CITY OF PHILADELPHIA
SINKING FUNDS COMMISSION
Wednesday, March 13, 2019

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LOCATION: Two Penn Center Plaza
16th Floor
Philadelphia, Pennsylvania

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MR. SCOTT: Good morning, everyone. I'd like to call this meeting of the Sinking Funds Commission to order.

The first order of business is the approval of the minutes from January 16th. Is there a motion?

MS. JOHNSON: I make a motion.

MR. SCOTT: A motion has been made. Is there a second?

MR. WHITE: Second.

MR. SCOTT: A motion has been made and properly seconded. All those in favor?

MR. WHITE: Aye.

MR. SCOTT: The next item on the agenda is review and selection of passive small cap. And, Christopher, I'm going to turn that over to you.

MR. DIFUSCO: Thank you, Mr. Scott. So you recall our Commission previously hired Copeland to replace the two active managers -- small cap managers we have in the lineup that contracts the work

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being worked on. That contract's paperwork is being worked on now. We'd like to pair them as the Commission previously had with a small cap index manager so an RFP was put out recently for that.

We got three responses to that RFP: BNY Mellon, Drumline, and Piedmont. We liked Piedmont's response for various reasons, mainly their length of track record was not a qualifying response. Given our previous and our current relationship with Drumline, they've done a nice job. Fees are extremely low and they were the lowest fee for the year at about two and a half basis points. We're recommending that the Commission hire them for the index slot.

As Alex notes and marked in their memo, they are 100 percent employee owned. Their minority or female ownership is over 50 percent. They also comprise over 55 percent of the employees -- the firm's employee base and they've done a very nice job as you've seen in the numbers I sent around. I recorded it on the brokerage

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reports. They're always very, very high, well over the diversity in local brokers. So we'd like to recommend that they be required for the S&P 600 small caps loan, in that slot.

MR. SCOTT: Is there a recommendation? I guess you made the recommendation?

MR. DIFUSCO: I did.

MR. SCOTT: All in favor of that recommendation, please say aye. Now, let's get it over with. There's a motion that we accept the recommendation made by Christopher. Is there a second?

MS. RHYNHART: I second it.

MR. SCOTT: All those in favor?

MS. JOHNSON: Aye.

MS. RHYNHART: Aye.

MR. SCOTT: All right. Thank you for that, Christopher. The next item is asset allocation renew and update.

MR. DIFUSCO: So I'm going to let Alex do most of the heavy lifting here.

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But just by way of introduction, the purpose of this, you know, is for a broad background discussion on where the plan sits now in terms of asset allocation. You know, thoughts over the next five, you know, ten years and beyond where, you know, where invested returns, you know, maybe take us according to the experts and some thoughts on, you know, things that we might consider as a Commission and as a staff in terms of all their asset classes and things of that nature.

We're not asking for any action to be taken today. This is designed to be a high level review to let folks, you know, ask questions, you know, review the material, and take the discussion kind of wherever, you know, folks would like to see it go. So with that, I'll let Alex start.

MR. GOLDSMITH: Thanks, Chris. So, yeah, this is the third tab of the folder, you know, asset allocation and presentation. You know, this is something that, you know, we at PFM typically review

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for our clients on an annual basis and, you know, recommend that it's reviewed by the Board of Trustees or their pension trustees, you know, typically every two years or three years.

It's designed to inform the strategic asset allocation of your plan. The strategic asset allocation being, you know, the targeted allocation to each asset class that is codified in the investment policy statement and what the benchmark for the plan is based off of. So, you know, right now, your asset allocation is 65 equities, 35 fixed income.

And, you know, again, while that may change day to day or month to month or quarter to quarter based on our recommendations, overweights to underweights, those are more tactical in nature and those short-term changes are not reflected in, again, the IPS or the benchmark which are typically long term and typically static.

Things that would require the

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strategic asset allocation to change would be, you know, major shifts in the capital market that cause, you know, significant change with respect to returns for asset classes over the long period of time. We're talking beyond 30 years. So, you know, I'm thinking it's a structural shift that might lead us to expect the GDP will be much lower or much less than expected for many, many years to come.

And so that's what I'm talking about when I say strategic. If you want to -- you know, how we do this is if we run a Monte Carlo simulation which is an optimized simulation using a variety of inputs, in this case, the inputs are the expected return, the expected volatility, and then correlations between asset classes.

So if you flip to page 3 of this presentation, you can see the first of these inputs. These are PFM's capital market assumptions and we compile these on an annual basis. Our investment committee, our chief strategist, and our research director

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supported by the research team is the group that comes up with these. They're entirely internal. We don't buy anyone's capital markets assumptions. We don't take other firms into account.

They're based on our, you know, views of the market and our data. You can see there are two sets here, intermediate on the left side and then long term. As it says, the intermediate are the expected returns over the next expected annualized returns over the next five years. You know, more of a short-term market cycle.

These are typical numbers that we would not use to inform long-term investment policy type decisions. On the other side, you have the long-term projections. You know, there's no data figure here. You can think of these as in perpetuity or really, you know, beyond 30 years. And the reason why we take that term is because the approach that we go into creating these long-term assumptions is one that, you know, typically does not use cyclical type data,

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more near team data.

You know, it's really a building lock approach that takes into account long-term fundamental factors, primarily GDP growth. And so how do we factor GDP growth? We're using things like population growth and productivity growth and long-term inflation numbers. And so these are things that are far less cyclical over a long period of time.

And also that that more than 30-year figure lines up with the duration of benefits for a typical pension plan which, you know, is fairly viewed at 30 years and beyond, particularly so when there's survivorship benefits at play, et cetera. And so these are the inputs. You can see predominantly they are lower over the intermediate term than over the long term and that's based on a number of things.

For equities primarily, the intermediate term assumptions do take into account current market conditions, primarily valuations. And even with the volatility

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we've seen in the market recently, valuations are higher than their long-term averages. And so, again, based on, you know, that expectation, you know, if we were to extrapolate what valuations are five years down the road, we expect them, again, on a mean reversion figure, to be slightly lower than where they are now.

And so in order to get there, the price of equities would have to return lower than what is expected in over long periods of time. So that's why I think the intermediate numbers for equities are typically lower. For fixed income, for the long term, you know, we look at mostly -- for the intermediate term, we look at the nominal coupon yield of the fixed income security assuming the whole to maturity and then to apply the effects of interest rate movements over the five-year period.

So movements in the yield curve, you know, actions of the Fed. And so then we adjust those numbers up or down. So, for example, core fixed income taking a nominal

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yield of, you know, 5% or so and then lowering that because our expectation is that interest rates over the next five years, regardless of what may happen this year in 2019, there's a lot of uncertainty about the Fed.

But we believe that over five years, you know, interest rates will rise so that would weigh on the returns for fixed income. So that's why they're typically lower of the intermediate than versus the long. If you flip the page, you can see the next set of inputs. So it's not just we're running the Monte Carlo situation. We're typically running 10,000 simulations. It's a bell curve distribution and the median is looked at.

But, you know, it's not done. It's just, you know, we'll take equity returns and then their volatility. And sort of one simulation of equity returns might generate 25% annualized. And then fixed income will generate their return and their volatility independently so you can have equity returns

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that are very low and fixed income returns that are also very high.

Those are, you know, maybe both is the 75th percentile equity output but a 98th percentile fixed income output. You know, this is an extremely rare event. That doesn't happen in these simulations because we include the correlation. So the correlations are also a factor and that's important because, you know, they inform how specific asset classes move in relation to one another.

And I use the fixed income equity example there because they, you know, typically -- while the economy is good they both might appreciate, but appreciate in equities might be significantly higher. Or in periods like we saw last quarter when the equity market was off sharply, the negative correlation between equities and fixed income comes into play. And so that's why we include correlations.

For example, there's a high yield -- a high correlation between high yield and

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equities, you know, which are data shown over time. That helped draw in the last quarter. So it's not just that, you know, in Monte Carlo where we -- the asset classes can just do what they want. This is designed to operate like the markets would so the interplay between asset classes, you know, is a factor.

So we ran a number of scenarios in this. On page 6, you can see, you know, the top of this chart, you know, the broad allocations. So equity, fixed income cap, and the suballocations within those. And then the portfolio is moving across from left to right. You know, the current -- there are your current targets reflected in the investment policy statement. And there's 5% higher and 5% lower equity.

Typically, the major weight of the dial up or dial down risk and expected return in the portfolio is to adjust the equity of fixed ratio. And so that's why we chose those names. And as you can understand, it's increasing equity in these

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kinds of fixed or decreasing equity at the expense of fixed.

MS. RHYNHART: Did you run the Monte Carlo -- I see the sufficient fund here on the intermediate. Do you have that on the long -- on the 10 year or 20 year?

MR. GOLDSMITH: So the official frontier is not on a time horizon. It's surveyed point and time output. These --

MS. RHYNHART: Well, I was thinking you're using the expected return assumptions based on --

MR. GOLDSMITH: These are the intermediate assumptions.

MS. RHYNHART: So that's five-year, right?

MR. GOLDSMITH: It's using the five-year assumptions, yes.

MS. RHYNHART: Right. So I guess when we're -- when you're setting the assumed rate of return at 7.3% for this fund -- 'cause it's 7.3% currently, right?

MR. GOLDSMITH: Yes.

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MS. RHYNHART: So this is saying that in five years, we only have a 35% chance of actually hitting our rate of return. On page 6, it's saying that?

MR. GOLDSMITH: Yes.

MS. RHYNHART: And that long term over 30 years, we only have a 44.7% chance of hitting our expected rate of return?

MR. GOLDSMITH: Yes.

MS. RHYNHART: So my question is through this efficient frontier process through the Monte Carlo simulation, if you're looking on average -- I mean, I would think it would be 10 to 20 years but if it's -- in your opinion, based on the Monte Carlo simulations you run, what would be -- what should be the assumed rate of return that would be most reasonable that we should expect to see?

MR. GOLDSMITH: Okay. You know, so I can speak to this but we at PFM don't set the return --

MS. RHYNHART: I just wanted

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your opinion.

MR. GOLDSMITH: There's a number of factors. I think the return goes intangent with what the allocations could be. So there's a number of other allocations that we show on here that can get you towards that 7.3% return without significantly increasing, you know, equities.

It's by inviting additional asset classes, primarily alternatives that help diversify the portfolio and can increase returns without markedly increasing volatility. And so I don't -- we don't feel that 7.3% is unachievable taking into account some of those portfolio alternatives that we're going to talk about.

MS. RHYNHART: Is that what you're going to be recommending?

MR. GOLDSMITH: I'm not sure we're necessarily recommending anything. You know, as Chris said, this is for consideration and discussion.

MS. RHYNHART: Okay.

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MR. GOLDSMITH: You know, obviously, the actual data should be taken into account when that figure is set. There's also, you know, adjusting the discount rate is a decision that doesn't just affect, you know, this --

MS. RHYNHART: Oh, I know.

MR. GOLDSMITH: -- point. It has the ability -- it affects the portfolio recommendations.

MS. RHYNHART: I know.

MR. GOLDSMITH: So, you know, I can make recommendations based purely on my knowledge of the plan but there's no ability to meet those other liabilities. It's things I can't do.

MS. RHYNHART: Right. I think the question is, and there's been a lot of discussion around this topic outside of this plan, but, you know, that if a pension plan is setting assumed rate of return too optimistically, it's a false sense of security for them and for the union members as well that are trying to depend on

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the plan.

So that is my question of if we kept the current asset allocation, is this efficient frontier on page 7 saying that really that what we should be assuming is over around 6%, 6.4? Is that what it's saying?

MR. GOLDSMITH: 6.4 for --

MS. RHYNHART: I'm just looking at -- reading your efficient frontier, page 7. PGW current. Isn't the access --

MR. GOLDSMITH: The long term expected return for the current plan is 7% annualized over the long period of time.

MS. RHYNHART: But that's not this chart.

MR. GOLDSMITH: This is the intermediate efficient frontier you're looking at. The long term efficient frontier would be found on page 10.

MS. RHYNHART: Oh, okay.

MR. GOLDSMITH: And so you can see where the current falls in there.

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Now, that's an arithmetic figure, you know. What's shown on the chart is geometric. Geometric returns are what, you know, applies to annualized long-term figures. So it's not going to, you know, show higher than 7.0 if you were to draw the line on that chart. But, again, it's arithmetic versus geometric.

You know, it's a 44% chance over the long term. That's not above 50 percent. I think, you know, 7 -- and we'll get to it in a second here. I think 7.3% is reasonable given if we allow this plan to make some changes and allow for some asset classes that aren't currently allowed within the effects of the policy statement. You know, again, primarily alternative asset classes.

You know, there's been -- since we've been here at PFM, you know, fees in this plan have come down significantly and so I think that there is the ability to sort of add some active more expensive alternative managers. If you consider doing

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a fee budget, you know, we've reduced that fee budget that traditional asset classes are using for indexing and utilizing managers with attractive fee proposals in the active side.

You know, the alternative space, things like real estate and private equity, they do typically charge higher fees. But, you know, as you can see, it's small allocation. You know, we feel there's room to take on some of that increased fee for the, you know, for the benefit of increasing the chance of making that discount rate.

MS. RHYNHART: Okay.

MR. GOLDSMITH: So, you know, for illustrative purposes, that's what's shown on page 6. You know, we can dial up equity or dial down equity in trying to make that return, but what that does is, you know, pretty significantly increases the volatility or decreases the volatility. It's standard deviation only. And that's going into the volatility of equities we've seen over the last quarter.

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And, you know, getting back to the alternative proposal, if you want to flip ahead to page 14, for example -- well, not for example but to look at, you can see here the current -- you know, the same allocation we had earlier on the far left. But then there's, you know, that allocation with 5% to alternatives, 10% to alternatives, 15, and 20%.

And you see here the impact, you know, on the expected return and the risk of the portfolio, both on the intermediate term and the long term adding to alternatives, essentially adding diversity; diversified asset classes. It not only increases the expected return but also does so while not increasing volatility but lowering volatility.

MS. RHYNHART: That seems counterintuitive that it wouldn't increase the standard deviation with it increasing alternatives.

MR. GOLDSMITH: It seems intuitive?

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MS. RHYNHART: It seems counterintuitive. You would think that with alternative investments that the volatility would rise.

MR. GOLDSMITH: It does seem counterintuitive. It's almost entirely related to diversification and the fact that different asset classes perform very differently -- well, differently in different markets. And alternatives typically have, you know, private equity might correlate to the equity market somewhat but they will not perform exactly the same certainly in real estate, certainly in private debt, things like infrastructure and timber.

And so when you add more asset classes, assuming that you're rebalancing back to your targets on a fairly relative basis, you know, let's say one asset class overperforms while one underperforms, you go back to targets and then different asset classes outperform, it is the case that adding more asset classes reduces

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volatility. I'm not sure if I'm explaining that in the best way.

MS. RHYNHART: So you're saying the alternative investment by itself has increased volatility but partner, the correlation, is lower?

MR. GOLDSMITH: Yes. And if you were to look at the total portfolio level, it does reduce volatility. You know, you can even do this by just taking domestic equities and adding international equity. If you look at the return of the S&P and then the volatility and then you're adding in, you know, taking -- doing 50/50 S&P, 50/50 international index, that portfolio will be less volatile than either of those two indices combined simply because they're moving in different directions at different times.

And assuming that you are rebalancing that, you're not letting one investment appreciate, appreciate, appreciate instead of depreciating.

MS. RHYNHART: Okay.

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MR. GOLDSMITH: And so I agree. I mean, I asked the same question several years ago when I came. This doesn't seem to make sense but it gets back to, you know, one of the core tenants of a long-term portfolio manager is diversification. So looking at the hard numbers, you know, adding in just a small amount of alternatives, 5% over the long term, you know, your expected return goes up to 7.2% and 48 or 49% chance of achieving the 7.3%.

Going up to 10% alternatives, you know, which is not an unreasonable target by any means, many pension plans both that we manage and we don't revise on or that, you know, we have allocations to all, you know, above 5%, above 10%. And certainly within that 5 to 10% range it's not unreasonable for a plan like this which is highly liquid, very exposed to liquidity, you know. And I wouldn't say liquidity but liquidity in the markets and the volatility that goes along with that.

But, again, also it has a fairly

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low all-in cost. It's come down over the last several years. And so, again, you know, knowing that, sure, the discount rate could be changed but that has other challenges that go along with it. These represent some alternatives to not change the discount rate but increasing the chance of missing that number and having unfunded, you know, portions for down the road. So you can see that there's the intermediate CMAs, efficient frontier on 15 and on 18 is the long term.

And you can kind of see how really just adding asset classes moves the return boxes up and even slightly to the left, you know, left being lower standard deviation. That's kind of the realm you want to be in. You know, the floating bar charts here throughout this exhibit, and it shows the various cortiles, you can think of this as sort of the stress testing element. You know, the top box represents the top 25th percentile of returns. The outsides to the tail end, bottom similarly represent the

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tail risk for the downside.

You know, those I think, you know, it's interesting to see here that, you know, adding alternatives really does not, you know, expand the bottom box any lower than it can. You know, due to printing, the white boxes here should be ignored. It's, you know, the lighter -- the bottom lighter red-shaded box at the bottom is 25th percent. And you can see that as alternatives are added, you know, theoretically, you know, having some risk but we talked about correlation to volatility.

You know, the bottom box, it acually doesn't go any lower than what it was for the PGW current allocation. And actually, the whole box is on its own shifted upwards. So in general, it's a more efficient portfolio. You know, if you want to flip back for a counterpoint to that to page 11, so this is without alternatives again.

And so, again, the current

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portfolio on the left, you know, higher equity in the middle, lower equity on the right. For all these time periods, when you, you know, go to a higher equity portfolio, sure the top box, you know, goes up but so does the bottom box. And so you're adding the chance for higher risk but also higher volatility, particularly so in, you know, these tail risk periods of the upside or the downside.

So, again, sort of the -- we're not just -- in alternatives, we're not just expanding the box but expanding it and sort of moving the whole thing upwards. You know, there are cash flows included in this assumption. You can see those on page 20. We're just assuming, you know, what we have two million or so per month coming out.

You know, the difference in market value between over 30 years between the current portfolio and the 10% alternatives portfolio is roughly, you know, 160 million or so, you know, in real dollar terms. I don't know what the liability growth would

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be over here. That's a question for the actuary.

But ultimately, we do think 7.3% is reasonable. We do think that adding some alternatives in the 5 to 10% range is reasonable that this plan, you know, could take that on. So, again, this is designed to facilitate some discussion. We've already had a little bit. I don't know if there are any other questions?

(No response).

MR. DIFUSCO: And just to add a little bit of color to Alex's -- and I know Rebecca and maybe Kellan had asked about this recently. To Alex's point about the fees, they have come down fairly substantially over the last five fiscal years. So in fiscal year '14, we were around 49.5 basis points. The most recent complete fiscal year, we were down to 36 basis points and change. That represents over $400,000 a year in fee savings.

I would expect that to get a little bit bigger in terms of fee savings based on

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the fact that, you know, we'll have another index manager that was just approved today, and the fact that two international managers that were recently approved, Curtis and Acadia, they're cheaper than two of the three mutual funds that we're getting ready to exit the portfolio. So that should add, you know, savings.

Copeland was the active small cap manager, significantly cheaper than both of the two small cap managers we currently have in the lineup. So I would expect the fee savings to grow even a little bit more from where it is now once we have all that in place.

MS. RHYNHART: I think it's interesting that the modeling at 10% alternatives gets to 7.3 with the same goal. I mean, I find that interesting. I would be interested to have Matt from my staff who's right behind us and I have someone else on staff in my policy and data group who did the Monte Carlo simulation for the City's main public pension plan.

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I would just like to have them take a look at what you've done just to better understand it 'cause I find it really interesting that you're able to get to 7.3 with volatility only at 10.7. So I just -- that would be helpful, Chris, if that's okay to do?

MR. DIFUSCO: Yes. And we have no -- yeah, we've worked with them, as you know, so that's not a problem. And, again, we don't expect to see a decision to be made today. I mean, next steps in my mind would be taking a closer look, you know, Alex and I and the IPS, just in terms of what would need to be amended if we went down this road. There would clearly need to be some changes.

And then what I think would also be helpful at either the next meeting or the meeting after depending on where we're at to just talk about if we went down this road what type of alternatives we would start with, you know, what that would look like. Would we start with real estate? Would we

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start with private equity? Where do we start? What would the cost look like? How would we scale in?

You know, one of the challenges, and I know Alex and I have talked about it, is that with a smaller plan, sometimes your options are more limited in terms of they can become more expensive which I'm not in favor of. So you can have a little -- you don't have the economies of scale. One option that we've talked about and it can be tricky is in certain situations we could potentially partner when it makes sense with somebody that the large funds do to keep the fees down.

Now, that's tricky because we have a much more robust private equity, right, portfolio. With the big plan, we only have one or two relationships here. We have to be a little bit more concerned about diverse -- just because it's a little bit more tricky. And so I just want to make sure that -- and I'm not saying any of you or me or Alex won't be, we just have to be

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thoughtful and prudent about how we do that.

So I think in my mind, those would be the next steps in terms of looking at the IPS, you know, taking a look at any of the additional research Alex does or that Matt and Nick, you know, provide in terms of any of the things they do, and then maybe just talking about a discussion as to where we think we would start on alternatives if we went down that road.

MR. GOLDSMITH: On page 14, this is kind of the most current 5, 10, 15, 20. That's generally along the lines. If we were to scale in, we would scale in in that order from 5 to 10, for example.

MR. DIFUSCO: I just mean with regards to the order.

MR. GOLDSMITH: Yeah. There would be specifics and there is education on the elements of the proposal.

MS. RHYNHART: Sounds good.

MR. DIFUSCO: Thank you.

MR. SCOTT: All right. Next on the agenda is investment performance

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management.

MR. GOLDSMITH: So today I think we'll cover -- on the last tab in the book, in the folder, you can see the full report for the quarter end, December 31st, the fourth quarter. We covered performance here in the January meeting so there's really nothing new. I'm not going to go through this. But, again, this does include, you know, your full performance report.

You know, page 2.5 shows the cash flows over the quarter of the year and, you know, contributions, distributions, fees, and expenses, you know, investment return. If actually, if you want, you can flip ahead to page 2.5 in the lower left. So, you know, on the box on the bottom is the full year. You can see the market value as of January 1st.

Last year, it was 543 million. About 27 million, 26.5 million, came into the plan, 51 million in distributions over the full year. You know, fees and expenses

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are now -- and then, you know, the investment return which reflects negative 26.3 million reflects a minus 5.4 return for the full year. And so that's, you know, how you get that 543 to 491,000.

On page 2.6, the asset allocations, this is where we were for most of the year. You know, even more overweight to equities typically around 2.9 to 3% underweight to fixed income and then in line with international equity. It's important to take that at this time because that's really the reason why the plan had outperformed for most of the year and then underperformed in the fourth quarter when the equities were off sharply. It's also the reason explaining why the plan has performed fairly well year to date in 2019.

MS. RHYNHART: I'm sorry. On this page 2.5, this is showing the cash flow, right?

MR. GOLDSMITH: Yes.

MS. RHYNHART: Okay. So on the bottom, one year. You have

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contributions of 27 million, distributions 51.8, fees 1.6. I mean, so a common method of looking at cash flow in a pension plan is to take out the return on investment and just look at contributions and distributions. The fact that it's so negative, are we comfortable with that because it's close to fully funded?

MR. GOLDSMITH: So you're talking about, let's say a net basis, you know, 24, 25 million or so net outflows for the plan for the full year. You know, I think that's -- again, on a year when we're achieving the right or getting close to it or over long periods of time, that is an appropriate amount of distributions, again, assuming you're making the rate of return. This is a little -- Chris, maybe you know better than I do.

This plan doesn't really receive contributions in the traditional sense so most of the money -- you know, when we look at it, we look at about 24 million coming out per year, like I said. And, again, if

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you take that number on its own over long periods of time, you know, we've shown it in the asset allocation number, you know, your market value in the median will grow, you know, assuming you're making -- you're getting close to making those assumptions.

MR. DIFUSCO: I would also say I think that -- I know that's part of the reason why when the finance director set the rate at 7.3 a couple years ago, we also made changes which required PGW to start making greater contributions.

MS. RHYNHART: Yes.

MR. DIFUSCO: And Tom, the actuary, gets mad because I always flip this. It's the greater of the 20-year closed or the 30-year open annualization and I may have flipped the open and close. But it's the greater of those two things so over time requiring PGW contributing more to the plan, more to the benefits should improve cash flow and help to pay down the unfunded piece more quickly. But that definitely was part of the rationale when that change was

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made in addition to lowering the rate down about 30 or 35 basis points at the time.

MR. GOLDSMITH: And over the last several years, the plan, even with those outflows, have been cash flow positive. You know, we have an update as of March 8th. It's not quite back to the market value where things were but, you know, it's getting that close. And also Medicare payments have continued to be made, you know, over this period as well so we're still -- we've made, what, 15 months of active payments since January 1st last year. So with 15 months of payments, a very volatile quarter, you know, and close to where things were.

The rest of this book contains a lot of supplemental information. Let's see here. You know, it included allocated, you know, managers, et cetera. I'm not going to go through all of that. It includes the number of alerts that I think we sent out and discussed in previous meetings; our alert from October that addressed market

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volatility at the time, our alert from January 7th that addressed the market volatility towards the end of that period, and then, you know, a short version of our capital markets assumptions.

I have a long version that I'll leave everyone with. But at the very end, there's a green page. If you flip beyond that, you can see the performance as of January 31st. So this was not -- I can't recall. I don't think we had this at the January meeting. It was a little too early. Back on January 31st, the market value of the plan was back up to 520 million, 520,736,000, a one-month return of January of nearly 6% net of fees, outperforming the benchmark on overweight to equities.

You'll see most of the active managers working close to their benchmarks or underperformance slightly with the exception of fixed income. But, you know, it was the allocation not overreacting to a volatile quarter, not getting out of equities but remaining slightly overweight

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to equities that allowed that performance to be the way it was. February performance will be released by the end of the day tomorrow or so.

It was a similar month in February. The markets were up to similar amounts. Outperformance was similar. And that trend has generally continued into March. We've seen a little bit more volatility but so far, you know, most equity markets are flat to up slightly here in March. You know, again, I mentioned within equities, a lot of the active managers were, you know, fairly close to their benchmarks, you know, net of fees.

The international managers, you know, get close, a mixed bag, hopefully rolling off variances soon when we have the new international managers. But then on the next page, page 2, the fixed income, you know, this is one where the whole fixed income segment outperformed the benchmark by about half a percent. This one was largely on active management so it's nice to see

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that we're underweight to fixed income, you know, not relativity out of that less-performing asset class but also taking advantage of active management, you know, pretty much across the board.

There are some exceptions; Logan Circle investment grade credit. There's a slightly missed benchmark, 2.35 to 2.48, but that 2.35 was still, you know, 1.3% part of its aggregate which this whole set is trying to beat. Logan Circle's credit is a credit overweight that we've had in these plans since last June when we were added. Skyhard, we're at the bottom, 4.33, lacks high-yield benchmark slightly but still the decision to be in high yield when it's not in the benchmark.

The benefit of this plan has benefited most of last year. It detracted during the fourth quarter both in investment grade credit and high yield but that trend has, you know, as much of the equity markets flipped back here in 2019. So we expect, you know, when February comes out, similar

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performance. You can see what was handed out as of March 8th.

The handout, the top left, market value is 530.9 million. And, again, this is after another month. I think you used it to pay the benefits from cash, I believe. It's also after the March benefits have been paid.

MS. RHYNHART: Can you talk a little bit about Von Nelson? So under small cap on -- I'm looking at January 31st. I mean, Von Nelson looks like they've underperformed year to date one year and three years. They also have one of the highest fees at 100 basis points. Why don't we get rid of them, I guess is the question?

MR. DIFUSCO: They are. Their contract is done.

MS. RHYNHART: Oh, wonderful.

MR. DIFUSCO: And so is Eagle. They'll be replaced by -- Von and Eagle will be replaced by Drumline who you hired today. And Copeland --

MS. RHYNHART: Oh, perfect.

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MR. GOLDSMITH: And that's what Chris was saying too. If you're going from 100% active management to 50% active management --

MS. RHYNHART: Can we always do this? So I ask when --

MR. WHITE: I think Chris is just happy that you asked a question and he can say yes.

MR. DIFUSCO: I think I say yes a lot.

MR. GOLDSMITH: And the same thing is like, as we've said, it's underway at international too. The contract is pretty close there so they'll be, you know, inactive in the effects and approach there if that's what we're -- fees will be lowered.

You know, the Von Nelson, their underperformance, you know, they were actually doing, you know, fairly well for most of the calendar year in '18 and then I think it just suffered in the fourth quarter. And they've had issues with

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utilizing the direct broker so, you know, there's no --

MS. RHYNHART: No positives?

MR. GOLDSMITH: No loss or anything.

MS. RHYNHART: Okay.

MR. DIFUSCO: So both of those will be out once we have the contracts done.

MS. RHYNHART: Okay, great.

MR. GOLDSMITH: So that's the end of my comments. I think next time we'll probably take another look at the mechanics of the investment portfolio and maybe look at the IPS language and look at some specifics of the individual alternative asset classes that we would consider adding, and then where they would be sourced from.

MR. SCOTT: All right. Thank you. Is there any new business for us to consider this morning?

MR. DIFUSCO: No. Just the next meeting is May 15th and then a reminder that the July meeting got moved to the 11th.

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I sent that out to everyone and to scheduling assistants but just so you know. It's on a Thursday on July 11th so those are the next two meetings. But I didn't have any other new business.

MR. SCOTT: All right. Is there a motion for us to adjourn?

MS. JOHNSON: Yes.

MR. SCOTT: So moved. Thank you very much.

- - -

(This concludes the hearing at 10:50 a.m.)

- - -

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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 upon the foregoing matter dated March 13, 2019 and that this is a correct transcript of the same.

Amy Marzario
Court Reporter - Notary Public

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