CITY OF PHILADELPHIA

SINKING FUND COMMISSION

In Re: December Meeting

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Friday, December 2, 2016

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

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A P P E A R A N C E S

COMMISSION MEMBER:

DON SCOTT, JR., CHAIRMAN

ALAN BUTKOVITZ, CONTROLLER

RASHEIA JOHNSON, TREASURER

ALSO PRESENT:

MATTHEW MAZZA, EXECUTIVE DIRECTOR

CHRISTOPHER DIFUSCO, CIO, PGW

ALEX GOLDSMITH, PFM ASSET MANAGEMENT

BILL RUBIN, DEPUTY CONTROLLER

ALSO PRESENT: JANET M. WERNER, CEBS, CRSP

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THE CHAIR: Welcome. I'm pleased to call this meeting to order. And the first item on the agenda is the approval of the transcript of the meeting on September 14th. Is there a motion?

MS. JOHNSON: Aye.

THE CHAIR: Is there a second?

MR. BUTKOVITZ: Second.

THE CHAIR: A motion has been made. All those in favor?

(Chorus of ayes.)

Ayes have it.

Item number three on the agenda is PGW pension plan investment consultant.

MR. GOLDSMITH: Thank you. Alex Goldsmith from PFM. Marc Ammaturo sends his regrets. He's unavailable today. I'll talk about the markets a little bit. We last met in September, the third quarter. I can speak a little bit about the third quarter and then where we've come so far through November, the fourth quarter. Then I'll cover planned performance allocation through the end of October, which is in your report.

I think the story we spoke mostly about the last time was the British Brexit decision that occurred at the end of the second quarter, June 28th. Immediately following that, there was selloff in the U.S. market, a selloff internationally, and then a pretty snapback for the U.S. International took a little bit longer.

But the end result was, I think, a little bit surprising to us; market highs in the U.S., Dow Jones, NASDAQ through July and August and into September. International equity actually outpaced domestic equity in the third quarter, which was surprising given the vote for the second largest economy in the EU cultural political leader to depart.

Moving forward in October -- that was up through September. October saw a little bit of reversal. I think the market got ahead of itself in the third quarter, coupled with arising interest rates during October. There was a lot of Fed rhetoric in August and September about a possible rate height in September. A week prior to the Fed's September meeting, Janet Young gave a speech indicating that they would act to raise interest rates. It was a little bit of a surprise when that didn't happen.

Market forces I think essentially even took over, and there was a bit of a rate hike, rates moved up through October. Fixed income sold off. Rate sensitive investments like REITs sold off. And equities struggled as well. It's a little bit of a dual impact, again, in October.

And then that takes us into September to the trend generally persistent right up until the election, which a lot of people were surprised -- I'm not going to say it was a full blown surprise to me. After the Brexit frankly, a lot of people re-examined their reliance on polling data. So I'm not going to say that I called it at all.

What the election -- I think the outcome of the election, Donald Trump the President Elect means for markets, our views, the views of PFM as an investment committee are that it, generally, will be good for U.S. equities over the intermediate term at least. Certainly --

MR. BUTKOVITZ: Why?

MR. GOLDSMITH: The main reason would be a rolling back of government regulations and corporate tax rates. That's the number one reason, the lower corporate tax rate, which he has explicitly mentioned. And then I think an amending or eliminating of the repaid creation tax on foreign earnings will be huge for U.S. companies, just their bottom lines.

More broadly, I think the elimination of other regulatory red tape, regulations that make sense to get rid of, not things like you can dump toxic waste in rivers. He has talked about scaling that certain EPA initiatives. I think we also would like to see what actually takes place once he gets inaugurated.

MR. BUTKOVITZ: Isn't a lot of it already factoring in a huge infrastructure? I mean, Caterpillar's profit taking is way over the horizon, and yet the serious questions about whether there is any there on that plan? I mean, it's a public private partnership plan. It's not a real infrastructure plan.

And yet people are buying the stock as if somebody sold the tractor or sold all this machinery. What happens when they hit reality? Isn't there a shake out on those sharings?

MR. GOLDSMITH: That's where we are today. I think, as of the end of November, the Russell 3000 year-to-date is up 10 percent. The Russell 2000 is up almost 18 percent. Corporate profits in the third quarter came in generally on the line or slightly ahead of estimates. Those estimates have gotten cut. So it makes the estimates easier to make.

So I would certainly say the market is diverged from fundamentals. I think a lot of it is there's a republican in the White House. Capital, I think, is just expecting -- capital is floating into the equity markets. I think capital holders are expecting that a rollback in regulations will free up the ability to do business and to create growth.

MR. BUTKOVITZ: You're saying that exuberance about the proposed infrastructure plan is not a big component of this exuberance?

MR. GOLDSMITH: I didn't say that. I didn't get to the infrastructure yet. Certainly, I think that the stated plan to invest in domestic infrastructure, people are excited about that. That's one we have to see if and how it gets implemented. I don't think Donald Trump didn't do that necessarily unilaterally. He needs support of congress.

MR. BUTKOVITZ: The question is, what proportion is that of the gains that we're seeing on the market?

MR. GOLDSMITH: I don't think I can answer that right now. I wouldn't expect half, less than half, a third. It's tough to put a number on that. I think it's definitely a component.

Other regulations --

MR. BUTKOVITZ: How do you determine that the majority of uptake is because of the enthusiasm about the rollback of regulations?

MR. MAZZA: Think of bank stocks. Banks have what -- do you know the increase in banks since Trump's been elected? It's be due to the momentum that Dodd-Frank will be repealed. Banks will have the ability to grow more.

MR. BUTKOVITZ: What has been the performance of bank stocks?

MR. MAZZA: Enormous. I think bank stocks have gained something like 300 billion in market cap since Trump has been elected. That's just the aggregate of this big banks since the time.

THE CHAIR: You don't think that's a function of the fact that rates are likely to increase?

MR. MAZZA: I think that it is a portion of that I think. I think that although Trump has been elected and has hired a number of insiders who have been supportive of repealing regulations and have been very supportive of not completely getting rid of Dodd-Frank but saying that Dodd-Frank is not a perfect law and they are going to repeal some aspects of it, I think that that's momentum. And that's the market buying on that momentum.

MR. GOLDSMITH: I think that's a good point, especially as we've seen this week. We finally have seen the economic appointees starting to get revealed. Immediately following the election, we didn't know. That was seen in one of the later sectors that he's moved to appoint. We're still waiting on secretary of state and other internationally focused appointees. That was when it had been two weeks.

MR. BUTKOVITZ: Is the market factoring in the possibility of a 45 percent tariff from Chinese or Mexican goods? Hasn't he said that also?

MR. GOLDSMITH: He has, right.

MR. BUTKOVITZ: And also buying U.S. treasuries at less than their nominal value.

MR. GOLDSMITH: Yes. I think certainly some things are weighing on the markets. Others aren't. I think the press, investors are -- largely the press -- kind of handicapping what actually will get done. He himself has laid out priorities in some things related to immigration were not as in the forefront as they were during the campaign. I think some of the trade -- his stance on trade is at less of the forefront now than they were prior to the election.

Maybe he himself might have been surprised a little bit that he got elected. I want to go back to the point Matt made about the appointees that were made this week. I think that is an action that has been taken. We still need to wait for confirmation. But an action was taken indicating what the administration's priorities might be. That includes tackling regulation, tackling the healthcare law, the affordable care act, which is another element of regulation that I think will end up impacting the bottom line of corporation. The rollback of an effort --

MR. BUTKOVITZ: Here is the thing: Traditionally, when the president or the secretary of treasury says something, markets all over the world react on a hair trigger. Now we're going through an experience where basically he can say wild vacillations of things day-to-day. And if you respond in the normal pattern to the positive stuff and the next day it's contradicted, don't you have to build -- who is setting the momentum on Wall Street? I think everything that is said today can be contradicted tomorrow.

MR. MAZZA: I think the street is smart enough to know what makes sense and what doesn't. I think they know if he's going to come out and say, I'm going to cut corporate taxes down to a certain level but I'm going to be against free trade, I'm against NAFTA, I'm against TBP, they know that one of those shoes fits. One of them doesn't.

I think they are betting that he will lower corporate taxes. I think that's what they are betting on. I think that's what you're seeing in the rally of the market. He's not going to get rid of NAFTA. He's not going to get rid of significant aspects because you can't be a fair trade person and --

MR. BUTKOVITZ: On what basis do they conclude that?

MR. GOLDSMITH: Based on their own fundamental research understanding what sets the --

MR. BUTKOVITZ: What they think

makes sense.

MR. GOLDSMITH: Well, you said what dictates that. That's the flow of capital. That translates into valuations in markets. Not all capital is smart. Not all capital is stupid. For example, interest rates, the ten year bond has ticked up over 2.4 percent. We tend to think that that is a little too high and too fast.

Regardless of -- the Fed may still act and probably will act in December to raise interest rates. The market -- that may have a negative impact on the market rates. But, again, the movement of capital, the independent acts of investors could lead to a decrease in the interest rate through January, if they think that the fixed income market is overbought as we do.

I think -- I don't follow capital flows on a week to week basis. But that would be something to look at, flows from equity to fixed income.

MR. BUTKOVITZ: And the tax cut plan is calculated as a $6 trillion addition to a $20 trillion deficit. How does that impact the market?

MR. GOLDSMITH: Again, over the short to intermediate term, I think it would be positive for the markets. Longterm sustainability. There is a lot of questions about the president, his administration, and these plans. You know, you talked about it. I think we're in uncharted territory a little bit.

MR. BUTKOVITZ: Since when has congress revised that proposal, instead of corporate tax returns getting the same amount of money to every taxpayer?

MR. GOLDSMITH: I think if -- that would be potentially the catalyst for a reversal of the raising market trends we've seen. I think the market has -- again, as Matt was getting at -- taken into account the reduction in corporate taxation.

MR. RUBIN: How do you put the

valuations of the companies that are supposed to be the driving force behind the market movements and the valuations are so far off that there has to be some point where they come back together; right?

MR. GOLDSMITH: Yes.

MR. RUBIN: That's supposed to be the foundation of the markets. If that's not in any way, shape, or form being followed, as more importantly, as a pension fund, how do we look at our investments and say we're willing to try and take the ride with them while he's reversing these trends, but when all that falls apart, we want to be out of it so that we don't get hurt? How do we judge that? That's our issue.

MR. GOLDSMITH: There is a couple ways to tackle that, actions you can take on a monthly and a quarterly basis. I don't think we try to time the markets. For a fund like this that takes about three million or so in cash every month, there are opportunities to selectively rebalance away from areas we feel are overvalued to areas that we feel are undervalued. Over the long term, on 5 years and 30 years, our outlook for equities surpasses that fixed income. Over the very short term, I think fixed income represents a buying opportunity.

In the last month, we took -- it was our recommendation to rebalance from small -- or to take cash from small caps, which were up in the month of November 11.1 percent, versus large caps up 3 percent, and fixed income was down 4 percent in November. We rebalanced from small caps to fixed income.

Now, again, rates have continued to move up. But, again, in the short to intermediate term, I think that's a logical movement. That's what we can do in a monthly basis. On a quarterly and beyond, we do have the ability to make recommendations to tactically shift the portfolio from benchmark positions or toward targets, 5 percent overweight to equities, a shift from domestic to international or vice versa, choosing not to rebalance or to rebalance when positions get away from their targets.

For example, international equity right now is about 1.7 percent underweight. It seems slight. But for a plan of this size, it represents a significant amount of assets. For example, we're making the recommendation not to rebalance. We favor domestic relative to international.

Over the intermediate term, we're able to take cash from equities to fixed income. Over the long term, we don't recommend a significant rebalance, going overweight to fixed income. Your benchmark is a 6535 benchmark. I don't think it would make sense to go significantly below that equity target.

We have that position, if the market would warrant it. For example, I think going back about three, four, five years equities were undervalued. That was pretty solidly across the board. I don't think we're in an uncharted overvaluation of territory yet where it would make sense to go significantly below.

MR. DIFUSCO: The only other thing I would add is I read an interesting article a week or two ago. I'll try to find it and send it around. It's really dangerous to read too much into short term and kind of what we expect, like this president got elected or this congress, ergo defense stocks will go up or ergo -- like over the short term or the long term.

There is some interesting studies that show historically that that's not always been the case, kind of like the prevailing wisdom of, well, a conservative got elected, ergo gun stocks are going to go up, or defense stocks are going to go up, or likewise, a liberal got elected, we're going to see a bounce in environmental stocks. That doesn't always work out.

It sounds really good as a

talking point or something people on a business show would say. When you go back and look after the presidency ends or the congressional term ends, it doesn't always match up real nice that way, which strengthens what Alex has been saying before and Mark and others on staff that the key is to be, you know, have a prudent well-thought out long-term asset allocation pivot or make tactical withdraw for benefits where necessary, maybe be a little bit overweight or underweight as he's suggesting but not to overreact to any one market event. That's kind of where I come out.

MR. GOLDSMITH: I agree. I think, again, for trustees of a plan like this, I think it's important to be cognizant of benchmarks, cognizant to risk where you have a risk being non-benchmark positions, and understand that there are a number of tools. It's not just the allocation. It's investment manager that was selected and looking to trust in those

managers to maintain diversified
portfolios, be cognizant of what their
goals for performance are.
Again, it goes back to long
term -- maintain a long-term focus and
diversified portfolio. You know, to
overreact I think is not what you would
want to do.
MR. RUBIN: With that as a
process, do you look at non-correlated
markets? And do we go into areas that
aren't connected? Should we look at oil
plays or timber plays or --
MR. GOLDSMITH: I think that may
be a little specific. One of the
initiatives that we brought forth, going
back to last spring when we started working
with this plan, was adding some non-core
sectors, diversifying within fixed income.
One area of the market that has done very
well even in recent weeks is high yielding
credit fixed income.
I think today we have plans to
conduct the search for intermediate or for

investment credit. High yield is up 15 percent year-to-date through November and a 5 percent quarter year after year.

Those are the things that make sense for the long term. We're not talking -- they would further diversify and help out. So that's an example. When it comes to equities, I think our view -- my view is that you allow the active equity managers to make certain sector decisions.

You know, getting back to the markets very briefly, through November, again, for the month, the Russell 3000 up 4 and a half percent while international equity, a different reversal, fell down 2 percent. Emerging markets down 4 and a half percent. Emerging markets have outperformed year-to-date.

I think that's possibly just a relative value play. That being said, I think, again, we still favor the U.S. for the intermediate to long term. It's a slow growth environment. But there are fewer concerns that we have in terms of geopolitical risks.

I think tomorrow or Sunday I believe the Italian vote is taking place. The prime minister wants to change certain elements of the relationship with Europe. He has said, if my plan doesn't pass our design, that opens the opportunity up for a new coalition government there that could be further anti-Europe.

I think a similar situation is taking place in Turkey and Austria as well. There is a French election coming up where another -- a harder line right wing government is leading in the polls there, which actually may be good for France. I think he's a pro-business leader. I think he would rollback some of their regulations that have hurt business in the past, like a 35-hour work week.

There is -- even with the U.S. election, there is more uncertainty in Europe. That's reflected in the current positioning of this plan and in our investment committee.

So any questions? If not, if you can direct your attention the tab PGW pension plan report in the book. This is the performance asset allocation for the fund, again, as of October 31st.

You can see, again, number of periods. I think I'll mostly focus on the one quarter and year-to-date columns. Right up at the top of the page, market value for the fund 482.8 million, down slightly from the end of the third quarter due to market performance.

But for the quarter, pretty solid protection on the downside, down 80 basis points versus 1 percent for the benchmark. Over the longer periods, year-to-date, slight out performance. And while intermediate term returns have lagged I think the last second half of 2015 was a tough time for the markets. So that one-year number is slightly below where we are year-to-date. But over a five-year period, 7.95 percent exceeds the actuary of rate return of 7.3, which is the goal for this plan.

Moving through the managers, the index funds did their job. So they matched benchmarks fairly closely. The active managers within the large cap equity both protected, was shown he actually returned a nice positive absolute return for the quarter. Again, about a percent of that performance but negative absolute return.

It was nice for Shaughnessy because they struggled in the first half of the year. And so to see that number year-to-date get closer -- Alger, again, year-to-date is still behind about two-and-a-half percent. Some areas that have benefited them this quarter overweights the IT gross sectors, which outperformed value.

No utilities and telecom holdings. That is a theme for a number of managers in the portfolio. O'Shannessy, a value manager, by focusing on value, I think that led them to do a little better in October with -- cross it down market and also focusing on shareholder yield. It's one of the factors that they emphasize.

On the small cap, I think it was a little bit -- I would say is the area of the fund that disappointed the most. Both managers underperformed on an absolute relative basis. Again, the bulk of the third quarter, July, August, September, growth stocks significantly outperformed value. I think that's another reason why we've in the past discussed our desire to move from split valued growth managers in the large and small cap sectors to a core approach.

You can see, again, particularly within small cap, the differences between Vaughan Nelson, a value manager, and Eagle Asset Management, a growth manager. I would say a 4 percent difference in one quarter. October was a month where value stocks outperformed. For the three months prior, growth stocks significantly outperformed.

It doesn't make sense I think to

try to time those. What makes sense is to select a core manager that can invest and make some selections based on their views of these stocks themselves. Just within Vaughan Nelson, I mentioned they had the utility telecom theme earlier. They had no allocation there. And a selection attracted Vaughan Nelson 6 percent cash allocation drag for the three months prior to October would have -- October --

The international side, the three active managers have helped out year-to-date Mondrian and Harding did well in -- excuse me. Mondrian missed for the quarter but has done well year-to-date. Harding Loevner, with a 2 percent or so or 1.8 percent downside protection. Up nearly 5 percent relative to the benchmark in the year-to-date column.

DFA missed by about a percent and a half. However, it leads by 2 percent or so year-to-date. DFA is a blended active index fund, where it's largely -- they have a problematic trade program. So it will be close to the index with slight variations on quarter to quarter.

MR. DIFUSCO: For Harding, you guys list two benchmarks for them, obviously, very different benchmarks. Which one do you really think is the more appropriate?

MR. GOLDSMITH: I think it's the all cap world U.S.A.

MR. DIFUSCO: The first one?

MR. GOLDSMITH: I'll have to double check the characteristics. It's relative to the emerging markets holdings. I think it's up 20 percent.

MR. DIFUSCO: Thanks.

MR. GOLDSMITH: Fixed income, moderate out performance for the sector as a whole on the following page, down 35 basis points versus the Barclays down 94. Essentially, right on top of the benchmark year-to-date, I would say that the theme for every manager here was an overweight to corporate, overweight to credit, with the exception of Garcia Hamilton. They were underweight to credit, underweighted corporate. However, they have a shorter duration profile than the benchmark, which, in a month or a quarter that saw rates rise, that helped them.

The other managers are generally closer to the duration profile, slight overweight, slight underweight to duration. I think that, again, in this market neutral duration is what we would like to see from these managers.

That's performance --

MR. MAZZA: Can we just state one of the managers coming in today to present the IG fixed income mandate is a current manager Logan Circle. Staff has had a conversation with Logan Circle about any overlap in the two strategies, and we've been assured that there is not a tremendous overlap, that there is a significant differentiating factor between the two strategies.

Whereas there's not a lot of liquidity in the fixed income markets right now, they've assured us that the strategies are different enough where they do not believe that we'd be doubling up on fees or paying double for the same strategy, that they are different enough to present today.

I just wanted to state that.

MR. GOLDSMITH: I think we can address that too.

That's the performance as of 10/30. The following section is the full report from the third quarter. We produced this on a quarterly basis. It has a detailed discussion of the market's economy. It also includes peered performance relative to peer institutions and, again, characteristics for the investment managers.

So we can look at this together offline. Unless there are any questions, I don't plan to go through this booklet.

The one last thing I'll mention just briefly is rebalancing. We drew for cash last week. Right now the plan is overweight to domestic equity, underweight to international equity by about 2 percent overweight to domestic, 1.7 percent underweight to international and a slight underweight to fixed income largely offset by cash.

Our recommendation is not to do any rebalancing at this time. Market value as of November 21st is 4.92 million so in excess of the October market value.

THE CHAIR: In terms of equities and what has happened since the election, you're saying that you guys were not totally surprised by that?

MR. GOLDSMITH: Maybe a little bit to the magnitude and the length. I think perhaps we would have seen a little bit more of profit taking, more pullback in the markets at this point. That's why I don't think we would be surprised if that would happen a week from now, a month from now. It would be interesting to see.

It could be a catalyst. Maybe it's the Italian election this weekend. Other appointees, the actual inauguration itself can be a catalyst. I think the equity market is overvalued. And that's reflected in the week-to week and day-to-day positioning changes.

THE CHAIR: We're getting ready to move to -- now, we're going to go to item number four, revised IPS recommendations.

MR. GOLDSMITH: We've discussed this for several meetings now. I believe the plan today is to simply get a vote to approve it. The tab labeled revised IPS recommendations has the marked up copy that you have seen before. I don't believe a plain copy is in here.

But again, a lot of this was done to facilitate the expansion of the fixed income portfolio and to further diversify into some other sectors, including real estate as well. It's a simplification of the previous IPS, a simplification to the restricted guidelines. And another broad theme is that it moves to diversification compartments to the total fund level rather than the investment manager level.

THE CHAIR: Is there a motion?

MS. JOHNSON: I move.

THE CHAIR: Is there a second?

MR. BUTKOVITZ: Second.

THE CHAIR: Motion has been made and properly seconded. All those in favor?

(Chorus of ayes.)

I think the ayes have it.

MR. GOLDSMITH: It's just in time. This IPS will be placed to implement things for the managers that we're going to talk about today.

MR. DIFUSCO: We'll circulate a clean copy. We'll send it when we send it to the managers by the end of the day. It's not a problem.

THE CHAIR: We're going to move down to item number five, investment grade credit fixed income recommendations.

MR. GOLDSMITH: Yes. Another tab, the investment grade credit, this is a memo prepared to introduce to the three managers. They are here today. They are out in the lobby. Again, I think the plan here was to add some enhanced yield corporate credit and above and beyond treasury agency securities.

Our views for over the next five years are that rates will rise significantly. We're not going to jump from 2 percent to 6 percent overnight. Even I think 3 percent will be considered a low to moderate yield environment where credit would present an opportunity. It's a long-term strategy, which is why we wanted to amend the IPS. This isn't a temporary tactical trade.

And so we have looked to active managers, three active managers. And they will be coming in today. Income Research Management, known as IR&M, are largely fixed income specialists, independent, partner owned, 60 billion in assets, again, largely fixed income. They are very fundamentally driven. Credit research formed the backbone of their process.

That's understanding the operations of the companies, the balance sheets that they are buying, almost taking an equity managers approach to their credit selection. Their feed proposal is a separately managed account with 30 basis points for the first 50 million.

Logan Circle is actually quite similar. Their process is fundamentally driven, routed in an understanding of the underlying credit and underlying company. Logan Circle I would say maybe places an additional emphasis on the actual structure of the bonds they are buying. The bonds are going to be structured a little differently. They do place some emphasis on that. This portfolio will also have some government securities, some ABS and MBS, mortgage back and asset back, and some allocation to high yield. But the bulk of the strategy is corporate credit. Their feed proposal is 25 basis points for the first 25 million, 20 basis points for the second 25 million.

The last fund, SIT Investment Advisors, is another independently owned firm. It's the smallest of the three that's coming in. Predominantly a fixed income specialist. But they also operate some equity strategies as well. Their process is fundamentally driven, but the strategy they've proposed is broader and more diversified. While corporates do present I think the biggest single sector, it's not an overwhelming majority like the other two funds. They will go into a broader range of fixed income subsectors, including APS, MBS, as well as some closed-end funds. I think you'll hear them speak to that today. Their feed proposal is 35 basis points for the first 10 million, 25 basis points for the next 10 million. So smaller break schedules there, but I think a higher starting point than the other managers.

MR. DIFUSCO: The only thing I would add is that Logan Circle is a locally-owned firm down on Arch Street. We do have an account with them as Matt mentioned, a different strategy. SIT Investment Advisors, in Minneapolis, is a minority known firm. And I know you mentioned that. I just wanted to point that out as well.

So we've told -- they are here. They will be here in the order that they are in Marc and Alex's memo. They will have 20, 25 minutes, with Q&A to the extent that the commissioners have it. And whenever people want, we did order lunch. It's out there so folks know. Whenever you want to get started, we can go out and get it.

THE CHAIR: Ready to get started?

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(Whereupon, a brief recess was taken at this time.)

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MR. HEGSTAD: Thanks for having us here today. Just by way of quick introduction, I'm Nils Hegstad. I work on the client team. I interact with our clients and consultants. This is Matt Walker, who is one of our credit portfolio managers on our investment team. And I figure we'll keep this to 20 minutes. But feel free to interrupt us along the way with any questions. We'll leave some time at the end for any questions.

At this point, I feel like we -- at this stage where you're looking at three -- I think three managers. In my experience, there is not a lot of differentiation between performance and potential the portfolio. We'll focus on a few things that we feel does make us different from a firm perspective and from a strategy perspective. I'll just focus on that in the 20 minutes. And we'll get right to it.

Page 2 is who we are as a firm. I'll focus very quickly on the upper left-hand side of the page. There is basically three bullet points that I'll point to as things that make us different.

We were incepted in 1987. So we've been around for almost 30 years. We were cofounded by a father and son, who are still involved in the business today. The third managing principal joined the firm shortly thereafter, a gentleman named Bill O'Malley, who came from Wellington.

Bullets 2, 3, and 4 are really the ones that I'll focus on. So four to three employee shareholders; that's ownership structure. So over one in four of our employees owns a part of the business. For us, that's very important. It lends itself to a lot of accountability and engagement across the firm. Our interests are aligned with our clients. So if our client's portfolios are happy and doing well, we're happy, and we're growing the business also.

The next thing is our size. It's 62 billion in assets. We feel that we're at a nice healthy spot where we're large enough to have good relationships with dealers and have a lot of technology and resources in place for the investment process and the risk management side. We're also at a size where we're small enough to participate in some of the smaller sectors and in some of the nicher areas that differentiate us from our larger peers.

Lastly, I would mention our exclusive USD fixed income focus. We're an investment grade fixed income manager only. We take the specialists approach. That's all we're doing all day, is looking at investment grade bonds. We're not trying to be all things to all people. We don't take the supermarket approach. We're looking at these bonds and trying to source the best investment grade bonds possible for our client's portfolios.

Basically, those three things in isolation -- each on their own is probably not that unique. But when you kind of blend all those three together, we think it's pretty unique. We think that's our differentiator.

The other thing I would mention on the upper right are assets by client type. We have about 10 percent of our assets, so 6 billion in assets, with public fund clients, such as you guys. Page 3 just kind of gives you an idea of our product lineup. We manage about one billion in assets in the intermediate credit strategy that we're going to talk about today.

Pages 4 and 5 is to represent the client list. The upper left is a good idea of the public fund clients that we manage assets for. And then beyond that, I would mention we do manage assets for a lot of public funds and education and corporate plans in the Pennsylvania area.

Actually, Temple University is one of our clients, as well as University of Pennsylvania. We're really happy to have some representation here in Pennsylvania. And we would love to grow that with you guys.

Page 5 is kind of what we would

consider our secret sauce. It's kind of the output of those three bullet points that I mentioned on the previous page. Page 5 gives you an aerial view of our office. It's an open office floor plan. We have about 100 people sitting in this room, 42 investment professionals sitting in the middle all side by side, shoulder to shoulder. We feel that's pretty unique.

We have portfolio managers and traders all sitting shoulder to shoulder, the ability to collaborate on a minute by minute basis. It allows us to be very flexible and nimble, to act on things very quickly. Ideas don't die on the dime. And we really think that's very important for our client's portfolios.

Lastly, on page 6 and 7, before I turn it over to Matt, is our investment team and our resources. You'll see on the upper part of the page on page 6 is our 15 portfolio managers and directors. So we take a true team based approach. We don't have lead portfolio managers. We don't have a star system. That lends itself well to continuity, a lot of eyes on the portfolio. We have some youthful perspective and energy on the desk. And we have some older, gray hair, wiser people on the desk. It kind of compliments each other very well in terms of their skill set and their experience.

Matt, would you add anything to the portfolio managers?

MR. WALKER: No. It's becoming more and more popular going with the team approach. We always refer to the wisdom of crowds, so not just having one portfolio, manager in and out of the portfolio. We have the team approach.

So there is a lot of collaboration, healthy conflict, and challenging each other's opinions and viewpoints to make sure really we're looking under every rock and digging as best we can to review the bonds that make it into the portfolio. We think it's, again, a differentiator for us.

MR. HEGSTAD: Lastly, our client service is very important. That's where I fit in. I'm looking at this box here. The good news is that, if you don't like me, there is nine other people available for you to talk to. We always pride ourselves on being very assessable not just from the client side but the investment side.

Page 7 is our investment research resources. So we have 27 investment -- 27 research analysts that are focused on the credit and the securitized side. Those are all ideas that make it into the intermediate credit portfolio that we'll talk about.

With that, Matt, maybe you can take over.

MR. WALKER: Again, feel free to stop us with any questions. I'll talk about the philosophy process and the portfolio and how it's constructed. I think one of the things that a lot of our clients like about our approach is it's very simple. We don't use derivatives. We don't use any complicated instruments.

We buy the best cash bonds that we can find on a duration neutral basis. We're not trying to predict the direction of interest rates. We feel that that's extremely difficult to do. For the past several years, everybody has said rates will go up, and they've only gone down until recently.

We don't try to predict interest rates. We think it's very difficult to do. So we manage portfolios on a duration neutral basis. You will tell us what mandate you want to be benchmarked against. And we'll manage the portfolio to that same duration. There is no additional interest rate or risk on the portfolio.

Bottom up security selection is another hallmark of ours. Again, we're not a macro shop. We're not trying to predict rates. We're trying to find the best bonds from the bottom up basis, again scouring all sorts of corners of the market. We think our size really lends ourself to be able to do that. We'll get into some examples of that in a few moments.

Lastly, our philosophy is pretty simple. Adding security selection is extremely important. We've seen a number of times over the past few years, even in this calendar year in February, when the market was very depressed. And we were able to take advantage of that and add some risk to the portfolio. And we were compensated to do so.

Again, trying to be flexible and nimble, and we think having that collaborative team approach really lends itself to that purpose. That's a little bit of our philosophy again, very simple.

Our process is on page 10 and 11 here. How we're set up as an investment team is we have a target team, which oversees the investment process. We have 15 portfolio managers across the different sectors, credit, securitize and municipals, so on and so forth.

And six of those senior

portfolio managers make up the target team. They are not sitting in a room preaching this is what you should do. They really take input from all of us on the desk. We pride ourself on saying that ideas can come from anywhere, a trader, portfolio manager, an analyst. And the target team's job is really to synthesize all that information, all those suggestions, and make a decision in terms asset allocations across the different sectors.

So for example, if we think corporate bonds are too rich, we may recommend that -- the target team, they might agree with that suggestion and suggest that we reduce our exposure to corporate bonds and increase our exposure to treasuries. Those are the types of decisions that the target teams make, a relatively high level of cross sectors.

The other group within the investment team is sector management. I'm part of that sector management team. Our job is really to look at the market, try to find the best opportunities from a credit structure and price standpoint, and really suggest those bonds or those opportunities to our portfolio strategy team, which they are on the right-hand side. They are really putting the portfolios together.

So we have a collection of the best ideas. And the portfolio strategy team takes those best ideas and is optimizing them in the portfolios on a duration basis, on a key rate basis. Really making sure the portfolio fits. And the client guidelines are a big part of that as well.

Page 11 is a little bit of what I already discussed. This is how we approach investment grade bonds. It's really across the different sectors. It's not just credit. It's credit, municipals, securitize, et cetera. We start with the bond investment grade fixed income on the left-hand side of the page.

Again, credit, structure, and price are the three main filters that we use. We have a team of analysts that do really the fundamental research in terms of credit work, really making suggestions to the portfolio managers regarding the credit work or if any issue that might make its way into the portfolio.

Structure is another important part. When you think about the equity market, equity markets are pretty straight forward. You can by one stock but fixed income forces the ability to buy short bonds, long bonds, bonds with high coupons, bonds with low coupons, sinking funds.

There's all sorts of different structures in the fixed income universe. Again, our size allows us to kind of pick some of these interesting structures, whether it be put bonds or SBAs, which are small business administration certificates. Structure is a very important part of our investment philosophy.

And, lastly, price. There is a saying that there is no such thing as a bad bond, just a bad price. Our job is to get the price that we're being offered on that or a bid we receive in the market to determine whether or not it's a fair value. We want to make sure that we're selling bonds that we think are too rich and buying bonds that we think are cheap. That's really how we work. That's really a good summary of the sector management function on the middle of the page there.

On the far right side of the page, it's more of the portfolio strategy aspect, really taking those ideas, putting them all together to make sure you have the best, most optimized portfolio.

Any questions so far?

Page 12 and 13 I'll hit on very briefly. Twelve is really a more in-depth description of our issuer selection process. These three things are extremely important to us when we're looking at a corporate bond, one being quality. As it says there, we're trying to find companies that can weather a business cycle so not companies that have very low margins or very narrow focus, very large blue chip companies.

If you were to look at your portfolio or any portfolio we manage, you would recognize almost all the names in the portfolios. It speaks to the more simplistic approach.

Liquidity is another factor. Liquidity in this day and age is extremely important. We want to make sure we're not buying names or issuers that are too small that can be very liquid in tough times.

Lastly, the management team is becoming more and more important to us. Having a solid management team in place to run the business is extremely important to us. Having that consistent financial policy and really delivering on what they say they are going to do is extremely important to us and our investment process.

Really quickly on 13 is the little sample of what we look at and the opportunities set in the market. As I mentioned, there are all sorts of different structures in the market. That blue line there is sort of the most liquid, the most on the run, most recently issued bonds. This is actually City Group bonds outstanding. The blue is, again, the most on the run.

If you look at some of the other opportunities, some of the orange circles, those are a little bit off the run, a little bit less liquid. But you can pick up additional yield without taking on any additional credit risk. If you buy a six-year bond instead of a five-year bond, you can pick up 10 to 15 basis points of incremental yield, which can add a lot of value long term.

MR. DIFUSCO: Where is the line? A minute ago you said -- maybe I misunderstood. I thought you said that you don't want to buy something that's too small or going to cause you liquidity problems. But now we're talking about maybe picking up some more liquidity to get a yield. Where is kind of the line or the

firm philosophy on we're willing to take on
this much liquidity risks if we think --
how do you balance those two things?
MR. WALKER: When I was
referencing liquidity earlier, that was
speaking more towards the issuer itself.
If you're a really small insurance company
that you never heard of and you have one
bond outstanding, a name like that is going
to be very liquid.
But to your point about off the
run, on the run, it's our job to really
ascertain the type of environment that
we're in. And I think right now there is a
lot of euphoria in the market. There is a
lot of folks looking to buy corporate
bonds. And that liquidity premium has
shrunk.
When that happens, we want to
make sure that we are selling those less
than good bonds because we're no longer
being compensated for that. If you think
back to February when corporate bonds were
at their weakest point of the year, that's

when there's a lot of compensation in liquidity. We'd be willing to take on a little bit less liquidity because you're being compensated to do so.

We don't really have a strict firm philosophy. But it is -- especially today, precrisis liquidity was hardly even mentioned. And now, today, liquidity is one of the most important factors in an investment decision. So we want to make sure that, if we're buying a name, we're getting compensated for it, and we can sell it down the road if need be.

So those are part of our conversation as a portfolio managing team.

Page 14 is a snapshot of our securitize opportunities. The intermediate credit benchmark is all really corporate bonds. We're not afraid to be a little bit unique and go outside of the benchmarks.

As we'll get to in a minute, you can see we have an allocation to securitize bonds in the portfolio. And, really, it's the last three sectors on this list, being

CMBS, commercial mortgage back securities, ABS, asset back securities, and SBAs, small business administration certificates. They are -- the SBA is full faith in credit. That is effectively the same risk as the treasury. It's just a different program.

ABS, all triple A rated, very, very high quality not dipping down into sub prime auto. We're buying Ford, Mercedes, Hyundai auto loans and leases. Again, names you know and names you recognize.

The CMBS side is a very similar story, top of the capital structure. So this is a lot of subordination below us, which gives us a lot of protection when we're buying commercial mortgage back securities.

They are all very short in nature. And when we look at some of these opportunities versus corporate bonds, you can oftentimes get a triple A rated commercial mortgage back security. That's two years maturity at a significant discount doing a two-year triple A corporate bond. Those are conversations that we're having on the desk on a realtime basis.

Fifteen is just a quick snapshot. We talked about some of these opportunities. This is our tool kit. These are not an exhaustive list of all of the different opportunities. It's sort of an example. Put bonds, they don't get issued much anywhere. They are a structure that we really like and have liked for a number of years. It's very powerful from an investor perspective.

Century bonds, not really appropriate for this type of portfolio. But 100 year bonds we look at versus 30 year bonds and coupons. If a name runs into some trouble and gets downgraded by one notch, some bonds have coupons, which step up on that downgrade. That's a nice feature as well.

Again, it's kind of a sample of all the different opportunities that are available to us that we can add to the portfolio given our relatively small size.

MR. HEGSTAD: Just page 16 and 17 really highlight our commitment to risk management. Page 16 highlights some of the risks that we look at. And risks can come in a lot of different flavors. So we've highlighted a few that we are paying attention to on a continuous basis.

So durations, interest rate risk yield, quality, tracking, error are all very important to us. We are benchmark aware. We're duration neutral. So we're looking at all these risks outside of just the duration aspect.

Page 17 gives you an idea of our resources and tools across the firm for our commitment to risk management. We have a dedicated compliance team that is making sure that we are adhering to our client's guidelines and their missions on what they are trying to achieve.

That's kind of a sequestered kind of area that's cornered off from the investment desks. It's almost like an auditor to what we're doing on the investment desks. So it's very important to us. Then maybe we can go through and give some examples of the strategies.

MR. WALKER: So 19 is just a summary of the intermediate credit strategy. You can see on the top left there the portfolio as of the end of October versus the Bloomberg Barclays intermediate credit index. We've got a nice yield advantage in the portfolio, 2.7 percent versus 2 and a quarter of the index, which is a nice sort of a tailwind for us.

If nothing should happen in the market, that differential is what you expect to earn over the course of the year. On a duration basis, 4.3 versus 4.32. So if rates should rise 100 basis points or if rates should fall 100 basis points, the portfolio will react the same way the benchmark will react.

On an average quality basis, it's very, very similar in terms of average quality or not taking a significant amount of credit risk, you're going to have high yield or low triple B's. The portfolio is roughly the same credit quality as that of the index. On the right-hand side of the page shows you -- I mentioned earlier that we're not afraid to look different than the index.

That's pretty notable on how we've got 83 percent credit versus 99 percent on the benchmark and 10 percent securitize and 4 percent tax -- and I think the biggest takeaway from this is what you've got here is a nice diversified portfolio.

We think securitized adds a lot of value in the front end. So between zero and three years is primarily our securitized allocation, again, very, very high quality. Once you go further up the curve, that corporate bond allocation comes into play. A nice mix between financials, industrials, utilities, so on and so forth.

We think tax immunities is a

nice added layer. These are hospital systems, universities, some high quality GOs. All tax immunities that, again, we look at versus corporate allocations, securitized allocations. We think that can have a lot of value over time.

Lastly, the very top of the page, three-and-a-half percent in government guarantee, which is the SBA certificates, full faith in credit, triple A. And we think -- again, we look at versus the other sectors who have some diversification and some opportunities that outperform the index.

MR. HEGSTAD: We don't have to really get into it, but I would just mention that we do strive to deliver excess return over the benchmark after the net of fees. That's really our goal for our client. We've achieved that on our track record here.

I would also mention just that fixed income in general has been taking a hit over the last five or six weeks. These numbers on the left-hand side of the page are a little lower. But we've been able to provide downside protection and increase that advantage over the index. I think that's just sort of proof of our process and what we try to deliver for our clients, which is downside risk protection and also delivering some excess return on the benchmark.

MR. GOLDSMITH: Is your preference to run this as an intermediate strategy? You know, I know you're agnostic. If anything else, you prefer to run this on an intermediate basis?

MR. WALKER: Yes. I think it's your decision. If you want this type of duration, if this time horizon is appropriate for your goals, if that's what you select in terms of intermediate duration that fits the plan, that's what we'll manage to you.

We have a lot of clients in that intermediate and ag so the middle of the yield curve. And we also got a lot of assets on the longer term.

MR. MAZZA: Sorry. Finish, please.

MR. HEGSTAD: We do have a full credit strategy. But we do find that our clients gravitate towards the intermediate part of the curve there.

MR. GOLDSMITH: Do you have a view or a recommendation or your own opinion intermediate or --

MR. WALKER: I really think it depends on what your goals are, what your time horizon is, what you expect to do with the funds over a long period of time. We have to have a conversation and really work with you to come up with a solution that fits you the best. Absent that conversation, it's pretty tough to make that recommendation.

MR. MAZZA: It seems like with the strategy, right, the lower -- the more risk you take, the higher yield you get; right? Benchmark A2A, you go A3A minus, you're taking on more benchmark.

Obviously, you're going to have more yield in the benchmark just through law. How is that a unique strategy?

MR. WALKER: That's not unique. I don't think that necessarily is -- going a little bit down in quality, building that yield is necessarily unique. The way we get there is unique, with all the different structures and securitized product. How we build a portfolio from the bottom up is relatively unique.

I think what we do in this strategy, which is 100 percent credit benchmark, so there really is no treasuries. When times are tough, we want to lower the quality because we're being paid to buy more low quality bonds. In a time like today where we think there's publicly -- you know, looking ahead to the next years, probably more downside than upside in some of these sectors. We want to make sure we're rotating into the appropriate sectors.

So we'll have an overweight to

financial perhaps going into next year because we think the opportunity is there. So making that rotation at the appropriate time is really what we're trying to add value and be bottom up security selection. I think that -- like you said, having a yield advantage is not unique to us. But it's sort of the output for what we're doing.

MR. DIFUSCO: How much distribution -- how much are you relying on your internal ratings as opposed to relying on a big three or someone saying I know they rated as an A, but I think they are a triple B, or they have them as a triple A but we think they are really a double A? How much are you relying on your own research as opposed to theirs?

MR. WALKER: We rely on our research almost exclusively. We're certainly cognizant of what the rating agencies say. You can have three different rating agencies that have different opinions on a certain name.

If you look at our triple B exposure, for example, 55 percent versus 42 percent on index, when we challenge our analysts to look at these names, oftentimes the triple B you think of a name like Verizon or AT&T or some of these really blue chip names or some of the major rails or major utilities in the country are rated triple B. These are extremely high quality companies that just happen to be rated triple B by the rating agency.

So we're certainly cognizant of that. We don't think it's really a predictor of risk per se. We're, again, not really afraid to have a little bit of a higher allocation to triple Bs. What we found over the past couple years is some of the higher rated companies have been more aggressive if you think about the pharmaceutical sector.

They are very high quality, single A or double A rated. But they've been amongst the most aggressive in terms of shareholder friendly activity or making some large acquisition.

Over the past few years, we found that those relatively high quality companies, if you look at just the rating agencies, have been more aggressive than some of triple Bs. We certainly look at and are aware of the rating agencies. But we rely on our own opinions of the credits.

THE CHAIR: Any other questions? Thank you.

MR. HEGSTAD: Thank you very much. We really appreciate your time. We'd love to work with you.

THE CHAIR: Welcome.

MR. GIBAS: Thank you for inviting us in. SIT Investment Associates. John Gibas, Mark Book. My responsibility is to work directly with our institutional clients, any consultant that may be involved in working with our internal investment team to get you what you want. He is the senior portfolio manager or fixed income manager. We'll being directly involved in managing this portfolio, along with the team. And we'll talk about the people apart of it. And so we're prepared to take any questions or go through a -- our proposed presentation and take your input.

We'll go through here on a good pace. Chris suggested maybe 20 minutes so we can certainly to do that. I guess I'll start by saying that SIT Investment Associates we believe is a great fit for the organization, the sinking fund here. Culture of our firm, the investment team, investment philosophy, we follow the investment strategy that we're proposing is a great fit, and we're confident that we could do an excellent job managing the fixed income assets.

It's incumbent on us to exhibit that today and off we go. Page numbers are in the lower right. And let me just give a little brief overview of the firm and then hand the conversation to Mark on the portfolio management side.

If you look at page 4, this is

information as of September on the upper right-hand side. We manage 13.7 billion in assets for our clients, taxable fixed income, 6.9, 4.0 in municipal bonds. Today we're a little over 14 billion. And so this portfolio we're going to manage is going to be a combination of our taxable team and part of the municipal because we use taxable municipals. That's a differentiator for us.

The pie chart below identifies the type of clients we work with. Two-thirds of our clients are institution separate accounts. We're not proposing a mutual fund or a package product. We're proposing a separately managed portfolio to your guidelines. And we believe the taxable total return strategy fits the mandate. If there is some nuances that we need to customize, we're capable of being flexible on that.

On the left-hand side, a couple of points. We're an independent employee owned firm. We don't have to answer to a bank or insurance company. Marc is a good example of being an owner in the firm. All of the senior portfolio managers and other senior people at the firm are owners. They have skin in the game and appreciate your position.

There is an item, the fourth bullet down, that first category, the SIT mutual fund group was ranked number one by Barons in 2015. And we're not going to dwell on that. There is an item in the back of your booklet, the flyer, referencing that.

And if you open it up, they list all the mutual funds. And so it's a who's who list of mutual fund companies. There is a nice article and picture of Rogerson. He makes some comment there that you might want to look at. Our point here is we compete on a national basis.

We might not be the most recognizable firm from a retail perspective. But in the institutional marketplace and with consultants, we're well recognized. That's a point of credibility we believe there.

Under the investment teams, what we'll talk about is what you'll see at SIT is very experienced people but, more importantly, long tenurial. Mark's an example of 30 years in the business, 15 years at SIT, and very instrumental in building a track record on the strategy we're talking about today.

The way we work and service the clients is clients have direct access to their portfolio management team, along with -- there is a lot of other people supporting the. We don't put them behind the curtain. There will be someone from the portfolio management team that is responsible for this portfolio at every meeting.

So Mark will talk to that. So it's very important that we communicate clearly and appear to you in working with a client. Any questions?

Page 5 just gives you a

reference of our different investments that we offer under fixed income. We highlighted a taxable total return. That's what we're talking about today. We believe that's the best fit. We do a number of other things. But we'll set those aside right now.

Page 6 gives you a perspective of some of our corporate values. SIT Investment is a Chinese name. The reason I mention that is there is a very strong culture inside SIT, along with the ownership across the employees, a very hard working culture. It's a family business.

And the Sits are still involved. Roger Sit is the CEO of the firm who's profiled in the back. Just it's a great group of people and a great firm with a very unique culture. And that fosters consistency of people and attracting people.

So under corporate values, our business is simple. We like putting our clients first. That makes us successful.

And corporates goals, we many times serve as a true extension of our clients. We'll do some extra work for them in checking out something from a research perspective or input or investment guidelines, working closely with consultants. So much more than just managing a portfolio.

Page 7 is a commitment to you. It started with -- our proposal is to manage a separate account to your guidelines, direct access to the portfolio managers. One point I was referencing the fourth bullet item, we have an annual client workshop, which we're in the process of informing our clients right now. That's held in San Diego this year. And fund trustees like this show up as both educational and an opportunity to meet other clients.

It's highly educational. That's the way we structure it. None of the presentations are done by us. They are all done by external people. We're trying to bring our clients extra input on that regard.

So that's a snapshot of our firm, independent, employee-owned firm, highly motivated with a very strong product that we believe fits. And it's the taxable total return. I'm going to have you reference one item in the back, again, a product profile sheet, which we did send before.

So Mark is going to talk about this in more detail. The strategy is diversified domestic fixed income portfolio. And you'll see that the investment team is Brice Dody [ph], Mark Book, and Chris Rask [ph]. Those are three portfolio managers that collaborate on the decision making process.

On page 8 is a snapshot of the fixed income people involved in the portfolio. Roger Sit is the CEO. He's in charge of running the firm and is in charge of overall macro research. When it comes to fixed income, he delegates everything to Mike and the fixed income group below.

So I'll hand it to Mark in talking more about the team and the investment strategy.

MR. BOOK: One of the things we do that's unique is a lot of times big firms have a trading desk and a big group of analysts. We want our analysts involved. So all of our analysts trade securities. I think that's one thing that sets us apart.

When we hire someone, we hire them with the expectation they'll be able to trade securities, obviously with the guidance of the portfolio managers. We find that helps to keep all of the skin in the game. And otherwise coming from an insurance company, a lot of times we have analysts that want to just approve or recommend the very highest quality of securities.

You can't make any money that way. You don't get much yield. So we found this works much better. It's also a good training for future portfolio managers as well. As John mentioned, Brice, myself, and Chris are the three portfolio managers. We do things as a team. There won't be any one person assigned to your account. We don't assign certain accounts to people. All three managers -- since we provide direct access to the portfolio manager, we want to make sure there is several that you contact.

For example, when I'm here, it's hard for a client to contact me. So we think that works really, really well. One of the other things that's important for you to look at is, you compare the years of experience and then compare that to the years at sale. We're very good at obtaining our employees. We make it a good and interesting place to work.

The next page is our philosophy. It's very simple. We're looking for income. We want high risk adjustment returns. We want all of that or at least most of the return to come from income. If you look at page 10, you can see why.

If you look over time, that's what provides the returns in any sort of fixed income portfolio. You might be right in guessing rates are going up or down. But the next time you could be wrong, and you kind of wipe out. We really are focusing on income. You'll see that as we look at a little more detail on the strategy.

Page 11 is a lot of numbers. I think maybe the best thing to look at is towards the middle, those columns where it says yield, compare SIT and the benchmark. We say we're focused on income. And you can see a big yield or income advantage. And there's all the different strategies. The theory there -- and you can see actual results.

On page 12, you can see for this strategy is a very strong income advantage over 1.3 percent, more yield. We consider this strategy the best idea. It's not -- we're not typically saying here's a benchmark, let's make the portfolio look like that and tweak it a little bit.

We're really a bottoms up type of manager. We're looking for the best securities that we can find to kind of fill on the right part of the yield. I think that's another differential for us. We're not afraid to be a lot different than the benchmark.

MR. RUBIN: Is that net of fees or gross fees?

MR. BOOK: Gross fees.

MR. DIFUSCO: While we're on that page, you guys are benching this against the Barclays ad. Is that for an intermediate kind of strategy like this? The kind of strategy we're looking at, is that a fair benchmark? Is that the only benchmark your clients use?

MR. GOLDSMITH: We are focusing on a credit portfolio.

MR. BOOK: We have our total return strategy. And we have what we call an intermediate operation strategy. And we use the market's intermediate aggregate or the intermediate government corporate. They are very similar. The intermediate strategy just doesn't buy bonds that are longer than about 12 years. Otherwise, there is about 80 percent overlap of the security. We can use whatever benchmark --

MR. GOLDSMITH: Just in your opinion, do you think the taxable total return would be a fair comparison to the Bloomberg Barclays credit index?

MR. BOOK: Yeah. I see what you're saying. Yeah, it would be. We very often have underweighted. And they don't provide income. And we think there is more risk. So yeah, we would be happy to run against the benchmark.

MR. GOLDSMITH: I think it would be appropriate.

MR. BOOK: If you jump to page 15, page 15 sort of paints a picture of what the portfolio looks like for this strategy. I will say that they are not drawn to scale. So the size of the circle or the bowl doesn't represent weighting in that sector. Weightings are on the page below. Maybe I can just run through a couple of examples to help you understand how we approach the strategy.

First of all, it's kind of what we call a barbell portfolio. There is not a whole lot of investments in the middle part of the yield there. That's because we're expecting flattening. And that's the strategy we want to use. When you get a flat yield curve, obviously, you're moving things to the middle of the yield curve, if we think the opposite is going to happen. So it's an ever moving, ever changing type of structure.

If you look, for example, on the upper left, you see something that says CEF. Those are closed-end bond funds. Those are typically a security that is traded on New York Stock Exchange. But it basically takes a pot of money and buys a bunch of bonds.

The reason we like them is because they often trade at a discount to their underlying net asset value. And they also have very high yields compared to most other bonds that you can buy out there. so it's a small part of the strategy. But it's something we use that we think can add yield and return, as well as diversification. Because they are traded on the New York Stock Exchange, they don't always move like bonds. Sometimes bonds are going up. And even though they are basically holding a bunch of bonds, the price might fall on a certain day and vice versa.

Another good example would be in the blue, sort of the bottom left, it says government mortgages. This is a type of security we use in almost all of our strategies because we can't find anything that we think provides a better risk adjusted return and with extremely low credit risk, almost zero credit risk, a government type credit risk in that part of the yield curve.

So for example, we have a short

duration strategy. It might be 90 or 100 percent of these government mortgages. This strategy tends to be somewhere around 25 or 30. You can see below it's changed over time depending on your view of interest rates. These securities are interesting in that they are government agencies so there is no credit risk. And they are very, very high coupons. So we're buying 6 percent in high earned coupons.

These -- the underlying bonds in these securities are very old and seasoned. And they are loans that should have been refinanced any day over the last ten years. And they have not. One of the reasons we like those securities is, if someone has a 7 percent mortgage rate and haven't refinanced by now, it's very unlikely if mortgage rates fall from 4 to 3-and-a-half they are going to all of a sudden wake up and refinance. That's really a big risk in these securities.

We pay a big premium for these big coupons. I've paid 110 or 115 percent the actual value. But because the coupons are so high and because they're very stable prepayments, you end up getting a very nice return, somewhere around 2-and-a-half to 3 percent type of return.

MR. MAZZA: What about from a credit risk standpoint with a new treasury secretary who has said in the news that he doesn't believe that Fannie or Freddy should be a part of the government? What is that going to do to the total return on these bonds?

MR. BOOK: It's something we suddenly have talked about a lot and we think about a lot. First we think, if something gets done -- we do believe it's unlikely. But if it does get done, it will take a while. But even if it would happen next week --

MR. MAZZA: Going to have some selloff in securities?

MR. BOOK: There would definitely be a selloff to some degree if they didn't continue the existing securities with that government guarantee. There is precedent done. For example, the government used to guarantee student loans and they used to securitize them. When the government stopped that program, all the outstanding securities still kept the government guaranteed.

So we think that is the most likely. The other reason we don't think it's likely is that they do somethings -- it would really be hard on the housing market because banks would have to charge a lot more. If they couldn't securitize people's loans and give that government guarantee, rates would go up a lot, and the housing market would get hurt.

I think that would be something different than what the current administration would want to do. I guess we'll see. But I do believe that these securities -- the other reason I guess these securities wouldn't selloff as much as a normal agency mortgage is that, since these loans are so old, people have a lot of equity in their homes. Even if there were defaults at some point, if the person couldn't pay off their mortgage, if the banks took over and sold it, you would probably have enough to be made whole any way. So the delinquencies on these types of securities are very, very low already.

Then maybe one other thing to look at is sort of in the middle of the page, is the taxable municipal securities. In these securities, they are very similar and most similar to a corporate bond. They are issued by municipalities. And either the municipality ran out of their availability to borrow tax exempt, or the funds are being used for a purpose that doesn't quite fit.

And given -- currently, the yields on ten-year tax exempt bonds are very close to ten-year taxable bond. Municipalities, particularly universities, are taking advantage of this. They are buying a bunch of money. They are investing it and trying to make the spread between their costs and what they can do.

What we like about them is you're getting a higher rated credit compared to a corporate bond. You usually get about a whole rating category higher, and you have less default risk. Municipalities default much less on average than corporations.

And you can still get the same or slightly higher yield. The reason you can do that is because you do develop some liquidity. So you want to sell an Apple corporate bond. And you can put it out for bid and get multiple bids very quickly.

On a taxable muni you might get a bid right away or you may have to work it for a day or two. You do get a little liquidity. We typically have bought larger issues -- larger issue sizes. So we have not have had problem. It's one way to get a lot of extra yield with updating credit risk.

Sort of the summary is we're looking to provide a high level of income without going in credit quality and without increasing the risk of portfolio, the interest rate risk. You'll see that we are shorter in duration or shorter in average life and have more yield. We try to get that extra yield by buying things like taxable municipalities and high coupons, government securities.

Or in corporate bonds, for example, we'll buy bonds that have sinking funds. For some reason, a lot of bond managers don't like those. They like their ten-year, nice and clean, and you can get interest payment every so often. We like bonds like that because you get more yield for the same credit. And when interest rates are rising, you're getting cash flow back every six months that you can invest an entire rate. To us, that's a great tradeoff.

MR. RUBIN: What was the thing in the government agency shift that looks like it was the biggest shift in ten years away from government agencies?

MR. BOOK: On the very top line, we -- basically, when the Fed brought interest rates to zero and rates got so extremely low -- and this was before we had a lot of negative rates out there in other parts of the world -- we thought there was more risk in treasuries. We thought that interest rates go up and treasuries have the most duration of any of the sectors. We wanted to earn income and decrease the interest rate risk. The treasury was actually the riskiest part of that.

MR. RUBIN: When the Fed didn't raise the interest rate, did that negatively effect your return? How did that play out?

MR. BOOK: It did. Because treasury yields continue to fall from six or seven years ago to recently, it did hurt. We were underweighted at a particular part of the sector that was doing very well. We just happened to have enough income advantage in our other strategies and enough long corporate bonds that did very well that, overall, we were able to outperform. But that particular decision was one that did hurt our overall return over that time period.

MR. RUBIN: Is it your thought to reverse that? Or is it something you're sticking with and something you think is going to pay off in the long run?

MR. BOOK: We have not reversed it. We don't plan to any time soon. We believe the Fed will act on December 14th. And we've been indicated a little bit so far this quarter as we're outperforming by quite a bit by having less duration and the underweight treasuries, the worst performing sector.

It's not to say we would never kind of go back to 30, 40 percent weighting. Given what our philosophy is and generating as much income as possible and trying to keep the risk of the portfolio as low as we can, it's likely that we will continue to be underweight treasuries for a while.

MR. MAZZA: Out of time.

MR. GIBAS: And I'll close in a couple of items here. We do have some delivered IRP and then conference call. The performance on page 25. So the performance has been nice and consistent. We have the detailed performance on page 26. Quarter by quarter you can see it.

Our investment team that's been working on your portfolio has built this track record. It's not some different investment team that's taking over. We have a lot of continuity in our investment team. We're probably going into a little bit of a challenging interest rate cycle where teams have to work together better than when things are easy. The teams have gone through ups and down, working very well through ups and downs and are well-positioned.

The second item worth referencing is this strategy and really the best ideas in the diversification of using corporates, taxable immunities, and closing funds is our best ideas for portfolios and is a great diversifier. Most of our clients we're one of two, three, or four managers. We're not the only manager. In other words, we're brought in as a diversifier. And the portfolio will move strategically.

We are not really active traders. But we are strategic traders. I think Mark just talked about our under-weighting in treasuries and the strategy there. So now we got some volatility that's helped us. We're a great fit from the perspective of being a diversifier. And that concludes our comments.

THE CHAIR: Thank you.

MR. GIBAS: We would like the opportunity of working with you. And I'm confident that we could deliver you the investment expertise and personal attention you would expect.

MR. KILFEATHER: I'm Brendan Kilfeather. I'm the client service rep for

Logan Circle. I have been dealing with PGW for the City for a few years now. We have what we feel like is a great relationship in existence. And we appreciate the business honestly and appreciate you having us here today to talk about this opportunity. Andy Kronschnabel is one of the senior PMs of the firm. Andy is involved with the 200 portfolios that we currently run on behalf of PGW and on behalf of the City. So he's involved with all of the portfolios regarding the City.

We're going to talk about another strategy. Chris, I don't know much you want us to get into the overview of the firm since --

MR. DIFUSCO: Unless folks feel like they have any questions, I think they are pretty familiar with the firm. One thing I would ask, and it came up briefly during intros, and I know we talked about it with you guys on the call and Alex did. Go into a little bit to the extent that it may overlap in the portfolios, if you can.

People may have questions about that existing strategy. That's definitely something we want to hear about.

MR. KILFEATHER: In terms of -- unless there is firm questions, I'll cut my part short. We're a shop right down the street. I got two parents who are City employees and retired. So the pension on the other side of the fence is important to me personally. It's an important relationship.

Okay. Other than that, I'll turn it over to Andy to address this company and the overlap.

MR. KRONSCHNABEL: And just right off the bat, the strategy we're presenting is a corporate fixed income strategy, 100 percent corporates. And the strategies that we already run for PGW are ag-based strategies, so different index and a different portfolio construction.

So it's I think reasonable to assume that there is some overlap between the portfolios because our ideas that are corporate based will be included in both. But the ag-based strategies consist of mortgage back securities, commercial back securities, asset back securities, and treasuries as well. The behavior of the portfolio is going to be dramatically different as the ag-based strategies are multi-asset strategies.

Really dramatically different duration in both portfolios. The ag-based is about a four year. The corporate is about a seven year. Just for number, there will be somewhere around 20 percent overlap. But the behavior of the portfolios are going to be different because the structure of them is pretty dramatically different as well.

But it wouldn't be unreasonable to assume that, if we have one of our better ideas, that it could populate both portfolio where it's appropriate, risk appropriate. So a small degree of overlap, but I would say that you should expect a different return profile because they are pretty different portfolios from a structural standpoint from the assets that are going to be included.

MR. DIFUSCO: Thank you.

MR. KILFEATHER: Maybe I will skip a few slides in. The first few slides are really generic to the firm. And I'll turn it over to Andy. And we'll go to slide 6, the performance, real quick, and then we'll get into the team and philosophy and the strategy. And then we'll open it up to questions.

MR. KRONSCHNABEL: We won't page through the whole book. I understand that can be monotonous for both sides of the table. On 16 we have our performance here. It's our track records that we're very proud of that stacks up attractively to our peer group. Even pealing the onion just a but more is some of the risk adjusted metrics that we've included on this page in tracking your financial ratio.

We've been able to achieve an attractive track record but also within what we think is a very appropriate risk adjusted manner in terms of keeping the tracking low and that results in higher information ratio. We've managed this strategy since our inception in 10/1/2000. So we're coming up on 16 years of managing this type of strategy and the experience of our firm.

Then the team that's generated this performance has been together for -- or most of the team have been together for that entire track record. I've been involved with this team since our entire track record. Our director of research has been with the team, and the senior research analysts and most of the traders have been with the team for the entirety of that track record. We have a cohesive team that's been together for a very long period of time.

I worked for the CEO and CIO of our firm since 2000, over the entirety. So a nice continuity of team over the course of a pretty long track record. The team is here on the page. We're all 100 percent fixed income at Logan Circle. We focus on institutional fixed income clients, such as yourselves. And so everyone on the page is an investment professional focused on the area of the investment process within the fixed income market place.

And the way we structure that at Logan is to focus people on components of the investment process, whether that be the research on the left, the portfolio management on the right, or the trading on the right. Those are the veins in which we're examining an idea for inclusion into the portfolio; fundamental component, the risk component, and the technical component.

One of the things that differentiates Logan in how we've structured the team and it feats through to the investment process and to the care of the client portfolio is that these aren't utility functions. Our traders aren't simply execution traders that are waiting for an order to execute it, move on their way, then wait for another order, execute it, move on their way.

The research team aren't a team of people in offices waiting to have research. Everyone on the page is involved in an area of the market that is their career path. So our traders are career traders. Our analysts are career analysts, such that they can follow their companies, their sectors, their management teams over a very long period of time to see how they make capital allocation decisions, how they make balance sheet decision, merger and acquisition decisions.

Similarly on the trading side, our traders follow roles depending on their sectors, understand very specifically the bonds that they are trading, how indentures could differ from multiple bonds from the same issuer. They are also our eyes and ears to the street and our advocates to Logan Circle to counterpart on the Wall Street desk with who we do our execution, which is very important to a fixed income market being an over-the-counter nonelectronic trade market.

In a lot of ways it's an antiquated voice operated market I guess if you will. And they promote our interests to assignat desks and the depth capital markets component, which is a very critical component of our business in securing our allocations and issues of the market. We want our clients to take part in that.

The last piece is the risk management team. Portfolio managers are focused on certain portfolios. And investment grade corporate portfolios is an area of my focus. That's my responsibility, to manage the risk of that portfolio and to understand the client and their risk intention within the portfolio, sizing positions appropriately, monitoring sector allocations relative with the benchmark, quality allocation decisions of the portfolio, as well as supported by a group of risk management portfolio analytics that we're currently adding some resources to.

I think that subsequent there might be a bigger box on the bottom of that page there in terms of the risk team that we have in place at Logan. That's the team. Every one is touching the portfolio. Every position in the portfolio really has three sets of eyes on it because of the way we culturally set up our team. We have a trader, a research analyst, and a portfolio manager watching every single cusip in our client portfolios and not just a portfolio manager that's orchestrating it.

I'll hit just two slides to talk about the philosophy process. And we'll open to questions, if you have any. But from the philosophy standpoint at Logan, we feel that the market is very efficient with respect to interest rate risk. And to take that in a portfolio or bias in a portfolio based on our view of where, for example, the ten year is going or what the curve is going to be, it's very, very difficult to consistently over time for our clients.

So we've -- you've seen on the previous page we dedicated the resources of our firm towards the area of the market that we think we can get an edge on, that we can capitalize on consistently for our clients in these particular portfolios, risks related to credit, credit risk, default risk and liquidity risk. That's where we feel that we can get an edge.

We have 14 dedicated corporate research analysts, five dedicated high-grade traders, four dedicated high yield traders. We are focusing our efforts on conducting a bottom-up fundamentally focused portfolio construction. We're looking at in-depth balance sheet, cash flow characteristics of companies.

We're doing deep dives into covenants and dentures of bonds that we're investing. We do a lot of work around -- I think we put it in here -- risk reward characteristics. There's a lot of that as breaking in spreads where securities are valued versus the potential to increase value from those holdings or lose value from those holdings, again targeting duration neutral portfolios.

So when we talk to our clients, we have client reviews. As a portfolio manager, one of the best tools of that risk management perspective is detailed portfolio attribution. When we conduct that detailed portfolio attribution with our clients on a quarterly basis and just amongst our team on a weekly or sometimes daily basis, we're looking at where the excess return in the portfolio is coming from and making sure that it's from security level decisions and then, to a lesser degree, sector quality level decisions in the portfolio.

When we talk to our clients about portfolio performance, it's from the securities that we've invested in. If we maybe overweighted or underweighted certain sectors, not that we thought the election was going to go one way and it went the other, and rates have moved 60 basis points in the last three weeks, and that has really hurt our portfolio. We take that out of the portfolio and make sure it's not contributing to the relative performance to the portfolio to the benchmark.

MR. DIFUSCO: Is there a certain type of security that you guys are investing in the strategy that you think should be relative to your peers? We hear some folks say we spend a little more time on the closed-ended fund. Is there a certain type of security that you think kind of differentiates the portfolio? Or no? Or a structure.

MR. KRONSCHNABEL: There is definitely structures that because of the resources that we have -- and Brendan kind of whispered a point that I hasn't elaborated on. But if you look at Logan, we're a $34 billion asset manager. A lot of our peers out there are much, much larger peers.

Why is that important? Why does

that differentiate? One, if there is a $300 billion deal or $500 million deal, that's a deal of a size that we could amass a position that would make sense and move the needle in terms of performance for our clients. If we were a $200 billion asset manager and we owned all $500 million of those bonds, it wouldn't make a shred of a difference in our client portfolios if we allocated that on a pro-rata basis.

In that way, I tell you our ideas in our fishing pond is larger. And because we have dedicated resources to that fundamental research, we can do work on it too. We can look at it. I think of O'Reilly Auto Parts. They've got 4 bonds. Their biggest one is a $400 million deal. You guys all know the stores. It's one that our analyst really likes a lot.

But we can get a position in our portfolios that makes a difference for our clients. They can't do that. That's kind of neat. We have a lot more bonds that we can look at. That's interesting. But where it really makes the difference -- the portfolio, we're talking about investment grade portfolios here.

Car parts bonds, you know, aren't going to go generally to 120, 130, 150. They could go down. So where the size of our firm and the ability of our team to maneuver the risk in portfolios is when we have changed our opinion in a negative way and are able to get out of positions in portfolios without impacting market prices.

We're not trying to sell 300 million City ten-years. If we want to reduce our exposure to City, we might have to sell 25. That's something that's easily done within the context of the market. That's maybe a unique factor.

In terms of types of security, we have found that we've been able and it's partially because of the size that I just mentioned but because of the resources that we have, kind of the interesting story in the market is the changes in bank regulatory capital now and what's going to count for banks in terms of regulatory capital. We've been able to get through all these situations recently in deals that aren't huge deals. But they are like legacy bonds issued by names like Wachovia that are still out there in trade because these companies were just purchased by other companies.

There is bonds that are in new regime that are not going to count. Total loss, reserving capital rules that are going to be implemented are not going to count as capital. If we can do the work and dig into the indentures, what we found is we can get access to securities that the issuers want to take out of the market.

We've had our goals at 6345, a bond that was issued in 1996. They tendered for it twice because it's inefficient capital for them. We were able to get involved in that. It's not a big deal. It's like a $600 billion deal.

So maybe that from a structure

standpoint is -- that's kind of popping in the top of my head as something interesting that's happening in the market right now that isn't always there. And I wouldn't tell you we're big players. We're really subordinate in European debt. Not a big area of the market for us.

Quickly, the investment process. I'm cognizant of your time. How are we doing this? How are we implementing the portfolio consistent with our philosophy? We think it's pretty straightforward and easy to understand the process. In the center of the process again are the three teams, which I want to reiterate that there are a cohesive and a directional effort from the three teams.

But around the outside are the steps of the investment process. We generate an idea. Again, that can come from anyone. The trading desk can have more of a price or relative value idea, maybe a market situational idea. They are in the trenches seeing the supply and demand that transpires within the market.

The analysts teams are going to be more fundamentally focused, maybe on a sector that's trending positively or negatively or an issuer that's doing things that we either like or are concerning from a bond holding perspective.

Portfolio management ideas may be more top down, where we like to be on the credit curve with respect to what the treasury curves are doing if we look at differences in quality and so forth.

If we have an idea and if it's a particular security level idea, we kick it to the research team. And we do a very in-depth deep dive into the fundamental of the particular idea. We create a report that goes out to all the research analysts and portfolio managers that could be -- consider the idea. We sit down as a team.

This isn't done with a portfolio manager and an analyst talking about an idea. We sit down as a team. We get our entire analyst team to focus on an idea.

We want different perspectives on an idea. We might be looking at an idea that's say a favor of force product, but there is legacy litigation issues due to asbestos. Tobacco analysts might have some insight on that litigation because they went through it, or a farm analyst because they went through it. So they might have some insight on that.

We're going to do it, look at it as a team, and critically evaluate an idea in a pretty darn in-depth way. And we're right across the street. We have these meetings at 2 p.m. You're all welcome to come and sit in if you'd like. They can get heated sometimes, but we have good discussions.

MR. KILFEATHER: Heated for bond people.

MR. KRONSCHNABEL: For us, it's exciting. That's true. It's all very relative.

From there, we'll move to security selections. We are working very closely with the trading desk. The bond market isn't other markets like the equity market. If we say we want to buy, we don't have just one choice on the New York Stock Exchange. We can have three months to a hundred year bonds. We have senior subordinated bonds. We have bonds issued by something that they bought in the past, and those bonds are still outstanding.

At our trading desks, once we vet an idea, we're working with the trading desk very closely to pick what's the best bond. We don't just closet index these portfolios. If we like Atta, we don't just go buy a five- or ten-year bond. We're going to look at the indenture. Maybe there's a bond that was issued a few years ago that has a coupon that steps if the ratings get downgraded.

There is -- all these bonds have different structures, different indentures, even if they are issued by the same issuer. So we like AT&T just fine. But we don't buy their ten-year. We own AT&T in three quarters and 31. That was a bond issued by Cingular, if you remember Cingular back before they recombined all the wireless companies. That's a box in the 18 capital structure that's never going to issue debt again. It can probably never be rolled out of AT&T Wireless.

And they don't even want that bond in the market anymore. It's at the best asset. That bond is at the very best asset in the whole AT&T capital structure, which looks like a bowl of spaghetti a bit. We'll do that research. That's what we're doing on the securities intake within the capital structure.

The last two, sell discipline and risk management, are maybe I'd say less steps within the process, more ongoing processes, overrunning processes. The sell discipline, like I said, our traders have their eye on the positions of the portfolio. Our analysts know the positions of our portfolios. The portfolio manager, I'm watching the positions in the portfolio. We're constantly watching the valuation.

We might sell because something got to what we thought was fair value. We might sell because we think something else is more attractive. But in terms of the effect in the portfolio, the portfolio management has the buy/sell decision at Logan.

But if an analyst came to me and said we've got X, Y, and Z credit in the portfolio, this just happened, and I'm concerned about it, we're not going to sit down and do that 2 p.m. game. We're not going to take the time to write the report that I mentioned and get the team together because, by then, it's just too late.

If an analyst comes to me, nine out of ten times, unless there is some sort of extenuating circumstance, we're going to exit the position in a timely manner so that it doesn't negativity effect our client portfolios.

And then risk management, I

touched on it a bit. For me, portfolio
attribution, it runs through for us from
trade and all the way through compliance
with fairly robust systems with black rock
solutions that we use to implement that in
our process.

MR. KILFEATHER: Let's pause.
Do you have questions?

MR. GOLDSMITH: I have a couple
clarifying questions. So you talked about
different structures and maybe some
different sectors. This is really
corporate strategy? Your universe is the
corporate universe?

MR. KRONSCHNABEL: Yes.

MR. GOLDSMITH: You've added
pretty significant value to the benchmark
over time. Where do you look from that
income -- you mentioned trading and sell
discipline. Is it 50/50 between
appreciation or --

MR. KRONSCHNABEL: That's a
great question. I think I have a slide
that I think addresses that pretty well, if

you go to 2.7. Once we've done the research in working with the trading desk and picked the bond that we think is the most attractive, we really think of it as falling into one of four categories represented by the boxes on this page here.

They are not to scale. The largest at the bottom is our core holdings. Those are going to be situations that we feel that we have long-term incentive to fundamentals or we're comfortable holding for a long period of time. Maybe they are mature situations in the portfolio. But situations that we can have in the portfolio, that's going to generate our income.

When you look at a fixed income portfolio, 80 plus percent at least in the fixed returns -- that's what we're doing with the core holdings component. This is where I normally -- if we were having a two-hour presentation, I would have elaborated on that. And I mentioned that to you before.

We're not just saying, hey, we like Anheuser-Busch, so we're going to buy the new ones that they issued when they bought -- when InBev bought Anheuser-Busch a couple years ago. Maybe old Budd 8s of 20 are bonds that we like now that were issued in 2000 as 20-year bonds -- actually issued in 1990 so 30-year bonds. Maybe that might be the bond.

That's where we're building the core holdings, income generating, very stable part of the portfolio of hard quality assets. As we move up the page, then we're thinking more about income return. But we're looking more towards price appreciation. I kind of grouped the next two together, expected rating upgrade or undervalued bonds really having ownership from our research team.

These are going to be the better ideas in the portfolio. Maybe it's a company that did an acquisition and is de-levering from that acquisition. And we expect spreads to tighten. Perhaps it's a baby with a bath water situation. We put Mylan on the page because that's one I like and threw into that category. Mylan of course has been in the news with the EpiPen price increase. EpiPen is a very school part of their business.

And most of their business is generics business, which already has no margins. And they do quite well. And it's not an issue for predatory pricing or anything like that. We can take that and say let's say EpiPen goes to zero, which it won't. We'll look at that bond, look at the fundamentals if that happens. And that would be an undervalue situation.

We think that company or those bonds can be undo and admonished by the market. In that, we might be -- if we're thinking of core holdings longer term, maybe shorter duration bonds and we grind up positions so that -- this is a diversified portfolio, 125 different names.

And we will get some wrong some sometimes. We're trying to keep smaller positions so that, if we do get one wrong, it doesn't adversely effect the portfolio to a large degree. But with the next two categories, we'll be a little bit bigger. We'll be a little bit further up the curve. We'll look at a 10-, 20-, 30-year. Frankly, they are the ideas that we have. And they are what we directed our resources for and what we think will add value over our competitor.

So we'll take more risk in those situations in the portfolio if we're thinking that we're going to get some price appreciation in addition to the income return. On the last at the top is the shorter term opportunities in the market due to the illiquidity of the fixed income market.

They are not risk changing to the portfolio, but they are opportunities to pick up nickels and dimes. It couldn't simply be a situation where Bank of America, which issues bonds about two to three times a year, is coming to the market

to issue a new ten-year bond. And because
they want to borrow $2 billion and not
interest rate markets when volatile, they
have to pay a little more spread to do it.

Normally on a Bank of America
ten-year bond, the old one will buy the new
one. We can make 10 basis pounds. I think
20 basis points will enhance a portfolio.
It doesn't change the risk of the
portfolio. And that's where our trading
desks adds value as well.

MR. GOLDSMITH: Thank you.

THE CHAIR: Thank you.

MR. KILFEATHER: We appreciate
you having us in.

THE CHAIR: It sounds to me
these guys had a relationship with the City
of Philadelphia; is that true?

MR. DIFUSCO: Both the sinking
fund and the --

THE CHAIR: They just aren't
listed?

MR. DIFUSCO: No. They did.
But if you go to the flash report, you'll

see Logan Circle for the sinking funds and $3 million for corporate strategy. And then they are also managing another core plus strategy for municipal retirements.

THE CHAIR: What are the keys factor we need to take into consideration if we're going to vote on one of the three?

MR. GOLDSMITH: I think -- again, so the theme is to add credit spread in the enhanced over what is in the portfolio now. You saw them talk about their corporates that makes the backbone, and there is the additional sector. The sector allocation and the structure of the portfolio is one thing to consider.

Duration being another. All the managers seem generally duration neutral, with the exception of SIT, they said we're going to maintain a lower duration generally. We've done that in the past though. We're not actively trading around in rates. By design, if you can have the same yield with lower duration, we'll take the lower duration.

Usually the relationship is, as you would increase duration and go further out, you have a higher yield, again, focusing on higher income, higher yield. So you can get that with a lower duration that gives you a little more flexibility.

So certainly the quality of the portfolio again, yield and quality. If you have a lower quality investment, chances are there will be higher yield. If you can get a higher yield with a good quality portfolio, that to me represents a benefit.

I think there can be opportunities to go into lower quality. And that's what I think they were getting at, the Logan Circle. They talked about the various opportunistic sectors they can look at. You can go low quality not just for high yield, but there must be a catalyst for something on the horizon.

I think the team -- quality of the team, size of the team, how the team works together, it generally seems like the teams are somewhat similar with the exception of SIT, who has their research analysts also trade. Everyone else has dedicated functions. But they all seem to collaborate very well.

The tenure of the team at the firms, stability of the team, experience of the senior professionals, abilities of the junior -- I say junior research analysts, but they are all junior. Some firms -- SIT mentioned that they are career analysts not a track record to promotion to PM. That's a differentiating factor, pros and cons to that.

Level of service I think is something to take into account. It's not the most important thing by any means. But it's important I think to note -- not so much the quality of the response but the abilities the teams that were sent today, what we can expect if we have questions, interactions, if we need to change the guidelines of the portfolio.

Also, I think getting their opinions on the market, like when I asked the first group about their opinion on duration. That will be a question that we have our opinions on. But I would like to get that from the managers as well. They are all duration neutral but, okay, where should we have duration if you --

And then the smaller firm things independence, ownership, allocation to some extent. And then, lastly, performance of fees. Past performance isn't indicative of future results, but it's an indicative of how the strategy is managed. There are slight differences in each of these groups. How is that translated to performance? They are going to be different in the future. How would we expect those differences to translate to performance in the future?

I had my own thoughts coming in today. I don't know about you. I know you guys sat with me in the earlier calls. But, first, I can say that we have confidence in all three of these managers. That's why they made the short list.

THE CHAIR: Before you go there, am I misreading this? When I look at Logan in terms of the returns, are they the highest returning?

MR. GOLDSMITH: That's what I'm looking at myself right now. They are. Again, is that just a moment in time? Or is it a result of their process? They are a little bit different in Logan, is that they are essentially corporates only. I think that maybe I was skimming my memos as I read in the intro.

MR. MAZZA: Also, in terms of risk, they take a little more risk than the other managers. They are buying bonds there.

MS. JOHNSON: They have the triple and double Bs.

MR. MAZZA: That's just the fundamental.

MS. JOHNSON: That's where you're going to pick up that yield.

THE CHAIR: A higher risk portfolio.

MR. GOLDSMITH: Yeah. And I think also the other two managers have an element to -- certainly SIT outright expressed it -- but a virtue of if they are intermediate, or this one was benchmarked immediate. I think there is a higher degree of focus on income with these two, whereas Logan Circle is 30, 40 percent of the trades are looking for appreciation.

I think, as they mentioned, that could expose you to certain risks. But there's a risk management process to make sure that the compensation is there if the trade plays out.

MR. MAZZA: From a fees standpoint too, due to the existing relationship that Logan has with the City, I think we can be a little bit more aggressive getting the best pricing for the plan as well.

MS. JOHNSON: I know it was mentioned earlier. But just remind us, what fee --

MR. MAZZA: Logan did it tiered.

Logan and SIT both did tiered. I think SIT was 35 then 25. Logan was 25, 20, and then a little under that. And Income Reit was flat 20.

MR. DIFUSCO: Income Reit did not do it flat. Originally, that was inaccurate. Income Reit was also tiered 30 on the first 25 and then 25 on -- so I would say the effective fees are probably pretty close, within a basis point or two.

I agree with Matt's assessment that, if we like Logan the best or if it was close, we could definitely lean on them based on the existing relationship to come down a little bit more. I have confidence that they would not forego the account if we leaned on them more. But they are all within a spitting distance of each other in terms of where the effected fee is.

MR. MAZZA: If we went to Logan and said 20 basis points flat fee, they are going to say yes.

MS. JOHNSON: I just have one question. Income Reit and Logan Circle kind of benchmark themselves against the Bloomberg Barclays U.S. Credit Index, whereas -- and then you asked questions -- benchmarks themselves against the Bloomberg Barclays aggregate index. Can you just give me -- I don't know if that's the most appropriate compared to the other two --

MR. MAZZA: Yeah. In the RP2 I think it was specified that the intermediate credit index to be used as a benchmark. I think that, not to interrupt Alex, but a lot of firms that defer to the Barkley ag it's just because it's the most used aggregate. I think that it shows, if you picked up on it and you used the intermediate credit index in the presentation, that you're paying attention to our fee. That's from my personal standpoint.

MR. GOLDSMITH: I think I agree with that not to why they used this. Again, broad fixed income benchmarks Barclays aggregate are used for total planned benchmarks. Typically, there was -- they used the phrase we're not the only bond manager with our clients. We're usually a smaller allocation. And I think, again, they are trying to convince people to go into credit in the first place.

Here's the aggregate. This is your mandate. Here's us in a high -- a small allocation. I think maybe that is why they probably do this all time for any presentation, compare themselves with the aggregate. I think we could use. We would obviously.

I'm -- I'm looking at performance now. I think their duration was slightly higher than IR&M. Duration was about comparable to the ag. So I think actually somewhere in the middle of all three of these. The yield was higher, which was at IR&M as well. And IR&M compared themselves to the intermediate credit. So part of that is the spread sectors that SIT vests in. Part of it is the higher duration. The higher you go up in duration you go up in yield.

Quality, off the top of my head, I would say it's comparable to the credit index, certainly lower quality from aggregate. I think that's a fair comparison. I don't know why exactly, especially given --

MR. MAZZA: Barclays is a higher percentage of treasuries. That is what is the different factor. That's -- we're not -- we specified as well, even with our IPS, that we want more exposure to -- the reason why we have this is, if you have a core plus portfolio that we already have, we don't want that significant exposure to treasures that we already have.

MS. JOHNSON: This is supposed to be different.

MR. MAZZA: You have new credit. And to boot, we don't want someone who's going to benchmark against Barkley ag. I mean, we can just index it for a lot cheaper, if you're going to say we're going to follow the Barclays ag to be honest.

MR. GOLDSMITH: Even if they are

saying, our goal is to beat the Barclays ag by two percent, which that would be a significant goal, even that, again, I think from a risk perspective, from they are still looking to the ag somewhat. There might be benefits from saying, well, in time, we can go to treasuries. And we saw the allocation change.

I would say there is something to be said for that. This is a smaller allocation, the core managers. Again, our thesis behind it was we want additional risk, additional yield, additional return. And so, again, while I think it's totally fair to benchmark them, compare them to credit, the fact that they themselves presented this way, I think it's goes to their thought process.

There are some interesting things they do. I like the inclusion of closed-ends funds. I like the broadly diversified sector portfolio. That was originally what drew me to SIT. And in some extent, IR&M is opposed to Logan

Circle. After today's presentation,
understanding again -- Logan Circle, I
think, is taking more of an equity like
approach in some ways to their management.
I don't know. I don't know what your
thoughts are.

MR. MAZZA: So yesterday Income
Reit reached out to Chris and I and asked
if there were any investment restrictions
in the portfolio, basically showing that
they didn't know what Sandy Hook Principles
or any of our current restrictions on
investment policies we had. They were
giving us quotes from co-mingled funds
rather than a separately managed account,
which is a big mistake to make.

MR. GOLDSMITH: Yeah. I would
hand you guys probably the level of service
that we'd get from them, based on the
feelings today, probably would be the
least. It's not the only thing that makes
the decision. The fees would be probably
the highest effective. Now, it is
important to discuss the possibility for

overlap.

We had a separate call with Logan Circle about this. At first, I was a little concerned that there was not more overlap in the two portfolios. I was thinking, if these are your best ideas, why wouldn't they be in both. I think their response to that was a good one.

And that is, look, this truly is a different mandate. And you can see it in the returns they've got, in the characteristics of the portfolio. And as he mentioned several times, these issuers have a number of different structures, a number of different dates. And I think we -- within the corporate sleeve of an ag strategy and the corporate sleeve of this, which is all corporates, it makes sense that they would be different.

Even, again, in the same -- in a lot of it they had the same issuers in both plans, different issuances. And I think they gave the right answer for that. It sounds like I'm leaning towards recommending Logan Circle.

Again, I think -- that wasn't predetermined before this meeting. It was based on what we heard today in the presentation, as well as due diligence prior to this whole process to begin with.

THE CHAIR: You know, I looked at it from the standpoint of the relationship, from the standpoint of performance, and from the standpoint of what I heard them say in terms of the financial analysis. And I came up with Logan too. I don't what factors you all used to make the decision. But they not only deal with us, but they also deal with SEPTA --

MR. GOLDSMITH: We know them very well.

THE CHAIR: I cast my vote for Logan.

MR. BUTKOVITZ: I'll second it.

MS. JOHNSON: Aye.

MR. DIFUSCO: We will push on the fees as we always do.

MR. MAZZA: See if we can get a flat 20.

MR. DIFUSCO: We'll make that clear. We'll have a conversation with them today or Monday.

MR. GOLDSMITH: Great.

MR. MAZZA: 20 basis points will be a steal.

THE CHAIR: So we have the last item here, new business agenda.

MR. DIFUSCO: Just real brief I just wanted to make sure folks knew we put -- we continue to put the stuff we got, the requests about the benefits and stuff in the back of the books. It's there if folks want to look at it.

And the next meeting is scheduled for January 11th. We start at 11. That's kind of a historical thing. I don't know why they chose that time. If folks have an interest in starting earlier at a different time, we're certainly open to that. I think that's just something they've been doing for the last 20 years.

I couldn't tell you why. But if folks would rather come in 9:30 or 10 and get it done before lunch, just let us know.

THE CHAIR: Whatever y'all want to do, I can work with. Ten?

MR. DIFUSCO: Ten?

MR. RUBIN: Whatever works for you, Chris.

MR. DIFUSCO: We'll move it to ten. We'll move it to ten.

MR. RUBIN: One question. There was like a haste I think that was being done that we discussed at PGW that may change some of the salary structure. And if there is going to be a huge change in what the payouts would be, we'd like to know.

MR. DIFUSCO: When you say "salary," you mean for current employees?

MR. RUBIN: Yes. Correct. I don't think it should change what the payouts will be in a major way. But if it's going to effect what we have to account for --

MR. DIFUSCO: We'll plan for it going forward. I'll circulate it to Dan Leonard or somebody.

THE CHAIR: So January 12th?

MR. MAZZA: The 11th at 10 a.m.

THE CHAIR: Motion to adjourn?

MR. MAZZA: We don't need a motion.

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(Whereupon, the Sinking Fund Meeting was concluded.)

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

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

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