

Sinking Fund Commission - Bimonthly Meeting - May
May 20, 2020

CITY OF PHILADELPHIA
SINKING FUND COMMISSION

IN RE: Bimonthly Meeting

- - - - -
Wednesday, May 20, 2020
- - - - -

This Meeting of the Sinking Fund
Commission, held pursuant to notice in the above
mentioned cause, before Angela M. King, RPR, Court
Reporter - Notary Public there being present, held
via conference call on the above date, commencing
at approximately 10:00 a.m., pursuant to the State
of Pennsylvania General Court Rules.

- - -
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A P P E A R A N C E S

COMMISSION MEMBERS:
(via teleconference)

- Donn Scott, Chairman
- Christian Dunbar, Treasurer
- Rebecca Rhyhart, Controller
- Kellan White, Controller's Office

ALSO PRESENT:
(via teleconference)

- Christopher R. DiFusco, CIO, PGW
- Alex Goldsmith, PFM Asset Management
- Marc Ammaturo, PFM Asset Management
- Vanessa Jackson, PGW
- Adam Coleman, City Solicitor
- Janet Werner, Wells Fargo
- Matthew Bowman, Treasurer's Office
- Dominique Cherry, Private Markets,
Pensions
- Nick Hand, Director of Finance, Policy
and Data, City Controller Office

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2 PHONE COORDINATOR: Greetings and
3 welcome to the Bimonthly Meeting. During
4 the presentation, all participants will be
5 in a listen only mode. If at any time
6 during the conference you need to reach an
7 operator, please, press star zero. As a
8 reminder, this conference is being
9 recorded. Wednesday, May 20, 2020.

10 I would now like to turn the
11 conference over to Chris DiFusco. Please,
12 go ahead.

13 MR. DiFUSCO: Thank you.

14 Good morning, everybody. Thanks
15 for -- thanks for making time to -- I know
16 everyone has a lot going on, as I said
17 yesterday, with budget and their own
18 office's work. Only two listed agenda
19 items today, the Minutes and the
20 Performance Report.

21 Just a couple housekeeping items I
22 wanted to mention so I didn't forget at the
23 end before Donn takes over. The audit RFP
24 is up. It closes on the 5th of June. And

1 questions from vendors are due on the 22nd.
2 We will plan to do the consultant
3 presentations. I have already coordinated
4 with the vendors for July. And if we are
5 not able to do that in person, I appreciate
6 everyone's willingness to do it over Zoom
7 or Teams, et cetera. We will move forward
8 with that. And then we will pivot perhaps
9 in August to the consultant RFP.

10 So with that, I will turn it over
11 to Donn to start the meeting.

12 MR. SCOTT: Good morning, everyone.
13 I just want to make certain that you can
14 hear me. Can you hear me?

15 ("Yes.")

16 MR. SCOTT: Okay. Thank you for
17 joining us this morning. My pleasure to
18 call this meeting of the Sinking Fund
19 Commission to order.

20 First order of business is the
21 Approval of the Minutes from January 15,
22 2020 and March 3, 2020.

23 Is there a motion?

24 (Duly moved.)

1 MR. SCOTT: Is there a second?

2 (Duly seconded.)

3 MR. SCOTT: All right. Motion has
4 been made and properly second.

5 All those in favor, say aye.

6 (Ayes.)

7 MR. SCOTT: Thank you much. The
8 motion is approved.

9 The next order of business is the
10 Investment Performance Review. I will turn
11 it over to Chris.

12 MR. DiFUSCO: Thanks, Donn.

13 So, I know most of you have heard
14 from me, you know, periodically with
15 investment updates. I know Alex and Marc
16 have a couple of specific managers they
17 want to focus on as well as just talk about
18 the portfolio generally. So you know, I
19 will let them jump right into it.

20 MR. AMMATURO: Thanks, Chris.

21 This is Marc with PFM. I will
22 start off and then I will hand it over to
23 Alex. I will just give some very high
24 level comments about what we are seeing in

1 the market. And then, Alex will dive into
2 the portfolio as of the end of April.

3 In terms of the market, last time
4 we were together, you might recall Alex and
5 I and Surya Pisapati from PFM's office met
6 in person in early March in regards to the
7 significant development that was occurring
8 due to the pandemic, the health crisis.
9 And from keep to trough, the equity markets
10 sawed off about 35 percent.

11 Since then, the month of April was
12 a significant upturn for the equity
13 markets. The month of April, the S&P 500
14 was up 13 percent just in the month of
15 April. It was the best month on record
16 since 1987. So you know, as we sit here
17 and you look at Year April 30 return, you
18 will see this portfolio is down for the
19 year now about 9 percent. And the first
20 quarter of the year, the portfolio was down
21 about 16 percent. So again, April was a
22 strong recovery month for the domestic
23 stock market.

24 We are kind of scratching our heads

1 in terms of why the market rallied as much
2 as it did in the month of April. Where PFM
3 obtained discretion, we remained
4 underweight risk asset classes such as
5 equities. You know, our rationale for the
6 market rallying in April is as follows.

7 One, the Fed. Obviously, the Fed
8 is doing anything and everything they can
9 to address this crisis we are all living
10 through from the stimulus packages to
11 buying corporate bonds, buying high yield
12 bond to lending to companies, lending to
13 governments. Again, they are doing
14 anything and everything they can to be
15 proactive in putting this crisis we are all
16 living through.

17 The second reason the market
18 rallied in the month of April is a "peak"
19 in new cases and the reopening of the
20 economy. That's another reason why the
21 markets are rallying in April and the
22 beginning of May. One thing about the peak
23 of new cases, if you look at it just within
24 the US and you exclude New York City, the

1 epicenter of the crisis here in the US, we
2 have not hit the peak. Cases continue to
3 rise, again, as you exclude New York City
4 from that analysis.

5 The other reason the markets are
6 rallying in April was the potential for a
7 vaccine to come out.

8 And the last reason is, we think
9 the market is pricing in a V-shaped
10 recovery for the economy. A V-shaped
11 recovery means that the economy really
12 contracts significantly and then rebounds,
13 like, on a dime and accelerates from there.
14 And we just don't see that happening. But
15 again, we think the April rally is pricing
16 in a V-shaped recovery for the economy.
17 And again, that's not how we see it playing
18 out.

19 So again, PFM remains defensive.
20 In other words, underweight risk asset
21 classes such as equities where we have
22 discretion. You know, some of the latest
23 data we are looking at is gross -- the GDP
24 for the US was negative 4.8 in the first

1 three months of the year. It's now
2 expected to be negative 38 -- the last
3 reading I saw was negative 38 percent for
4 the second quarter. Again, a contraction
5 of 38 percent for the US gross domestic
6 product per the Congressional Budget
7 Office. Obviously, a huge, huge
8 contraction.

9 The other number that recently came
10 out, unemployment for the month of April
11 was 14.7 percent. We all know earnings are
12 down significantly in the first quarter.
13 We all know retail sales are down
14 significantly in the month of April.

15 The other data point that is
16 interesting is lending spenders are being
17 pythoned[phonetic]. And when lending
18 spenders are being pythoned, that usually
19 is not helpful, obviously, for the economy
20 to get back on soft footing going forward
21 if banks are not going to be lending to
22 corporations as freely as they once were.

23 So again, I don't want to go into
24 all the nitty gritty about one of the

1 providers high level comments about the
2 economy, about the markets and about how
3 PFM, again, remains defensive really at
4 discretion in our clients' portfolios.
5 Because we tend to be fundamental investors
6 and not kind of just dry -- not making
7 moves based upon solely how the equity
8 market is performing. Because again, the
9 equity market had its best month since 1987
10 in the month of April.

11 So with that, I can hand over to
12 Alex to go through your portfolio.

13 MR. GOLDSMITH: Thanks, Marc.

14 I am focusing on the April/Report
15 that Chris sent around last evening. And
16 you can see here as of the end of April,
17 the plan is backed up over 500 million,
18 \$503,586,411 up from roughly, you know, 460
19 or so million, you know, at the bottom of
20 the market at the end of March.

21 Large -- on performance today, I
22 mostly am going to focus on the one-month
23 figure for April as well as the
24 year-to-date column, several columns to the

1 right.

2 You know, as Marc mentioned, stocks
3 rallied in April 8 percent. You know, just
4 behind its benchmark was 8.1 percent. You
5 know, again -- and year to date, you can
6 see the plan was either down, as Marc
7 mentioned, nearly 9 percent, down 8.91 lag
8 behind the benchmark, which was down
9 6.4 percent.

10 You know, certainly going into
11 this, you know, being overweight to
12 equities, you know, was a detractor and
13 stocks fell through March. But you know,
14 we might recall the Special Meeting we had
15 early March, you know, where PFM presented
16 our defensive positioning. You know, you
17 still did take some action at this
18 portfolio to move some equity assets to
19 cash. You know, again, it didn't bend
20 fully, but on the margin that move did
21 help.

22 The largest relative detractor year
23 to date had been fixed income. So you
24 know, negative contributions from active

1 management as well as allocations to
2 corporate and high yield. You know, in
3 March, those were fairly significant
4 detractors. You will see in April, those
5 trends have reversed. And for most of the
6 additives as well as the high yield
7 allocations, those are once again
8 contributing to performance.

9 I will move down through the asset
10 classes and through the managers.

11 MS. RHYNHART: Yeah, I'm sorry,
12 just one thing. As your -- wait, hold on.

13 Can you hear me?

14 MR. GOLDSMITH: Yeah.

15 MS. RHYNHART: Okay. Just as you
16 go through it, I mean, given the -- I mean,
17 year to date we are down 8.9 compared to
18 benchmark of 6.4, which is a huge
19 difference versus benchmark, negative
20 difference. So as you go through it, if
21 you can just explain -- you know, that's
22 obviously concerning to me. I am sure it's
23 concerning to other Board Members just how
24 badly the performance is versus the

1 benchmark.

2 So if you can just keep that in
3 mind as you go through it, that would be
4 great.

5 MR. GOLDSMITH: Absolutely. That
6 is what I planned to do.

7 You know, again, we still -- within
8 large cap, the plan was slightly overweight
9 in the beginning of the March, you know,
10 when stocks fell anywhere from 20 to
11 30 percent in the first quarter. You know,
12 that was certainly a detractor. You know,
13 active management, you know, passive
14 management -- you are largely passive with,
15 you know, nearly over 27 percent of the --
16 of the portfolio was passive.

17 You know, PineBridge is the loan
18 active manager. On a year-to-date basis,
19 it has detracted from performance slightly.
20 You can see their year-to-date number is
21 down 9.88 where the benchmark is down 9.29.
22 So, it's a slight detraction. But this
23 manager was placed on a Watch List at the
24 end of last year. You might remember when

1 they were added to the portfolio. You
2 know, they're a quantitative manager
3 designed to keep tracking error to the S&P
4 500 low while delivering, you know, steady
5 consistent outperformance. And since their
6 inception, that has not been the case.

7 You know, the story from
8 PineBridge, that has been verified by PFM
9 is that, you know, the environment you were
10 in prior to this as well as now, there has
11 been a pretty significant type of diversion
12 between both values. You know, PineBridge
13 is a factor-based manager that allocates to
14 certain buckets. And you know, they have
15 been overweight their value bucket in the
16 face of this wide (muffled) -- diversion.

17 They have the newer version. You
18 know, their years and years of data
19 collection, gathering point them that way,
20 you know. It has not happened yet. Hence,
21 they are on Watch List.

22 You know, PineBridge has shown, you
23 know, understanding of their situation.
24 They have come to the table and offered,

1 you know, pretty generous, you know, fee
2 adjustment, you know, with the reduction of
3 their fee from 18 basis points to about 2
4 and a half basis points with an
5 outperformance with incentive component.
6 So you know, if they were to outperform the
7 benchmark, it would be increased. However,
8 that incentive component, you know, goes
9 back to the start of this year. So you
10 know, they have to recoup what, you know,
11 has been lost and then generate
12 outperformance for that incentive to kick
13 in.

14 So you know, we view that as a
15 positive development. You can see their
16 performance corrected slightly, you know,
17 in April even as sort of growth and value
18 continued to diverge. But you know, we
19 will remain -- keep them on Watch List. We
20 were working through that fee adjustment.
21 And you know, hopefully, they will start to
22 earn that incentive fee.

23 So within Small Cap, you know, the
24 next section down, this is a segment where,

1 you know, there has been a slight tilt to
2 small cap in the portfolio, you know,
3 within the total equity overweight. That
4 was a detractor as small caps have
5 underperformed the large cap stock year to
6 date.

7 You know, when you think about
8 where the stress is being felt, it's the
9 smaller companies that have less diverse
10 business lines and, you know, less of the
11 universal -- their capitalization is not as
12 strong. They have less ability to go to
13 the lending markets and refinance at lower
14 rates. And there is just more stress that
15 was felt in March in the small cap market.
16 So, the tilt -- slight tilt was a
17 detractor. And then, active management and
18 passive management, frankly, was detractors
19 within this.

20 You know, Copeland, you know, you
21 can see for the month, they underperformed
22 by about 5 percent, 8.6 versus 13.7. Year
23 to date, they are still ahead of their
24 benchmark slightly. You move up to the

1 year-to-date column, you can see Copeland
2 is down 20.2; the Russell 2000 is down
3 21.0. Copeland was slightly defensively
4 positioned. They did well to protect in
5 March. That's hurt them in April. But
6 really where, you know, the -- the
7 detraction small cap game is, you move down
8 to the Rhumblin small cap core.

9 This is a passive bunch. It's
10 benchmarked to the S&P small cap, you know,
11 S&P 600 which is different than the small
12 cap benchmark to the point -- above what
13 you see is the Russell 2000.

14 If you recall back this summer when
15 we were doing the small cap RFP, it was a
16 recommendation made by PFM and accepted by
17 the Commission to fund the index with a
18 benchmark to the S&P 600. The S&P 600 is a
19 higher quality benchmark than the Russell.
20 All of the companies are profitable and
21 they have positive earnings; whereas,
22 that's not the case for the Russell 2000.
23 The Russell 2000 has a higher concentration
24 of tech and healthcare companies in

1 particular. And that latter point is what
2 has caused the S&P 600 to underperform the
3 Russell 2000.

4 You know, our recommendation to
5 fund the S&P 600 index is a long term
6 recommendation. You know, we believe that
7 when you are investing in small cap, which
8 are generally riskier than large caps, you
9 know, we would prefer to be -- you know,
10 prepare the path. There is no active
11 component here. You get the index. You
12 know our -- we would prefer to be at a
13 higher quality index. In this brief period
14 we are looking at, because that's been the
15 case so far and, again, it's because the
16 healthcare weight component of the Russell
17 2000.

18 Moving down to International
19 Equity. The allocation factor here was
20 minimal. The plan was generally -- we're
21 right on top of the target to international
22 equity. You know, the active component
23 here was a slight detractor year to date.
24 You can see for the month, you know, focus

1 on the blue bar, 7.98 in April versus 7.58
2 with the benchmark, so taking some back.
3 Then moving out to the year-to-date column,
4 the international equity composite was down
5 18.1. The benchmark was down 17.5. The
6 bulk of that underperformance comes from
7 EARNEST partners, which you can see. Down
8 22.7 versus 17.5 of their benchmark.

9 You know, EARNEST was funded mid
10 last year following the international
11 equity RFP. So you might recall there
12 was -- it was very, very close. I think
13 PFM's recommendation was for Acadian. You
14 know, EARNEST was a very, very close
15 second. You know, they are a
16 minority-owned firm based out of Georgia.
17 The asset allocation was split there. And
18 you can see Acadian actually making up some
19 ground year to date. You know, they are
20 down -- part of it was down 17. But again,
21 EARNEST drawdown offsetting Acadian
22 contribution.

23 You know, I speak on EARNEST. They
24 were placed on the Watch List this quarter

1 due to the underperformance. You know, one
2 of their main detractors was an allocation
3 to and then selection within consumer
4 discretionary. Picture really, you know,
5 they were overweight to certain travel
6 stock; primarily, Carnival Cruises. You
7 can imagine that being a big weight on
8 their portfolio.

9 They maintain those positions,
10 which is another reason why we are
11 following it very, very closely. You know,
12 knew when they were interviewed and brought
13 in, they were a fundamental manager. They
14 do, you know, make dramatic investments
15 like this in the eastern hospitality
16 sector. So again, we want to, you know,
17 track their ongoing performance very
18 closely on a monthly basis. And you know,
19 track their positioning, as well.

20 Moving on to Fixed Income. So you
21 know, in a year-to-date basis, fixed income
22 would be the largest detractor to
23 performance in this portfolio.

24 Historically, it's been, you know, pretty

1 large contributor. But you know, with the
2 sell off in equity market, that bled into
3 the corporate bond market. Typically, you
4 know you think bonds are, you know,
5 risk-off assets in times like this. And
6 that is usually the case. You know, if
7 these were treasury bonds up at corporate
8 and high yield, you know, sold off in March
9 pretty significantly and those spreads
10 widened.

11 You know, this -- this plan has
12 allocations, dedicated allocations to
13 investment grade corporate bonds as well as
14 high yield corporate bonds. Right now,
15 they are smaller allocations, but they
16 certainly did detract given the magnitude
17 of the underperformance there. And then
18 most of the active managers, the core and
19 intermediate managers, maintain overweight
20 on a regular basis to the corporate bond
21 universe. And you know as a result, they
22 performed pretty significantly in March.

23 You know, you can see here for the
24 month of April, you know, we get that trend

1 has reversed, you know, pretty quickly.
2 And we have seen, frankly, a lot of
3 opportunities for active managers in the
4 fixed and the bond market.

5 You know, the loan manager that you
6 have that was really on target or even
7 slightly underweight to corporate bonds
8 this year is Lazard. You can see net of
9 fees, they lag. You know, in a
10 year-to-date basis, they are at 3.59 versus
11 3.66 the benchmark. They also
12 underperformed for the month of April as,
13 you know, the corporate and high yield
14 trend, you know, got back on track.

15 Most of the other bond managers, if
16 you look through their April returns and
17 year-to-date returns, you can see that
18 they -- again, their corporate allocations
19 are once again bad right now.

20 You know, MetLife Investment grade
21 credit, formerly Logan Circle and Sky
22 Harbor still underperforming their specific
23 benchmarks for the month, but you know,
24 also turning in performance ahead of the

1 Barclays aggregate, which is what -- the
2 fixed income benchmark for the client which
3 is what we are trying to be. Again,
4 those -- those weightings intervening again
5 in April.

6 You know, the last thing I will
7 note on this page, you can see the custody
8 cash level at 16.9 million. So, that
9 reflects the change that has taken in early
10 March. You know, we don't need -- we
11 haven't needed to sell assets through April
12 and into May as the markets have rallied.
13 But again, we -- you know, the portfolio is
14 now relatively close to the Fed, again
15 slightly overweight, you know, slight tilt.
16 We don't need to sell assets as needed
17 throughout the year. But again, as Marc
18 noted PFM, where we have discretion, we
19 maintain a defensive positioning.

20 With that, that's the end of my
21 comments. I will open up to questions. Or
22 if Marc, I don't know if you have anything
23 to add.

24 MS. RHYNHART: Are you concerned

1 about our fixed income holdings given the
2 end of performance?

3 MR. GOLDSMITH: You know -- you
4 know, it was something that happened not
5 just a portfolio. It was a big detractor
6 in PFM's discretionary portfolios, as well.
7 You know, we did make those defensive
8 equities shift that we presented to you
9 all. And you know, our portfolios, they
10 outperformed slightly as a result. But you
11 know, the fixed income even there was
12 certainly a detractor.

13 You know, I don't have the data in
14 front of me, but I did look at this last
15 week. I looked at the performance of the
16 benchmark, the Bloomberg Barclay aggregate
17 in the universe of active fixed income
18 managers. And normally, it supports the
19 bottom.

20 Fixed income is an asset class
21 where asset management really has not, you
22 know, shown, you know, an ability to
23 outperform consistently. This quarter, the
24 benchmark was up towards the top. I don't

1 know the exact, you know, percentile
2 ranking, you know. But that to me shows
3 that, you know, it was a surprise, you
4 know, at least for now one-month flip. You
5 know, we view it with rate -- if rates are
6 going to be -- with a low rate environment,
7 you know, you will have to find return to
8 fixed income market elsewhere. And you
9 know, similarly to, you know, what happened
10 in 2009, you know, there was a shock to
11 spread and then that created a lot of
12 opportunities going forward.

13 So you know, none of these managers
14 are on Watch List. We have no plans to,
15 you know, reduce or terminate the high
16 yield or corporate bond allocation. They
17 are already slightly below target. You
18 know, but you know one thing that we -- you
19 know, again, you might recall the addition
20 of alternatives into the investment policy
21 statement and the plan to go ahead with,
22 you know, some alternative fixed income
23 primarily private credit.

24 Now, those plans are still in

1 place. So you know, that will be another
2 way that this portfolio could, you know,
3 enhance yield, drive return in an ongoing
4 low rate environment.

5 But no, we are not concerned right
6 now with these managers or the allocation.

7 MS. RHYNHART: Okay. Thank you.

8 MR. GOLDSMITH: Any other
9 questions?

10 (No response.)

11 Okay. Thank you for your time.

12 MR. SCOTT: Thank you.

13 MS. RHYNHART: Thank you.

14 MR. DiFUSCO: I just wanted to
15 mention briefly, Donn and Rebecca and
16 Christian, I know all of you had asked
17 about the fees. We did go ahead. PFM, you
18 know, was a great help here. You will see
19 on page 6 of the report, the calendar year
20 fees are on the last page of the pdf for
21 all the managers. We also note, I think
22 it's the last -- or four of the last five
23 so Harding, Eagle, Delaware and Vaughan
24 Nelson who are, I think, the most

1 expensive, they have all been terminated.
2 Dimensional, as well. So yeah, that
3 presents, obviously, you know, we would
4 expect to see, you know, fees continue to
5 go down. And we will continue to publish,
6 you know, those fees as the Board requested
7 on, you know, an annual basis.

8 MR. GOLDSMITH: Yes, Chris. We
9 were looking at the fees for the first half
10 of this fiscal year, you know, just
11 unofficially. And it's looking like fees
12 will be down, you know, pretty
13 significantly in Fiscal year 2021 or 2020,
14 whichever we are in right now. I can't
15 recall.

16 But you know, this is the -- the
17 current fiscal year will see a pretty sharp
18 reduction in manager fees.

19 MR. DiFUSCO: Thanks, Alex.

20 MR. SCOTT: Chris, is there any new
21 business that we need to focus on? Any
22 more new business?

23 MR. DiFUSCO: No. I covered the,
24 you know, the upcoming RFPs and

1 presentations. Like I said, we will
2 probably go to Zoom or Teams, you know, in
3 July if we need to. And obviously, if
4 anyone has any other, you know, manager or
5 portfolio-specific questions coming out of
6 today's meeting, don't hesitate to, you
7 know, call me or email me. You know, I
8 know we only get together every couple
9 months. So, don't hesitate to reach out in
10 the interim with any questions or concerns.
11 Happy to, you know, engage offline.

12 That was it, Scott.

13 MS. RHYNHART: Thanks, Chris.

14 MR. SCOTT: Thank you.

15 Is there a motion to adjourn?

16 MS. RHYNHART: Okay. Are we done
17 then?

18 MR. SCOTT: Motion for --

19 MR. DiFUSCO: Yeah. There is no --

20 MR. SCOTT: Go ahead, Chris.

21 MR. DiFUSCO: That was it. No, I
22 cut you off. I'm sorry, Donn.

23 MR. SCOTT: I was saying if there
24 is a motion for adjournment, we are hereby

1 adjourned.

2 MR. DUNBAR: So moved.

3 MS. RHYNHART: Second.

4 MR. SCOTT: All right. Thank you
5 very much. Thanks, everyone.

6 PHONE COORDINATOR: That concludes
7 the conference call for today. We thank
8 you for your participation, and ask that
9 you please disconnect your lines.

10 (At this time, the Meeting
11 adjourned at 10:29 a.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.

ANGELA M. KING, RPR,
Court Reporter, Notary Public

(The foregoing certification of this transcript does not apply to any reproduction of the same by any means, unless under the direct control and/or supervision of the certifying reporter.)

Sinking Fund Commission - Bimonthly Meeting - May
May 20, 2020

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