

Sinking Fund Commission - July Meeting
July 11, 2018

CITY OF PHILADELPHIA
SINKING FUND COMMISSION

IN RE: July Meeting

- - - - -
Wednesday, July 11, 2018
- - - - -

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
Rasheia Johnson, Treasurer
Kellan White, Controller's Office

ALSO PRESENT:

Christopher R. DiFusco, CIO, PGW
Marc Ammaturo, PFM Asset Management
City Solicitor Representatives
PGW Representatives

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2 CHAIRMAN SCOTT: I call this meeting to
3 order. Thank you all for coming out.

4 First order of business, as usual, is
5 approval of the Minutes.

6 Is there a motion?

7 MS. JOHNSON: I make a motion.

8 CHAIRMAN SCOTT: A motion has been made.

9 Is there a second.

10 MR. WHITE: Second.

11 CHAIRMAN SCOTT: Motion has been made
12 and properly seconded.

13 All those in favor?

14 (Ayes.)

15 CHAIRMAN SCOTT: Ayes have it.

16 We have a pretty short agenda today. I
17 think we are going to move right into the
18 investment performance review.

19 Chris, I turn it over to you.

20 MR. DiFUSCO: I will let Marc cover most
21 of the specific numbers. Just as an update, the
22 plan balance as of this morning is approximately
23 \$552 million. Pension benefits will go out
24 today, so it will be about 550 by the end of day

1 with a 2 million-dollar draw. And we should
2 have the June numbers, if not by the end of the
3 week, then early next week. I will get those
4 out to everybody.

5 Marc, if you want to cover so as to the
6 specifics.

7 MR. AMMATURO: Sure. Thank you.

8 I will walk you through the May flash
9 that you have in your binder there. Just as
10 a -- just to give you some background before
11 jumping into the numbers. Again, this is as of
12 May.

13 As of May, the domestic stock market was
14 up about 2 and a half percent, again, through
15 May. International stocks, unfortunately as you
16 will see, were down about 2 percent. Again, a
17 4 percent -- roughly a 4 percent differential
18 whether you invested domestically or
19 internationally, again, through the month of
20 May.

21 And then the bond market was also
22 negative. Negative about one and a half percent
23 through the month of May. So you know, the
24 ten-year treasury slowly has been increasing.

1 And there is a head wind to bond prices. That
2 is why bonds are negative through the month of
3 May.

4 Just to give you a quick update. I know
5 this is as of May. If you turn the clock
6 forward as to where we are today as Chris just
7 eluded to, you know, the stock market continues
8 to do well. The stock market is up about
9 6 percent, the domestic stock market. Again,
10 just to fast forward real quickly through today,
11 international stocks are still slowly negative.
12 The bond markets are still slowly negative.
13 Again, domestic stocks continue to generate nice
14 returns.

15 And what's really been happening at a
16 high level is, you know, the negative is all
17 we're reading about in terms of a tariffs and
18 trade wards. That is holding the markets back
19 one would suspect. But the positive is the
20 economy continues to generate solid returns and
21 tax cuts are a boost to that. So you know, net
22 the positive of the solid domestic economy is
23 leading to this strong U.S. stock market.
24 Again, up 6 percent through yesterday.

1 So with that very high level backdrop,
2 let's spend a little more time on your plan. So
3 your plan market value, you know, Chris just
4 provided a more up-to-date number. But as of
5 May, your market value is 538,30,000. Again,
6 nice increase since then. In terms of the
7 returns, you can see the month was positive
8 1 percent, 1.09. If you look at your fiscal
9 year to date, positive 6.8. It's getting close
10 to your actuarial assumption. My assumption is
11 7.3. You are getting close to that at 6.8.

12 Your year to date, again, this is just
13 calendar year 2018, is 0.83. So again, you
14 know, probably not exactly where you want it to
15 be five months into the calendar year. Largely
16 driven -- largely held back, I would say, by the
17 slight negative returns in international and the
18 slight negative returns in the bond market. The
19 good news is, I will hit the one year number.
20 In the trailing 12 months, your portfolio is
21 positive 9 percent. That is in excess of your
22 goal of 7.3.

23 Those are the absolute numbers. The
24 positive here, the silver lining, if you look at

1 it verse the benchmark for the fiscal year, for
2 the year to date, for the one year, you see nice
3 outperformance. You know, what's really driving
4 that? My opinion is how you were allocated.
5 You know, your benchmark is 65 equity. Your
6 target is 65 equity. You have about 68 percent
7 in the equity markets. Again, you have about a
8 3 percent overweight to the equity markets.
9 Again, equities have been the place to be
10 relative to the bond market.

11 So, you have a -- again, 68 equity, 32
12 in the bond market. And your target is 65
13 equity, 35 to bond market. So that in addition
14 to active management adding value, your overall
15 allocation is added to incremental returns over
16 the benchmark. With that backdrop, I will go
17 through some of the managers.

18 In the large cap bucket, as you know,
19 most of the assets here are indexed. The most
20 recent addition is PineBridge, the last manager
21 listed there. They just got hired. If you look
22 to the far right in November of last year, so
23 far so good. They are adding a little bit of
24 income of return over the benchmark. If you

1 look at the year-to-date column, 2.3 versus 2.0.
2 If you look at the composite level, which is the
3 shaded combined large cap, you know, you are
4 generating a little bit below the benchmark.
5 For the fiscal year, 12.2 verse 11.2. And for
6 the year to date, 2.3 verse 2.1. Everyone see
7 where I'm looking at? So, slight outperformance
8 is what you want to see. That's 38 percent of
9 your assets in that combined large cap bucket.

10 Again, I skipped over the first two.
11 They are both index funds. PineBridge looks to
12 generate a little bit over the benchmark. First
13 two are trying to replicate the benchmark.

14 Then again, the small cap. Not as good
15 of a relative story here. On an absolute basis,
16 very strong. If you look at the fiscal year
17 column of September 2017 to May 2018, you're up
18 16 percent in the small cap. So, from an
19 absolute perspective, very strong. I didn't
20 mention that in my opening remarks. But small
21 cap stocks continue to lead the way
22 domestically. One could conclude that they are
23 less reliant on the trade. And that's been a
24 headwind to stock prices. So, one would argue

1 they are less reliant on the trading between,
2 you know, multi-national trades.

3 So, they are insulated from that
4 rhetoric, if you will. Again, small cap stocks
5 are up significantly more than large cap
6 domestically.

7 On our absolute basis, strong returns
8 from your small cap. If you look at the fiscal
9 year, if you look at year to date even. But
10 it's a lag verse the benchmark.

11 Why the lag? It's mostly driven by
12 Vaughan Nelson.

13 As you know, as I think you are aware,
14 Vaughan Nelson and Eagle will both be liquidated
15 moving forward. There is a small cap core RFP
16 outstanding that we are working our way through.
17 So, the intent is potentially for both of these
18 managers to be liquidated going forward once the
19 small cap core RFP is completed.

20 But Vaughan Nelson is on our watch list
21 since the third quarter of last year. Their
22 performance hasn't been where we'd like it to
23 be. They are under weight the energy sector.
24 Energy has been a good place to be this time of

1 year. They have also had stock selection issues
2 in the materials and financial services sector.
3 Again, if you look at their performance on a
4 fiscal year to date, they are basically behind
5 by 3 percent. You know, 11 and a half is a
6 great return, but not when the benchmark is up
7 14 and a half. Year to date, they were up 1.8.
8 Again, the benchmark is up 4.8. They are
9 lagging by 3 percent for the fiscal year and for
10 the year to date.

11 You know, longer term, they have added
12 value. You know, they have been in your
13 portfolio since 2011. So longer term, they have
14 added value. But they undoubtedly faced
15 significant headwinds in the more recent time
16 period.

17 Eagle has been very benchmark like. And
18 for the fiscal year and year to date, they are
19 actually outperforming.

20 On the international side, I think it's
21 a good story. You see good incremental return
22 for the fiscal year. Your 5.9 verse 4.9, a
23 whole percent above benchmark. Year to date,
24 you see the negative number. As I eluded to in

1 my remarks, if you look at one month,
2 international stocks were down by 2 percent. If
3 you look at year to date, they are still down.
4 Your portfolio is down about 1 percent. Again,
5 I mention this in my opening remarks.

6 International stocks are facing
7 headwinds this year. You know, the good news is
8 your managers are, for the most part, protecting
9 capital. That is why you see negative 1.05 for
10 year to date relative to negative 1.92.

11 So you know, Mondrian, for example, is
12 minimizing losses on a year-to-date basis. And
13 actually, Harding Loevner, as well. Harding
14 Loevner is actually positive 1.01 for the year.
15 The benchmark is negative 70 basis points.

16 And DFA is facing some headwinds. DFA,
17 if you look down to the bottom, DFA is always
18 going to have a value tilt to their portfolio.
19 Value has not been the place to be. It's more
20 of a growth led stock market, if you will. You
21 should also be aware that, I think you recall,
22 all three of these managers I just went over --
23 Mondrian, Harding Loevner and DFA -- will all be
24 liquidated in short order.

1 When I was here last, we did
2 international manager interviews, if you recall.
3 EARNEST Partners and Acadian were both selected
4 to replace these three managers. So my
5 understanding is, you know, contracts are being
6 reviewed. And that's in process in terms of the
7 transition.

8 Rhumbline International is the only one
9 I jumped over. That's an index fund. It's
10 going to be, if you look at the returns, they
11 are up 5 percent for the fiscal year. Negative
12 1 and a half. Very benchmark like in terms of
13 the returns set there. In my understanding,
14 that's in the process of moving to an acqui, all
15 punching world ex-USA. That is still in
16 transition.

17 So, the flipside is fixed income. So
18 again, this is one of the other challenged asset
19 classes. If you look, this is 30 percent --
20 roughly 31 percent of your assets. If you look
21 at the fiscal year, again, similar to
22 international. Good protection of capital in a
23 down market, I would say. So one, you are
24 underweight this asset class which is a

1 challenge to asset class. And two, your
2 managers have minimized losses, for the most
3 part. So again, if you look at the fiscal year
4 column, negative 1.1. Unfortunately, the
5 benchmark is negative 1 and a half. If you look
6 at the year to date, negative 1.1 again.
7 Benchmark, again, is negative 1 and a half. So
8 again, silver lining, slight protection of
9 capital by your active managers. And you're
10 underweight by this challenged asset management
11 class.

12 So, Weaver Barksdale, Logan Circle.
13 Logan Circle investment grade credit and Garcia
14 Hamilton, all those managers actually have
15 protected capital in this challenging market.
16 So you have five active fixed income managers.
17 Four of the five protected capital both on a
18 fiscal year date and a year-to-date period. The
19 only manager that's not protecting is Lazard.
20 If you see Lazard there in the middle, Lazard
21 asset management, if you look at their fiscal
22 year, negative 1.49 verse the benchmark of
23 negative 1.39. If you look at year to date,
24 negative 1.2 versus benchmark of negative 0.94.

1 They are slightly missing it. Every other
2 manager listed here against slightly protected
3 capital.

4 SKY Harbor, as you might recall, is a
5 recent addition. The bottom manager in the
6 fixed income bucket. If you look all the way to
7 the far right, they just got hired in April of
8 last year, so very early -- I mean, April of
9 this year. Early you talking about performance
10 there. And it's only 2 percent of your assets.
11 This is a high yield manager, so they invest in
12 companies with low credit quality. That can be
13 very volatile. It's a small allocation of 2.69.

14 The only other -- within fixed income,
15 again, the overall bond market is down about 1
16 and a half percent. Look at high yield, though.
17 Look at high yield. High yield, if you look at
18 the benchmark, Bloomberg, Barclays, U.S.
19 corporate high yield, it's positive. The fiscal
20 year, 1.13 when the overall bond market is
21 negative 1 and a half. High yield has kept its
22 value in this down turn which is good to see.

23 It's also kept its value year to date.
24 It's negative, but it's only negative 0.24.

1 Again, the overall bond market is down one and a
2 half percent. So, the lower credit quality
3 companies that are issued have held their value.
4 Credit overall has not.

5 So if you look at Logan Circle
6 investment rate credit and look at the
7 benchmark, Bloomberg Barclays U.S. credit five
8 to ten year index, look at the fiscal year,
9 negative two and a half for both the fiscal year
10 and the year to date. So, that's an environment
11 where the overall bond market is only negative
12 one and a half. That is something we are
13 looking at. Credit is taking it hard in this
14 period. One can argue it's also related to
15 trade tariffs and attentions there.

16 But credit overall has been hit hard
17 relative to the overall bond market. But high
18 yield has held its value. And those are both
19 small allocations. They are both 2 percent of
20 your plan.

21 That was the overview of the portfolio.
22 We do have a market value sheet in here. Chris
23 already provided a more up-to-date version than
24 this. But I believe behind the next -- behind

1 the divider, you have an updated market value.
2 Again, Chris provided the update of 552 million
3 as of this morning. This is stale. This is
4 July 2, 541 million. But again, Chris provided
5 another up-to-date this morning. Only thing I
6 will point out in this slide, which again, I
7 will reiterate is how your plan is invested
8 relative to its targets.

9 If you look at equity and if you look at
10 your target, I mention this in my opening
11 remarks, your target is 65. Your current
12 allocation is 67.58. So, that's what I was
13 eluding to. Your overweight equities by two and
14 a half percent in an environment where that's
15 been rewarded. If you looked at fixed income,
16 halfway down the page, your target is
17 33 percent. And you're at 31. So again, I
18 already mentioned that, but just so you can see
19 in numbers what I was eluding to. That position
20 overall is really what drives the returns of
21 your total fund.

22 Mr. Chairman, those were my prepared
23 remarks.

24 CHAIRMAN SCOTT: Are there any

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1 questions?

2 MS. JOHNSON: None.

3 MR. WHITE: No.

4 CHAIRMAN SCOTT: Any comments you want
5 to make?

6 MR. DiFUSCO: None.

7 CHAIRMAN SCOTT: Well, the next item on
8 the report I think is new business. First of
9 all, thank you for that presentation.

10 Next item is new business.

11 MR. DiFUSCO: I just have a couple of
12 reminders or announcement. The actuarial will
13 be here in September to go through the current
14 funding status of the plan and answer any
15 commissioner questions. As Marc mentioned, we
16 have small cap search outstanding for Eagle and
17 Vaughan replacement, a small cap core. We will
18 either do that in September -- that may be a
19 long meeting with the actuary -- or in November.
20 And then we will have updated diversity
21 brokerage numbers for the second quarter
22 probably by the end of July or early August.
23 That's the deadline. So as soon as I have that,
24 I will get that out to everyone. And we will

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1 compare the first and second quarter, you know,
2 of 2018. You will see both of them side by
3 side.

4 Couple of the managers that have come in
5 already, at least one that was very low in their
6 account, has already shown major, major
7 improvement and is inching up towards that
8 30 percent number in one of their accounts. We
9 had -- I had a sit down with them a few weeks
10 ago. Hopefully, that's -- they are starting to
11 get the message. I will get you those numbers,
12 again, probably by the end of the month.

13 That was all I had.

14 CHAIRMAN SCOTT: Okay.

15 Seeing that we have addressed all items
16 on the agenda, is there a motion for
17 adjournment.

18 MS. JOHNSON: Make a motion.

19 MR. WHITE: Second.

20 CHAIRMAN SCOTT: Motion been made and
21 seconded. Thank you very much.

22 Have a great week.

23 (At this time, the Meeting concluded at
24 10:18 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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