CITY OF PHILADELPHIA

SINKING FUND COMMISSION

In Re: Special Meeting

- - -

Wednesday, July 8, 2015

Philadelphia, Pennsylvania

- - -

This Meeting of the Sinking Fund Commission, held pursuant to notice in the above mentioned cause before Susan A. Hurrey, RPR, in and for the Commonwealth of Pennsylvania, held at Two Penn Center, 16th Floor Conference Room, on the above date, commencing at 11:09 a.m., pursuant to the State of Pennsylvania General Court Rules.

- - -

STREHLOW & ASSOCIATES, INC.
FULL SERVICE COURT REPORTING AGENCY
54 FRIENDS LANE, SUITE 116
NEWTOWN, PENNSYLVANIA 18940
(215)504-4626
WWW.STREHLOWCOURTREPORTING.COM

APPEARANCES:

COMMISSION MEMBERS:

Benjamin Gilbert, Chairman

Alan Butkovitz, Commissioner

Nancy Winkler, Commissioner

Bill Rubin, Alternate for Mr. Butkovitz

ALSO PRESENT:

Charles Jones, Executive Director

Christopher DiFusco, Chief Investment Officer, PGWPP

Frank Domiesen, Gallagher Fiduciary Advisors, LLC

ALSO PRESENT:

Ellen Berkowitz, City Law Department

\- - -

MR. GILBERT: We will hear presentations from the candidates from the large cap domestic equity. I guess, Charlie, you'll monitor the time.

MR. JONES: I'll give them 25 minutes so that you have some time at the end of the meeting for deliberation. So I'll give them 25 minutes and I'll give them a five-minute warning. Are you ready?

MR. GILBERT: Yes.

MR. JONES: The first one is Bridgeway Capital Management.

So this is Cindy Griffin and Elena Khoziaeva. They're from Bridgeway Capital Management. You're going to be presenting to the Sinking Fund Commission today. It's made up of Ben Gilbert, the Chairman; Nancy Winkler, the commissioner; and Alan Butkovitz, also a commissioner.

The floor is yours for 25 minutes. That's for your presentation and Q&A. And I will give you a five-minute warning. Okay. So the floor is yours.

MS. GRIFFIN: Great. Well, thank

you so much for inviting us here today. We really appreciate the opportunity to introduce Bridgeway. My name, as Charlie said, is Cindy Griffin. I'm the senior member of our marketing and I've been with Bridgeway for four years, and of course with me is Elena Khoziaeva. Elena is one of our highly talented portfolio managers and Elena has been with Bridgeway since 1998. And not only has she been on the large cap value strategy since its inception, she was also involved in development of the strategy. Elena is fluent in Russian and English, but we like to say her first language really is math. So there are two other people that would be on your client service team that are not here today that I want to let you know about. The first is Monica Henderson. Monica is in our office in Houston today and she will handle all of your operational needs, including client reporting. In addition to -- Monica has been with Bridgeway since 1998 as well, by the way, and she'll bring her extensive client service experience to you.

In addition to Monica, we have Tammira Philippe. Tammira is our head of marketing and client service. Tammira actually wishes she could be here today, but she's out of the country and she couldn't change her schedule. She just recently celebrated ten years with Bridgeway, and she and I will work very closely together to serve you.

So today we're going to spend a little bit of time going over our large cap value strategy and our firm overview. I'll spend a little bit of time on the firm and our team, and then hand it over to Elena who will talk about our investment philosophy process and the results. So we're going to do a presentation and then save a few minutes hopefully at the end for Q&A.

Bridgeway -- on page three, Bridgeway is a statistically driven, evidence-based investment manager. Elena will explain more about what that means and how that's reflected in our investment philosophy and process. But what you really need to know is that we work hard every day with our clients and their consultants to deliver better investment outcomes.

We were founded in 1993 as an independent investment management firm and we continue to be that today. We have 5.1 billion dollars in assets under management and we bring a team mindset to everything we do. From an investment management to client service, what you'll see is that we're very team oriented. All 24 of our partners bring a team mindset to serve you. And all 24 of our partners also have an equity ownership stake in the firm. This means that we are really encouraging a long-term mindset that we think our clients desire through our partners, and a commitment to our investment philosophy and process that ensures long-term success.

Bridgeway has a very unique culture and that was recognized by Pensions & Investments last year as one of the best places in money management to work. And while we feel like this is a really great award to receive on its own merit, what we believe that it demonstrates is that we can attract and retain some very highly talented individuals to serve you.

And of course what we're here today to talk about is our large cap value strategy and how it's diversified orientation really brings long-term consistency, which you can see on the next page.

MR. DIFUSCO: Real briefly. When we did reference checks, one of the things that came up -- just in 30 seconds, can you just talk about the firm culture a little bit? Certainly came up during reference checks. Can you just talk about, in 30 seconds, like what's different in your firm culture vis-a-vis competitors, what I'll call traditional --

MS. GRIFFIN: Sure, I'll respond to that. We have a very ownership and stewardship culture at Bridgeway. And we have four core values which totally drive everything that we do; integrity, performance, efficiency, and service. We have what we call our partners in charge that are essentially our team leaders. But we have a very leader-oriented team. So everybody is a leader in some respect and everybody supports each other. So it's very unique in that we don't have, for example on the investment management team, any star portfolio managers. We value this sort of diversity among all of our team members and how they contribute.

MR. DIFUSCO: Thanks.

MS. GRIFFIN: So on page four, what I want to talk about is consistency. We evaluate our strategy a number of different ways. And one of those ways that we evaluate our strategy is on a three-year rolling basis excess performance versus the benchmark.

And as you can see on this page, the Bridgeway large cap strategy has outperformed the Russell 1000 Value Index on a three-year rolling basis one hundred percent of the time. That is what we call consistency of performance. And that consistency of performance is really due to our people and our process.

So let me talk a little bit about our people on the next page. These are on page five, the investment and risk professionals that work on the large cap value strategy. One of the things I would like to point out on this page is that a number of our professionals have the same number of years at Bridgeway as they have in the industry, and we feel like this is really distinctive, that people really come to Bridgeway and they stay. But also, we have no problem attracting highly talented people to our team. In fact, as can you see, Dr. Andrew Berkin, who is our director of research just joined us two years ago.

We value diversity of thought of people and that's why we are -- we team manage everything. And each one of these people brings their own strengths to the team. And I would love to talk about every single one of them, but we have included bios for everyone of this page in the back of the presentation.

One of the rolls for our CIO, John Montgomery, that is not reflected on this page is the role of president. He assumed this role recently after our president of 12 years, Michael Mulcahy, departed the firm to pursue an entrepreneurial opportunity. Once Mike left, we put into place our succession plan and that succession plan called for John stepping back into the role of president. Now, one of the great legacies that Mike provided as our former president was to put in place a very strong leadership team through our partners in charge. And those partners in charge are really supporting John through this transition, ensuring that it really is a smooth transition. The key to know is that this is not an indefinite position for John and that he feels like he only needs to stay in this position as long as he absolutely has to and that we have already initiated the search for the next president of our firm.

The final thing I'm going to say before I hand this over to Elena and we get into the investment philosophy process and results is that I wanted to point out our portfolio risk and review committee. In addition to the risk management and review that we do in the research and investment management process, we have a separate committee called the Portfolio Risk and Review Committee that's made of three team members, two of whom are independent from the investment management team. Carey Peek, who is a performance analyst and then Tammira Philippe, who is the head of marketing client service, both of whom are CFA charter holders. This committee really looks at risk from your perspective. Are we performing as designed and why or why not. So with that, I'm going to turn it over to Elena. She's going to discuss investment philosophy process and results.

MS. KHOZIAVEA: Thank you, Cindy. So I want to echo Cindy in my appreciation for your time and the opportunity to present Bridgeway large value strategy to you today. As she mentioned, my background is Russian so I came to the United States a long time ago, and having math as my favorite subject at school allowed me to pursue and continue my education in the United States, you know, much easier. But language is different and so Russian and English are different languages and I think English is much harder to learn. So you'll hear that with my accent and I'll do my best not to mix Russian. Be sure it's not challenging for you.

But I want to start on page six and tell you first about our investment philosophy. And what I think of it is a glue that kind of is used to structure all of our strategies. And these are important because they show you our overarching principles and, you know, why Bridgeway is doing what we're doing in such a successful way. What we believe is that the three components are crucial to the long-term success in investment. And those components are long-term data, academic theory, and the statistical process.

Long-term data is crucial because it allows us to study performance of our models and factoring over different market environments. Whatever cycle it is, we have some expectation and we studied the performance of those models in different environments because we look back over long term. The theory is important because we don't want to data mind. We don't want to find some correlation dependency that just exists there that are not repeatable in the future. So it allows us to have a repeatable process. Also, this has helped with our statistical analysis in the process. We use math, we use statistics to study extensive sets of data so we can use large universes of data and we can remove behavioral biases and human emotions out of that process. That allows us to create a consistent process that is repeatable with time and there is some expectations of the performance that are based of that research. So long-term data, theory, and statistical analysis.

In addition to that, there is, you know, surrounded principle as those that are described on the right-hand side on slide six. I want to take a little bit of time going over those. We already talked about data. Data is important because it allows us to study performance over a long-term cycle. Quota data is important because we rely on our results. What I mean by data? These are the financial -- fundamental about the company from financial statements and we use all financial statements in our process, as well as the prize data.

The next two items that are pretty much what set Bridgeway apart in a unique -- describe the uniqueness of our process. First is factors shape returns. What are factors? Factors is -- it's a proxy that describes how sets of stocks are going to move in a certain fashion over time. What are the risk and return characteristics for this particular set of stocks? To give you an example, size can be a factor. For example, for this particular strategy, large is a factor that describes the performance of those stocks over time. Or value. You know, stocks can be deep value, that is a factor, that is a proxy for risk and return characteristics.

Now what we found in our research is the more select you are in the sets of stocks, for example, the more -- you have a large universe and then you shorten that and you go through the universe. The less names you pick, the more volatility exists in those names. The more risk they bring into the portfolio, which is not what we want. So how to address that? That is described with the next bullet point and that is that we address volatility of each of those factors by combining multiple factors in the model or in the strategy. And we keep those sets unique and separate. And then we will rebalance to those ways, those strategic ways and I'll go over that. But it's crucial. So we diminish the volatility of each factor by diversification via bringing multiple factors in the portfolio. And that is kind of the gist of the strategy. You have exposure, deep exposure to certain factors. But then you have multiple factors in one portfolio. And I'll demonstrate that with our process and result.

Also very important to know is that once we put this in place, study the data, apply the processes, we do not fall asleep. We don't say okay, let's just have that for the next 20 years. It takes a lot of research and work to make even small torques to the portfolios, but there's a continuing process, continuing investment research that's going on to study the factors to be sure that we put the most effective factors in the portfolio. And that's what produces the results.

Now, the theory is only as good as its application and the process that it's used in. So with that, if we can go to page seven, and this I really like. It demonstrates our process and I like the funnel because it's important to know now you have your universe, you have all the stock. How do you actually get to the client's portfolio? And I'm going to show you right now how the process is applied for the large value strategy. So we start with our beginning universe which is the Russell 1000 Value universe. It's about, you know, let's say 700 stocks. And what we do, we then apply our statistical methods to select stocks. Now, the first group of metrics is what we call value. The strategy is large value. I already talked about our factor exposure. What we want to deliver is a deep exposure to value. We want to create the portfolio that has more factor exposure to value than the universe. So we apply our value metrics and they are responsible for 70 percent of the portfolio. So majority of the portfolio is selected by value metrics. And I can give you a couple of examples. There's different ways of looking into value and selecting value names from the universe that already has some characteristics.

For example, we have a model that consists of different ratios, price ratios, price to cash flow, price to sales, price to earnings with different coefficients in it. And this one particular model selects, let's say, group of stocks of 10 or 15 and those names are assigned, they belong to model number one. And that's in the one group of stocks. There's other ways to look for value stocks. There's a dividend yield model, there's activity model. So those multiple ways looking into value select the groups of stocks, and now this bucket is 70 percent of the portfolio with some ranges that is exposure to value.

Now we could stop there. We could have put hundred percent in those value metrics and we could create a portfolio that behaves like a value portfolio and it would still be a large value portfolio. However, I already talked about diversification and the volatility of this value metrics. We don't want that. How do we address the times when values out of favor? You know, in 2014 there were periods when the value underperformed. We, and you as our clients, do not want to see it in the portfolio. So we don't give hundred percent to value metrics. We only give 70 percent. And we bring the other two categories that create diversifying exposure, and then create a cushion and increase the results, increase the consistency when value is underperforming. And those two categories are company financial health and price momentum. They are diversifying buckets of categories. Company financial health represents about 25 percent of the portfolio and price momentum interestingly is only five. And here is what they do. Company financial health, there are several models that are looking now for quality names, for names that exhibit some earnings growth. Improvement of earnings. It's no longer about them being value or cheap. It is now still within the Russell 1000 Value universe, but we're looking for improving fundamental, and that group of stocks does not have a strong correlation with the value. It's actually performing differently, which is exactly what we want for that portfolio.

So in 2014 when the growth and, you know, stocks were awarded, that's the category that performed really well. In addition to that, research shows that the great diversified value is momentum and that's why there was a price momentum category in here. Even in the five percent exposure, there is still -- you're going to see some results later in the presentation, it still gives the returns and diversifies the underperformance of value and then over time creates the consistency that Cindy was referring previously.

So three categories. Value as the major drive of the portfolio, company financial health, and momentum. And those three components select the stocks. We go from 700 stocks to -- we see here about 7200, typically, with a separate-managed account where you have experience with the strategies. Recently launched two separately-managed accounts, so I have a very recent history of that. It's going to be about 70 to 80 names in the portfolio. So, you know, filter the universe and the name -- the models select the portfolios.

One important thing to point out on this page before we move to characteristics is the risk review. Risk is something that's addressed at every step of the process. We do the risk review and pay attention to the risk characteristics of the model when we design our models. When we create the portfolio and put those together, we look at the consistency of the performance. We look at the sharp ratios. We look at the -- how the portfolio performs in the times when the market is in negative territory. All of that is risk review that's done at the research stage.

After that, when the portfolio is already put in place, there are several views into the risk that we apply and this we call our risk management. One of those, and it's -- you know, we have experience of information and client guidelines. We have a way to either filter the universe and put restrictions in either our research process or in our trading system to incorporate client guidelines in the process so we don't violate those restrictions that are imposed by the client.

In addition to that, one example that I want to give you is a diversification.

When models are looking for stocks, deeper value stocks or stocks with approved fundamentals, they go any sector. They can pick names from any of the sectors. The result, the portfolio that's put together, may be over and under weighted in each sector. We've studied those exposures versus the benchmark, versus Russell 1000 Value. And what we found is that being too much over or under actually is detrimental to the consistency, because during the time when, you know, the IT crisis hit, that's where you have a quick turnaround. And because the portfolio is positioned to be -- you know, have a hold -- a long holding period, the portfolio is going to lapse. So we address that by implementing a 10 percent relative sector constraint. What it means is that you have a 10 percent allowance over or -- above or below the sector weight in the sector, in the -- benchmark weight in the sector. For example, if a healthcare is at five percent, our -- will be at 15 percent and we'll have some exposure on the lower side. That's one example.

In addition, the portfolio managers

are responsible to look at the portfolio characteristics at each of the security diversification. So the risk review done is on a daily periodic basis, as well as on the quarterly basis with the CIO, and the portfolio review committee that Cindy mentioned is also a formal way of looking into the strategy and be sure that it's performing as designed and will deliver the expected risk and return characteristics.

MR BUTKOVITZ: Can I interrupt you for a second? So what does this look like in 2008?

MS. KHOZIAEVA: This is presented on slide nine and this is -- this is a segue in a characteristic -- in the performance which is the result of the process. In 2009 the representative account, the composite, returned 25.96 percent and in 2008 will provide a little bit of a cushion. And it's not much. You know, it's only basis points. But it's during the time when everything is moved together, when correlations were very high. And so this portfolio is able to provide that cushion --

strategy was able to provide this cushion because of the diversifying exposure and not being exposed to one factor.

MR. BUTKOVITZ: But you mean minus 36 percent was a cushion? I mean, what happens when there are abrupt changes in the market? Your modelling is based on expecting some kind of replication of historical performance, right?

MS. KHOZIAEVA: Yes.

MR. BUTKOVITZ: So 2008 shows when there is some abrupt shock. So how is that cushioned?

MS. KHOZIAEVA: Because of the relative performance versus the benchmark. So the strategy is not -- it's not an absolute return strategy. It's not something that is designed to be going into cash or time the market. Our research shows that it's, I would say, close to impossible, but I would say difficult to time the market to know when to exit and when to come back. So the strategy is designed to capture the performance on the upside and provide cushion on the downside.

And let me use this demonstration on

slide eight and talk about up and down market capture to answer your question on the performance in the down periods.

MS. WINKLER: Could I just ask another, sort of, related question which is, you indicated that you would be selecting a portfolio that would be typically in the 70 to a hundred stock, and I think you -- 70 to 80. So I guess I'm a little -- you make individual portfolios for each one of your clients so each -- so this is a theoretical performance? I'm a little unclear as to why this particular portfolio -- this isn't actually -- have you been in -- you know, invested with you back through since 2005. We might or might not have had these same stocks, right? Because you seem to indicate that you customize the portfolios for each.

MS. KHOZIAEVA: We do not customize. What you see on the page is the actual strategy that was in place.

MS. WINKLER: And you're applying that for all of your clients?

MS. KHOZIAEVA: Yes. The only

reason why you see more names in this strategy on slide eight, you see like 116, because the portfolio is in a significant inflow mode. So there is a lot of cash that's coming in. And as we run our models and we position the portfolio, when we're updating we have a new model, pick new names, we typically would invest in the new name that provides the same exposure to factors. But that kind of increases the number of names in the portfolio to a certain degree. And some of those positions are 20 to 30 basis points. When we actually get the new accounts set up, it's the same names, name models --

MS. WINKLER: Everybody is in the same -- okay.

MS. KHOZIAEVA: Unless there's client guidelines. It's the same portfolio, same factors, same exposures.

MR. DIFUSCO: And I was piggybacking on that, just if we had a stock get kicked out for Sandy Hook or McBride, would you just equal weight all the remaining positions or do you go to your next best idea? How do you account for it?

MS. KHOZIAEVA: We would go to the next stock. And the reason why is that this portfolio and this strategy is all about the exposure to those factors and models. So it's not about individual stock. There is another stock that's going to have the same --

MS. WINKLER: We don't have much time.

MS. KHOZIAEVA: So up down -- up and down market capture, this is on slide eight and this is one of my favorite characteristics of the portfolio. What do clients want? They want a strong performance in the up markets. You know, can you capture the up market and deliver better performance in the market live, let's say 2013. And at the same time, can you provide a cushion at the time when the market is under -- in the negative category. Can you preserve the capital. And that's what this up and down market capture shows and this is done over three-year, five-year, ten-year basis. So over this long term, our up market capture is significantly higher than the down market capture.

What it means, that the market is at a hundred, we're going to get 1.11 percent or ratio of the up market and then providing the cushion on the downside. Now 2008 is a special year. It was very difficult to perform in that year for, your know, any of our peers as well. We do think that, you know, matching the market at the times when all these correlations are so high, this is a special event, was a benefit for this portfolio. It did still underperform as far as versus the -- not under perform, but created a negative return. However, it performed slightly better than the benchmark. So even a little bit of a cushion in 2008 and then we picked up on the following years after that. So this is what that up and down market capture shows.

Very briefly, on page eight you see our sector exposure as I mentioned. We are not sector biased, so we're not selecting names in certain sectors. But this is the output of the model. So very diversified currently. Our market cap is typically smaller because we can take one percent position in a stock like Exxon or we can take a one percent position in a stock that's a low market cap. We have our model weights. So that's interesting to see on this page.

The performance page is the result. This is our score card. This is what we call the proof statement that our strategy that's been in place since 2002 does deliver the results over time. On the top of the page you can see the chart that shows our performance since inception and over a long-term period of team. And the green bar is Bridgeway large cap value strategy. So we are proud of that record. And even the recent performance in the first quarter of 2015, the market underperformed. We were able to deliver 1.9 percent in the first quarter. And then you see our calender year performance as well, that in each year by year we still deliver the consistent outperformance.

I have one more slide left so I'm going to -- this is why I start to speak fast, but I'm going to slow down. I want to demonstrate how we look into this performance and why we talk about the factors and the models and what drives this return. As an example, if you look at 2014, the strategy of 15.6 percent versus the market that's 13.5. We get questions, how did that happen. What helped the performance and how do you know that your process is working and that's the result of your process. So we want to demonstrate that and this is on slide ten. This slide shows our quarterly performance in 2014, as well as the first quarter of 2015. And on the bottom of the page you have calender year performance. Each bar, the green, the first three bars, represent the performance of each of the categories. Value metrics, company financial health, and price momentum. And at no -- very rarely they will be all aligned like in 2012 when they all performed well. Typically going to have some diversification and some different results from each of those categories and that's expected. That's why they are in the portfolio. Because they all deliver different risk and return characteristics to the portfolio. The goal is to have our strategy, which is represented by light gray bar here, outperform the benchmark, which is the dark gray bar. And you can see in 2014, that value actually underperformed other categories. And even if we were all invested in the value metrics, we would not have beat the index, the benchmark. However, our company financial health performed better, as well as momentum. And those two categories move the results higher and then provided the performance which you see there, which is 15.5. And you can see it also in the quarterly basis here.

So this is what the strategy is about. This is the result. This is the consistency we're talking about. And my pleasure to be part of your team and to talk more about the strategies later.

MS. GRIFFIN: Thank you. We're committed to serving the Sinking Fund of the City of Philadelphia at a high level with our team approach. And we have listed on here the multiple ways that you'll see us as Bridgeway Partners for years to come as a part of your team and we'll get to know you, and it would be an honor to have you as a client.

MR. GILBERT: Any questions?

MR. JONES: Thank you, ladies.
MS. GRIFFIN: Thank you.
MS. KHOZIAEVA: Thank you.

- - -

MR. JONES: This is Jaime O'Neil and John Hamblett from Cooke & Bieler. They are our current large cap value managers. Their faces are probably familiar to some of the people in the room. But they're here today to discuss their products, their process, their philosophy.
So as before, we'll give you approximately 25 minutes for your presentation and Q&A. So as of right now, the floor is yours, gentlemen.
MR. HAMBLETT: Thank you very much, Charlie, and we're pleased to be here today. As Charlie said, my name is John Hamblett from Cooke & Bieler. I'm a partner of the firm. I have been there for 11-plus years, and I handle the client service side of the relationship. Joined by Jaime O'Neil. Jaime is also a partner of the firm. He's actually been at the firm for almost 28 years now. And he's a portfolio manager and a senior analyst on the investment

team that makes the buy and sell decisions for all client portfolios.

Cooke & Bieler, as many of you know, is at 1700 Market, so we're just two blocks away. Actually, our headquarters have been in Philadelphia since the firm was founded in 1949. So we have had a 65-plus year relationship with the City of Philadelphia. We have also been fortunate enough, as Charlie said, to have managed the PGW pension plan for almost ten years now. Both Jaime and I were involved in the initial presentation. We did the rebid five years ago, and we would be the team that would be working with the plan going forward if we were fortunate to retain the business. So we're very familiar with some of the needs that the pension plan has. You know, we have been through it, whether it's McBride or Sandy Hook principals, and we have been able to operate in line with those principals through this period.

We have also been very pleased with performance through this period of time. You know, Cooke & Bieler has delivered 170 basis points ahead of the benchmark, gross of fees and over a hundred basis points net of fees. So we have definitely added value through this period of time.

One thing you'll note about Cooke & Bieler, and we've tried to do it with having us involved, is that you'll notice that we're a very stable organization, one that has continuity. People don't tend to leave Cooke & Bieler very often. So once you get to know us, you'll find that we're the people that you're going to be dealing with and we find that that works very well for us.

Through this period, we have been able to grow the plan assets to almost 40 million from the initial amount of 27 million. So happy to be able to help with paying retiree benefits and things like that. So I would like to thank you for the business, and also thank you for the opportunity to continue to be of service to PGW going forward. You're clearly an important client of ours, a local client, so we would like to see that relationship continue.

Before we get into the formal presentation, I just wanted to ask if there are any specific questions or concerns that you have that we need to address before we get into that?

MR. DIFUSCO: I think from my perspective, I won't speak for the Commission, I would like to see some discussion on recent performance. I think, obviously, long term the numbers obviously, I think, match up with what you say. But I think the three to five-year performance there obviously have been some challenges. I would like to know what's driving that, if you have changed your process to address that, or if you think that where your position now is going to make sense in the longer term. So from my perspective that would be --

MR. HAMBLETT: Okay. Jaime, do you want to take over?

MR. O'NEIL: Our understanding is that some of you know us very well and some of you don't know us so well. So I'm going to spend a brief period of time talking about, you know, our philosophy and process and then we'll get right into this question about performance. So if you turn to page five. That's probably a pretty good place to look as we talk about philosophy of process. First of all, we believe that fundamentals drive stock prices over the long term. Over the near term a lot of other things can drive stock prices. You know, a poor quarterly earnings report, a sell-side analyst recommendation. Any of that stuff can drive stock prices. Ultimately they'll come back to long-term fundamentals. We also believe capital preservation improves returns. During -- if you lose -- when the market is down, if you're down like the market or a lot worse than the market, that's hard to come back from. So we think preserving capital is very, very important. We can just kind of hang in there in the real up markets and produce really good relative performance in the down market, we think that adds up to really good long-term performance. That's been our history and we'll show you that performance history shortly.

Culture shapes investment decisions. We are fundamental bottoms up type investors. We want to get to know the companies really well and we want -- and we're collegial. We really help each other. You know, I actually introduced a new idea, one that's not in the portfolio currently, the last week and I got grade support from my colleagues. By support, I mean challenging, really challenging me. What about this? Different people seeing something from different angles and that gave me a lot to go back to the drawing board and think about. That's the way we operate. We're a team and we're a collegial group of people. We do think valuation matters. We want to -- you know, we start with a high-quality universe. We do a lot of analysis on the company in that universe, but then we only buy them when the valuations are reasonable. That has to be part of the equation or we won't get the good runs. So that's basically the way it works. There's one little schematic on page six that kind of demonstrates this schematically. Intrinsic value for the kinds of company that we invest in tends to be pretty stable. That little blue chart, upward moving blue chart, that's the way we think about a lot of our companies. There's kind of a fairly steady intrinsic value progression. But the stock price tends to be very vulnerable around it because of some of the things I mentioned. Sometimes it's a news item, whatever. That gives us opportunity to buy stocks, sometimes sell stocks. That's kind of the way we think about both the long-term, as well as short-term type news.

The last page I'll point out before we get into the performance issue is page nine. This is kind of the result of all that philosophy and process I talked about. We typically generate a portfolio with 40 to 50 companies. We won't go over 50 companies. That's actually an internal constraint for us. We do a lot of research. We want it to count. So we want each stock in the portfolio to be a sufficient size to count, but we also realize diversification is important. So we -- as you can see under the risk management, we have limitations as to sector, industry, and individual position sizes.

The final point I'll make is we have an accountability system whereby we monitor the portfolio daily. We have a weekly review. A team review of the portfolios. Absolute relative diversification. And we have at least a quarterly accountability process for each individual stock in the portfolio. More often than that if need be, if there's a lot going on with a company, but at least quarterly.

So that's the Cooke & Bieler review. If there are any questions on that, I can either take those now or, you know, a little later on as well after performance. So feel free to ask any questions on that, if you would like.

Okay. So the issue of performance -- on page 11, what we have done is we have actually shown all periods of performance, year to date, one year, two years, all the way to the inception, which is not quite ten years, close to ten years. And we show up both the PGW pension plan performance, that's the dark blue bar, and the benchmark, the Russell 1000 Value index, how that performed. And the one thing -- we're in kind of a place right now in his history where the near-term results have been pretty good, the last year has been good, the long-term results, which is probably the most important we think, have been very good. As John mentioned, we have been able to do 1.7 percentage points per year on a gross basis better than the benchmark. However, the intermediate term, the three-to-five-year -- which we understand, that's what a lot of people do tend to look at, the three-to-five-year periods, those middle places are about even with the benchmark. And we think there's a pretty good reason for that. That's been a period of time where the market has been very strong. As you can see, that's the period of time on this page where the bars are the highest. The market has been the strongest and it's been pretty steadily strong.

A couple of charts on this point. If you turn to page 12, we show you 25 years worth of data for our equity large cap value. You'll notice that when the bars for the index, that would be the market, are below line, they're negative, we do quite well. We do very, very well. That's the capital preservation I talked about. When the bars are very high, sometimes we do a little better, sometimes we do a little worse. On average we're probably about even with the market. I would say -- when the market is very strong, if you were to kind of add up and average those. But what that adds up to at the end is outperformance by a meaningful sum, as you see here. The annualize 25-year performance. And of course you know what your 10-year performance has been.

A slightly different way of looking at that is on the next page. This again is the same period, 25 years, but we took the liberty of carving up the market as to what we think as being six different phases. Three of those are down phases. The S&L crisis, that was 25 years ago, long time ago; the tech bust, a little closer, early -- the early part of last decade; and the financial crisis, which I guess -- it's starting to become a distant memory, but probably still somewhat fresh on people's minds. And as you can see, we do very, very well. We had a lot of value in those periods. Then there are the other periods. They're the kind of boom parts of the market, the tech boom, the old commodities and what we'll call quantitative easing. There we tend to kind of hang in there, try to stay as close as we can, maybe lose a little bit of ground. But when you put it all together, you know, if we add value, the one point about three-to-five-year results, because we know everyone does look at, is that the three-to-five-year results at this point in history really include just up markets. It doesn't include any kind of a down market. So it's not really surprising for us and we're not uncomfortable that, you know, we're kind of hanging in there, but around even with the market, not beating the market during that kind of a phase.

In answer to the question have we changed anything. No. We think our philosophy process is very sound. We think it just simply needs -- you know, it needs different -- it needs a full market cycle to show its stuff.

MR. DIFUSCO: What do you consider a full market cycle?

MR. O'NEIL: It would include one of these bust periods on this chart. Typically a full market cycle -- when I joined the business, I thought it was five years. I thought five years would be a full market cycle. The tech period kind of blew that out of the water. That ended up being almost -- well, in here eight years, depending on how you define it. So it doesn't quite operate on a calender. The market kind of does what it wants to do. So sometimes it can be longer than that period.

MR. DIFUSCO: So what would your down and up capture ratio look like over a longer term? I know what it looks like -- I have numbers for three-year period and five-year period. Example, five-year period through the last time that you guys updated in PSN. So it would be -- captured about 91 percent down over five years and you captured about 96 percent of up. It's about three months stale. How would you expect that or what would the numbers look like then over 10 years or over 20 or something that captured one or more of these down cycles you're referring to.

MR. O'NEIL: That's an interesting question. I would say directionally it would be the same. It might not be -- it might not be quite as severe both ways. You know, going forward as you -- I'm sorry, the history might be more severe than it has been recently or will be going forward. Part of that is just -- the tech boom and bust was really once in a generation. That was so extreme, we wouldn't expect that severe a correction again. So you probably wouldn't have quite as much opportunity for upside and downside capture in those two periods.

MR. HAMBLETT: We did run the numbers not too long ago from 2000 to the end of March and the down capture ratio was about 80 percent. So that's better. And the up capture was close to a hundred percent. So that kind of profile is what we would expect more on the long term and what we have seen historically.

MR. DIFUSCO: Okay.

MR. O'NEIL: One other point we'll make on performance is on page 14. We realize that, okay, five years, you know, we're about even. It's easy to get a little bit impatient, but we show this chart. If you look at the left-hand chart, it shows all the rolling five-year periods over the last 25 years. And, you know, what the actual market has yielded that's on -- that's kind of the bottom horizontal chart. And what Cooke & Bieler's return has been kind of on the vertical chart. You can see generally, not surprisingly, given what you have heard here so far, when the market is very, very strong we tend to underperform, be below that line a little bit. When the market struggles a little bit, we tend to outperform by quite a bit.

Importantly, what we also charted on the right-hand graft here is what happens in the subsequent five-year period. So after a five-year period where you underperformed and through the end of the calender year, '14, that was one of those periods. We show it with a red dot here. That red dot is five year ending 2014. What has tended to happen over the next five-year period, that's what we show on the right-hand chart. And as you can see, we almost always outperform, typically by quite a bit. And when we -- the few times we have underperformed, we don't underperform by much and it's -- and it's always in a period when the market is very, very strong. That subsequent five-year period. So, you know, we can't predict for sure, but the trend seems to be in our favor in terms of predicting what our next five years will look like.

So that's kind of the answer hopefully to the performance question about the last three or five years. We think it just happens to be kind of an odd period in history but not one -- is it something that we're disappointed with, you know, given the way the market has been, do we think something is not working? No, not at all. We think we're kind of right on schedule given the kind of market we have had. And we think the market inevitably over the next 25 years is going to be made up of up and down markets. And the way that we manage money is to make sure that we're doing well when you put the markets all together over the long term.

Are there any questions on performance? Happy to come back. It's an important question. I mean, we understand why you're asking it.

MS. WINKLER: I guess maybe I'm not quite sure how to frame the question. But it would be -- looking at similar time periods for other firms under consideration, they have a similar pattern of avoiding very much on the down side, but have better performance, it seems like, on the upside, for total aggregate better performance over these same time periods. What would be your response to that?

MR. O'NEIL: No, it's a --

MS. WINKLER: In our role that we're --

MR. O'NEIL: I think what we would say is make sure you look at what they have done over a long period of time. Because over relatively short periods of time, three years, five years, 10 years -- we actually think of -- we're very long-term people. We actually think of 10 years as being kind of intermediate term maybe. Over those periods of time, you're going to be able to look at a universe of managers and find some that have done very well over the short periods of time. We think it's going to be very hard -- we're guessing it's going to be very hard to find a manager who has done what we have done over the last 25 years with real money. Meaning throughout that whole period we have been managing billions of dollars. That period doesn't include that startup period where we were only managing a hundred million or something like that. We have managed billions of dollars, multiple billions of dollars throughout that whole time period and performed very consistently --

MS. WINKLER: Are you saying we're going to revert to the mean over time?

MR. O'NEIL: Well, if we were -- no. Because if we reverted to the mean, that would mean we would have to underperform. If that's what you're suggesting. Do you mean -- I mean the other managers? Yeah, I think if you're looking at a lot of managers and you're looking at their three or five-year performance, or even their 10-year performance, yes, I think a lot of them will revert to the mean. In other words, at least they haven't proven -- it's not time tested. It happens to be that over the last three to five years, maybe they have done very well. Maybe even over the last ten years. But how many of them have done well over 25 years with meaningful money under management? We don't think there are that many out there whose philosophy and process has been time tested like ours has been, to the extent ours has been. That's what I'm saying. So I think yes, I am -- I would be --

MS. WINKLER: We would just go to your philosophy because that's what you're selling --

MR. JONES: Got five minutes, folks.

MS. WINKLER: I'm trying to find that page.

MR. O'NEIL: Are you looking at the first page --

MR. O'NEIL: Yes. Valuation. I wrote down fundamental bottom up valuation. You only buy when value is reasonable. That's about what I got out of this.

MR. O'NEIL: Okay. You got the right things. We start with -- maybe one thing I add is we always -- we stick with the quality universe at all times. We don't go to low quality when we think it's a good place to be. We always stick with quality. We do a lot of fundamental bottom up research. That means company by company -- company by company -- we're not macroeconomic people. Company by company research and try to own those good companies when the valuations are reasonable. That's our equation. That's what we have been doing for -- we show you 25, but we've actually been doing it that way for 40 years. We don't show you 1987. That was -- now many people remember '87? We don't show that data point. That was the period through October -- up through October I was a summer intern in 1987 at Cooke & Bieler. I remember thinking and they kept lagging. They weren't buying anything. They couldn't find anything good to buy because the market was over value. They had a good valuation discipline. We think we do now. Then October hit and then it was the aftermath. And by the end of the year, we were outperforming by four, five percentage points. So, you know, it's a very time-tested process and philosophy.

MR. HAMBLETT: I also think taking a long-term approach. You know, when we buy a company, we expect to own that for three to five years minimum. And having that long-term approach as Jamie said gives us opportunity when there is volatility in the marketplace. And I don't know if anyone knows, but the average holding period for a stock in the New York Stock Exchange right now is less than a year. You see it every day, there's so much trading going on. Well, we are an investor. We're a buy-and-hold investor, and we use that volatility to take advantage. So if we find a fundamentally strong company, a high quality company that Jamie is talking about, invest in it. Well, we can be patient with that company maybe through a dip and allow it to achieve its market appreciation potential over time. So I think it's another component of our philosophy and process that gives us a little bit of an advantage.

MR. DIFUSCO: So in terms of long term, the way you just described it was three to five years in terms of the hold period. You had mentioned maybe thinking about a longer period.

Have you seen an increase in your holding period then in the last five years for a stock given that we haven't really had a down market?

MR. O'NEIL: Yeah, on average I think we have. Particularly in that 2012, 2013 period. If you remember -- I think it was '12 where we underperformed. I think I have the years right. And that was a period where our turnover was single digit, was extremely low, because we like fundamentally our companies -- the market wasn't recognizing the value so we held. And then '13 was a very, very good year for us because basically the market recognized the value. That's kind of a microcosm. Kind of what we would expect last five years versus the next five years.

MR. DIFUSCO: No, I get it. I was trying to reconcile the two statements if we're thinking about over 10 or 15 years or a longer period than long term in terms of how long you hold a stock, a little shorter. I was trying to reconcile those two things. Thank you.

MR. O'NEIL: Last -- and we can go through this really quickly and see if there are any final questions. Portfolio characteristics. That's on page 15. Cash interest coverage. Ours is very strong. Talked about quality. Here we demonstrate it. Cash interest coverage hasn't been very important lately. Interest rates have been very low. Eventually they'll go up, it will become important. And we maintain that quality throughout.

Page 16 shows you the portfolio. Those are all the holdings in the portfolio broken down by economic sectors so you can get a sense of diversification. And yeah, that's -- those are kind of the numbers and the holdings and the facts and figures. The one thing I would say, just to underscore John's point, you know, you're an important client to us. You know, we're Philadelphia, we have been for 65 years. You're Philadelphia. No question logistically -- we like having Philadelphia clients, but viscerally we like it too. We hope you choose us again. You know, if you don't, we're glad that we have been able to provide some pretty good performance for you for 10 years. And, you know, thank you for your time but please, if there are other questions please ask and we'll do our best to address them.

MR. JONES: Anything else?

MR. GILBERT: Questions?

MR. JONES: Thank you, gentlemen.

MR. O'NEIL: Thank you.

MR. HAMBLETT: Thank you very much. We appreciate it.

- - -

MR. JONES: These are gentlemen from O'Shaughnessy Asset Management. As an Irishman, I like to hear that name. This is Michael Hattrup and Chris Meredith. And you'll be presenting to the Commission today. Ben Gilbert, who's the chairman. Nancy Winkler and Alan Butkovitz are the Commissioners. So you'll have 25 minutes for your presentation and questions and answers and I'll give you a five-minute warning.

MR. HATTRUP: Thank you. Good afternoon. Thank you for the opportunity to be here. We are certainly flattered to be considered. As Charlie said, I'm Michael Hattrup. My colleague Chris Meredith. Wait for the copies to be passed around.

So before we get to the information, just as a way of quick introduction on who O'Shaughnessy Asset Management is. We are a quantitative long only equity manager. We have spent the last 30 years conducting research to identify the characteristics of companies that typically outperform the equity market. We are exclusively an equity manager. That is our specialty. We do this -- we focus on these characteristics with extreme discipline that we think that once we have conducted our research and identified the factors that work, you have to stick to that process. And we also do so with extreme transparency. It's our belief that these are your funds, your assets. You deserve to know exactly how they're being managed. So as we go through the presentation today, please, if you have any questions, there are no topics or subjects that are out of bounds.

The quick stats on the firm on slide two, our core management team has worked together since 1997. We're 41 employees based out of Stanford, Connecticut. All but three of us work in that Stanford, Connecticut office. There are a couple of remote sales people as well in Detroit, Northern California and Southern California. 6.8 billion dollars in total assets under management. Approximately 4.9 billion dollars in institutional in nature. Our market leaders value strategy, which is our large cap value strategy we're talking about today is approximately 2.5 billion dollars.

These last two bullet points: 13-person investment team. Our folks are all generalists and we are 90 percent employee owned. The reason I want to spend sometime on these is that independent -- that 90 percent employee ownership gives us the ability to direct resources within the firm to the areas that best benefit our clients. And additionally, that 13-person investment team that are all generalists, they're not assigned -- our portfolio managers aren't assigned specific strategies or sectors or segments of the market. So there's no competition for resources among the team. That it really is a function of conducting research to benefit or clients. What we believe, an introduction to our philosophy, and then I'll hand it over to Chris to talk more about our research and the investment process, we believe that characteristics drive the return of stocks, that it's not headlines, it's not the talking heads on CNBC that we follow. We are looking exclusively at the data and have, like I said, conducted research on data sets going back to the 1960s, and in some cases the Great Depression in order to identify these characteristics. Very little duplication of the benchmark. That our position is if you decide to hire an active manager, you have to be different than the benchmark in order to outperform so we view, you know, our position differently. Very transparent investment process, as you'll see. High conviction that we are typically more concentrated than a lot of other managers and we put some weight into our preferred names. That as a name and our portfolio holding continues to exhibit our preferred characteristics, we'll continue to increase its weight in the portfolio. And the way we measure ourselves is based on 30-year batting averages or three-year batting averages. Excuse me. 30 might be a little bit too long to evaluate a manager's effectiveness. Three years is probably a reasonable time period to evaluate whether or not we have been effective in the marketplace. And so we're looking at that from our research and from the live track records over rolling three-year periods.

With that, are there any immediate questions about the firm that I can address before I hand it over to Chris? No?

MR. MEREDITH: Thank you, Michael. Listen, we appreciate the ability to come down here and talk to you about our process. I can appreciate the difficulty from your side. You're looking at multiple managers today. You're trying to figure out which one to select and invest your money with. You're going to look at -- I'm sure everybody has a pretty good track record. So my job is to try to explain the investment process to you so you can understand. From your side, what I think you should be looking for is one, does the investment process makes sense; and two, do you think it's a repeatable process. What's going to be generating that track record that we have had? We generated a successful one over the last number of years? Is that a process that we're going to continue to be able to generate? And so my goal is to communicate that process, what it is to you and make sure I give you confidence that we will be able to.

Michael said our core philosophy, if you boil it down to one sentence, is that characteristics drive the returns. We don't listen to headlines on what's going on with the news, we don't look at short-term events. We look at large, historical data sets, 50 years, and in some cases 80 years and we do analysis on these characteristics. And we look for ones of what has been systematically rewarded in the marketplace over time. If I can compare to anything that you might have exposure to it's probably moneyball and baseball. The idea that scouts are looking at players, checking out their body types and their confidence levels, when really they need to be looking at their skills on base percentage, how well they're able to draw a walk.

This first page on page four is meant to represent what we put together for an investment process. It's hard to put it all on one page, but really what we do is we take multiple data items from historical data sets, put them together through a lens of analysis. Most of our people, most of you time is spent looking at historical data sets, taking apart the balance sheet, the income statement, the financial statement of companies and looking for characteristics that have been rewarded. We develop east over time by looking through this lens of return. What's generating the strongest returns, the consistency of returns. Michael talked about the three-year batting averages and how we like to make sure it's not going to for that entire 50-ear data set driven by one year. We look at the risk that is attached to these characteristics and we want to get market level risk or lower. And the real world application, the idea that there's costs, we build a process that's sensitive to what you're doing on transaction costs. We build these themes. These themes are going to make intuitive sense to you. These are ones you're going to hear from fundamental managers. The idea of yield is a total return of capital U.S. equities. It's a very important characteristic for this process. We're going to talk more about it.

Valuation. You want to buy companies that are cheaper based on their earnings and cash flow versus other things. Financial strength. You look at the leverage of the company, making sure that it doesn't have unsustainable levels of debt and it's not taking on more. The quality of earnings. Companies that are representing their earnings faithfully and they're not cooking the books. And earnings growth. You're avoiding companies that are essentially looking for a most recent quarterly decline. These are all characteristics that we've researched.

Page five gives a top level look at our research. Particularly shareholder yield. Now shareholder yield, I talked about it as total return of capital. Within the large stocks, universal, which is what the market leaders value strategy is ed on, we look at total return of capital as both a dividend yield plus a repurchase yield, a buyback. And the idea is that managers are steward of capital. And a large, stable company they're getting strong cash flows in, hopefully, and they'll be able to spend that money in certain ways. And what you see is there are some managers that are -- say they got big eyes. Big projects in mind and they want to sit there and spend money on projects that might not have the best ROI, but it would be for their status. We like to look at conservative companies, ones that are returning the capital and they make those choices and say you know what, sometimes the best decision is not to spend money on a project that will lose money but to return it to you as an equity stakeholder. Return it to shareholders because that's who I'm beholden to.

And if you look, this is research that's done from 1964 to 2014, over a 50-year period. We look at stocks that are large stocks universe. So a market cap greater than average.

To set the tone for that, right now that would be about 407-and-a-half billion. So these are companies in that large cap space. And if you were to just buy the top ten percent and do that for a buy and hold for one year, and roll that process over time, on average that outperformed the market by four percent annualized. That's a pretty significant outperformance on one characteristic.

So, also, Michael talked about consistency on that three-year base rate. If you were to look and start at any point in that 50-year history and buy and hold for a three-year period on one characteristic, it outperformed 83 percent of the time. So this is a very effective characteristic.

If you look on page six, this gives you an example of what happens with a single company in this idea of buybacks. The left-hand line on this chart is what we call our value composite. Ranks from zero is the cheapest and a hundred is the most expensive. And the black line is showing that Seagate had a dramatic turn towards cheap valuation in 2010. It was being called one of the top ten shorts. Everybody thought the hard disk drive industry was imploding, everything was going mobile, so there was no reason to own Seagate, and they watched the stock get driven down at one point the very first percentile, one of the cheapest one percent of companies out there.

MR. HATTRUP: This was an example of headlines driving the stock price. When analysts and the wisdom -- the common wisdom on Wall Street was Seagate, a hard drive manufacturer, was going to be put out of business because the transition to solid state memory and cloud computing.

MR. MEREDITH: What management saw though is they have a diversified business and the headlines we're driving their prices. And they said you know what, this is a valuation opportunity for us. Let's repurchase our shares.

We see on that blue line, that's the buyback deal. The net buyback is a percentage of the market. You see that 2010 they started repurchasing shares to the tune of almost 15 percent by the middle of 2011, which is when we started billing a position. We recognized the super normal return of capital through share repurchase.

Over time you can see that fluctuates a little bit, but it peaked out at a point where at one point they were repurchasing 30 percent of their shares outstanding on a trailing 12-month basis. If you think about that, as an equity stakeholder the earnings are flowing to you. Three out of ten shareholders just got taken out, so you were going to get a 30 percent on your earnings, even if the company stayed steady. That's a pretty significant change in what's going on with you as an equity stakeholder.

MR. BUTKOVITZ: How did you determine that the prognostications were wrong, that they were not going to be put of business?

MR. MEREDITH: It comes from the underlying characteristics. So as we look at the share repurchases, we have other characteristics looking at the financial health of the company, the quality of earnings, the earnings growth, and the relative valuations. And all of those put together tell us this is a healthy company --

MR. BUTKOVITZ: But wouldn't that be a technology question or something about the substance of the business? Is that something that is trackable based on trends?

MR. MEREDITH: What we look at are the underlying characteristics. So at the end of the day, what you're asking about is there a fundamental portion of this that would drive the returns. And what we're saying what's really important is the underlying characteristics of this. And more often than not -- not every company works -- but if you find a company with these attractive characteristics and management is repurchasing these shares, it is a very strong signal that the company is healthy, it's a continuing operation and it's going to outperform the market over the next 12 months.

MR. BUTKOVITZ: So basically they know something that we don't know.

MR. MEREDITH: A very good way to put it is we're following some of the management inside signal on how they're deploying their capital.

MS. WINKLER: How heavily is that weighted in your buying decision?

MR. MEREDITH: It's a final characteristic, it's a predominant factor within this process. If the process -- if you were to look on page eight, very transparent. We do that to make sure it's understandable for you. If you're going to invest with us, we want to make sure you understand exactly how we're investing your money. We take that large stock universe, again, about 750 to 800 names, market cap rate greater than average. So you wind up with a seven-and-a-half billion and up. We cut it in half essentially. Taking about 375 to 400 names. And that's where we're removing the worst. The worst of financial strength, earnings quality, earnings growth and valuation and buying the absolute best on the shareholder unit.

Now if you look, we gave you two examples here, Illinois Tool Works and John Deere. Both return capital at a pretty decent rate. Two percent yield for ITW. Two and a half for John Deere. 11 percent buybacks for ITW versus ten percent for John Deere, right? So they're both doing both a decent amount of dividend, market level dividend, but a really strong repurchase in the 10 to 11-percent range. They're both trading at a discount. They're both sitting their valuations, 31 ITW is cheaper than average in the top third. John Deere in the top 20 percent. John Deere is a little bit more cheaper on price to sales, price to earnings. ITW, they're equal on about the free cash flow. ITW has double the free cash flow from John Deere. If you look at the earnings growth, the earnings growth is one where you see ITW have a 30-percent bump in its earnings over the last year, whereas John Deere has seen negative 20-percent drop. That's a pretty significant difference between the two. And the idea that that earnings growth means that the company will be more likely to be able to continue to repurchase those shares, versus the drop where they will be unlikely to. The earnings quality is also one saying that John

Deere is boosting its earnings somewhat through accounting choices. It's not in the worst at the time, but it's worse than average. Versus ITW is growing and it's being very conservative in representing those earnings. And then the financial strength where you see that John Deere has three times the leverage of what's happening with ITW, it's going to make it difficult for the company to continue to share repurchasing trend.

That's the process of how we separate between the two. Those quality and health metrics that come through this funneling process eliminating the worst and then focusing very strongly on this last characteristic of shareholder yield. Every month taking 25 names for consideration. It's a concentrated process which leads to active management, which leads to our -- we think leads to our returns. The idea is you have to look different than the benchmark to beat the benchmark. So for us the idea of 25 names every month, we're considering them for either an initiation position or increase in the position. The example on page nine, Mosaic is one that started qualifying where it had those high quality metrics and that very strong return of capital over the last 10 months. We take an initial position of about 40 basis points. If it qualifies for all 12 months, we'll build it up to about four percent and cap out at about five percent. And then once the characteristics -- it falls out of that top range of the shareholder yield or falls below the large stocks or over that top half on the quality, we'll start moving out of there gradually. And our research has shown that these names tend to -- these are large stable names. They don't tend to react very quickly, and there's a bit of a drift that happens even if it falls out of that very top concentrated level of shareholders. And what we see with Motorola is how it trails down over time. Now, the example before on page -- Seagate, we started building that position in that manner in 2011 using those characteristics because we saw the opportunity through the shareholder yield. We saw the stock continue to outperform to the tune of a return of 300 percent -- over 300 percent versus the

S&P at a hundred percent over that five-year period. And Seagate was a great story for us. But here's the thing, it stopped qualifying about a month ago and we're starting to work out. We don't fall in love. It is a very disciplined and repeatable process.

MR. DIFUSCO: Within your definition of shareholder yield, what value do you assign to each of the three underlying characteristic dividend, debt and stock repurchases?

MR. MEREDITH: So it's dividends and stock repurchases, those two characteristics, and we just add the two together. What we see is typically about two-thirds to three-quarters of the yield right now comes from repurchases because we're in a very strong repurchase environment. There's a number of companies where we have seen repurchases pick up over the last five to eight years. But that for us, we think, is a greater opportunity where we're seeing more other companies and more opportunities for those that are returning capital stronger.

MR. DIFUSCO: And do you

differentiate at all for different motives of stock repurchases?

MR. MEREDITH: That's where we wind up with these other characteristics. We do some analysis on the separation between the best and worst of, for example, stocks that are being repurchased but are in the top third of valuations underperform those in the bottom third valuations by about five percent. So a company that's repurchasing shares, irrespective of the valuation of the marketplace, tends to get penalized on market-level return. So that's part of the motivation, is understanding that it's going to be cheap and that the company is aware in looking at those characteristics underneath, it knows it's got a strong balance sheet, it's representing its earnings faithfully, those are good companies. Whereas, the ones that are sitting there repurchasing shares from another motive, those are going to fall out based on the process of how we're cutting our universe.

MR. DIFUSCO: Okay. Maybe you answered this or maybe I didn't -- I guess I'm talking about stock repurchases that are the ones where the repurchases are, like, held in treasury or held by the company, as opposed to ones where it's being done for maybe a different purpose, to dilute shareholder power or to give management -- does that factor come in at all?

MR. MEREDITH: Typically those wind up not winding up in that top 25. This top 25 is a really strong return capital. It's a high conviction play.

MR. HATTRUP: What we found is when you take shareholder yield by itself, it's an effective factor. The companies that have very high shareholder yields typically outperform the market by four percent per year. When you add on the value and the quality characteristics, that level of outperformance improves. You don't dilute that effectiveness of shareholder yield. You're picking stocks from a higher quality, cheaper universe and you see additional excess return.

MR. RUBIN: How about the companies that you weren't with that didn't fall into -- that fell into your model but didn't work?

MR. MEREDITH: Well, there's always going to be a percentage on investing your portfolio, a hundred percent of the names don't work all the time. The part is that this, on average, more of the names are outperforming than not.

MR. RUBIN: Right. So why didn't it work in the ones where it didn't work?

MR. MEREDITH: You're looking for a name in particular?

MR. RUBIN: Just in general, what you found and what experience you had with it, and then how you changed that to make sure it didn't happen again.

MR. MEREDITH: Sure. So that the innovations we have done over time is that we've revised our quality universe. In fact, what we have done in 2011 was we had been using characteristics like sales and cash flow from operations and we had refined our teams and financial strength and earnings quality. Before that we were allowing companies that were repurchasing with debt. The idea is they were making a trade with equity and debt to come in.

That was one where we saw more mediocre returns and we adjusted the process now to account for that. Trying to think of an example right now of other ones where it hasn't worked. Most of time where it hasn't worked there's been short-term trends in the marketplace. An example would be in the fourth quarter, if you look at our one-year numbers, we're slightly behind the benchmark. That's going to be driven by the fourth quarter. What happens is that this an active process that will take sector bets. The energy sector looks very cheap and we start building a position. Went from a five-percent underweight to a five-percent overweight. We were a little bit early. And quite plainly, that made back up in the first quarter but it was one where the fourth quarter worked against us because we were getting into the trend energy companies being extremely attractively valued. And if you look at what energy companies did, they were very nimble in how they responded to the oil price drop. The idea of shoring up their balance sheets but also -- and what their capital expenditures were.

So --

MR. JONES: Five minutes.

MR. MEREDITH: So that was one where we saw an opportunity that we just got in a little bit early.

MR. RUBIN: How do you determine the length that you're going to wait for your analysis to pay off before you would pull out?

MR. MEREDITH: It is a one-year holding period. So what we do is when we have that allocation, we see a shareholder yield in particular, it gets rewarded over that 12 months pretty equally. And our process, because we're time diversifying it, we're taking -- every month we're looking at those characteristics and we're building conviction through that dynamic process. Typically the average holding period is about 18 months. If you look on the characteristics, you can see the turnover about 73 percent. What we're seeing is that's an appropriate -- the characteristics are mediocre and they drop off. What we'll do is that -- we'll never get a high conviction weight and they'll typically have about a 12-month holding period. Higher conviction names can last three years, and that's where we have seen that because the continuation of those characteristics.

MR. BUTKOVITZ: So your average rate of return is about 12 percent.

MR. MEREDITH: Since inception. 12.5 percent since 2001, which is about --almost five percent over the benchmark.

MR. HATTRUP: So the gentleman's question is -- well, I think it's important to note that we do not make changes to the investment process based on short-term underperformance. That these factors are based on 50 years of data and research that should we underperform in a given year, we're not going to change our investment process. So for example, there's -- on slide 11 there's the annualized rate of return chart which is really a snapshot that's a view of performance -- that's great for our current investors. What's probably more informative for perspective investors is the base rate table at the top. That's the movie that shows how consistent we are. So just taking that one year line, there have been 151, 12-month growing periods since the inception of the strategy. We have outperformed gross of fees versus the Russell 1000 value 68 percent of the time. So, you know, there is a fair amount of time, you know, one out of every three years that we have not outperformed gross fees. But as that time period expands, our consistency of outperformance by focusing on the characteristics and refreshing the portfolio with regularity, our consistency of outperformance dramatically improves.

MR. BUTKOVITZ: So in the general, market downturn, you just keep your blinders on, you're affected by that, you just continue to do this relative --

MR. MEREDITH: We keep our discipline on is the right way to put it in my opinion. We have our discipline process. We have looked at up markets, down markets, we built this for multiple market environments. And the idea is that consistency, those base rates have borne themselves out over up markets and down markets.

MR. HATTRUP: For example, 2008. In 2008, we had market-like performance, that we slightly underperformed the Russell 1000 value. In 2009, we stuck with our process, continue to invest based on the characteristics, and in 2009 calender year, we outperformed by 41 percent.

MR. MEREDITH: If I can leave with one point, because I know we're getting short on time.

MS. WINKLER: I mean, I have had a question -- you know, if you could just build on that comment that you just made.

MR. HATTRUP: Sure.

MS. WINKLER: Does that more than make up for what it sounds like, slightly more downside capture than the index?

MR. HATTRUP: Our downside capture is typically in the high 90s, so it's about 97 percent.

MS. WINKLER: It sounds like it was more than a hundred percent.

MR. HATTRUP: In that particular calender year, yes, it was.

MS. WINKLER: But overall.

MR. HATTRUP: Overall since inception, downside capture is about 97 percent.

MS. WINKLER: Okay.

MR. HATTRUP: Upside capture is approximately 151.

MS. WINKLER: Okay.

MR. DIFUSCO: The figures shown on page 11, they're actual invested numbers or model numbers --

MR. MEREDITH: This is the live actual track record of the strategy.

MS. WINKLER: I hear that you're saying this overall. But in a severe downturn, a severe -- which we all remember -- how much more did you underperform?

MR. HATTRUP: In 2008?

MS. WINKLER: Yeah.

MR. HATTRUP: I believe it was three percent.

MS. WINKLER: I'm sorry, where was that?

MR. HATTRUP: Page 16. If I can leave you with a final point on slide 13. Because of the existing relationship that we have with the City of Philadelphia Board of Pensions and Retirement account, we would consider this relationship a family relationship and then offer the same fee that the City of Philadelphia is receiving, and as well bundle break points as well.

MS. WINKLER: What are those? Would we benefit those bundle points now or --

MR. HATTRUP: Not immediately.

MS. WINKLER: -- would we have to wait for an increase in --

MR. HATTRUP: Increase in total assets.

MS. WINKLER: Thank you.

MR. HATTRUP: Are there any --

MR. GILBERT: Any other questions?

MR. HATTRUP: Thank you very much for your time and your consideration.

MR. JONES: Thank you, gentlemen.

MS. WINKLER: And these are net of fees, this analysis?

MR. DOMEISEN: Those are gross of fees on that page.

MS. WINKLER: Okay. Do you have a

net of fees analysis?

MR. DOMEISEN: No, because -- no, we don't.

MS. WINKLER: Okay. Because when you got -- I was told it was gross of fees -- net of fees.

MR. BUTKOVITZ: O'Shaughnessy seems -- I'm not quite sure I understand exactly what they do. Chris, do you? They seem to -- they seem to be doing it very successfully.

MR. DIFUSCO: I think that it's always -- Charlie and I were talking about it a little bit. I think quantitative presentations are always more difficult because it's -- you feel like a little bit more like it's a black box.

MS. WINKLER: I think both quantitative presentations were better than --

MR. DIFUSCO: I'm speaking more generally, Nancy. Sometimes quantitative presentations are more difficult. I actually thought, and I think it's the reason why these both rose to the top because they were actually very good, both their returns as well as when we talked to them. I think the shareholder yield characteristic is fairly unique compared to other managers we have looked at in terms of the emphasis that they've placed on it. The Board of Pensions has generally been pleased -- three years this month we have had a relationship with them. Net of fees through May, end of May, they're up about 322 basis points for the Board net of fee. So they have done very well. Their fee is obviously the lowest of the three too, which doesn't hurt, especially over the long term. You're talking about 11 points, I think, lower than Bridgeway and --

MR. JONES: Bridgeway was 50 and O'Shaughnessy is 39.

MS. WINKLER: 45.

MR. DIFUSCO: Cooke & Bieler is 45, which is a reduction from their current rate. So they're six basis points lower than the incumbent going forward. O'Shaughnessy is the lowest. Cooke & Bieler would be the second fees, they would be 45. And Bridgeway is the priciest.

MR. BUTKOVITZ: I liked

O'Shaughnessy. I move that we hire them.

MS. WINKLER: I'll second.

MR. GILBERT: Properly moved to second. Any questions on the motion? All those in favor?

MS. WINKLER: Aye.

MR. GILBERT: Motion carries. Motion to adjourn? Any other business? Okay. We are adjourned.

(Hearing concluded 12:43 p.m.)

- - -

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

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

SUSAN A. HURREY, R.P.R.
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.)