess my point is, how much of that net underperformance is because of the fee? If they are trailing by 115, is the fee 100 basis points, and therefore, that's making up the --

MR. JONES: The fee is probably in the 85 to 90 basis points range.

MR. DEVERS: That's a mutual fund. That's net net. If you grossed it up and removed the fee, you'd be underperforming by I guess 20, 30 basis points.

MR. DIFUSCO: The bulk of the underperformance --

MR. MAZZA: If we index that --

MS. WINKLER: You're recommending getting rid of them and moving them to index?

MR. MAZZA: Also, the benchmark

has no exposure to emerging markets. This Harding Loevner has 13 percent exposure. Index is -- our index funds very, very similarly trail the benchmark. That means we would have saved on fees and been closer to the benchmark if we just indexed this instead of hiring Harding Loevner.

I would ask the commissioners if we could put an RPF out for an index manager at international equities. If you guys could approve that, we'd greatly appreciate it.

MR. DOMIESEN: Excuse me. You may want to consider that on a blended index as opposed to just a growth only.

MR. MAZZA: Blended is fine.

MR. DOMIESEN: At the end of the day, when you put the value and the growth together, the blended index would cover that, growth and value.

On the prior page, page 12, if we look at the small cap -- or you can look at the large cap. And that's index primarily to Rhumbline and Northern Trust.

You have do have active managers, Fred Alger on the growth side. Longer term numbers, they've been favorable to the benchmark when you look over the three year number, 14.6 percent versus the benchmark of 13.6. The recent quarter hurt them.

They were underweighted staples, which are more conservative, more defensive category. They were overweighted healthcare. The comments from earlier, healthcare had underperformed. Those mines are now at the end of October had moved to -- sorry -- I'm still with Fred Alger.

Cooke & Bieler is the one that transitioned at the end of October into O'Shannessy [ph], which is replacing Cooke & Bieler on the value side.

MS. WINKLER: Cooke & Bieler will be out on your next quarter?

MR. DOMIESEN: We still show it in the October. It moved at the very end of October. We still show a majority of -- either it was very close to the end of the month, and I think there was some residual money that moved after the end of the month.

ATTENDEE: It was October 23rd.

MR. DOMIESEN: All of it?

ATTENDEE: Uh-huh. There may have been some residual cash.

MR. DEVERS: So we'll be out at the end of the quarter. Correct.

MS. WINKLER: Thank you.

MR. DOMIESEN: The quarter for the small cap grouping, Eagle really is a defensive manager. And you may recall that they had underperformed in the blue market, particularly 2013. And the market was up 43 percent. They were up 36. So you see that on the three year number where they are lagging. They include the 2013 and are up 12 percent. The benchmark was up 12.9.

More recently in the down market year to date and even on the one year, they've outperformed. And for the quarter, they were down 11 percent versus 13 percent for their benchmark. That's what our expectations would be for them being a defensive manager. Vaughan Nelson recently reviewed them, and we can see the longer term numbers are quite strong relative to the benchmarks.

When you look at the one year, they were up 5.2 percent, and their benchmark was down 1.6 percent. The value added in the combined small cap has been coming in a large extent over the last one year from Vaughan Nelson. So those are the major categories. We reviewed the major categories.

Again, the total performance down 5.7, and the benchmark down 5.4 percent for the quarter ended September 30th. There is a lot more detail here, but I can review with you what happened in October if that would be helpful.

MR. DIFUSCO: Yeah.

MR. DOMIESEN: With that, there is an additional handout outside of the packet. I think it was stapled. We'll go over that. I'll show you on page 3, total performance for the month of October was up 4.8 percent. We're looking at the October column, bottom of the page 3. It was up 4.8 percent versus the benchmark at 4.9.

When you look back over the year to date one and three year time periods, we see that the total had out performed the target index on these. And these the net-a-fees. I can go into the different categories, if you'd like, on the fixed income right above there on page 3. The group, overall, the combined fixed income was flat, and the benchmark was also flat.

MS. WINKLER: For the international equities at the top of the page, for the -- it was up 7.4 percent, and the benchmark overall was 7.4. There was a comeback in terms of performance for the month by Harding Loevner, the large cap growth manager.

GFA, the emerging market manager, lagged for the month of October. But when we look back over the one year and three year numbers, they protected versus their benchmarks, not damaged much. On the prior page, which is page 2, the top of the page we have the equities large cap. Combined large cap was up 7.8. And the benchmark for that group was 8.1. Part of that, again, Cooke & Bieler, the moneys moved towards the end of the month. The small cap -- finally, the small cap, in October, in a strong bull market we did see the two defensive managers lag, Eagle and Vaughan Nelson. And that ended up plus 4.3 versus a target of 5.6 percent for October.

Again, looking at the year to date in a down market, we experience small cap. They were favorable to the benchmark by an amount of 3.8 percentage points.

So page 4 --

MR. JONES: Before we go away from these return numbers, when I looked at the September report, I looked at the total fund performance for five years. And it was 765. That's a number that's kind of important around here. So, then, when I got the October report, I looked at it again -- again, the five year number, and the five year number had jumped 39 basis points to 804.

I noticed that the three year number went from 741 in September to a return of 9.36 in October. And I thought that seemed --

MR. DOMIESEN: We're moving forward a month. We're dropping off --

MR. JONES: That October month a few years ago, three and five years ago, must have been horrible.

MR. DEVERS: October 2010 was, I believe, down eight or ten percent that month, if memory serves me correctly. It was a very significant down month in 2010.

MR. JONES: Because it wasn't only our performance. I saw the benchmarks moved too.

MR. DEVERS: That just rolled off. It was a very strong, negative month.

MR. JONES: And I guess my point is, we have that bogey of 765.

MS. WINKLER: That's 765 for the

next 30 years?

MR. DEVERS: Of course.

MR. JONES: Yeah. And I guess --

MS. WINKLER: Every year.

MR. JONES: This portfolio, the way it is -- the way it's comprised right now, at times we can meet 765, and other times, we're below it. And other times we're above it. It's like I don't know that I would go chasing a bogey. If you think that 765 is the number, let's stick with it, and let's work towards that instead of moving it around. So I guess that's my point here, that sometimes we do hit 765.

MR. BUTKOVITZ: Yeah. But the assessment is that we're going to be falling further and further behind by as much as two and a half percent a year.

MS. WINKLER: Charlie, the point I think that you were making is that in this enormous bull market that we were in, which we now dropped off, with an unprecedented bull market now that you dropped off the bad part, we don't expect it to be an ongoing unprecedented bull market. What we're concerned about is what would be the reasonable place to be when we no longer -- we shouldn't expect and we shouldn't manage our future finances and plans around an unprecedented bull market of the last five years.

MR. BUTKOVITZ: When Donald Trump becomes president, we'll --

MS. WINKLER: You can vote for him. Go right ahead.

MR. MAZZA: We have to adapt. We have to adapt.

MS. WINKLER: I just like to read the jokes.

MR. BUTKOVITZ: The market and him are both up today.

MS. WINKLER: Is he up today?

MR. MAZZA: We have to adapt. We know that the market is not going to be like it has been over the last 15 years. Even with the recession of 2008, it's not going to be the same. We have to adapt. We have to think about changing our asset allocation and entering different spaces to chase that total return.

Anyone in their -- PA could have made 13 to 20 percent over the past five years. People put their money in Apple or put their money in Google, and tech stocks took off. That's not going to be the same way things are going to be going over the next five, ten years as you guys know.

MR. GILBERT: Any other questions for Frank?

Do we have a motion to accept the September 30th report?

MS. WINKLER: So moved.

MR. BUTKOVITZ: Second.

MR. GILBERT: Any questions on the motion? All in favor?

MS. WINKLER: Aye.

MR. GILBERT: Motion carries. Is there going to be a recommendation on a motion to put out the RPF index funds for international equities? Matt asked that question.

MR. DIFUSCO: It's a good idea. Just because we put out an RFP doesn't mean we're ultimately bound to use it. I think he gives us the option of flexibility if we decide -- or I should say the commissioners decide.

MR. BUTKOVITZ: I'll make the motion.

MS. WINKLER: Second.

MR. GILBERT: Any questions on the motion?

All those in favor?

MR. BUTKOVITZ: Aye.

MS. WINKLER: Aye.

MR. GILBERT: Motion carries.

MS. WINKLER: I voted. I second. And I intentionally didn't vote on other things.

MR. GILBERT: Break the tie.

MR. DIFUSCO: You voted a couple times.

MR. GILBERT: Now, the changing of the index fund, the 765, are we going to do that another time?

MR. BUTKOVITZ: Why don't we lower it to seven while we don't have a mayor. It's too painful to do it when we do.

MR. GILBERT: Nope.

MR. BUTKOVITZ: No takers?

MR. GILBERT: No action. Okay.

MR. BUTKOVITZ: I vote that we lower it to seven.

MR. GILBERT: Is there a second?

MR. BUTKOVITZ: You can vote.

MR. GILBERT: I understand. I'll second. Okay.

MR. BUTKOVITZ: You seconded it?

MR. GILBERT: Yes. Any questions on the motion?

MS. WINKLER: You're seconding going from 7.65 to 7.0?

MR. GILBERT: That's correct.

MS. WINKLER: First of all, I like -- now, I believe if everybody understands, so that we all understand, we -- however this is decided, we have an opinion from the law department that says it's the finance director who sets the target return. Is that correct? That is my understanding.

MR. BUTKOVITZ: Then it doesn't matter if we approve it.

MS. WINKLER: That was my understanding of the -- we did some work with the law department over what the duties were of the finance director.

MR. DIFUSCO: That's my recollection. Putting the levity aside just for a moment too, I do think the commission, given that we're talking about changing asset allocations, we have consultant presentations that if we're going to have discussion about lowering the assumption rate, my recommendation would be that that should be part of that.

MS. WINKLER: I agree with that.

MR. BUTKOVITZ: But the testimony -- but the testimony of the consultant is the best that we can hope for, is 7 percent. We might have five

percent. In light of that expert opinion,
how do we justify a -- essentially an
unsubstantiated optimistic rate?
MR. MAZZA: With all due
respect, we don't know if Gallagher is
going to be the consultant going forward.
I would recommend that we wait until we
find out who's going to be our investment
consultant at the January meeting to
determine what the rate should be.
MR. DIFUSCO: Part of the option
too may be that, at the current structure
that we have, the 6535, a 765 is
unrealistic, but that if we made other
smaller tweaks to the investment lineup,
then perhaps 73 becomes unrealistic --
MS. WINKLER: I'd also like,
frankly, to have a conversation with PGW to
talk about if we have a long term strategic
plan to lower the investment return on the
portfolio, that the affect of that under a
series of other changes that we have
enacted regarding the way in which we would
be measuring the annual contribution that

PGW will make, does have a budgetary impact on PGW.

From my perspective, I think the deliberative approach where we both look at the risks, the likely returns, and then maybe a phase in over time the way the large fund has faced in over time, lower return assumptions, I would feel more comfortable if you would take the time to, you know, at least consider that.

I appreciate and respect and generally find myself in the camp of lower returns, so for me, it's not about where we're headed. It's just about the process of getting there, how we get there, how we do it in a way that maintains the PGW -- you know, ask PGW to find the money, give them some time to find the money. I also think we also just need to make sure we understand what our actual impact --

MR. BUTKOVITZ: What would be the additional contribution at 7 percent?

MS. WINKLER: Do you know, Dan?

MR. LEONARD: I wouldn't know

that it would significantly drop. I
suspect it would be maybe in the magnitude
of anywhere from two to five million
dollars in additional expense. I mean,
that's just without looking.

MS. WINKLER: I thought it would
be --

MR. BUTKOVITZ: How much do you
think it would be, Charlie?

MR. LEONARD: I would have to go
back and check.

MR. JONES: I can't say for
sure. It's -- there are already putting
away $22 to $23 million. I would say if
they -- if we lowered the rate 10 percent,
which is I think what you're asking, that
would probably jump up $25 to $26 million.

MR. BUTKOVITZ: Same as what we
said.

MS. WINKLER: That is the same.
Okay. That's not -- you're right. Maybe
what we would like to hear back from PGW is
why can't you afford that.

MR. BUTKOVITZ: The problem is

this is the best decision -- this is the best time to make the decision because it's in the interregal.

ATTENDEE: If it's going to be underfunded, it seems like it should be getting ahead of it now. If this is an unrealistic number, we kick it down the road, the amount --

MR. MAZZA: I would assume if the finances are right. And I don't know. The director would have to make this directive.

MS. WERNER: There is certainly a large responsibility invested in the finance director. Generally, they have the approval of any proposed changes in the retirement plans schedule. I don't have a record of us addressing the specific issues. But we're obviously happy to do that.

MS. WINKLER: I believe it was addressed.

MR. GILBERT: Withdraw the motion. Do you want to amend it to have further study and then make the decision?

MR. BUTKOVITZ: No. What do you think?

MR. HORNSTEIN: I'm risk reverse in this situation.

MR. BUTKOVITZ: What does that mean?

MR. HORNSTEIN: I think what Nancy is saying is it makes more sense if you need to see where the next set of consultants says.

MR. BUTKOVITZ: What will happen? It will be played against budgetary concerns, and the pressure will be on the commission not based on fiduciary responsibilities but based on -- don't you understand that this means we're going to have less money for pre-k?

MS. WINKLER: This has nothing to do with kindergarten.

MR. BUTKOVITZ: When I arrived here, Mayor Street was the mayor. I made the first motion to lower it from 9 percent return to 8.75. And he said, if you do that, I'm going to layoff X number of people. He made the kind of argument that we're not supposed to be receptive to. We're supposed to be responding to the basis of fiduciary responsibility. The debate that just occurred was a fiduciary argument. Now, the counterargument that's being made is -- that's pretty audacious. May be she should let other factors come into this, such as -- and two five million dollar expenditures, why?

I mean, we have this kind of pressure. The numbers are so big that we can't -- if you've got a two to five million dollar cost and you're taking responsibility -- I just came back from pension conference. The consensus was the same. Return should be about six percent. We're way out of line.

Even though going from 7.6 to 7 is a lot, it's nowhere near where we should be. And people will always blink based on the pressure of do you know how much this is going to cost us today. But what is the alternative?

MR. LEONARD: My concern is what impact it would have on debt services. Five million dollars of additional expenses, we have to take that into consideration.

MR. BUTKOVITZ: If we make 5 percent next year instead of 7.65 percent, what will that affect be on our contribution rate? That's what we're dealing. We're dealing with trying to estimate what the reality of this next year will be. We're going to pay for it one way or the other; right? So doesn't it make sense to make a down payment on it and pay part of it, and therefore, the risk that it's hanging out there is less overwhelming.

MR. DIFUSCO: I don't think anyone -- I don't -- I don't disagree with your larger point. I just think that most people in this room probably agree with the larger point. My only concern is doing it in the absence of the additional information, the absence of what the asset allocations are going to look like. I think it's certainly an item that should be discussed.

MR. BUTKOVITZ: It's also true that the commission can raise the rate at the next meeting if it is an overreach. The commission continues to have that power. I'll tell you what, I bet if we lower it to 7 percent today we will have a substantial influx of information very quickly.

MR. DIFUSCO: There is also the --

MR. BUTKOVITZ: Rob will come to the meeting.

MR. DIFUSCO: -- there is also the very open question which Nancy raised, which is what my recollection of what the opinion that we were provided by the law, and the explanation is that the finance director is charged, among other things, with setting the discount rate and not the commission. So I'm just --

MR. BUTKOVITZ: That may ensure that issue as well. Instead of it being theoretical, they will get a full resolution of it. I'd say the overriding thing to me is the two to five million dollar exposure is not a sufficient intimidating factor to hold off on this. I think the city can afford the two to five million --

MS. WINKLER: This is PGW's money?

MR. BUTKOVITZ: Yeah.

MR. GILBERT: Any additional discussion? All those favor?

MR. BUTKOVITZ: Aye.

MS. WINKLER: Aye.

MR. GILBERT: Motion carries.

Debt service fiscal year 2016, Charles Jones.

MR. JONES: I'm still making notes on that last motion. When would that be affective folks; do we know?

MR. MAZZA: Immediately I would assume.

MS. WINKLER: It would be for the --

MR. JONES: The way we did it last time, the Commission lowered it to 765 affective the next fiscal year for PGW, September 1st of 2015. Is that a consideration here? Because -- because back then the consideration was what's the impact on PGW --

MS. WINKLER: When does your next rate case go in?

MR. LEONARD: The next rate case will go in effect fiscal year 2018, which would be September 3, 2017. We have to file nine months prior to that. It would be filing approximately January of 2017. That's when we expect to file for our next rate increase.

MR. BUTKOVITZ: Given the two and a half percent gap between now and then and all the pressures that are going to be brought to bear upon us immediately after this meeting anyway, I'd like to see it take effect immediately. That's my opinion. If we're going to do it, do it.

MR. GILBERT: You're saying immediately?

MS. WINKLER: Yeah. So does that mean that we would go to actuary have them recalculate --

MR. LEONARD: I would say we have to so we could identify what our contribution would be, the PGW contribution made on assumed discount 7.65 percent as opposed to 7.6 percent. If it's affective immediately, our contribution would surely change.

MR. GILBERT: Okay.

MR. JONES: That must have been the shortest lived discount rate we ever had, 765 for about 90 days.

MS. WINKLER: What?

MR. JONES: It became affective 9/1/15.

MR. BUTKOVITZ: I'm prepared to go to six and a half.

MR. GILBERT: Say it again.

MR. JONES: Yeah.

MS. WERNER: About confirming a prior opinion on this, we're happy to look at it, and we'll update you through our list of what changes.

MS. WINKLER: Thank you.

MR. GILBERT: Any other questions? So the rate is affective immediately.

MR. MAZZA: Yeah.

MR. GILBERT: That's payment for fiscal year 2016.

MR. JONES: Commissioners, I supplied you with a one-page document. This is just to inform you that the Sinking Fund is making payments is responsible for making payments of $971 million for fiscal year '16. This includes all the bond deals, all the re-fundings and new issues that have been completed through November 16 of this year.

So the commission is on the hook to make these -- is responsible for ensuring that these payments are made. This -- if we exclude the effect of the tran on this calculation, debt services have gone down $7.5 million from last year and $87 million from the year before that.

So Matt Mazza will be making -- is responsible for making these payments as they come due.

MS. WINKLER: Can you give me those number again?

MR. JONES: Sure. Excluding the tran, because of the volatile nature of the amount of the tran, I explained it, fiscal year '16 versus fiscal year '15, it's down $7.5 million and versus fiscal year '14, it's down $87 million.

MS. WINKLER: Okay. We should probably take a look at that by payment too. That's just total -- the general fund paid that column, the tran and pension funds, are paid out of the general fund. The rest is paid out of the enterprise revenues.

MR. JONES: Right. So I just wanted to inform you. I think it's my duty to inform you as to the amount of payments the Sinking Fund is responsible for.

MR. GILBERT: Any questions for Charlie?

MS. WINKLER: Is this the budgeted? Are these the budgeted payments for this year?

MR. JONES: No.

MS. WINKLER: Okay. What else?

MR. GILBERT: Other topics, the reworking of the Sinking Funds statements, who's going to do that?

MR. JONES: I'll work the accounting to get that done.

MR. MAZZA: I will work with Charles.

MS. WINKLER: Maybe I could review it before it comes back.

MR. MAZZA: Sure. I apologize to the commissioners for the statements, the way they are. We will improve them; that's my promise.

Other items, I just wanted to give you folks a sheet. This is our due diligence travel report for the investor consultant search that we bring candidates to the meeting in January. Chris and I visited a number of investment consultants, about six in total, if I'm correct. Or we visited Rhumbline, which is our index manager in Boston. We visited five -- we told the commissioner that we were going to spend a total of $1,500 on travel. We came underbudget at $1,400 and change.

And we found that the meetings, especially doing due diligence with a number of these consultants, including Gallagher, was very informative. And like I brought up earlier in the meeting, we've came to the conclusion with a number of these candidates that, our current asset allocation, that we would have not reached the 765 discount rate at our current asset allocation. We'd have to change that.

But over all, I was a skeptic at the beginning about due diligence visits. Now I'm in favor of them. I think we learned a lot about the folks and meeting the different teams that will be coming to the table in January, including Gallagher, which has an impressive team as well.

MR. GILBERT: Okay.

MR. MAZZA: I would also like to mention this is Charlie Jones last Sinking Fund Commission meeting. He is retiring December 18th. I want to personally thank him for his service to the Sinking Fund Commission and to the City of Philadelphia. Thank you for your time here.

MS. WINKLER: Thank you, Charlie.

MR. GILBERT: Thank you, Charlie.

MS. WINKLER: Have a great retirement.

MR. MAZZA: Have a great rest of your life.

MR. GILBERT: We need a motion to adopt the schedule for next year. We're going to move to bimonthly meetings, first one being January 13th, March 9, May 11, July 13, September 14, and November 9th.

MR. BUTKOVITZ: So moved.

MS. WINKLER: Second.

MR. GILBERT: Any questions on the motion? All in favor?

MS. WINKLER: Aye.

MR. BUTKOVITZ: Aye.

MR. GILBERT: Any additional business? Any additional business? We are adjourned. The next meeting is January 13th.

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(Whereupon, the meeting was adjourned at 12:05 p.m.)

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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.

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