CITY OF PHILADELPHIA

SINKING FUND COMMISSION

IN RE: July Meeting

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Wednesday, July 11, 2018

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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

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

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

Is there a motion?

MS. JOHNSON: I make a motion.

CHAIRMAN SCOTT: A motion has been made.

Is there a second.

MR. WHITE: Second.

CHAIRMAN SCOTT: Motion has been made and properly seconded.

All those in favor?

(Ayes.)

CHAIRMAN SCOTT: Ayes have it.

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

Chris, I turn it over to you.

MR. DiFUSCO: I will let Marc cover most of the specific numbers. Just as an update, the plan balance as of this morning is approximately $552 million. Pension benefits will go out today, so it will be about 550 by the end of day with a 2 million-dollar draw. And we should have the June numbers, if not by the end of the week, then early next week. I will get those out to everybody.

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

MR. AMMATURO: Sure. Thank you.

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

As of May, the domestic stock market was up about 2 and a half percent, again, through May. International stocks, unfortunately as you will see, were done about 2 percent. Again, a 4 percent -- roughly a 4 percent differential whether you invested domestically or internationally, again, through the month of May.

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

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

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

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

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

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

Those are the absolute numbers. The positive here, the silver lining, if you look at it verse the benchmark for the fiscal year, for the year to date, for the one year, you see nice outperformance. You know, what's really driving that? My opinion is how you were allocated. You know, your benchmark is 65 equity. Your target is 65 equity. You have about 68 percent in the equity markets. Again, you have about a 3 percent overweight to the equity markets. Again, equities have been the place to be relative to the bond market.

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

In the large cap bucket, as you know, most of the assets here are indexed. The most recent addition is PineBridge, the last manager listed there. They just got hired. If you look to the far right in November of last year, so far so good. They are adding a little bit of income of return over the benchmark. If you look at the year-to-date column, 2.3 versus 2.0. If you look at the composite level, which is the shaded combined large cap, you know, you are generating a little bit below the benchmark. For the fiscal year, 12.2 verse 11.2. And for the year to date, 2.3 verse 2.1. Everyone see where I'm looking at? So, slight outperformance is what you want to see. That's 38 percent of your assets in that combined large cap bucket.

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

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

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

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

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

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

But Vaughan Nelson is on our watch list since the third quarter of last year. Their performance hasn't been where we'd like it to be. They are under weight the energy sector. Energy has been a good place to be this time of year. They have also had stock selection issues in the materials and financial services sector. Again, if you look at their performance on a fiscal year to date, they are basically behind by 3 percent. You know, 11 and a half is a great return, but not when the benchmark is up 14 and a half. Year to date, they were up 1.8. Again, the benchmark is up 4.8. They are lagging by 3 percent for the fiscal year and for the year to date.

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

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

On the international side, I think it's a good story. You see good incremental return for the fiscal year. Your 5.9 verse 4.9, a whole percent above benchmark. Year to date, you see the negative number. As I eluded to in my remarks, if you look at one month, international stocks were down by 2 percent. If you look at year to date, they are still down. Your portfolio is down about 1 percent. Again, I mention this in my opening remarks.

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

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

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

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

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

So, the flipside is fixed income. So again, this is one of the other challenged asset classes. If you look, this is 30 percent -- roughly 31 percent of your assets. If you look at the fiscal year, again, similar to international. Good protection of capital in a down market, I would say. So one, you are underweight this asset class which is a challenge to asset class. And two, your managers have minimized losses, for the most part. So again, if you look at the fiscal year column, negative 1.1. Unfortunately, the benchmark is negative 1 and a half. If you look at the year to date, negative 1.1 again. Benchmark, again, is negative 1 and a half. So again, silver lining, slight protection of capital by your active managers. And you're underweight by this challenged asset management class.

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

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

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

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

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

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

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

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

That was the overview of the portfolio. We do have a market value sheet in here. Chris already provided a more up-to-date version than this. But I believe behind the next -- behind the divider, you have an updated market value. Again, Chris provided the update of 552 million as of this morning. This is stale. This is July 2, 541 million. But again, Chris provided another up-to-date this morning. Only thing I will point out in this slide, which again, I will reiterate is how your plan is invested relative to its targets.

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

Mr. Chairman, those were my prepared remarks.

CHAIRMAN SCOTT: Are there any

questions?

MS. JOHNSON: None.

MR. WHITE: No.

CHAIRMAN SCOTT: Any comments you want to make?

MR. DiFUSCO: None.

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

Next item is new business.

MR. DiFUSCO: I just have a couple of reminders or announcement. The actuarial will be here in September to go through the current funding status of the plan and answer any commissioner questions. As Marc mentioned, we have small cap search outstanding for Eagle and Vaughan replacement, a small cap core. We will either do that in September -- that may be a long meeting with the actuary -- or in November. And then we will have updated diversity brokerage numbers for the second quarter probably by the end of July or early August. That's the deadline. So as soon as I have that, I will get that out to everyone. And we will compare the first and second quarter, you know, of 2018. You will see both of them side by side.

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

That was all I had.

CHAIRMAN SCOTT: Okay.

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

MS. JOHNSON: Make a motion.

MR. WHITE: Second.

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

Have a great week.

(At this time, the Meeting concluded at 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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