

Sinking Funds Commission In Re: January Meeting
January 16, 2019

CITY OF PHILADELPHIA
SINKING FUND COMMISSION

IN RE: January Meeting

- - - - -
Wednesday, January 16, 2019
- - - - -

This Meeting of the Sinking Fund Commission,
held pursuant to notice in the above mentioned
cause, before Kathryn R. Doyle, Court Reporter -
Notary Public there being present, held at Two Penn
Center, 16th Floor Conference Room on the above
date, commencing at approximately 10:11 a.m.,
pursuant to the State of Pennsylvania General Court
Rules.

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<p style="text-align: right;">Page 2</p> <p>APPEARANCES</p> <p>COMMISSION MEMBERS: Donn Scott, Chairman Rasheia Johnson, Treasurer, Via telephone Kellan White, Controller's Office</p> <p>ALSO PRESENT: Christopher R. DiFusco, CIO, PGW Alex Goldsmith, PFM Asset Management Marc Ammaturo, PFM Asset Management City Solicitor Representatives PGW Representatives</p>	<p style="text-align: right;">Page 4</p> <p>1 the meeting over to Chris. And let's see where 2 we go from there. 3 MR. DiFUSCO: Sure. So you should have 4 both the November numbers, which came out in 5 your binders. And we just received the 6 December report yesterday. I'm guessing that's 7 where Alex and Marc will spend the bulk of 8 their time. 9 Just as a brief update, obviously, the 10 market has turned a little bit in January. 11 Obviously, October and December were both 12 pretty brutal months in terms of equity market 13 corrections. And depending on what index you 14 looked at, maybe even fair market. 15 As of this morning, assets under 16 management are just under 500 and 12 million. 17 They've come back up a little bit from where 18 they were, about 11 or \$12 million increase 19 since December 31st. 20 And I mean, I highlighted a few things on 21 the December performance in the email that went 22 out late yesterday, but I will let Alex and 23 Marc go through the specifics on what's 24 happening in the portfolio.</p>
<p style="text-align: right;">Page 3</p> <p>1 - - - - - 2 PROCEEDINGS 3 - - - - - 4 CHAIRMAN SCOTT: It is my pleasure to call 5 this meeting of the Sinking Fund Commission to 6 order. 7 The first order of business is the 8 approval of the November 14th minutes. Is 9 there a motion to approve? 10 MS. JOHNSON: I will make the motion to 11 approve. 12 CHAIRMAN SCOTT: I will second. 13 - - - - - 14 (Whereupon Mr. White entered the room.) 15 - - - - - 16 CHAIRMAN SCOTT: Now we have everyone in 17 their places. A motion has been made. All 18 those in favor say aye. 19 (Ayes.) 20 MR. GOLDSMITH: We do have a very short 21 agenda today. And it looks like most of our 22 focus will be on the investment performance 23 portfolio. 24 At this point, it's my pleasure to turn</p>	<p style="text-align: right;">Page 5</p> <p>1 MR. AMMATURO: Thanks. I'll kick it off 2 with talking about the portfolio and the 3 markets at a very high level. Then Alex will 4 walk through the portfolios of the underlying 5 managers. 6 So everyone has the December handout that 7 Chris just alluded to, so this is hot off the 8 presses. Everyone has a multi-asset class 9 portfolio update. I don't know if Rasheia has 10 these documents. 11 MS. JOHNSON: I have the December -- 12 MR. DiFUSCO: We have another handout. 13 We'll send it to you right after the meeting. 14 MS. JOHNSON: Okay. Perfect. 15 MR. AMMATURO: And the other document that 16 you should have if you're in the room should 17 look like this. It's a January 4th market 18 value update. Those are the three documents 19 that Alex and I will refer to. 20 I think it makes sense to start with the 21 portfolio update document. And Rasheia, I'll 22 try to kind of verbalize as much as I can off 23 this document since you don't have it in front 24 of you.</p>

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<p style="text-align: right;">Page 6</p> <p>1 MR. GOLDSMITH: We actually sent it out 2 when it was originally released on January 7th. 3 So if you're in front of a computer, Rasheia, 4 you might be able to find it. Chris would have 5 forwarded it along. But if not, we'll send 6 another copy later. 7 MS. JOHNSON: Okay. That's good to know. 8 Thank you. 9 MR. AMMATURO: So about a week ago, we 10 sent this document out to our clients, as Chris 11 alluded to. There was heightened volatility in 12 the markets in 2018. 13 If you look at -- I just want to start by 14 looking at the numbers, and I'll add some 15 commentary. 16 If you look at the section of the alert 17 that says update on recent market volatility, 18 and you look at the 2018 column, there was 19 really nowhere to hide, as it turned out, in 20 terms of investing across different asset 21 classes. 22 Negative 4 percent for the S&P, which is 23 domestic equity. Negative 11 percent for the 24 Russell 2000, which is small cap domestic</p>	<p style="text-align: right;">Page 8</p> <p>1 five years. Germany is the largest economy in 2 the Euro zone. That's a significant headway to 3 corporate profitability in Germany and their 4 trading partners. 5 So that's, undoubtedly, one reason why -- 6 it's again, slow down in global economies, 7 especially outside of the U.S. 8 Within the U.S., there was a heightened 9 fear of -- I'll call it -- a recessionary risk 10 in the fourth quarter. PFM is not in that camp 11 in terms of the economy domestically 12 contracting. We are not in that camp. We 13 think the economy will undoubtedly be slower in 14 2019. But for now, at least for the first half 15 of 2019, we are not in the camp that a 16 recession is looming within the first six 17 months of this calendar year. That's just not 18 how we're positioned. 19 But the market, especially the domestic 20 equity market, kind of priced in that 21 recessionary risk in our opinion. So those are 22 huge uncertainties. And as you know, the 23 markets don't like uncertainties. 24 One of the biggest things we're tracking</p>
<p style="text-align: right;">Page 7</p> <p>1 equity, negative 14 for international equity, 2 negative 14 and a half for emerging market 3 equity. The bond market, through the Barclay's 4 aggregate, was flat. And then a high yield was 5 negative 2 percent. 6 So as we all know, the market had a very, 7 very rough 2018. A lot of it came in the 8 second half of the year. A lot of it came in 9 the fourth quarter, and especially the month of 10 December. 11 There's a couple reasons why. 12 Undoubtedly, global economies are slowing, 13 especially outside of the U.S. That's why you 14 see greater pullbacks. 15 If you look at MSCI all country world ex 16 US and MSCI emerging, again, they were down 17 14 percent relative to domestic stock market, 18 which was down about 4 percent. 19 Why so much greater of a loss overseas? 20 Slow downs, in terms of economy slow downs, are 21 heightened overseas. If you look at the Euro 22 zone, Germany -- it just came out today, 23 actually -- Germany grew 1.5 percent last year. 24 That's the lowest Germany's grown in the past</p>	<p style="text-align: right;">Page 9</p> <p>1 and we're keeping a close eye on, is the Fed. 2 As we all know, the Fed increased rates several 3 times during 2018, the short-term rate, because 4 in their opinion, the economy was 5 self-sustaining. We basically came to remove 6 the punch bowl, if you will -- remove the low 7 interest rate in the environment, because the 8 economy is self-sustaining. 9 Well, right now, the projection is for the 10 Fed to increase rates two times this calendar 11 year. 12 We are hoping that the Fed remains, what 13 I'll call, data dependent, and not just stick 14 to their guns and increase rates two times 15 regardless of the signals that they are seeing 16 out there in the U.S. economy. That's a huge 17 risk in our opinion. You know, if the Fed 18 continues to raise rates even though the 19 economy is softening here in our backyard, that 20 could lead, potentially, to a recession. 21 MR. GOLDSMITH: Didn't the Fed make a 22 statement within the last week or so about 23 rates? And maybe they were not going to 24 increase rates at the same level that folks had</p>

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<p style="text-align: right;">Page 10</p> <p>1 anticipated. And as a consequence, the market 2 went up. 3 MR. AMMATURO: They, at one point -- at 4 least over a month ago -- they said the Fed's 5 fund rate is nowhere near the neutral rate. 6 They implied that there's still some increases 7 to be had. 8 More recently, they have softened that 9 language. But still, their guidance is to rate 10 increases for calendar year 2019. 11 Again, that's, in their words, data 12 dependent. We just are hoping that they 13 continue to be data dependent in their 14 increasing of the short-term writing. If they 15 continue and plow ahead with two rates -- and 16 again, the economy is softening -- that's a big 17 risk for the U.S. economy. Does that kind of 18 make sense? 19 MR. GOLDSMITH: Mm-hmm. 20 MR. DiFUSCO: Did you find it unusual, 21 particularly in October, that both stocks and 22 bonds were getting hit harder at the same time? 23 That's not a normal over -- I mean, over the 24 longer term. You were talking earlier about</p>	<p style="text-align: right;">Page 12</p> <p>1 MR. DiFUSCO: Absolutely. 2 MR. GOLDSMITH: Stocks remain volatile. 3 At that point, it could have gone either way 4 with equities. 5 But if my timing is correct, I think that 6 was a component of that. 7 MR. DiFUSCO: Okay. 8 MR. AMMATURO: The other thing that's 9 going on, obviously, is all the trade tensions. 10 That's obviously an impact on Germany. Germany 11 is a big exporter. 12 Emerging markets, especially China, are 13 big exporters. So all this trade attention 14 slash trade war is undoubtedly adding to the 15 uncertainty. And now it's impacting GEB 16 business in some of these countries overseas. 17 The U.S. is less reliant on exports. So 18 the U.S. is not hit as hard from a trade 19 tension standpoint. We're not as reliant on 20 exports as some of these emerging countries 21 are, especially in Germany. 22 So that's -- when you digest all of that 23 and you look at the U.S. economy, we're still 24 believers that the U.S. economy is on solid</p>
<p style="text-align: right;">Page 11</p> <p>1 nowhere to hide. But in October particularly, 2 I mean, it didn't matter if you moved all your 3 money into bonds, you were still getting hit. 4 That's not how we think about defensiveness or 5 asset allocation. 6 What were your analysts or your internal 7 folks kind of saying about that behavior in the 8 market? 9 MR. GOLDSMITH: Would that have been prior 10 to when Chairman Powell made his comments about 11 looking to the markets for future guidance? I 12 seem to recall that, I think, prior to that, 13 stocks could have been hit. And at the same 14 time, there was still a projection or 15 expectation for rising rates. 16 MR. DiFUSCO: That sounds right. 17 MR. GOLDSMITH: I can't remember what that 18 date -- when that date was when we stepped in. 19 There was a sharp market recovery in stocks, 20 but also an expectation of potentially lower 21 rates going on. 22 And from that point, the fixed income, if 23 I'm correct, the fixed income market recovered 24 following that.</p>	<p style="text-align: right;">Page 13</p> <p>1 footing. If you look at leading economic 2 indicators, if you look at corporate 3 profitability, it's still relatively solid. 4 So that's why when we look at your 5 portfolio, we're not going to be here 6 recommending trading. Your portfolio, as Chris 7 alluded to, it's actually slightly overweight. 8 It's domestic equity relative to your target. 9 That did not help you, obviously, in 2018. But 10 it has helped you in years past. And it is 11 helping you in 2019. So we remain committed to 12 that slight overweight in domestic equity. 13 International equity, you're flat, which 14 again, is a position we're comfortable with at 15 PFM. Again, we see more risk overseas than in 16 our backyard. So being neutral to that asset 17 class makes a lot of sense. 18 And then conversely, your portfolio is 19 underweight, fixed income. And again, that's a 20 position that PFM today is comfortable with. 21 We just came out with our new capital 22 market assumptions. They haven't been released 23 to the clients yet, but our projection for 24 bonds at this point last year was a hair under</p>

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<p style="text-align: right;">Page 14</p> <p>1 2 percent for the next five years, because 2 rates were so, so low, especially 12 months 3 ago. 4 Now our projection for bonds for the next 5 five years has moved from 2 percent to 3 6 percent. So again, over the next five years, 7 we're expecting bonds to generate a positive 8 turn of about 3 percent, because of the higher 9 yield with the rising rates. That really 10 hasn't impacted over positioning in your 11 portfolio yet, but over time it may, because 12 you're going to garner the higher yield from a 13 fixed income and to Chris's point about damping 14 volatility. So we're not there yet. We still 15 remain committed to an underweight in fixed 16 income and bonds. 17 But our capital market assumption for 18 asset class has gone up over the next five 19 years, again, 2 percent to 3 percent. We still 20 believe equity is our place to be. Our 21 projection for equity remains 6, 6 and a half 22 in that ballpark. 23 But as soon as we finalize that projection 24 for all those individual asset classes, we'll</p>	<p style="text-align: right;">Page 16</p> <p>1 level of questions I can entertain, I was going 2 to hand it over to Alex to walk through the 3 portfolio and answer additional questions that 4 you have. 5 CHAIRMAN SCOTT: What about Brexit? And 6 how might that impact us short and long term? 7 MR. AMMATURO: That's a good -- thanks for 8 bringing that up. So at the end of March, the 9 UK is expected to be removed from EU at the end 10 of March. There was an agreement proposed that 11 got vehemently rejected, nowhere near were the 12 amount of votes needed to get the agreement 13 accepted. So that's a huge uncertainty. 14 How it's going to play out, I don't want 15 to predict how it's going to play out. But the 16 fact that they can't get their act together and 17 get this Brexit agreement ratified is 18 concerning to say the least. So it just adds 19 to the overall uncertainty in the political 20 environment in the EU. 21 But again, I don't want to sit here and 22 predict what's going to happen by the end of 23 March, but that's the deadline. The end of 24 March, they are supposed to be out of the EU.</p>
<p style="text-align: right;">Page 15</p> <p>1 get that in front of you on a more formal 2 basis. 3 Another thing, before I hand it over to 4 Alex, when you look at your report, which Alex 5 will run through, you'll see, unfortunately, 6 your return last year was negative 5 percent. 7 Again, your return last year, 2018, was at 8 negative 5 percent. That comes on the heels of 9 a 17 percent return, I believe, the year prior. 10 And roughly an 8 percent return in '16. 11 So you had an 8 percent return in '16, 12 roughly a 17 percent return in '17. And now 13 you face a negative 5. 14 So when you look at your three year 15 number, I'm looking at the December 31st 16 handout, your three year number is still a 17 positive 6 percent, 6.1 to be exact. Not 18 exactly where you want to be from an actuarial 19 perspective of 7.3, but with the huge sell off, 20 you're still a positive 6 percent on a three 21 year basis if you annualize the past three 22 calendar years. 23 CHAIRMAN SCOTT: Got it. 24 MR. AMMATURO: So unless there's a high</p>	<p style="text-align: right;">Page 17</p> <p>1 MR. GOLDSMITH: It's literally day-to-day 2 at this point. Today there's a no confidence 3 vote of the prime minister. And they are 4 considering potentially taking it back to the 5 citizens to revote on the Brexit decision, 6 itself. So I agree with Marc. You can't 7 really handicap this. 8 In terms of the fallout, I think there's 9 been time to prep in the face of what's been 10 going on so far this year. Developed 11 international markets are up about 4.3 percent. 12 So it hasn't spooked the market here to date, 13 but I think the fundamental outcome has to be 14 seen. 15 CHAIRMAN SCOTT: For some reason, the UK 16 market responded positive. 17 MR. DiFUSCO: I think that's because the 18 market was -- two things. One, I think the 19 market was baking in the likelihood that 20 there's just going to be a delay. And that's 21 been discussed. They're going to kick it down 22 the road six months. 23 And then two, if you go back and look from 24 when they actually took the actual Brexit vote</p>

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<p style="text-align: right;">Page 18</p> <p>1 two years ago, or whenever it was, there was 2 all this doom and gloom if you remember, we 3 we're probably talking about it here. That if 4 they voted to exit, things were going to go 5 crazy. 6 And if you remember, European stocks, UK 7 stocks, did terribly for about a week. And 8 then a week later, if you had stayed in, you 9 actually -- literally within two weeks or three 10 weeks if you had stayed in, you would have been 11 better off than you would. 12 So I don't know if some of that memory is 13 coming back, like well, people told us if we 14 voted to leave it was going to be terrible and 15 nothing really happened. 16 So the market may be baking a little bit 17 of that into -- but I agree with you. It's 18 day-to-day. She's expected, the Prime 19 Minister, to survive tonight. That's what 20 everyone's saying. But where it goes from 21 there, I agree. It's anybody's guess. 22 MR. GOLDSMITH: So if there's no other 23 high level market questions, we can focus our 24 attention on the monthly performance as of</p>	<p style="text-align: right;">Page 20</p> <p>1 So again, for the month the plan was down 2 5.25 percent relative to the benchmark, which 3 was down 4.45 percent. 4 Full year 2018, the plan was down to 5.4 5 percent with a benchmark down to 5 percent. So 6 again, Marc mentioned the plan was down 5 7 percent for the full calendar year. He did 8 leave out, again, the market, itself, in your 9 asset allocation, your strategic asset 10 allocation, was down 5 percent. So it's not a 11 lot -- as he mentioned, not a lot of asset 12 classes that were even in positive territory. 13 Again, I mentioned the large theme being 14 the overweight to equities, but also there 15 would be under performance within fixed income. 16 Again, particularly attributable to this last 17 quarter of the year owing to the managers 18 overweights to high yield, overweights to 19 corporate credit, and the plans own overweight 20 to corporates in high yield -- very, very 21 slight. 22 But you might recall that those high yield 23 and dedicated investment grade corporate bonds 24 were added to the portfolio over the past --</p>
<p style="text-align: right;">Page 19</p> <p>1 December 31st, the stapled document. 2 You know, we can focus on the month -- the 3 one month column, the one quarter column, and 4 then also the 2018 column that's in the full 5 calendar year 2018. 6 But really across all three of those time 7 periods, the total funds, you know, the story 8 was the overweight to equity being a detractor. 9 And given the market index performance that 10 Marc just went over, you can see how being in 11 equities, you know, and out of cash or fixed 12 income would have been a detractor to the 13 portfolio for the month and the quarter and 14 even for the full year 2018, despite the fact 15 that equities are fairly significantly out 16 performed in the second and third quarters of 17 this year. 18 Really through September, if you recall, 19 the strategy being overweight equities, 20 overweight credit had contributed a lot to 21 relative out performance up until the fourth 22 quarter of this year. But again, those were 23 the themes that detracted during the market 24 crashing.</p>	<p style="text-align: right;">Page 21</p> <p>1 the high yields we had this year and corporates 2 were at last year. 3 Otherwise, within active management for 4 the quarter, with few exceptions for the full 5 year, active managers were remarkably close to 6 their benchmarks. I'll go through the section 7 now briefly. 8 You can see in large cap, the combined 9 large cap blue line, for the month down 9.04 10 right on top of the benchmark to Russell 1000. 11 For 2018, down 4.5 percent, slightly you have 12 the benchmark, which was down 4.7 percent. 13 It's largely passive with the exception of 14 PineBridge, which is 10 percent of the total 15 plan. PineBridge was slightly ahead of its 16 benchmarks over its period. That's kind of 17 what we would expect from this style of 18 manager. If you recall, they were at a larger 19 number of holdings, not quite an enhanced 20 index, but a programmatic trading platform 21 that's designed to overweight higher quality 22 stocks, maybe have a little bit less volatility 23 in the overall market. And that's downside 24 protection. It did that on the margin in this</p>

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<p style="text-align: right;">Page 22</p> <p>1 market environment. 2 Small cap managers down below, you can see 3 they got the blue line if you compare it down 4 11.8 for the month, right overtop of its 5 benchmark. For the full year 2018, down 7.6 6 percent, ahead of the Russell 2000, which was 7 down 11 percent. 8 There's a small cap, which really had led 9 the way last year in 2017 and also for the 10 first part of the 2018. They suffered a 11 greater deal in the downturn we saw in the 12 fourth quarter. 13 With that being said, I think active 14 management, particularly, from Eagle -- if you 15 look at their number over the full 2018 period, 16 Eagle was down 1.5 percent for the full year, 17 whereas their benchmark was down 9.3 percent. 18 You know, a lot of that came from their 19 out performance in the first half or first 20 three quarters of the year. During that 21 period, Eagle is a growth manager. They invest 22 in growth stock and sectors and IT healthcare, 23 et cetera. Those were really the hot sectors 24 of the market for the first three quarter,</p>	<p style="text-align: right;">Page 24</p> <p>1 did last year. 2 MR. GOLDSMITH: But as you recall, with 3 that being said, small cap managers are in the 4 process of being replaced by Copeland, which 5 was hired at the last meeting. And there's an 6 RFP out for passive management. 7 So fees will be lowered there. You'll 8 match the S&P 2000 or the S&P 600, excuse me. 9 And with any core active component with 10 Copeland. 11 On the international equity side, again, 12 looking at that blue line, for the month right 13 on top of its benchmark down 4.49 verses 4.53, 14 a slight lag for the quarter. But for full 15 year 2018 coming out about a half percent ahead 16 or so, down 13.7 percent versus the benchmark, 17 which was down 14.2. 18 I would say one of the -- again, for the 19 full year, most of these managers out 20 performed. Again, their benchmarks were down 21 fairly sharply down 12, 13, 14 percent. The 22 managers were ahead by -- from anywhere from 1 23 to 1 and a half percent or so. 24 The lone exception being DFA, down at the</p>
<p style="text-align: right;">Page 23</p> <p>1 pretty significantly outpacing value markets. 2 But even in pace of that, in the midst of 3 that, a strong market, Eagle, itself, 4 demonstrated stronger stock selection, managing 5 to keep ahead of that pace in the strong 6 market. 7 If you look for the month and the quarter, 8 they're about a percent ahead during the 9 quarter -- right on top of their benchmark for 10 the month. So they were susceptible to the 11 downturn, along with the rest of the growth 12 universe. Being ahead in the earlier quarters 13 of the year gave them that margin that's led to 14 their one quarter of their full year 2018 out 15 performance. 16 MR. AMMATURO: That's a significant out 17 performance. Again, just to highlight -- 18 that's what you want active managers to do. 19 Again, if you look at Eagle 2018, negative 20 1 and a half percent, negative 9. I know Alex 21 mentioned these numbers already, but that's 22 what you're looking for, obviously, in a down 23 market from an active management. You want to 24 see capital preservation, and that's what they</p>	<p style="text-align: right;">Page 25</p> <p>1 bottom. DFA outperformed during this 2 negative -- sharp negative fourth quarter. But 3 for the earlier quarters of the year, lags 4 somewhat. 5 There has been underweight energy, 6 emerging market economies do have a higher 7 component of their economy focus on the 8 sourcing and sometimes export of energy. 9 Being underweight energy hurt in the first 10 three quarters as energy crisis recovered, but 11 that was a benefit to them in the fourth 12 quarter as -- during the brief downturn energy 13 crisis sold off somewhat. 14 Additionally, they've been overweight. 15 Alibaba, you might have heard that name, the 16 Chinese, sort of, Amazon company, which has 17 struggled this year as China has slowed. They 18 have a drag in their portfolio, as well. 19 These managers were also -- they're in the 20 process. And I think, pretty soon, will be 21 replaced with Acadian and EARNEST Partners, the 22 two active managers you may recall, as well as 23 a, I think, total international index. 24 Moving on to fixed income, this is one</p>

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<p style="text-align: right;">Page 26</p> <p>1 where active management, I think, for the 2 quarter, for the year, did detract most of 3 their yearly under performance is owing to this 4 fourth quarter. So again, the blue line you 5 can see fixed income of 1.0 percent versus 1.8 6 for the Barclay's aggregate. For the full year 7 2018 fixed income is a group down .3 percent. 8 We're getting -- the benchmark was essentially 9 flat. 10 The themes owing to the manager under 11 performance in the fourth quarter are pretty 12 consistent across most of the managers. A lot 13 of these managers, whether they are core 14 managers or intermediate managers or more 15 investment grade corporate managers, they do 16 include allocations to high yield -- very, very 17 small very, very slight. But those allocations 18 have largely driven their out performance in 19 prior quarters in a normalize or sort of an 20 easier to predict fixed income market. 21 In the fourth quarter, when there's 22 volatility in the equity markets, those fixed 23 income sectors, they're more closely correlated 24 with equities -- will exhibit stress. So</p>	<p style="text-align: right;">Page 28</p> <p>1 important. Those are two sectors where you can 2 achieve higher yields. 3 MR. AMMATURO: Our capital market 4 assumption for high yields remains right around 5 4 percent for the next five years. 6 And again, I mentioned this earlier, our 7 overall return for the bond market is 3 percent 8 for the next five years, but the high yield is 9 4 percent, to just kind of put some numbers 10 behind Alex's comments. 11 We still think high yield is big on a 12 relative basis, although it really got hit 13 hard, obviously, in the fourth quarter. 14 MR. GOLDSMITH: So those are my comments 15 on the performance, the plans performances, 16 broad asset allocation. I don't know if there 17 are any questions -- clarification. 18 CHAIRMAN SCOTT: Go over SKY Harbor for me 19 one more time, please. 20 MR. GOLDSMITH: Sure. So SKY Harbor, they 21 were added -- you can see they were added in 22 March of 2018. I think they were approved late 23 last year. And that was a decision going back 24 to some broad themes that PFM brought to the</p>
<p style="text-align: right;">Page 27</p> <p>1 that's the investment grade corporate market, 2 corporate bonds, and then high yield bonds, 3 which, you know, high yield bonds are, 4 actually -- they exhibit about 50 percent or so 5 correlation to equities, which is among the 6 higher correlations with equities in the fixed 7 income sector. 8 So you do have very, very small 9 allocations to dedicated corporates. That's 10 the Logan Circle investment grade credit at 11 just 2.67 percent of the plan. SKY Harbor high 12 yield is 2.62 percent of the plan. 13 But again, those are non-benchmark 14 positions. And those were -- again, some 15 segments of the bond market that are closely 16 related to equities and thus under performed 17 during the quarter. 18 Corporate bond spreads did widen in the 19 quarter. And I think it's our view that as the 20 U.S. economy remains healthy, there's room for 21 those spreads to contract overtime. So I think 22 the long term our views of high yields and 23 corporate bonds have changed. It's an 24 opportunity to -- capturing that yield would be</p>	<p style="text-align: right;">Page 29</p> <p>1 table about three weeks ago or so. 2 And one of those was overweighting high 3 yield bonds. We were in a low rate environment 4 at the time. We still relatively are compared 5 to history in a low rate environment. And with 6 the stronger economy, strong corporate sector, 7 it's been our view to be viewed as -- 8 overweighting high yields is a good way to 9 capture income in that sort of low rate 10 environment. Defaults are down at low levels. 11 And so you're being compensated pretty 12 nicely for that extra risk that you're taking 13 from dipping into the low investment grade 14 space. 15 So that was the decision -- the theme to 16 add high yield, you know, SKY Harbor was 17 chosen. 18 You can see, here, one of the reasons SKY 19 Harbor was chosen was their views on building 20 the riskier end of the portfolio, the triple C 21 rated bonds and below. And I think their views 22 on quality -- so you can see for the month and 23 for the quarter, they actually outperformed 24 their high yield benchmark. They were down for</p>

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<p style="text-align: right;">Page 30</p> <p>1 the quarter -- down 4.13 versus their 2 benchmark, which was down 4.5. They are both 3 negative territory, but SKY Harbor was slightly 4 less negative. I think that's owing to their 5 slight quality bias. But also they had 6 superior selection within the short duration. 7 So as some yields spiked, their short selection 8 was a little better. That's just speaking to 9 SKY Harbor versus their style benchmark. 10 If you compare the high yield universe as 11 a whole versus the Barclay's aggregate, just 12 for the quarter alone, the quarter high yield 13 was down 4.5 percent. Barclay's aggregate was 14 up 1.6 percent. That's really where the high 15 yield is the allocation -- was a detractor. 16 If you go out over, for further 17 illustration, the three year column, you can 18 look at the benchmark for high yields, SKY 19 Harbor was in the portfolio, but the benchmark 20 for high yield was at 7.23 percent on an 21 annualized basis. That's every year for the 22 last three years. Whereas the Barclay's 23 aggregate returned 2 percent for the last three 24 years.</p>	<p style="text-align: right;">Page 32</p> <p>1 Equity as a whole 2.16 percent overweight. 2 And the bulk of that is in domestic large cap, 3 slightly under weight to small cap. Flat to 4 international equity. And then a slight 1.33 5 percent underweight to fixed income, with a 6 little more than half of that, .88 percent, 7 being an underweight to credit. You can see at 8 the bottom there, Logan Circle investment grade 9 and SKY Harbor, both of the credit sectors are 10 underweight. 11 MR. AMMATURO: So your target allocation 12 is if you add up the target allocation 13 percentage column. Target allocation 65 14 equity, you see that there? 15 CHAIRMAN SCOTT: Mm-hmm. 16 MR. AMMATURO: So your targets are roughly 17 65 equity, 35 fixed income. If you look at 18 current allocation, let's call it 68 equity, 32 19 fixed income -- so just to put numbers behind 20 the overweight. It's about 3 percent 21 overweight if you look at the equity markets. 22 And it was probably at 5 percent three months 23 ago when the market moved you to a what's 24 called a three percent of equity.</p>
<p style="text-align: right;">Page 31</p> <p>1 So again, it's like the overweight to 2 equity has really contributed to the last three 3 years. It did detract fairly meaningfully this 4 quarter. The overweight to high yield 5 contributed fairly meaningfully if it had been 6 in place, obviously, for three years. But for 7 this quarter, it was a detractor. We don't 8 view that as being a long-term trend. 9 Again, we look -- is there a recession 10 coming? Are the sectors the economy that rely 11 on high yield bonds exhibiting weakness, 12 utilities, energy -- nothing indicating faults 13 to meaningfully increase. 14 So we're maintaining the high yield 15 allocation. I think we're fine with it being 16 slightly below target. The target is 3 17 percent. It's again at 2.6 percent. But it's 18 not something we'd like to remove from the 19 portfolio. 20 CHAIRMAN SCOTT: Thank you. 21 MR. GOLDSMITH: If there are no other 22 questions, there is a rebalancing work sheet 23 that was sent around as of two days ago, the 24 end of the day on the 14th.</p>	<p style="text-align: right;">Page 33</p> <p>1 MR. GOLDSMITH: Marc mentioned we're not 2 proposing any trade today. The liquidity of 3 the plan is adequate. We have been sourcing 4 benefit payments from cash throughout 5 volatility. So we don't need to sell equities 6 to raise benefit payments. 7 And if you recall, I think throughout the 8 year, we have been settling equities as 9 equities continue to climb. So we maintain 10 a -- sort of that modest rebalancing strategy 11 around the cash draws and monitoring the 12 liquidity. 13 So really, that's the end of my comments. 14 I don't know if there's any additional 15 questions you might have or new business. 16 MR. DiFUSCO: I have a couple new business 17 things, but I don't know if there's questions. 18 CHAIRMAN SCOTT: I have a strange 19 question. How do we perform relative to 20 Philadelphia? 21 MR. DiFUSCO: So we haven't released the 22 numbers for the month. For the month, we 23 performed slightly worse. Longer term, the 24 numbers that Marc went over earlier, we have</p>

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<p style="text-align: right;">Page 34</p> <p>1 performed a little bit better. 2 The quarter, because of the overweight to 3 equities and because of some of the 4 alternatives that we don't have in this plan 5 that are more defensive, that would be why we 6 didn't do quite as well this quarter. 7 Once of the things I was going to mention 8 after new business is we're going to have a 9 discussion on broader asset allocation of this 10 plan in March. 11 You may remember that we had discussed, 12 going back a couple years -- there was 13 obviously a lot of steps to take in this plan 14 to clear out some of the managers, to add in 15 some things. 16 We do need to have a discussion about 17 whether there are other asset classes, be it a 18 real estate, be it a couple other possibilities 19 that belong in this plan. It's a little more 20 challenging to do alternative in this place, 21 just given the size. There's also certain 22 alternatives that we don't have any interest in 23 introducing, hedge funds, things of that 24 nature. But there are a couple possibilities</p>	<p style="text-align: right;">Page 36</p> <p>1 or May. 2 And then EARNEST and Acadia for the 3 international managers, Donn and I will be 4 sticking around for a few minutes after the 5 meeting. We have a bunch of paperwork to sign 6 for Wells. 7 Once we get that in place, Wells has 8 everything set up with the bank. We should be 9 able to reasonably and quickly make the 10 transition to those new managers. 11 And that was all I had under new business. 12 MR. GOLDSMITH: Anything else? Any new 13 business? 14 (No response.) 15 Is there a motion to adjourn? 16 MR. WHITE: Motion. 17 CHAIRMAN SCOTT: So moved. Thank you all 18 for participating. 19 MS. JOHNSON: Thank you. 20 MR. AMMATURO: Thank you. We'll get you 21 that other stuff in a little while. 22 MS. JOHNSON: Okay. Perfect. Thank you. 23 - - - - - 24 (Whereupon the meeting concluded at 10:48 a.m.)</p>
<p style="text-align: right;">Page 35</p> <p>1 that we do need to discuss. 2 But long winded in the longer term, we've 3 done a little bit better in the shorter term. 4 The quarter and the month we did a little bit 5 worse. 6 CHAIRMAN SCOTT: Thank you. 7 MR. DiFUSCO: Just under the new business, 8 briefly, I started the fourth quarter diversity 9 female veteran local brokerage numbers have 10 started to roll in. They are not due until the 11 31st. 12 Remember, this will be the last quarter 13 that we measure at the 30 percent, the old 14 target. Starting January 1st of next year, or 15 this year rather, we'll be measuring against 16 35 percent target. The two or three managers 17 that have reported so far have been near or a 18 couple occasions exceeded both the old and the 19 new target. So I will get those out probably 20 in early February. 21 I talked about the asset allocation, the 22 small cap index RFP is up. That will be 23 closing at the end of this month. And we'll 24 get the results of that to you either in March</p>	<p style="text-align: right;">Page 37</p> <p>1 - - - - - 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24</p>

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CERTIFICATION

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.

Kathryn Doyle
Court Reporter - Notary Public

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