CITY OF PHILADELPHIA

SINKING FUND COMMISSION

In Re: September Meeting

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Wednesday, September 13, 2017

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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 10:00 a.m., pursuant to the State of Pennsylvania General Court Rules

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A P P E A R A N C E S

COMMISSION MEMBERS:
Donn Scott, Chairman
Alan Butkovitz, Controller
Rasheia Johnson, Treasurer

ALSO PRESENT:
Christopher R. DiFusco, CIO, PGW
Bill Rubin
Alex Goldsmith, PFM Asset Management
Marc Ammaturo, PFM Asset Management
City Solicitor Representatives
PGW Representatives

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CHAIRMAN SCOTT: Good morning, everyone. I am delighted to call this meeting to order. I trust everyone had a great summer.

First order of business is the Approval of the Transcript. Is there a motion to approve the transcript?

MS. JOHNSON: So moved.

MR. RUBIN: Seconded.

CHAIRMAN SCOTT: Motion has been made and properly seconded. The transcript is hereby approved.

The third bullet point is the actuary report and presentation. Vicente, the floor is yours.

MR. VICENTE: Thank you. Do you guys have copies?

(PGW Reps enter proceedings.)

MS. JACKSON: Vanessa Jackson from PGW and Donna Davis.

CHAIRMAN SCOTT: Good morning.

MR. VICENTE: This is our annual report. The funding status of the pension plan, the PGW Pension Plan. For funding purposes, we are here

to -- this report covers the cash contribution requirements for the plan based on the funding policy adopted by PGW. Before we give you the report, the high level is generally speaking good news this year. On the liability side, we always look at the liabilities.

We have certain assumptions of what's going to happen in the future this particular year. You know, it varies year to year. You make assumptions about how many people are going to retire, how many are going to need employment, how long people are going to live. A lot of assumptions of that nature. This particular year, the assumptions all really matched what happened in the liabilities. Variation of what we expected versus what actually happened was off by less than 1 percent. Generally speaking, we usually look for variance of 3 to 4 percent per year up and down. Because there are so many things that can happen in a year, the idea is that any one year you can be off. Generally speaking, long term you are in good shape. This particular year, we are very close to what was expected.

Liability side, no surprises. No problems.

MR. RUBIN: Tom, what mortality table do you use?

MR. VICENTE: We are using the retirement Plan 2014 Mortality Table. It's published by Society of Actuaries. That's the base table. We use a generational improvement scale called the MP 2016 Scale.

MR. RUBIN: Is that age 85?

MR. VICENTE: Doesn't really have a particular age. It's all statistics. If you look in expectation of life for someone age 65, it would put you in the 85, 86 range.

MR. RUBIN: Okay. If you make it to 65, you make it to 85?

MR. VICENTE: Good chance.

(Laughter)

MR. BUTKOVITZ: Feel better already.

MR. VICENTE: That is the one assumption update we made this year. The base table, the 2014 one we mentioned is going to be in place for several years. What they did is they update the projection scale annually in the fall, late

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October. We did update, as we did last year, update the projections to keep pace with what the latest findings are. That actually, it will vary year to year. But this particular year, the projection was such that the projection of how much we are improving our longevity, so be ready for it, is less than we were last year. We are not projecting to do as well in the future as we were projecting to do in the future a year before that.

That actually provided gain to the plan. The liability is a little bit lower because of that. The expectation for improvements and longevity are lower than they were a year before based on the data. We are just updating that on an annual basis. So, be a new one that comes out late October of this year.

MR. BUTKOVITZ: There were people, I don't know, ten years ago who were trying to sell insurance product based on the old mortality tables that wanted to insure all the City employees. Do you have any idea whether any city did that and what the results were?

MR. VICENTE: Not that I'm aware of. I

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don't think it was really looked at as a really strong product.

MR. BUTKOVITZ: They made it sound like we couldn't lose on it. Sounds like we would have lost.

MR. VICENTE: Yes, they usually do. But no, I'm not aware of anybody that did that. There is a lot of that around retired medical area where folks try to sell the bonds to insure everybody's life. When people passed away, paid for the post-retirement medical. I don't know how many actually ever purchased that product. I remember being sold or pitched, but not --

MR. BUTKOVITZ: Was that ten years ago?

MR. VICENTE: That would have been probably that time frame.

MR. RUBIN: Tom, what's the 5 percent average pay increase based on? Is that raises that are going to take effect?

MR. VICENTE: The increase in pay is all increases. So, it's merit pay, cost of living pay, promotion pay. Anything that would increase pay year over year for the group, on average for the group over their career. We came up with

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that through talking with PGW in asking what their expectations were. And when they look at their workforce and how folks are moving through their careers as well as the kind of raises that are being given out.

While the -- I think the negotiated union pay scale may not be 5 percent increase. When you load into that changes in rank or status, you do end up with something that's close to the 5 percent. We confirm that with PGW before starting this year.

MR. RUBIN: Do you exclude the executive level employees who would not increase their liability to pension fund based on their salaries being above the limits?

MR. VICENTE: Yes. Yes. So, that's not a part.

MR. RUBIN: This is only employees that would fall into the liability characterization of future liabilities --

MR. VICENTE: Correct.

MR. RUBIN: -- in the pension?

MR. VICENTE: Individuals who are still working and earning a pension under the PGW

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Pension Plan.

MR. RUBIN: Okay.

MR. VICENTE: All right. If we want to turn to page 1 of the report, that's the high level. Page 1 we will walk through some of the different numbers here.

So page 1 gives you some basic information on the demographics. And you will see there that our head count active participants, those who are actively working, this is a snapshot of July 1 of each year. We are slightly lower active size than the year before. That's to be expected given that as new employees come in, they are given a choice between this plan and the defined contribution plan. So, there is a slip.

Most recently, it was about three-quarters of the folks were taking this plan. Previous to that, it was about half. It's going to vary year to year. We are seeing some different patterns there. Either way, we expect if 25 percent are taking the defined contribution plan, we will gradually see this group is getting smaller as not every person believes is replaced

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with somebody else. Because more than half will go to the plan. Eventually that will reach a stability point, where the number coming in will replace those going out. But we see slight decreases.

Retirees, you will see that's down a little bit. That's because there were a number of individuals who passed away this past year. Vested/terminated, those are folks who left employment but are vested in the pension but they are not yet eligible to retire for their age or likely to retire as the case may be. You will see there's a slight increase there.

In the back of the report for those who are interested in that type of thing, give you real turn to this. Back on page 22, there is actually a reconciliation of how individuals went from one point to the other. So, that gives you an idea of about what the ins and outs were so to speak for the categories.

You see payroll there up about 4 percent. Average pay about 5 percent. Again this particular year, it matched pretty well what our assumption was. In other years, you will see

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it be higher or lower. Average age stayed pretty steady as did average past service. Both good. And part of the reason why, we kept actuarially pretty sound or pretty level everything. Nothing changed that much. That's the demographics.

MR. RUBIN: The average past service, that means that most people are serving 15 years and retiring?

MR. VICENTE: That's just the average service of the group that's in place right now. That was 1,243 individuals who were working there today. That's their average service.

MR. RUBIN: So, there could be a longer service which would be higher liability?

MR. VICENTE: Exactly.

MR. RUBIN: Okay.

MR. VICENTE: If you turn back to page 19 of the report, you can see -- actually, it's page 20 really. Is the -- a big chart on page 20 that shows you how much -- what people fall for in terms of on the vertical access. It's their ages. In the horizontal access is their years of service. Graphically, if you turn to the next page, page 21, you can see how the group breaks

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down by years of service on a graphing basis. Even though the average is 15 years of service, you will see that we have more people in the 5 to 10 yeas of service group than any other group. Which you would expect with turnover, generally that type of thing. You will generally see more of the service agents that spread out farther to the right. A little bit of a dip there between 15 and 25 years of service. You will see that change over time.

That gives you and idea how to come up with the 15. That's how it's distributed. The average can be a little bit misleading as most people are either well below or well above that, but they average that 15 years.

MR. RUBIN: Distribution of inactive participants. So that's --

MR. VICENTE: On page 19?

MR. RUBIN: Yeah. What's the inactive? That's somebody who is --

MR. VICENTE: What we have here are the top table of those receiving benefits. Those are who are either retirees themselves or beneficiaries of retirees.

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MR. RUBIN: Okay.

MR. VICENTE: That gives the idea of how long they have been in pay status based on age. You will see some very young people that would be beneficiary clearly of somebody or perhaps sort of disability. And the bottom table, the vested terminated, those are those folks who have left the Authority or the Gas Works but have not yet started their pensions and how old they are.

There are a few. There are five over age 65. So from an administrative standpoint, the idea we get them in pay status as soon as possible since they are at their full retirement ages. Chances are if there are only five of them, they are probably who we have trouble locating and that is why they haven't started yet. What happens, people leave and 20 years later you are trying to find them to get their pension started. They may have left the country for all we know.

MR. RUBIN: On 20, when you have the number and -- is that dollar amounts underneath that?

MR. VICENTE: The number is the head

count. On the first cell on the 20, the top left, you will see 16. There are 16 individuals there. And the average pay of those 16 individuals is the $38,240.

MR. RUBIN: Average pay?

MR. VICENTE: Right.

MR. RUBIN: Not pension?

MR. VICENTE: Correct. Average pay.

MR. RUBIN: Thank you.

MR. VICENTE: That's a lot of the demographic information. If we turn to page 2 of the report, you see some of the financial metrics for funding purposes.

The first item is what is called the Normal Cost. That's the cost allocated as a group for those individuals who are actively working. How much does it cost to pay for the benefit they earn from working a year? In this case, $7.7 million, which is roughly 9 percent of payroll.

So if you think about the cost of this plan on a long term basis, if you are a hundred percent funded, the plan would have a cost above 9 percent pay. You are paying just the normal

cost, the cost that is being earned in a particular year. Below that you will see the contributions schedules. The policy adopted by PGW is to use the larger of what's called the 20 Year Contribution or the 30 Year Contribution. In this case, it's the 20 Year Contribution. About $28 million this year, which equates to just under 30 percent of payroll.

We expect the 20 Year Contribution to be the dominant contribution method for the next 10, 15 years. And then gradually the 30 Year Contribution method will overtake it because of the mechanisms involved there. That is policy that was adopted, I think, two or three years ago by the Board as a way to determine the contribution.

About a 3 percent decrease from the prior year. That goes to the fact that the investments did relatively well. The change in the mortality expectation helped to bring that down, as well.

MR. RUBIN: How does that help to bring it down if the --

MR. VICENTE: The change in mortality

expectation?

MR. RUBIN: -- if they live longer?

MR. VICENTE: Because we expect the change in the projection scale reduced the level of improvement in longevity. We actually are assuming now people are going to live a little less long than they did last year. That factor, that improvement scales updated every year. We will have a tweak upwards or downwards every year. Should be relatively small overall.

That's the main outcome there. When you turn to the next page, you will see some of the liability figures at the top. The unfunded liabilities is about $217 million. And that's on a cumulated liabilities for about just under $700 million. We are about 70 percent funded overall on the plan.

If we turn to the next page, page 4, we show the asset values. We have two values there on page 4: The market value and the actuarial value.

The market value is just what you would expect. We take -- look at the actual investment statements and pulled a number off there. This

is a preliminary market value. So, we get the value from a flash report from the Sinking Fund and working with PFM. However, when the auditor goes through and completes the audit or financials for the plan, there could be a small upward or downward change in that. That is still in the case, we have seen some preliminary audit financials just this last week. They are a little bit different. About less than 1 percent different. So, we will refine this report once we get the final audited financials. Basically, the difference right now, we don't expect there to be anything material in terms of a change of the outcomes.

The actuarial values, again methodology adopted a couple of years ago. And what that does is essentially averages in investment returns that are above or below the 7.3 percent assumed return. So, we have a higher return than assumed, than we don't actually recognize all of that in the first year. We phase it into the asset value over a couple of years. On the same token, if we return less than 7.3 percent in the year, we phase that loss in.

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The idea is that over a three or four year period, the period will exceed and miss will average out and keep the asset value a little smoother, which will keep the contributions level a little smoother. At the same time, not letting us deviate too much from where we really sit. That is a method we adopted several years ago.

You see this particular year, they are very close together, closer than they were last year. This year we returned, I want to say, about a 12 percent return which is much higher than the 7.3 a year before that. We had almost a 0 percent return or so. Those two are more or less offsetting when you look at this particular year, which is why the two numbers are so close together.

CHAIRMAN SCOTT: Would you expect it to be -- is it better when it is closer together or versus a negative variance?

MR. VICENTE: I mean, yes. If they stay relatively close together, that means our assumption is pretty good as far as modeling what the returns have been in the past, which gives us a good outlook for the future. If they are

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persistently higher or persistently lower, it means we are either being too aggressive or too conservative in our assumption. Either way, with a plan like this, there is no getting away from the actual cost of the plan.

So you know, if we are being too aggressive with our assumption, for example, and assuming 7.3 when really we should be thinking something lower than that, it will come back. It will just be a timing issue that we will have lower contributions initially. But as the effective lower returns makes itself felt, we will catch up. And vice versa.

If we are too conservative, we will have higher contributions initially. But then as the higher returns make themselves evident, we will see our contributions come down. So it's more about backloading and front loading. Ideally, we are not doing either, and that's a good sign that we are relatively close. But we will likely see it fluctuate up and down every year. That is what you expect in the investment makeup, which includes some fairly volatile type of return.

Flipping forward a couple of pages,

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probably the next page to look at is just on page 10 of the report. Just have graphically shown the two contribution levels. I can go through every page of the report, but a lot of it is actuarial mathematics. I'm not sure if everybody wants to do that. I enjoy doing it, but not everyone wants to hear it.

Page 7 gives you graphically how the contributions are made up. We mentioned that normal cost figure, which is 9 percent pay. That's the orange or red there. The blue bottom is the amortization. We are paying off that $200 million unfunded liability. That's how much -- you can see a large portion of annual contributions is paying down what's unfunded due to past service.

And a lot of the unfunded that we have right now came about from a number of sources. So certainly if you go back far enough, you'll find this plan had been a hundred percent funded. But some of the investment ups and downs beginning in 2008 affected the plan as it did most pension programs. And on top of that for this plan, as you recall, we actually reduced the

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expected long term rate of return several times over the last four or five years.

And that's -- when you look at this, we changed the liability based on the expectation for how, what kind of return rate we are going to get on that. When you make that change, that creates a liability you haven't funded for. You thought of previously with the higher rate, you are essentially implying that investment returns will pay that off. Once you lower the investment return assumption, you are saying the investment won't pay that off. Instead contributions will pay that off.

MR. DIFUSCO: Tom, I think you mentioned this last year when you were here. We also had that one year or two-year spike in retirements which I think also added a couple percentage points to the unfunded, as well.

MR. VICENTE: That is true. Experience deviating from what we expect.

As we go forward to page 12, page 12 shows the cash payouts of the plan. Our expectation based on our assumption about retirements and new hires and pay increases and so forth translates to a certain pay amount being paid out of the plan to cover participants benefits as they retire. You will see there, we are expecting about $53 million for the year that just began this past July. Increasing gradually to about an extra $10 million per year about ten years from now. That's based on the age of the group and the size of their salary and service and what kind of pension we expect to get. That gives you an idea what the outflows would be for the plan.

MR. BUTKOVITZ: So, that's assuming that the payments would go to their spouses?

MR. VICENTE: Correct. We have an assumption about how many people will -- what kind of benefit option folks will take.

MR. BUTKOVITZ: What's the assumption?

MR. VICENTE: I don't -- I have to look it up for you. We have an assumption based on what the pattern has been in the past. It's usually -- with this group, I imagine it's relatively high percentage assumed to take the survivor benefit. This is a male dominated workforce. And men generally tend to take

benefits that cover their spouses. Historically, that's because their spouses generally didn't have a job or were more at home. They didn't have another source of income versus when you have female dominated workforces, the husband generally has a job. It's less trend to take that. Not universal, but that's the trend.

If we turn to page 13, you have a historical review of the funded progress of the plan. So, the bars represent the liability. That's our projection of the current liability of the group. You see that historically from 2009 to 2017. And you will see some places where there are jumps. And those jumps do correspond to where the assumed rate of return was changed. And then the blue line is the market value plan assets as compared. You see that goes through. In black, we have the percentage funded. You are seeing 70.6 percent funded currently, which is improvement by about 5 percent over where it was in 2016.

Nice little pick up there making up most of what we gave away last year when we changed the assumed rate of return from 7.65 down to 7.3.

You will see that's a increase in 2016 as we made that change. The investment returns this year were, again, close to a 13 percent return. You can see how that's trended over the last decade or so.

CHAIRMAN SCOTT: So, what happened in '14 and '15? What's responsible for -- it was 80 percent funded in '14?

MR. VICENTE: Right. The big -- one big thing there was went from a 7.95 percent assumed rate of return down to a 7.65 percent return. 30 basis points decrease in our assumed rate of return. That boosts the liability up. We also had at that point in time, that was right around the time I think a lot of the sale discussions were going on. And that's when we did have a lot of individuals sort of rush to the door a little bit earlier than otherwise projected. So, that increased the liability as well.

MR. DIFUSCO: Tom, when you list the funded ratios for the past years, have they been adjusted in the sense that, you know, we had -- we weren't using smoothing then and we were doing other things. Or you just using the returns that

are in the older reports with the then, like, all the same assumptions?

MR. VICENTE: It was the assumption that were in place at that time.

MR. DIFUSCO: Okay. That would affect, I mean, the numbers and how the gap looks as well because there's not a smoothing affect. There's not --

MR. VICENTE: Right.

MR. DIFUSCO: That's what I thought, but I just wanted you to confirm.

MR. VICENTE: That's what we have there. If we flip forward a couple of other pages to page 16, page 16 is this. If I was looking back, page 16 is looking forward.

Page 16 is our projection of cash contribution and how the fund levels is going to progress in the future. So, the table at the top and then the bottom we have a chart showing the same information. And because this is a projection assuming that all our assumptions are going to come true absolutely every single year, it shows this very nice pretty picture with a very straight line of the investment with the funded ratio improving every year very gradually. In real life, we will see ups and downs. Real life won't show this way. We will have years like this year, 13 percent return. We will have years like two years ago where we have 0 percent investment return. Years where the pay increases are flatter and years where the pay increases are more. So, we will see ups and downs there.

But assuming everything goes along, our plan and this verifies our funding policy, is to fund the plan over 20 to 30-year period. And that is why you see this gradual increase in the funded ratio. Seems like it's taking forever to go from 70 percent to 78 percent. But that is the nature of funding this on a long term basis.

In the middle of the table at the top, you will see a column, Type of Actual Mid Year Contribution. So, that's telling you what the cash contributions are expected to be. Again, making certain assumptions about the workforce. So here, we are assuming that -- I believe we are assuming that three out of every four new hire comes into this plan versus going to the Defined Contribution Plan. So, that's driving the

contribution to some extent.

This is our projection. You do see the contribution level rate amount does go down year to year. That's partially as a consequence, even if you are replacing three out of four, there is one person you're not replacing as they go into the other plan. And that is where that cost shows up, in the other plan, not this plan.

The next two pages we don't go into detail. But they show the two different methodologies, the 20 Year Method and the 30 Year Method. You can see how they vary one versus the other. If you held them side by side, the 20 years is the dominant method for most of the period. But as you get into 2024 and 2025, the 30 Year Method starts to take over just by the nature of the mechanics. Two different methods.

Then we already talked about the information on pages 19 through 22, our demographic information. So we don't have to do that again. The next section starting on page 23 is all our methods an assumptions as we mentioned. The only assumptions we change this year was the mortality improvement scale. All

the other assumptions stay the same, which are the -- our assumptions about when people retire as far as age and length of service, when they will leave voluntarily is based on PGW's actual experience.

We update that experience and study every three to five years. I think it's been three years since we did it. Probably next year we will talk to PGW about whether we should update that study, see if we validate whether the assumptions are still working as expected. If there are any trends emerging and update it from that point of view. But for right now, we are using that same assumption because we haven't come to the point.

As you saw when I mentioned, the liabilities turned out to be pretty close to what we expected. We are not seeing any indication that we are having a real deviation right now. Again, it's good practice. Next year we will start talking about do we need to do a new study or review those assumptions.

No changes in Plan Provisions from last year. Everything stayed the same there in terms

of cost.

So, that's the report. I don't know if there are any other questions you want to ask. Nothing? Thank you.

MR. RUBIN: Thank you.

MS. JOHNSON: Thank you.

CHAIRMAN SCOTT: Thank you very much.

MR. DIFUSCO: Thanks, Tom.

CHAIRMAN SCOTT: Next item on the Agenda is the PGW Pension Plan Investment Consultants.

MR. GOLDSMITH: Thank you.

I will make some brief comments on the markets and economy. And in your binder, you have the flash performance as of July 31. The August performance is ready typically about ten business days after the quarter end because of the start timing of September with Labor Day. We are at eight business days today. By Friday afternoon, we will have that distributed to you, all the August flash performance.

But just briefly speaking to markets and economy, I think if you followed markets this year, the story continues that it's been a good period for equities. Domestic equities are up,

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you know, year-to-date as of yesterday about 12 percent. International equities leading about 20 percent year-to-date. And large cap stocks outperforming small caps. Another brief trend I will note, growth stocks and sectors, healthcare, information technology outperforming value stocks and sectors.

With the performance of the markets here, I get questions about overvaluation and do we think markets are overvalued? You know, certainly looking at the data, price-to-earnings being a major metric of valuation, U.S. stocks are higher than their long term valuation rates. S&P 500, 18 times; price-to-earnings times 16. That ratio has been relatively consistent year-to-date.

Earnings growth, earnings per share growth in the second quarter was 16 percent. So, prices are certainly up with going back to the the election of Donald Trump last year and really, you know, seven years ago to the recovery from the financial crisis. But as long as, you know, corporations here in the U.S. have delivered positive results, positive earnings,

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that, you know, the overvaluation that we have seen has remained in check.

I think what's interesting to note that's emerged over the last month or two that has injected some volatility in the market has been geo political concerns, mostly related to North Korea. Certainly, there was an episode in early August and then about a week ago with the test of the hydrogen bomb. You know, again, volatility which had been near record lows for most of 2017 went up 12 percent but still remains fairly low. And you know, I think despite, again, a bit of negative return in some sectors in August, U.S. markets hit record highs yesterday with both the Dow and the S&P 500 simultaneously hitting record highs. Now, they are off again slightly today.

But with consumer confidence up, strength in the housing market, strength in U.S. corporations, certainly unemployment has fallen now 4.4 percent. Our view for the intermediate term here in the U.S. is positive. Certainly, international markets have done a little bit better. Get primarily based on valuation. They

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started the year undervalued relative to U.S. stocks and performed well as a result.

I'll briefly speak to the fixed income market because of additional challenges, you know, lie ahead there. Rates certainly shot up following the election. We have very weak fourth quarter last year for fixed income returns. On the margins this year, long term rates have fallen slightly while short term rates have increased. Bit of a flattening in the yield curve, which in turn has supported equities. The Fed still indicates that they intend to act at least one more time to raise rates this year with the economy doing better. It's looking like that will take place.

Again as interest rates rise, the impact on existing bond prices is such that it forces those down. So certainly, challenges they had, I think, for fixed income.

Focusing on the report here very briefly, page 1, you can see the market value as of 7/31, 522 million, so up slightly from the 7.1 figure that Tom presented. The one month return was right on top of the benchmark slightly above

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after investment management fees. Year to date, it's nice to see moving over several columns about 60 basis points of outperformance year-to-date. And 25 basis points or so the one year number. The single greatest contributor to that outperformance for year-to-date numbers been in the one year has been overweight to equities. Certainly with fixed income returns, delivering very, very low absolute numbers, you know, the 12 to 15 percent depending on domestic international is certainly outweighing at that. The overweight is delivering the greatest amount of outperformance.

That being said, again, some active manager, at least on the year-to-date, you know, basis active management has outperformed.

MR. AMMATURO: Just to interject there on the application just to amplify that, numbers behind what Alex just said. If you look at large cap and small cap and the percent column, you add those two numbers up, that's 47 percent; 39 percent large cap, 8 percent small cap. That is 47 percent. Your target is 45. So, just to put numbers behind what Alex is saying, that

2 percent overweight to domestic equity has helped. If you look down to international equity, you have 21 percent international equity. Your target is 20. That's 3 percent overweight to equity markets. It's 2 percent domestically, 1 percent internationally which I would say has been beneficial and tailwind to your portfolio. We don't recommend rebalancing back to target at this time.

MR. GOLDSMITH: Some of the highlights within the active managers. Certainly, O'Shaughnessy for the quarter as well as year to date. They have benefitted from that flattening of the yield curve with long term yields for bonds falling. They, basically, look at one metric in building their portfolio. That is total shareholder yield, stock buy backs and dividend payments. And those high dividend stocks have really benefitted year-to-date.

It's not necessarily quality buys, but looking for high yielding stocks. And so despite challenges to the value market, O'Shaughnessy delivered there.

I want to touch on some negative

performers. I think the most important being Vaughan Nelson again. Year-to-date they have lagged a little bit certainly over the one year number. The fact they have struggled to their value positioning, but also even in addition to that and underweight or, excuse me, selection with industrials overweight to industrials, you know, so they are really -- they are squarely in their style buckets, but it's been one that's underperformed. It's been offset somewhat by an overweight in healthcare I talked about how healthcare tax sectors have done well. But it's very slight overweight.

One exception that I think I would say, you know, as a whole I talk about -- if you look at the black lines on this report, you go out to the year-to-date column, you know, the combined large cap figure 12.84 versus 11.44. That is why I am saying that active management has outperformed in that sector. That doesn't take into account overweights or underweights. That is just purely roll up of the manager.

Year-to-date outperformance in large cap, outperformance in small cap, outperformance

international. The one exception is fixed income. And I think that again owes to some challenges presented thus far in 2017 following, you know -- following a sharp rise in the rates to end the year. Interest rates ameliorated slightly before, again, this recent flattening of the yield curve. And I think that has thrown, you know, a challenge to a number of the active fixed income managers.

That being said, over the one-year number, you know, more characteristic outperformance of fixed income. A steady, you know, call it 1 percent or so of outperformance. That is the steady months and quarters of outperformance.

So you know, again, we are not recommending any change to the positioning. I believe we passed around a rebalancing page as of yesterday, excuse me, as of Monday evening. The plan market value is up to 529 million. Again, a 2.79, 2.8 overweight to equities, 1.8 percent underweight to fixed income and a percent underweight to cash. Again, underweight those cash and fixed income sectors, overweight

equities. We continue to as, you know, we view rises in markets -- in the markets continuing, we continue to source benefit payments from equities. We are not continuing to go underweight to fixed income again. Evaluations are high. There are some geopolitical risks certainly out there. So, we are not advocating going any higher but looking to take profits as needed, you know, from where a performance has been good year-to-date.

MS. JOHNSON: I have a question. We've been going back to Vaughan Nelson. I mean, you look at their five-year numbers and they are probably where they should be. But look at three year, one year, there is a trend.

Is there a recommendation, or should we just kind of be looking to see, you know?

MR. GOLDSMITH: Vaughan Nelson has not been placed on Watch List. It's really recent underperformance has caused a lot of those trailing numbers to look, you know, bad. It's a slight miss over the three years.

MS. JOHNSON: Right. I will say, it's not significant.

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MR. GOLDSMITH: But we like to see outperformance over three. Certainly, over the five years a full market cycle, that is what we like to evaluate. So far, there has been no change to the investment team or their process. Certainly, in what's been a struggling climate for value investors, we would like to see maybe some of their -- given some to like let investment theses play out, particularly again overweights in selection within industrials where they have historically exhibited good selection ability.

So, they are not on a watch list at this time. Again, I think we are not -- we don't want to churn some managers when there is, you know, just a certain brief periods of underperformance more recently.

That concludes statements on this report. I passed out the rebalance sheet. No recommended changes to this allocation at the time -- at this time. You know, I recall, I think two meetings ago we approved an allocation to Pinebridge on the domestic equities side to replace Fred Alger and O'Shaughnessy with a less

volatile core active approach, and then some of those assets would go into domestic equity. I believe we are still waiting on contract.

MR. DIFUSCO: Yeah. Contract, actually, I think -- we talked yesterday. Went out for signatures this week. I anticipate that change being made relatively soon.

MR. GOLDSMITH: And you know, again, without any indication of August performance with the active manager, I do have the benchmark performance for the month of August. The benchmark was up 0.51 percent. Half a percent. It's reasonable to expect that, again, the fund was generally close to that. You know, I received some early discussions with active managers. Nothing official. Nothing I can hand out. It was about a mixed bag with half the managers underperforming by slight amounts, some good active outperformance from the equity side and a lot of the fixed income managers were right on top of the benchmark, net of fees.

We will see again on Friday. You will receive an updated report.

MR. DIFUSCO: The only slight, you

know -- I note this morning I took a look at the total fund AUM. It's about 530.6 as of this morning September 13. And we have about 7.6 million in cash because we moved the money following the benefit payments. These numbers Alex provided are post September benefit payments. We have already made that payment for the month and are still around 530, 530 and a half.

MR. RUBIN: Alex, do you have any idea what the Fed is going to do?

MR. GOLDSMITH: Statement indicates one rate hike likely in 2017. You know, I think -- you know, originally if you had asked me at the beginning of summer, I would have probably said indications at least one. Maybe in September, definitely by December.

I think the -- September is looking slightly less likely than it did, you know, a few months ago. Inflation expectations have come down again slightly, long term rates have come down. So that being said, I mean, the economy is doing very well. The Fed looks at the health of the economy outlook for inflation and then

unemployment. Unemployment is ten year low at 4.4 percent. GDP growth was 3 percent in the third quarter. Pretty significant compared to recent numbers.

So I would -- if not September, most certainly but very likely that December. And I think it's one more rate hike of 25 basis points. It's a slow and steady climb for interest rates ahead. They are not going to shoot up to 5 percent overnight. You know, if U.S. remains really at the peak globally for interest rates, Australia has been the only country with higher relative rates than we do.

MR. RUBIN: Do we have any impact in our portfolio with the devastation and the terrible storms that have hit two parts of the country?

MR. GOLDSMITH: You do have some exposure to U.S. rates through the index funds in the portfolio. You know, broadly -- you know, I am involved in the real estate market as well for other coverage of other funds. You don't have any dedicated real estate funds. Indication in Houston was, I think, you know, generally positive for the core properties that these own.

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Actually, I think a lot of what happened this past week in the U.S. markets, the second Hurricane Irma missing Miami where a lot of U.S. do have some investments mostly in apartments and multifamily units. I think, frankly, the hurricane shifting westward slightly is why we hit record highs a little bit yesterday to some extent.

MR. AMMATURO: What percent of the index reaches a small component of the index?

MR. GOLDSMITH: It's 4 percent maybe or less, 3.6 percent.

MR. AMMATURO: His comments pertain to your exposure to RhumbLine and your exposure to Northern Trust. Again, we are talking about 3 to 4 percent of index fund is in publicly traded real estate.

MR. GOLDSMITH: Again, more broadly, I think the people had increased expectation for devastation in South Florida. And that not happening is, it's odd to say, it's almost like an upside, an unexpected upside.

MR. RUBIN: If there can be any.

CHAIRMAN SCOTT: We don't have exposure

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to short side?

MR. GOLDSMITH: Sorry?

CHAIRMAN SCOTT: Do we have any exposure on the insurance side firms that provide insurance coverage for these homes?

MR. GOLDSMITH: Again, certainly, I think through the index funds, you would have exposure to major U.S. insurers. And most likely, I think, O'Shaughnessy obviously being a valued investor would have allocation to financial stocks and sectors. So it's most -- market weight exposure there in those sectors.

You know, I think frankly it's a little early. I know that there is big port -- we were talking before the meeting, a big portion of uninsured people down in Texas. Everything that I read, it said will take a while for the full impact of that. And I guess the mechanics of how that debt gets unwound will come out.

MR. AMMATURO: You undoubtedly do have exposure to your index funds to insurance companies. Then again, to support what Alex said, O'Shaughnessy tends to buy value stocks. And a lot of financial services are value stocks

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that pay dividends. They are viewed as value stocks within financial component. You have a subsector that is insurance company. You do.

Too early to tell what the ramifications are in terms of economic impact of those companies, but definitely have exposure. It's a small exposure.

MR. RUBIN: On the other side, if there are going to be any good things that are coming out, the employment rates will probably drive up. People hired to go down there and work. And they are going to need supplies and things to rebuild. So, are we invested in companies and firms that are going to be a part of the timber or any of the other things that are going to generate there?

MR. GOLDSMITH: Again, similarly, I was the broad index exposure. Also, I mentioned industrial overweights and selection. I think Vaughan Nelson being major. That's a small cap value manager. And so, a lot of the -- to the extent that there are smaller public companies that are engaged in reclamation, certainly building products, materials, there are a lot of

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innovation happening here in the U.S in interesting developments and materials. There are a lot of smaller companies.

To the extent that, again, they have an overweight and they've typically over long periods exhibited good selection in those sectors, I would expect there is some allocation again to those types of companies, certainly Caterpillar. To the extent that this moves the needle for the global giant there, there is also exposure on the large cap side. Similar companies like Home Depot -- Home Depot has struggled this summer. Home Depot struggled year-to-date. Just they have caught -- retail companies as a whole have struggled. You certainly wouldn't expect a building product supplier like Home Depot. You can't really get that from Amazon. They struggled as well by virtue of being in the retail sector. This may be a catalyst for some improvement for them.

Again, it's just one area or one somewhat broad region of the country. There is still, you know, large swath of people that aren't impacted by hurricanes. We have seen earthquakes in the last two weeks. We have seen forest fires. Again, fortunately nothing that has injected too much fear into the markets. Again, we didn't hit record highs yesterday. So, it's pretty early. But I think over the long term neutral to positive outlooks based on those storms despite, obviously, the destruction and loss of life.

CHAIRMAN SCOTT: Any other questions? Any new business for us to discuss this morning.

MR. RUBIN: Motion to adjourn.

MS. JOHNSON: I second.

CHAIRMAN SCOTT: Done. This meeting is hereby adjourned.

(Sinking Fund Meeting adjourned at 10:49 a.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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