CITY OF PHILADELPHIA

SINKING FUND COMMISSION

In Re: July Meeting

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Wednesday, July 13, 2016

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This Meeting of the Sinking Fund Commission, held pursuant to notice in the above mentioned cause, before Angela M. King, RPR, Court Reporter - Notary Public there being present, held 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 MEMBERS:

Donn Scott, Chairman

Alan Butkovitz, Controller

Rasheia Johnson, Treasurer

ALSO PRESENT:

Matthew Mazza, Executive Director

Christopher R. DiFusco, CIO, PGW

Marc Ammaturo, PFM Asset Management

Alex Goldsmith, PFM Asset Management

Bill Rubin, Deputy Controller

Ellen Berkowitz, Deputy City Solicitor

Adam Coleman, Assistant City Solicitor

Also Present: Other Members and Interns

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MR. MAZZA: Thanks everyone for coming to our Sinking Fund meeting.

Just a quick note. Just want to introduce Donn Scott as our new Chairman. Donn is a veteran of the commercial banking world, government relationship manager at Wells Fargo for 40 years even though he doesn't look it. Younger than his age. We thank Ben for his time and service in the Sinking Fund Commission and we welcome Donn.

So, Donn, welcome to the Sinking Fund.

Chairman, the floor is all yours.

CHAIRMAN SCOTT: All right. You guys are awfully punctual.

Let me call this meeting to order. And let me also say thank you all for coming out and joining us this morning. I am delighted to have an opportunity to serve.

I think the first order of business is approval of the transcript of the meeting of May 11.

Is there a motion?

MR. RUBIN: So moved.

CHAIRMAN SCOTT: Second?

MS. JOHNSON: Second.

CHAIRMAN SCOTT: All those in favor please signify by saying aye.

(Ayes.)

CHAIRMAN SCOTT: Did I hear that?

MR. RUBIN: There's only two of us.

CHAIRMAN SCOTT: Maybe next time I just say raise your hand.

The next item, I guess, is informational items. Who should I turn this over to?

You got it.

MR. DIFUSCO: We have two informational items. The first is memo and update.

I think we had set out previously on the SEC rules surrounding money market reform. And we noted the Commission in consultation with PFM, we made a change to a different account, a government backed account. PFM has the memo here summarizing the reasons for the recommendation.

Obviously, if there is questions now or in the future, we are happy to answer them. This is a change we needed to make in light of the SEC ranks change.

MR. MAZZA: Yeah. Floating NAV, money market funds since, you know, the -- back in 2008, there have been a lot of talk about change in the money market reforms. This is one way it's going to impact us.

CHAIRMAN SCOTT: Do we need to make a motion to approve this?

MR. DIFUSCO: No. No.

The second item was, we had received a request regarding one or two meetings ago to start receiving a list on PGW retirees and then the changes to those. So, we provided two items. I believe they are in your binders. We sent them out electronically, as well. You have a full list of the PGW retirees after June 10. Then you have update from PGW as to folks either added on or dropped off as of July 1.

I think that's fairly similar to the information we get for Municipal Retirement System. We will continue to do that, you know, on a -- every two months at the meetings, we will provide that. If there is any desire to see the information in a different format or you see something missing, by all means, let us know.

CHAIRMAN SCOTT: Do retirees have a ability to take a lump sum?

MR. DIFUSCO: No.

CHAIRMAN SCOTT: Okay. Thank you. All right. Thank you very much for that.

Next item on the Agenda is the Pension Plan Investment Policy Analysis.

MR. GOLDSMITH: Going to pass that around, updated plan as of yesterday.

MR. AMMATURO: What's coming around is an update as of June 30. I will wait for it to get passed around before I jump right in. There is two coming around. One looks like the update of performance. There is another sheet that looks like this, one pager. Just an updated market value as of July 12. But I will hit upon the stapled document, I'm sorry, the June 30 document first.

This is an abbreviated version since we are so close to quarter end. I will go over the markets at a high level. Then I will segue and spend a little more time on your portfolio. But in terms of the markets, if you just want to flip to the market index performance page which is page 1, just to close a loop on the markets for the first -- for the second quarter and year to date.

If you look at Domestic Equity, you know, for Donn's edification, your portfolio was roughly 65 equity/35 fixed income. I will get to that in a second. Equities have a big factor behind how your portfolio does. And equities markets have done fine. If you look at S&P 500 the third row down in Domestic Equity was up two and a half percent in the second quarter. If you look at the Year-to-Date column, the domestic stock market was up 3.8 percent in the first six months of the calendar year. Again, ballpark, 65 percent of assets are in the equity side of the equation.

Couple things I will put out within equity -- within domestic equity. One is, if you can compare and contrast S&P 500 to the Russell 2000, the Russell 2000, that's two from the bottom within domestic equity, if you look at the year-to-date column, it's also positive. It's only positive 2 percent. The Russell 2000 is small cap domestic equity stocks. So small cap stocks did not keep up with large cap stocks in the first six months of the calendar year. That's actually a good thing for PGW. Because when we get to your portfolio, you will see you're overweight large cap domestic. And it's really pronounced if you go out to the One Year column.

If you go to the One Year column, Russell 2000 is actually negative 6.7 percent. Small cap domestic stocks have sold off 7 percent in the trailing twelve months. But look at the S&P 500, positive 4. An 11 percent differential between the large cap domestic stock and small cap domestic stock. Again, your portfolio is overweight large cap. That's been helpful.

One thing I will point out briefly also within domestic equity, if you look at Russell 1000 value and Russell 1000 growth, Russell 1000 value is what's known as value stocks. Russell 1000 growth is known as growth stock. There's been a fairly big dispersion. Look at the year-to-date column, 6.3 for Russell 1000 value. Look at Russell 1000 growth, 1.3. If you look at Russell 2000 value, positive 6 for the year.

Russell 2000 growth, negative 1 and a half for the year. Something we were going to address at this meeting is do we want to continue that volatility or do we want to go with a more core approach. Again, Alex will handle this later in the meeting. I want to point this out while looking at this page.

There's been a big dispersion between value stocks and growth stocks. It causes volatility in your pension plan. Do we want to continue down that road, or do you want to have a more core approach to investing. Again, that's an Agenda item coming up. I wanted to point out those numbers since we are on this page.

On the international side, the first row underneath international equity, that's developed markets overseas. They sold off with the UK vote to potentially leave the EU in June. Obviously, that sent shock waves through international markets. MSE IE, is developed markets overseas down 1 percent for the quarter, down 4 percent for the year. Again, for the six months ending June 30, international developed markets are negative 4 percent.

EM, interestingly enough, look at EM. The emerging markets, the last row underneath international equity, positive 6 percent year to date. At 10 percent differentials, whether you invested in developed stock overseas or an emerging stock overseas. Part of that rally in emerging markets is driven by the rebound and the price of oil and the price of commodities in the second quarter.

Because if you look at in the alternative section, if you look at the last row in alternatives, commodities were up 13 percent just in the quarter. I'm looking at the last row in the alternative section. 13 percent for the quarter and actually 13 percent for the year. If you go out one year, though, I think we all know the price of oil lags, negative 13 percent.

And it's a direct relation. Look at what the emerging markets have done in the past year. Looking back up at international equity, MSE EM is off 12 percent. Undoubted, correlation between commodity prices and how emerging market stocks have done as of late.

Fixed income, this is where you have

roughly 30/35 percent of your assets in the pension fund. I will get to your performance in a second. But the Barclays Aggregate continues to do well. Was up 2 percent in the second quarters. Was up over 5 percent for the first six months of the calendar year. Why? Because the Ten Year Treasury continues to decline with Brexit, with U.S. economy slowing down and global economy slowing down, there's been a flight to quality, flight to safer investments. Not many more safer investments than a treasury bond. So, that's led to a ten year decline to the tune of being at 1.47 percent as of June 30. Again, 1.47 percent. The lowest it's ever been is 1.39. We are at 1.47 at June 30.

Historical times. But that drop in the yield obviously leads to appreciation in the price of bonds. And that's what we saw in the first six months of the calendar year to the tune of 5.3 percent.

That's the overview of the markets. I kind of wanted to leave it right there in terms of kind of where we are in the markets. The equity market continues to do well. See there are kind of fully or overvalued at the time. But relative to bonds, domestic equity is actually fairly value and one could argue relative to the bond market which is significantly overpriced because of where interest rates are priced right now.

With that, I am going to segue to your portfolio which is on page 2. We get into your pension plan here on page 2. The total market value on the top row of page 2 is 483,258,662. That's where you ended June 30. If you want to take a sneak peak, this is only less than two weeks after quarter end. The hand out is July 12. The market value is 493,828 217. If everyone sees where I'm looking. I just quick sneak peak on the bottom row on July 12. It's grown since the end of the quarter.

In terms of performance, performance has been fairly solid. For the month, your portfolio was up 72 basis points for the most recent quarter, was up 1.76. For fiscal year, it's up 4 percent. On a year-to-date basis, for the first six months of the calendar year, your portfolio was up north of 3 percent, 3.22. So when you think about it from an expectation standpoint, you are trying to generate a return of, let's say, over 7 percent from an actuarial perspective. Halfway through the calendar year, you are at 3.22. You analyze that, you are getting close to the actuarial assumption. Not meeting it, but getting close to where you kind of want to project out going forward.

You know, slight underperformance verse the benchmark. If you look at year to date, it's relatively tight, 3.22 verse 3.31. I'll go into the rational in a second. But at a high level, international equity managers are doing really well. Outperforming, generating incremental returns, generating alpha relative to their benchmarks. A different story in domestic equity. Your domestic equity managers aren't keeping up. They are kind of offsetting each other on a relative basis. And that's why your portfolio is kind of, in line, if you will, for a year-to-date period.

To get a little bit more specific, combine large gap. That first bold row is how all these large cap managers have performed in the aggregate. So you have two index funds, RhumbLine and Northern Trusts. You have two active managers, O'Shaughnessy and Fred Alger. If you just want to concentrate on the year-to-date column, in the aggregate, those four managers were up 2 percent. Again, I'm looking at the year-to-date column, 2.06 to be exact. The benchmark was actually up 3.74.

So if you look at O'Shaughnessy, if you look at Fred Alger, you look at the year-to-date column, they do not keep up with this upturn in the market. O'Shaughnessy by quite some -- but a healthy margin, by a tune of over 5 percent on the year-to-date basis. There is a factor driven investment process. There are factors that have driven them to be overweight retail. Not a place to be.

Macy's has sold off. Bed, Bath and Beyond has sold off. Michael Kors has sold off especially in the second quarter. They are also underweight energy. As I mentioned, the price of oil rebounded in the second quarter. They are 6 percent underweight energy. Those two things are working against O'Shaughnessy.

They are a very recent addition to the portfolio. The far right column is when PGW hired the manager just in November of last year. You can see they are down 5 percent since PGW hired them. The benchmark is actually positive 4.4. A manager we need to keep a close eye on, rather recent addition to the portfolio.

Fred Alger, you know again, year-to-date the two managers are both underperforming. They are down actually negative 2 and a half percent for the first six and half months the calendar year. Benchmark is positive 1.4. They had stock selection issues in the healthcare space, more specifically in the biotech space. They had one biotech stock that was off 40 percent in the second quarter. We will talk about them a little bit later. We all know that there's an RFP that we were potentially going to have them come in and interview. We will talk about that in a second.

On the small cap side, if you look at the year-to-date column, still slightly a lag relative to the benchmark. You know, small cap for year-to-date, positive 1.8. The benchmark, positive 2.2. That's all driven by Vaughan Nelson. Vaughan Nelson underperformed by 2 percent on a year-to-date basis. Actually, Eagle slightly outperformed. Vaughan Nelson had some stock selection issues in the IT and financial sector which really held their performance back on a year-to-date basis.

Different story, like I said already, on international. Look at international year-to-date. Look at the bold line, if you will. Four and a half percent positive year-to-date. The benchmark is actually negative, negative 1 percent. Significant alpha, significant incremental return generated by your active managers which obviously is good to see.

Across the board, first one, positive return on the year-to-date basis of 1 percent. The benchmark was negative 6. Harding, positive 3.6; benchmark was flat. And your emerging markets only manager DFA was up 9 percent. The benchmark was up 6 and a half. Again, I'm looking at the year-to-date column. So across the board in good incremental return generated by your active international equity managers.

That's your equity side of the equation.

On the flip side is your fixed income. You know, fixed income, if you look at the year-to-date period, positive 4.62. Did not keep up with the Barclays Aggregate. The Barclays Aggregate is the proxy for the overall bond market.

Why is that? If you look at Lazard and Garcia, performance is good but their -- it's an intermediate benchmark. It's an intermediate mandate that they manage, too. Intermediate bonds did not keep up with the Barclays Agg in the first six months of the calendar year.

So managers did fine, but you have us call at 17 percent allocated to intermediate. Intermediate did not keep up with the aggregate, the overall bond market. So it's more a strategy, if you will, as opposed to the manager. If you look at Lazard and Garcia Hamilton year-to-date, they are both doing fine. Lazard is kind of in line, 3.68 verse 3.78. Garcia is actually outperforming 4.3 versus 4.07. Intermediate wasn't the place to be relative to the aggregate. If you look at the aggregate again, it was up over 5 percent in the first six months of the calendar year. You have two managers that are managing to the aggregate, Weaver Barksdale and Logan Circle. You know, they both were kind of in line for the first six months of the year, 5.3 for Weaver Barksdale; 5. 5.2 for Logan Circle.

MR. DIFUSCO: Marc, is that benchmark then for the combined fixed income an appropriate benchmark in your mind for combined total if over half the money being managed is being managed against something other than the agg?

MR. AMMATURO: Yes. In the IPX, remind me. We revisit targets for -- on the fixed income side of the equation. We do not -- it's a good question. Because in my opinion, we're currently reevaluating this. And we currently have RFPs outstanding as you know, Chris, for corporate fixed income. Working on the emerging market debt.

Is the Barclays Aggregate a good proxy for the overall composite? Yes. But is the mix appropriate? I think answer the is no. And that's why we are working on these RFPs. Does that make sense?

MR. GOLDSMITH: Currently, the benchmark for fixed income mandate is 47 percent aggregate, then 53 percent intermediate which is itself a blend of the intermediate.

MR. DIFUSCO: I just mean, like, if we are showing the flash report like we do here, we said combined fixed income and then we measure combined against the Barclays, we have 687 million and, you know, managed against something else where 78 -- I guess my question is even if it's just on a flash, should it be -- should the combined fixed income target be a combination of the Barclays Agg and something else? Or is the overall proxy still the Barclays Agg?

MR. AMMATURO: I think the overall proxy should be the Barclays Agg. That's what you want to manage to and outperform. But again, that's where we don't want to just hire agg managers even though the overall benchmark on our page remain the Barclays Agg, at the end of the day, that's the treasury market -- sorry, that's the domestic bond market the agg. It's a good proxy, good benchmark to aim at. We want to diversify outside the agg in our opinion.

MR. GOLDSMITH: Those are the themes we actually present at the May meeting as part of the asset allocation. I think I will cover that as part of the IPS discussion and the benchmark questions as well.

MR. AMMATURO: Last page before you move on the next Agenda item is the allocation. If you look on page 4, you know, this is what drives your returns. If you look at the bottom of page 4, the bar chart, the blue bar is how PGW is invested. So like I mentioned earlier, large cap, you are at 42.4 percent. You are overweight large cap because your target is 41. That's helped you. Large cap has done well. Actually helped with the small cap. That helped you. That is what I was referring to earlier.

All the other, you know, targets, if you will, for assets classes, you are right near the target. Small cap you are at 8.8. The target in your investment pol statement is 9. International equity, you are slightly underweight which has been a good place to be, too, as international equity has not kept up with domestic equity. You are almost a percent underweight international equity, which again has been a good place to be. And then fixed income, let's call it right on top of target, 34 and a half versus target of 35.

And again, the other sheet I passed around I just wanted to provide an update as of July 12. I talked about the increase in market value already. If you look at the current allocation percentage column versus the target allocation percentage column, the themes are very consistent with where you were June 30. Obviously, this is less than two weeks after the quarter end, so not much has changed. The main takeaway here is kind of your total plan market value. I want to communicate where you are as of July 12.

But the theme of being international equity underweight still remains. For example 14.18 versus target of 15. But I didn't plan to go through that row by row.

CHAIRMAN SCOTT: Are we done with that section?

MR. AMMATURO: Yes.

CHAIRMAN SCOTT: Thank you very much.

So now, we are going to move to the Pension Plan Investment Policy Analysis.

MR. GOLDSMITH: Yes. I will direct your attention to the tab, the binder labeled Draft Investment Guidelines. And before we sort of go into the document a little bit, I think it makes sense to revisit some discussion that was had at the May meeting, you know, both for Donn's benefit and also kind of set the stage for the red line document here.

At that meeting, while we presented an asset allocation review of the plan, both the existing asset allocation and several alternative allocation structures using our capital market assumptions. And the purpose of that was both to look at where the plan is currently and also to review, you know, potential new themes for the portfolio. You know, was brought to us when we assumed our consulting role back in March to present some additional directional themes we like to take the portfolio or revise the portfolio.

Coming out of that analysis were three

prior -- one main primary theme, that was diversification of fixed income. Marc spoke about it a little bit in covering the performance review there. Unfortunately, we don't have analysis here. But it was really within that diversification of fixed income division of three subasset classes designed to enhance yield and provide some diversification outside of the United States.

So the main -- the three themes were investment grade credit, which currently -- these were agreed by the Sinking Fund Commission in that May meeting, some of this is underway; the addition of the investment grade credit to the portfolio. All investment grade triple B rated or above corporate credit, you know, corporate bonds. It can include some asset backed credit, as well, private credit card debt, some car loan payments as an example of some asset-backed credit. And currently, an RFP is underway.

Just yesterday, I think we finalized an RFP for the second subasset class, which is emerging market stat, diversifying away from just U.S. based fixed income. If you were to reference the performance report that Marc covered, you will see as emerging markets equity have outperformed for the year, emerging market debt has, as well. Over the long term, the rise in emerging markets, talking 30 years or 10, 20, 30 years out, I think necessitate the need to include both the sovereign debt and corporate debt of those countries.

And then the final theme within the fixed income subasset class is the addition of high yield securities. As the name implies, these are below investment grade securities that are higher yielding than traditional treasuries, agencies and some of the more investment grade corporate investment grade credit.

We all know we are in the low yield environment. Again, if you were to reference the performance report, you see year-to-date high yield pretty significantly outperforms broad core fixed income. It does come with additional risk, certainly default risks. But you know, it's included as return and answer for the portfolio at a typically lower allocation.

That's really the themes we discussed.

And why we're revisiting the investment policy guidelines are because currently those themes would not be able to be implemented the way we would like. Primarily, a restriction to foreign bonds which would preclude the emerging markets debt piece and below investment grade securities, which would preclude some of the credit investments as well as most high yield.

So, that's where we were starting. If we're going to review and make an amendment to this document, there are some other potential areas where I think we like to rework the document to allow for a more fluid framework in the future. Some future themes we discussed last month or at the last meeting that weren't approved in term of set aside for perhaps a later date include the addition of alternatives, perhaps some real estate, infrastructure investments and then eventually perhaps private equity or hedge funds even further down the road. Those investments were also precluded by the current framework.

Additionally, there are some benchmarking requirements in here that we feel really over-restrict the investment managers. And so, we reworked that into a total portfolio approach to investment restriction. So I -- there are a lot in the document. It's red line. It's small. But I'd like to kind of walk through some of the high level changes that we are recommending, if that makes sense.

CHAIRMAN SCOTT: Can I just ask a question?

MR. GOLDSMITH: Sure.

CHAIRMAN SCOTT: Whenever I hear the term below investment --

MR. GOLDSMITH: Investment grade.

CHAIRMAN SCOTT: Yeah. That raises a red flag with me. But again, I was also looking at it from a commercial lending perspective. And I know if it's below investment grade, you are going to get a high return, right, because you are taking more risk. So I would assume that the amount that you would allocate to that would be relatively small?

MR. GOLDSMITH: Yes. I think -- really for all of the subasset classes, I think currently right now in the asset -- I have my own copy from the last meeting -- 35 percent of core fixed income. The amended or the proposed allocation include -- drops that down slightly and includes 3 percent allocations to investment grade credit, the emerging markets debt both below investment grade and investment grade, and then high yield which is all below investment grade. So, 3 percent roughly allocation we are talking to below investment grade securities.

Not a lot of the portfolio. And I would be happy to kind of -- we can probably send it -- should send this around just to give you an idea of what adding that high yield does to the return to portfolio as well as the risk in terms of volatility. It raises it slightly, but it's pretty minimal amount.

MR. AMMATURO: And the conundrum we face is how much volatility do you want to take on? At the end of the day, we are risk managers at PFM. We need to take on some level of risk to make your actuarial assumption realistic to be able to achieve your actuarial assumption.

You know, our projection for core bonds is 1 and a half percent over the next five years.

That's the challenge. How we are going to get to 7, 7 and a half, 7.25 over the next five years if core bonds are generating a return of 1 and a half percent and our projection for our yield is 5 percent, north of 5 percent. There is no free lunch. There is volatility there.

It's not asset class we say invest and leave it and forget about it. It's an investment that needs to be closely monitored and maybe not even be held all the time. But in certain markets, it's warranted at a small allocation to your question, Donn. At a small allocation.

MR. GOLDSMITH: So, I want to flip right now to page 3 of the red-line document. And you know, this is partially related to the addition of the new fixed income subclasses, but it's also, again, a simplification of the guidelines to allow for more fluid portfolio management, more fluid asset allocation structures if market conditions, economic conditions warrant it.

So in the highlighted row there, you can see the new asset allocation framework and targets. The mix does not change. It remains 35 percent equity, 25 percent fixed income.

What does change is -- I'm down below what's crossed out. You can see what was there. It's a shift from having specific targets to large cap and small cap to pure domestic equity. It goes from -- it increases international equity from 15 percent to 20 percent. That's a proposal based on the market cap weighting of international equity securities within the overall global market cap. It's approximately 55/45 split.

So increasing international equity target would make sense. And then on the following page similarly to --

CHAIRMAN SCOTT: Before you move, I want to make sure I understand the presentation. I see international. And then beside in parenthesis I see plus or minus, what, 20 percent. I see target 15.

So what's changing? We are going from what to what?

MR. GOLDSMITH: The target weighting for international equity is moving from 15 percent to 20 percent to more closely reflect the weighting of international securities within the global market.

MR. AMMATURO: What's up above, right, Alex?

MR. GOLDSMITH: Yes.

MR. AMMATURO: What's up above is what we are proposing you move to. What's down below is in the current document.

CHAIRMAN SCOTT: We go from small caps, move from 9 to 20 percent? Am I looking at that right?

MR. GOLDSMITH: So small cap is being removed as a specific target. The rational being having a specific target to small caps overly restricts the portfolio. It means that you must by policy -- the target should really be 9 percent. And if you look at the ranges, the minimum range for small cap was previously 7.2 percent which means that at all times, any and all market conditions, small cap had to be in the portfolio.

By shifting to a total domestic equity target which is up above, and you will see that 45 percent. That includes large caps and small caps and allows for the possibility to potentially be further underweight small caps even fully or removing them from the portfolio if the environment dictates such a position.

MR. BUTKOVITZ: Does this mean that you don't concur with concerns about drops in international equities because of Brexit codes?

MR. AMMATURO: This is long term focus, Alan. This is not meant to be if this is adopted, this is where portfolio is going tomorrow. I think it's important to point out. This is not meant to be that. This is meant to be a long term 30-year plus investment guidelines. Again, if this gets adopted, the thought is these are long term strategic targets.

And then based upon current market position, do we gravitate in that direction? If we do, what's the pace of that --

MR. BUTKOVITZ: Don't the analyses say there is going to be this unraveling of the European market? And therefore, even the long term view right now is pretty negative. So, do you have evidence or reason to -- or am I wrong?

MR. AMMATURO: Where we have discretion we are underweight international equity in client portfolio. It's not asset class we are looking to aggressively add by any stretch. We are underweight internationally, I believe. Where we have discretion in your underweight international equity in your current pension plan.

MR. BUTKOVITZ: How can we make a projection about -- we are going to skip over everything that we know. It's a little bit like the Five Year Plan that the City does. What we know is the next year, and then we are kind of guessing about what happens in five years.

So, we say that we're entering a patch that's going to be very volatile, very dangerous internationally. But for some unstated reason, we have confidence that it's going to be very positive over the long term.

MR. AMMATURO: But the low end of the range is 10 percent. If you look at what we're proposing, the low end of the range is 10 percent. It's not like we don't have -- we're not saying we need to go to 20 percent. The low end of the range is 10 percent. Based upon current market conditions what we at PFM recommend, we are going to be recommending underweight international equity even though the long term targets may be increasing.

Does that make sense? The ranges are wider.

MR. BUTKOVITZ: The only problem I have is voting for a plan that seems to endorse a more aggressive posture with international equities when all the evidence, miscounted --

(Conversation held among the PFM people.)

MR. GOLDSMITH: Maybe it's -- for my own thoughts, I think long term is 30 years and beyond. That's the duration of the liabilities in this portfolio.

MR. BUTKOVITZ: My question would be, what are the building blocks that get you to 30?

MR. GOLDSMITH: It's productivity growth, population growth and the emergence I think of the global economy. I think the U.S. right now is 45 percent of global market cap. I expect that over 30 years to shrink. And you know, where is the population growth occurring right now? It's occurring in emerging economies, emerging markets. It's slowly developed economies in the U.S. I think the extreme long population growth is just point 6 percent.

And so, the extreme long term, I -- we do believe in the growth and international markets.

MR. BUTKOVITZ: You're basically shorting the domestic markets over the long term.

Is that the idea?

MR. GOLDSMITH: I don't think we're shorting. I think it's -- short to me is specific tree, I'm thinking. But it's a shift towards emerging markets and the asset allocation or towards the international markets because international copies. It is a trade between U.S. and -- that's reflected here. I think --

MR. BUTKOVITZ: What about the international momentum towards withdrawal from world markets? Is that factored in?

Are you saying the international markets are growing no matter what policies or procedures?

MR. GOLDSMITH: I can't say that. I don't think really anyone could. But how I view this current situation, I view it as an intermediate situation, a blip. It's certainly impacting policy. It's impacting formal legislative policy overseas. But it requires short term tactical abilities. And I think that's what the framework of this document allows for. It allows to go even lower than current target. Right now currently, 12 percent is the minimum allocation to international equity. Under the new framework, it can go as low as 10.

But I think -- who is to say in 15 years there may be another Brexit from something else.

MR. BUTKOVITZ: Another 15 months there might not be a European Union, right? You got five countries talking about withdrawing the presidential election, where a lot of people here are talking about withdrawal from the world before -- interfering with flows of capital.

MR. AMMATURO: You don't think this supports that? Again, to the point Alex just raised, this lowers your --

MR. BUTKOVITZ: But it also gives us greater flexibility on the higher end, right?

MR. GOLDSMITH: Yes. There is also the possibility that in the long run, the Brexit and ensuing exits are better than what we have now maybe. You know, 30 years from now we may look back on the Brexit as a good decision for the UK. That, we have no clarity to that now, I think. In the intermediate term, it's a huge risk. This gives us increased flexibility over the intermediate in the near term. I don't think that the Brexit is a Dooms Day device for international equities 30 years and beyond.

MR. BUTKOVITZ: So, is the basic argument for this that it gives you a freer hand to react?

MR. GOLDSMITH: It gives you a freer hand to react.

MR. AMMATURO: We don't have discretion. It gives us the freer hand to give recommendations, to be more tactical, yes.

MR. GOLDSMITH: Right now -- sorry.

MR. AMMATURO: We meet every two months. It gives us the ability to give our recommendations every two months to more nimble and more tactical. Yes, to your question. Yes, it does. The range is fairly restrictive. Your range was 12 to 18. That's pretty tight. That's pretty tight. That's being committed regardless of Brexit, regardless of what global economies do. That's tight range.

MR. GOLDSMITH: Right now I think the international equity is at 14 percent. And you know, we're talking about raising -- we have conversations through the week about raising cash for benefit payments. If we wanted a source of some additional cash from international equity, maybe bumping up against that 12 percent target at some point. My recommendations have been recently to source some recent cash from international primarily for the current risk environment.

So you know, we continue down that path as we may, we could end up bumping up against the 12 percent.

MS. JOHNSON: I think is it fair to say that the proposed amended targets is not where you would want it to be today, but something -- a goal to reach to staying within these ranges -- to proposed new ranges?

MR. AMMATURO: Yes. Correct.

CHAIRMAN SCOTT: For me, it was a whole

lot to digest in a very short period of time. I stated that as someone that I spoke with.

I'm just wondering is if we were to delay a decision on this until, at least for me, I had an opportunity to fully understand the rational logic behind these recommendations, does that put us in a negative position or?

MR. DIFUSCO: No. If after they finish their suggestions you wanted to table it until September, that would not cause -- because of the RFPs, we are not going to have manager interviews and such. I don't see tabling it until the next meeting causing any problems at all.

MR. GOLDSMITH: For investment policy statements in general, these are not documents that should be amended every quarter, every year. It should be a well thought out decision to adopt an investment policy for the long term. And so, that's why I recommend fully understanding everything. We don't want to be back here in a year. That's also why we will get private equity and such results. We have no plan to amend alternatives currently. We don't want to be back here in one year or two years amending or writing another document like this.

With that, I think we can move on from the targets.

MR. RUBIN: Hold on. Before you move on, is this what other pension plans are doing now in terms of all caps and all the different investments that are there? Instead of saying large cap/small cap, you are now combining them. Is that something that other pension funds are moving in the same direction, or is this sort of new? Because I don't know of any other fund that does it that way.

MR. GOLDSMITH: That's not what we have recommended to the vast majority of our clients, both discretion and non-discretionary clients, for the past five years or so at least since I've been with PFM. Speaking, I was the main fund of the City does it differently. I don't know, Marc, if you can speak to some other clients or plans that we don't manage that take an all cap approach.

MR. AMMATURO: Yeah. Yeah. Trying to think, Bill, of the clients. I think it's actually fairly mixed. When I think about the other client base that I service, a good bit of them do have strictly domestic equity target. And then there's quite a few that get granular. PGW currently does and splits it by capitalization. It's hard to give you -- it's hard to give you an exact answer in terms of trend. I think I see both out there in the market place.

MR. RUBIN: How do we end up not chasing returns and kind of market hopping? Because now we see large cap is in favor, so we're trying to get large cap managers in by the time you're very familiar with, obviously, the public strategy. By the time we recognize it, bringing managers, hire managers, get them legally through the system, it's now changed again.

MR. AMMATURO: What we are doing there, Bill, is hiring managers and kind of putting them on the bench. We are going to have managers come in, we're going to interview them and approve them. We may not give them dollar number one. We are going to have them there to be ready for when market conditions dictate this such manager is a good time to be in the portfolio.

That's the thought process going forward. We are doing three fixed income. We are going to be working on three RFPs and fixed income. That doesn't mean they are all going to be getting dollars once we decide who we want to do business with. That means they are going to be ready based upon how market conditions dictate. Okay, now we should diversify. It's more that.

MR. RUBIN: Let me understand that process. The Board is going to get three managers to take a look at. We are going to possibly or not select one of them. And then we are going to watch them over the period until we believe it's time to invest in that area, and then bring in one of the ones that we have selected?

MR. AMMATURO: No. We are going to select one -- take, for example, small -- we want to add another emerging market equity manager. We are going to interview three firms. We are going -- you are going to select one.

And then we are going to determine that PFM investment committee is now the time to increase emerging market equity. Let's give that manager at PGW some dollars. We will tell Chris and Matt that. That manager will be hired and go through the contract process, but will not receive dollar one until the market dictates they should be managing money for PGW. We don't want to be hiring and emerging markets manager. We can hire them, but we don't have to give them a dollar of business.

Does that make sense?

MR. RUBIN: No. We are going to hire them. Not give them any money.

MR. AMMATURO: Correct.

MR. RUBIN: And then when PFM thinks that the market is trending their way --

MR. AMMATURO: Yep, yep.

MR. RUBIN: -- then you are going to come back to us, say we now see a trend in small cap growth.

MR. AMMATURO: Yes, yes.

MR. RUBIN: We think you should be fund that manager.

MR. AMMATURO: Yes.

MR. RUBIN: The managers are going to be

okay getting hired without getting any money, and we don't have to pay them any fees or do anything while we have them hired?

MR. GOLDSMITH: No.

MR. RUBIN: You're saying yes; you're saying no.

MR. DIFUSCO: Me mean the same. We are answering different questions but mean the same thing. It's not dissimilar to the process, Bill, at the large fund where we hire bench managers, if recall, under the Opportunity Fund umbrella.

MR. RUBIN: Okay.

MR. DIFUSCO: Where we go through the contracting process and we say we are hiring manager A, B and C. At the moment, we don't have a need to allocate dollars to another small cap manager. However, in the event that it's time to, your contract you are ready to go. You're there. And when we have come back to the Board or Commission and say, now it makes sense. In consultation with PFM, staff is recommending we source $20 million from here and move it to here.

But there is no ongoing fees. There is no nothing because the fees are all asset based.

If the manager has no money, there is nothing -- there is nothing for them to charge against.

MR. GOLDSMITH: We will get into this a little bit more when we talk about the core and value growth. Marc kind of eluded to that earlier. I think obviously our goal is to hire managers that are fundamentally based managers and will outperform in all markets regardless of market condition. If we had managers who are comfortable, we may not necessarily need to add a manager. We can reduce the allocations internally. That's an easier way to react or proactively position ahead of, you know, if we see market fundamentals.

MR. RUBIN: Which takes me to my next question. You take money when a manager is not performing well. Does that mean that we would just reduce them down and hold them on the bench until they did perform well? Or does that mean when you take the money away, we would end our relationship with that manager?

MR. GOLDSMITH: It wouldn't necessarily be a -- this would be an asset class decision.

MR. AMMATURO: That's the key. That's

the key. It's asset class decision, not a manager.

MR. RUBIN: If we switch from large cap to small cap and took the money away from our large cap manager, would we keep the large cap manager and put them on the sideline until we felt that large cap was back in style and would go back to this same manager? So, they're not fired, it would just take the money away?

MR. AMMATURO: We would trim them. You are speak about extremes. I don't envision going to zero with large cap. It would be trimmed.

MR. RUBIN: They would be trimmed. Not based on their performance, it's based on what we see as the trend.

MR. GOLDSMITH: Good example would be emerging markets. There could be a very bad event at emerging markets. We want to remove it entirely from the portfolio.

Dimensional is a fine manager. They are very good with emerging market space. We may totally reduce that allocation to zero, keep them on. They wouldn't be charging fees. And then when the fundamentals indicate going back into emerging markets, we can add to Dimensional. That would be fully allowable in the framework of both this document, your previous document.

MR. AMMATURO: But again, I want to clarify. We are speaking in extremes here. I think it's more likely we are going to be reducing and adding managers based on asset class position that PFM sees in the markets and is not extremes going to zero, going back in, going to zero. We are not day traders here by any stretch.

MR. RUBIN: Marc, timing is my problem.

MR. AMMATURO: Yeah. We are trying to add value around the edges. When Brexit occurred, we reduced international equity before the vote and reduced it even further after the vote when we had discretion.

Just as an example, we reduced high yield after Brexit because of heightened volatility.

Again, at the end of the day, we are going to be voicing these recommendations. Whatever we are doing as an investment community under discretionary assets, we are going to be voicing them here to you. And then we will see it if I makes sense for PGW pension, as well.

MR. GOLDSMITH: Set to move on?

The next on page 4 now, that was the targets and the asset allocation framework is one thing. Another theme is in the allowable and non-allowable investments. And that's what we have here.

So the current framework is one of, I guess, it's inclusionary structure. These are the types of securities that are allowed. They are all listed here for domestic equity, international equity and fixed income. I think we moved to an approach where -- I have to find it in this document. It's exclusionary approach. We list what is not allowed. I, frankly, think that makes it a little more simple. You can list things that are allowed. List things that aren't allowed. If one security type isn't listed, where does that fall. I think from a government standpoint, it is safer to explicitly note what is not allowed in the portfolio. That's the text on 4, 5 and 6 that is grade out. Are these -- this is what's allowed. And those have been crossed out.

On the following section, you will see diversification. Previously, the diversification requires things such as on page 7 in that no more than greater of 20 percent or three times the applicable benchmark in that section weighting may be invested in any one market sector at one time. So that is a -- these are restrictions that apply to each individual manager. Each manager has to adhere to their benchmark, and have no more than 20 percent or three times the benchmark weighting in any one sector.

What those types of restrictions do are they prohibit certain concentrated managers that may hold a limited number of securities. This is a sector weighting. They are also limit in securities. No more than 10 percent may be invested in any one company. If there's a fund that is very, very concentrated and the manager only holds ten stocks, certainly a risky strategy. There is a lot to be said about concentrated portfolio and high conviction names the manager has.

Those can have a place in the portfolio.

Those are precluded by this framework. We have changed the diversification requirements to apply to the total portfolio. So, all the managers rolled up. You can see that at the top of page 7. It's when all the managers, all the holdings are combined. You can have no more than 5 percent or the weighting in the relevant index of the total equity portfolio in one corporation.

So at the total portfolio level, no more than 5 percent in any one name. And then you can some concentrated managers offset by less concentrated managers or index funds, which is the opposite of concentration. From the monitoring standpoint, that would be monitored both by us as we gather the holdings quarterly and prepare a portfolio characteristics and then staff would monitor those exhibits, as well.

That's how we make sure the 5 percent limit at the total portfolio level is adhered to.

MR. RUBIN: When you guys did this, was there a legal opinion if all the changes were okay and we have the ability to change some of this? And from a steward perspective, do you know why it was written that way in any way when they put it together?

MR. GOLDSMITH: I can't answer the historical question. I don't think I can answer the legal question either. I think that can be staff or, you know, I would assume it have to be vetted by a legal team. But a lot of these changes that I included is text from existing investment policy statements and existing plan sponsors in public plans. So, it's language that has been used. It's currently in use elsewhere.

MR. DIFUSCO: Adam, you and I talked about it briefly.

MR. COLEMAN: I think on a general level, we can definitely do more research on this. I think it's the Board's discretion to make changes to the IPS as long as they are consistent with fiduciary duties. That is really why we are here. We are doing this analysis to make sure that we cover -- the Board is covered as far as taking the steps to ensure that they are compliant.

MR. GOLDSMITH: Talking about some high flow themes right not moving from an inclusionary to exclusionary, moving from manager level to portfolio level diversification guidelines. I want to focus can on some specific things right now that preclude this is why we did this in the first place that precluded some of the RFPs that are either currently at issue or will be issued soon.

On page 8 you can see there in the top, no more than 20 percent of U.S. dollar dominated investment grade, non-U.S. debt. You can't have more than 20 percent in non-U.S. fixed income. No more than 25 percent in domestic asset banks. No more than 15 percent in commercial mortgage bank. These are all potential securities that could conceivably be in investment grade, nimble actively managed investment grate credit portfolio, which we currently have an RFP for. And thus, a manager could hold that.

By going to a total portfolio level guideline, we can again add that credit manager that has some mortgage backed credit, has some corporate commercial paper. On the other page you will notice, page 9, you can see convertible bonds, fixed income security, domestic bonds. About halfway down the page Letter A, which is crossed, must be rated investment grade or better by at least two of the rating agencies. For similar reasons, that has been stuck from the portfolio -- from the policy.

Again, some of the down the road themes I am looking at Letter C there, limited market building securities. These are the private equity, private placement type securities. No plan to put this in the portfolio now. But in looking to the future, that has been struck. It may be something that we want to include. This is all obvious up for debate, up for recommendation. We can -- we don't have to go down that road now. It can be done as an amendment. If we want to get this in the optimal shape, that's why that has been removed.

Moving on. You can see where we have eliminated the rest of these restrictive diversification requirements. We allowed the duration -- the duration requirement hadn't changed that was previously required at the overall portfolio level. So you know, that was -- that has been amended. You see the duration for the total fixed income portfolio.

Again, just taking away from individual managers. And then that section of prohibitive investments which include, you know, leverage investments which we don't feel replace the portfolio.

The final main theme of what is changing here is on page 13 under the objectives. This is where I was getting into the benchmarking discussion. So we don't -- no change to the goal. We want to exceed by 60 basis point on a net basis. But what did change, we changed the -- this gets back to your question about the all cap, Bill. We changed the allocation framework to an all cap more broad framework. The benchmark should correspond, move to an all cap Russell 3000 benchmark, total international. The benchmark international equity component.

And then as we discussed earlier, the Barclays Aggregate for the total fixed income component which represents really the core U.S. fixed income. That is what where we are trying to be there.

We also noticed there is a lot of information in here about the specific benchmarks for every underlying subasset class. I feel that

that should not be included in an investment policy document which again is designed to be very rigid and for the long term. Manager benchmarks are important, but they should be -- they shouldn't be codified in the document to allow for, again, the potential addition of a concentrated manager or a manager that maybe does a little more non-core or added flavor of benchmark. Kind of silly to have them codified as this is what they have to do.

MR. MAZZA: Grant it, it makes us from a legal standpoint, makes us a little more rigid in terms of definition that we provide in the IPS, correct? We are defining benchmarks in the IPS. It kind of puts a little more on us.

MR. GOLDSMITH: Right. You don't want to be in violation of this. The ultimate reason for making it more fluid and open is to prevent violations, because that's bad headline risk. And if there were ever to be -- performance were to flag in non-compliance status, that is not good.

MR. MAZZA: Like I said in the past, indices are bought out all the time. Bloomberg just bought indices of Barclays. If we have the wrong definition in the IPS, the IPS is technically wrong, right? We can say that, you know.

MR. GOLDSMITH: We ask, where does this get codified then? It's codified in the investment manager agreement. So when you approve a manager when they are hired, they sign an investment manager agreement. That's when you can -- you assign a benchmark. And you sign you will meet this benchmark by whether it's previously it was 20 basis points for some fixed income, you set your outperformance targets and the benchmark individually as you hire the manager.

At the total portfolio level, we are still looking for all the managers in aggregate to beat this simplified benchmark. But that is why we are taking the active manager positions and the allocation positions, adding high yield and adding emerging debt, et cetera. Those are allocation positions that will get us outperformance. But the manager is for their individual strategy, they will have appropriate benchmark in the management.

On page 15, we get to communications and responsibilities. Nothing changed that section. It's very minor language in terms of consultant custodian. It's nominal stuff. And again, similarly just to simplify, streamline the document, I moved the definition in the appendix to the end. A lot of that applied to the benchmarks which are no longer in this document.

So yes, to put it all back together, there is a lot changing. It's important to fully understand the new framework and if you are on board. It is setting the strategic direction for the portfolio.

MR. MAZZA: Now in your opinion, in terms of the investment policy statement, should we have termination language in there to discuss with managers if they aren't beating the benchmark? Or should it just be for the investment management contract?

MR. GOLDSMITH: My recommendation would be to have that in the contract. Though, I also -- I don't love termination requirements because then it, again, if you got a manager that's underperforming, are you required to terminate that manager? And this kind of ties back into some stuff Bill was saying. We are following performance. As performance goes down, we get a manager out. That's not always the best time to determine --

MR. MAZZA: Sure. I am saying over long term.

MR. GOLDSMITH: Sure. If you have termination language that make require you to terminate a manager due to performance. But fundamentally, you still like them. Maybe their asset class has suffered, you might be that your hands are tied. You have to get a manager out, you still like them, and than you end up outperforming later on.

MR. MAZZA: Put them on a watch list, so to speak?

MR. GOLDSMITH: Yeah. I have seen planned sponsors that have codified watch list language at the policy level and in the managers subscription level. I still prefer to have -- if you are going to could have that, I'd have it at manager subscription at that level.

Thank you. Appreciate the time.

CHAIRMAN SCOTT: My position on this, and I welcome input from the other commissioners here, is we ought to take a little more time to fully understand and appreciate all the changes.

And so, I'd like to table it. But I'm open to what you guys would like to do.

MS. JOHNSON: I think that's reasonable. And I just want to talk a little bit more about where this is a little bit more conservative than what the original policy is and what some of the proposed changes are. And I know we want to look at some options.

But what does that truly mean for --

MR. GOLDSMITH: We can amend this further, too, and add back some of the restrictions if, you know. But the themes are what I wanted to cover today, these core concepts.

MS. JOHNSON: Sure. Sure.

MR. DIFUSCO: We can obviously have discussions with anybody offline in the interim about specific points if you want additional detail on specific pieces of points. We are happy to have discussions offline in the interim.

CHAIRMAN SCOTT: Excellent. So, I think we are now item number seven; am I right?

MR. AMMATURO: Yes.

CHAIRMAN SCOTT: Large Cap Growth RFP recommendations.

MR. GOLDSMITH: I will direct your attention to the last tab titled Core Equity. I have an additional handout here, as well.

There was an RFP for large cap growth. This was issued before we assumed our role. And I think originally the managers were to come in to interview the March meeting, was pushed back. And staff said, well, let's wait a second. Do we even want to add more to this portfolio. There was conversation about fees and management do they under performing. Our response was, yes, even in the large cap space we believe there are active managers that can beat the S&P 500 or the Russell 1000 index.

The next question was, do we continue with this framework we have of one growth manager, one value manager and then the index fund which are core and standard. I think our recommended approach would be to go with a core manager rather than two style groups of valuing growth. You saw when Marc covered the performance earlier, the disparity between valued growth this year. It's pretty significant. I will show data shortly that shows the disparity in other calendar years. And while that's driven by fundamentals, there's really no discernible pattern to that. We don't want to try to time the market.

You either have both and performances offset and you end up getting a core approach. If that's the outcome anyway, I think we would rather have core to start with and then allow for those managers to look for themselves, build a portfolios that they want to outperform a core benchmark.

So, I will direct your attention to what I passed out. This is the weighting of the S&P 500, the Russell 1000 growth, the Russell 1000 value across the various industry sectors. When a manager -- you saw this in the investment policy, managers can't be more than X percent above or below a sector weight. So, they have to pay close attention to the weightings of these sectors and their benchmark. Because of the different nature of value and growth stocks, certain sectors will be over or underrepresented in any given sector -- index.

Technology is an easy one to see. 29 percent of the growth index, 9 percent of the value index. For the S&P 500, core is about 20 percent. Similarly, healthcare is another growth sector. On the flipside, traditional value sectors, I think you can see financials energy is a big value sector.

And when you have that weight in your benchmark, you're not looking for the best stocks across all sectors. You are looking for the best stocks in these sectors. It's that's not a fundamental decision. We prefer fundamental investment managers that can determine in their own rate whether value or growth, whether they live value or growth given the current market, whether they like healthcare or energy given the current market. They are not dictated by their benchmark. That is the first exhibit.

MR. AMMATURO: Now just to amplify that.

Right now at PGW, you have managers that manage two Russell 1000 growth. You have managers that manage to value benchmark and growth benchmark. We are trying to communicate here is does it make more sense to have managers that manage a core benchmark with less concentration -- sector concentration. That's the takeaway.

If you look at S&P 500, as Alex pointed out financials. It's huge in the value space. It's very small in the growth space. When I hire managers, that will manage to a 15 percent financials as opposed to trying to get managers underweight financial and managers of overweight financials relative to the core market, if that makes any sense? Just kind of amplify the main point we are trying to communicate.

Again, this is a round. Fred Alger, do we want to hire growth managers to potentially replace them or retain Fred Alger? Or do we take a different approach and issue a core domestic equity RFP. Just trying to level set where we are in this conversation.

MR. GOLDSMITH: On the following pages, again, this shows the performance of the indices.

It is divided in three sections on the following page. Index performance, large cap, small cap and international developed equity. And then you have a core, which is the bold line and then value and growth.

I think you can see, you know, taking last year, for example, growth significantly outperformed value. This year, as Marc indicated, value is significantly outperforming growth. Now there are fundamental explanations why, but surely just trying to -- again, we don't time the markets. That's a decision that can't be made. You will see some years they are, frankly, very close; others minor differences; others significant differences, both the upside and the downside. You know, I think 2006 is interesting to note significant value outperformance.

The other trend here I will point out that this adheres across large, small and international. Moving onto the following exhibit, these are index returns. You can argue what about active manager. Can active managers, you know, with their ability to pick different portfolios, can they overcome their value growth bias? And really, it's no. You will see that even last year, these are the median of their respective peer groups. The peer group of large cap core managers, the median performance there was 1.3 percent for 2015. As you can see, even active managers, the median large cap growth managers significantly outperformed the median large cap value manager over the last year. It persists going back to '05. It holds across large, small and international.

And you know really -- you will look at the core performance. It's kind of right down the middle there in those instances. We prefer to at least have that performance or better with core fundamental-based managers. One manager, you can have two. Think that's a decision for allocation. But that's our rational for recommending core.

The RFP has been issued. We received submissions. We reviewed them. You might say are there any core managers we can add? The very last page you will see the list of respondents. And you know, the name, the strategic name, clearly growth. But we have some stats there, price to earnings. These are just valuation metrics. Growth managers typically tend to have higher PE, higher price-to-book rations. You can see earnings growth rates are obviously going to be higher and yields will typically be lower.

So you know, Russell 1000 and S&P 500 core data at the top. If you look at all the managers, it's really indicative of these are pure growth respondents. So, our recommendation would be to pull this RFP and reissue a new core approach. Let's solicit a number of responses and add one or two core managers to the portfolio in large cap space.

Ultimately, as I mentioned, I think this trends holds across small as well as international. I recommend those changes, as well. But I think we have a lot of RFPs on the table. I think it makes sense to finally move through these.

MR. MAZZA: In terms of local managers as well, I can recognize one that's on this list and that's Local Capital, correct?

MR. GOLDSMITH: Let's see. Who else?

MR. DIFUSCO: I'm not even sure that's the same.

MR. MAZZA: There's a Local Capital base.

MR. DIFUSCO: That's the local one?

MR. MAZZA: Yes.

MR. DIFUSCO: Okay. They're in Philly.

MR. MAZZA: I think they're in Malvern or Radnor, one of those towns.

MR. GOLDSMITH: In conjunction with this, we have submitted a draft questionnaire as well as a draft RFP to the staff so it can be issued quickly. We submitted also an updated screen. I think I sent over 150 or so managers including a range of local managers we both like currently and some minority, women-owned businesses as well in the list. We vetted them. They are core approach. We would be inviting them if this RFP goes out.

MR. MAZZA: They are in Haverford.

MR. DIFUSCO: My only recommended tweak to what Alex said would be to not officially pull or cancel the RFP with these candidates because in the event that we don't like the core candidates or in reviewing the asset allocation as Donn and Al or Rasheia still have questions, if we decided we didn't want to go the core route, if you officially cancel this -- that's what I was asking Adam about -- my only recommended tweak would be fully support the recommendation to issue the RFP. Just would not want to officially cancel or invalidate the responses. That's my only recommendation, like, my only addition.

MR. GOLDSMITH: Fine.

CHAIRMAN SCOTT: Works for me. Is that okay?

MR. MAZZA: Want to take a vote on that?

CHAIRMAN SCOTT: Do we need to?

MR. DIFUSCO: Just to issue the core RFP. That's all.

MS. JOHNSON: And not pull?

MR. DIFUSCO: We don't have to have a vote, but just to issue the core part.

CHAIRMAN SCOTT: So whether we --

MR. MAZZA: Just should we issue the RFP for core.

CHAIRMAN SCOTT: Does someone make a

motion?

MS. JOHNSON: I'll make the motion.

MR. BUTKOVITZ: I'll second.

CHAIRMAN SCOTT: Motion has been made and properly second. And I assume it's in the minutes.

All those in favor?

(Ayes.)

CHAIRMAN SCOTT: The ayes have it.

MR. MAZZA: Nice job, Mr. Chairman.

MR. GOLDSMITH: Going back, these are managers that are core across different market conditions that we can dial up or dial down.

CHAIRMAN SCOTT: This now takes us, I think, to the International Equity Index.

MR. GOLDSMITH: This is second to last tab index. This was another RFP that was issued for, we assumed, our role. There were three respondents. And ultimately, it's for index strategy.

I think what we look for here is ability to replicate the index, ability to exclude or restrict the securities for the Sandy Hook and Northern Ireland restrictions, and the ability to do all that at the most effective fee.

Our recommendation again is RhumbLine. They have the lowest fee of the respondents. I met with them several times in the last -- this year. And you know, I think they're -- the hallmark of what they do is customization and client service. They will be able to work for PGW for those exclusions. And you know, that's ultimately what's most important.

The last page of this section is, you know, if we were to get -- mentioned you can approve a manager, you don't have to implement or give them assets right away. There is lot going on in international equity. You know, do I favor moving back to the 15 percent target right now? No. We are underway. This is as of this data here is as of June 20 when I sent it over. Now I think we are a little in the 14 percent range.

But do I recommend rebalancing? No. Would I add this index fund now? Yes.

And you can see in the bottom, frankly, it's to reduce active management risk, the risk that active managers miss their benchmark. And also, effective lower fees. So going to, you know, again, this 10 basis points from I think monitoring the DFA are in the close to 1 percent range. That's where these 24 basis points and fee savings come from.

The other issue here is you can see, we think these are developed strategies we have. Well, Harding Loevner has about 15 percent in emerging markets. At their current weighting in the portfolio, what does that do? It has your emerging market allocation there in the upper right at 37 percent, which is decent overweight to the emerging markets weighted within the international index which I think is closer to 20 percent.

So we like a -- in adding the index which is developed only, we like to shift those weights around, increase the allocation to the index. Again, it's passive lower fees as well purely developed. And then lower the allocation or at least the target to the emerging markets and the other managers. It reduces active management risk and then lowers the overall emerging markets weighting at the total portfolio level, which I think is warranted for the long term.

So obviously, there's another -- we recommend taking the international equity 20 percent in the investment policy. We're not -- you know, that hasn't been approved. We are still in discussions there. Obviously, I think if we were to go to a 20 percent, this would change a little bit on the target side. But again from an implementation standpoint, we would move there as conditions warranted. But right now, yes, I think the portfolio can accommodate a -- an index fund in international equity.

MR. MAZZA: Does the Board want to vote on hiring RhumbLine for international equity index manager, passive manager?

CHAIRMAN SCOTT: I think we do.

Is RhumbLine an existing fund manager?

MR. MAZZA: We visited them up in September. They had a very impressive shop.

CHAIRMAN SCOTT: We can save 24 basis points?

MR. MAZZA: Indexing is very much cheaper alternative than to active manager.

Active managers, like I said many times before, are on top of the benchmark, you know, 95 percent. And they're charging a lot more in terms of -- especially in this space compared to going to passive manager and being to able save a lot of fees and getting the same return.

CHAIRMAN SCOTT: Okay. Then I think we ought to move forward with our resolution.

Is there a motion?

MS. JOHNSON: I make a motion.

MR. BUTKOVITZ: Second.

CHAIRMAN SCOTT: Motion has been made and properly seconded.

All those in favor?

(Ayes.)

CHAIRMAN SCOTT: Ayes have it.

MR. GOLDSMITH: In terms of implementation of weight, does that need to be voted on or does that -- how does that proceed? Do we want to make a rebalancing page?

MR. MAZZA: I think we want to rebalance from the manager and put an allocation towards RhumbLine.

MR. GOLDSMITH: Does it need to be voted on?

MR. DIFUSCO: I think -- well, in this case, since it's not an initial -- since it's not a kind of like around the edges rebalancing, yeah. It's more like an initial allocation to an existing manager. It makes sense to me that the Commissioners are comfortable even if it's within give or take a couple basis points or a few dollars, yeah. I think to the extent we can -- they should be comfortable formally approving.

We are talking about proposed allocation of between whatever, 4 and 5 percent, whatever the percentages are. I think it make sense to have your approval for that.

CHAIRMAN SCOTT: What are you recommending in terms of the allocation?

MR. GOLDSMITH: I would recommend 5.5 percent allocation.

CHAIRMAN SCOTT: That 5.5 percent allocation would mean that one of our managers would be reduced?

MR. DIFUSCO: Right. A couple of them. So the existing on page 2 of the original handout, Donn. So, we would take capital from, you know, either Harding or DFA or Mondrain some, you know, give or take a few dollars. But I think at the top is where they are now. So 22, 23 and 20. And then under Alex and Marc and PFM's proposed rebalancing which staff supports, you would see what the numbers look like.

MR. MAZZA: Once again, these international -- every member of the team makes excess of 80 basis points.

MR. DIFUSCO: Yeah. It's very expensive.

MR. MAZZA: Now, we are reallocating 5 and a half percent to a manager who is charging us 10 basis points.

MR. DIFUSCO: Significant dollars.

MR. MAZZA: Savings right there.

MR. AMMATURO: Mondrian charges 88 basis points, Harding is 58 basis points, DFA is 62 basis points. Just to close the loop.

CHAIRMAN SCOTT: Okay. So, what we're going to vote on is allocation of the 5.5 percent?

MR. MAZZA: To RhumbLine.

MS. JOHNSON: Keeping that current

allocation at the 13.9 --

MR. DIFUSCO: The overall total.

MR. MAZZA: Yeah. Just the rebalance.

MS. JOHNSON: Okay.

CHAIRMAN SCOTT: Motion is on the floor.

All those in favor --

MS. JOHNSON: I made a motion.

CHAIRMAN SCOTT: There a second?

MR. BUTKOVITZ: Second.

CHAIRMAN SCOTT: All those in favor?

(Ayes.)

MR. MAZZA: Just want to make sure the Controller's Office got their information from PGW on the bonuses and the effect of their pensions for the officers.

MR. RUBIN: We are on new business or is that old business?

MR. DIFUSCO: Yeah. That was the last of --

MR. MAZZA: Just making sure.

MR. RUBIN: We did get that information. It was very helpful. I think from the staff perspective, it should be helpful to you guys as well understanding that we are putting out a lot of money over the course of the year. How is that fluctuating. So, it look like the average pension is somewhere between 2 and 3,000 dollars a month per employee. So assuming that they're going to have X amount of retirements over the next couple of years and that rate stays the same, it should give us a projection of what we need to return to be able to pay those benefits. I think it did give us some insight into what we need to do to get the allocations right.

Secondly, there was a bill that was put through Council that changed the benefit structure for a class of retirees when those things happen, does that get handled by PGWs --

MR. MAZZA: I'm assuming so.

MR. RUBIN: -- group there we don't do anything to benefit payouts?

MR. MAZZA: No. We just -- monthly payments, that's what we're responsible for.

MR. RUBIN: When those kind of things happen, do they notify you that it's going to happen?

MR. MAZZA: I would assume so. We have not received any notification yet.

MR. RUBIN: So one, I would ask that we send a letter from the Commission asking for any changes that go into PGW plan to be sent over so that you can then add that also into the calculations. I think from my understanding, the change that Council approved was similar to what we had, Chris, in the main fund for a trust to be able to be set up for the beneficiary.

MR. DIFUSCO: Okay.

MR. RUBIN: And so, is there some -- because there is a legal issue of when they received too much money, then they can't get the benefits. I think that's what Council approved. But that also may or may not add a cost to our plan and how we look at it. So anything that they are going to change that may effect how we invest, if we could have them send that legislation over to you guys so we can take a look at it.

MR. MAZZA: Good.

MR. DIFUSCO: I would just also add that the actuaries scheduled to come in, as far as I know, first annual report in September. So to the extent that legislation or any of the other folks -- the letter that we sent out about the retention payments or anything is in addition to his actual overall report you have questions on, you know, he should be here to answer them at the next meeting, as well.

MR. RUBIN: Since you asked the question. When they say it's over the IRS limits and won't have an effect, what does that mean?

MR. MAZZA: I think what it means is that they just make too much money for it to actually -- their pension is already going to be too much money for them to get any net effect of the bonus payouts. Is that --

MR. DIFUSCO: Yeah. The IRS -- Ellen you maybe familiar with this or Adam.

The IRS sets an annual limit in terms of compensation and what can be paid out, you know, in terms of deferred comp or retirement. My reading of Tom's letter was they are already at a level in terms of their income and where the retirement benefits are going to be. There's not going to --

MR. RUBIN: Does that mean there's a cap on their retirement benefits?

MR. DIFUSCO: Yes.

MR. MAZZA: I would assume so, yeah.

MR. DIFUSCO: IRS cap on --

MS. BERKOWITZ: Well, with deferred comp.

MR. RUBIN: That's pension payout.

MR. DIFUSCO: Retirement benefits generally. It's a pretty high number. I want to say it's -- I can get you the exact number. High 200s, low 300s. It's pretty -- in terms of overall compensation.

MR. MAZZA: That was just the top two executives.

MR. RUBIN: In a private company or public company? I just wasn't familiar with that IRS rule.

MR. DIFUSCO: I will.

MS. BERKOWITZ: We'll --

MR. DIFUSCO: I have a passing familiarity with it. We can circle up with Law and get you it.

MS. BERKOWITZ: There are definitely elements for deferred compensation. I believe Chris is correct, I just don't know what the word is.

MR. DIFUSCO: We will put that together and get it to everyone.

MR. MAZZA: Again, those bonus payouts didn't effect any of the other folks on the list assuming they will stay with PGW for a long period of time.

CHAIRMAN SCOTT: All right. I think this meeting is hereby adjourned. And it looks like our next meeting is scheduled for September 14, 11:00 a.m. and at the same location.

Thank you all.

(Sinking Fund Commission July Meeting adjourned at 12:25 p.m.)

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

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

ANGELA M. KING, RPR
Court Reporter - Notary Public

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