CITY OF PHILADELPHIA
SINKING FUNDS COMMISSION
Wednesday, March 14, 2018

- - -

LOCATION: Two Penn Center Plaza
16th Floor
Philadelphia, Pennsylvania

REPORTED BY: Amy Marzario,
Court Reporter

PRESENT: DONN SCOTT, CHAIRMAN
CHRISTOPHER R. DIFUSCO
MARC AMMATURO
ALEX GOLDSMITH
REBECCA REINHART
ROSEMUND HOWARD

STREHLOW & ASSOCIATES
PHONE: (215) 504-4622
FAX: (215) 504-7155
COURT REPORTERS - VIDEOGRAPHERS
54 FRIENDS LANE, SUITE 116
NEWTOWN, PENNSYLVANIA 18940
WWW.STREHLOWCOURTREPORTING.COM

MR. SCOTT: I'm pleased to call this meeting to order. The first item on the agenda is the approval of the minutes and I'm told that we can only address the January 10, 2018 minute because Rasheida is not here. So do we have a motion to approve them?

MS. REINHART: Motion to approve.

MR. SCOTT: Second?

MR. DIFUSCO: Second.

MR. SCOTT: Motion has been made. All those in favor?

MS. REINHART: Aye.

MR. SCOTT: All right. The third item on the agenda is review and selection of International Index Manager. Chris, I guess I'll turn that over to you.

MR. DIFUSCO: Sure. Thanks, Donn. So you see the memo from PFM. Just as a reminder, we had two outstanding searches for international managers, one passive and total passive international which is what we're going to talk about today and then active mandate which we'll address in May.

For this particular international equity total strategy, we only got two responses which is pretty standard, from Northern Trust and from Belmont.

Both presented best and final fee offers which after some negotiating came in identical, six basis points each.

MS. REINHART: I'm sorry. Can I ask you a question, Chris?

MR. DIFUSCO: Sure.

MS. REINHART: Why is it only two responses? Is that -- just curious about how we push out the --

MR. DIFUSCO: So we push it out pretty aggressively.

MS. REINHART: Okay.

MR. DIFUSCO: And one, there's not as many institutional index players in the space as you might think there'd be. You know, the Vanguards and other folks of the world we can't contract with because they only have mutual funds, right, they don't have separate managed accounts.

MS. REINHART: Oh, okay.

MR. DIFUSCO: And then a few of the other index funds we have heard from in the past are either significantly more expensive or many years ago we heard from Blackrock. Actually, they were selected, and forgive me, I don't remember if it was for this fund or for the bigger fund years ago, and we had just incredibly difficult contract negotiations. They just would not agree to the most basic -- I mean, I'm not going to get into it here and I don't know if Adam was with us at the time but, I mean, they wouldn't agree to the most basic things.

Forget some of the more idiosyncratic city stuff. I'm talking about like basis stuff. So these are the two that we generally hear from. We do push it out through the consultant, both here and at the larger fund. And I will say that their fees are very, very competitive. And we're told that even by the folks at Vanguard that for an SMA with investment restrictions and, you know, just having our own account that the fees are very competitive.

So both firms came in at six basis points so no difference then. But in discussion with PFM, I think we've described it, and correct me if I'm wrong, Alex or Marc, but the soft services I think are a little bit superior with Rhumbline. I think it's also a plus in their favor that they have significant female and minority ownership, about 51 percent in total. They also have, I'll say, reasonable, decent numbers in terms of the higher level professionals in terms of senior management in terms of African Americans, females, about one-third each on the female side.

And on the minority side, it's a little bit better than Trust. And so based on that, our existing relationship in both plans with Rhumbline, it would be our recommendation to select them for this mandate. I don't know if Marc or Alex want to add to that?

MR. GOLDSMITH: No, I just -- I think that they're currently managing a developed international index strategy to plan 25 million. And actually for this total international, they dropped that down from ten basis points to six. So they're actually expanding their mandate and reduced the proposed fees so I think that speaks to the level of service and desirability to work with the City from Rhumbline.

MR. SCOTT: And performance has been --

MR. DIFUSCO: Yeah, it's been -- it matches the index with, you know, very minimal tracking error.

MR. GOLDSMITH: And that includes obviously they're screening out the screens so they're able to locate performance with those screens.

MS. HOWARD: I'm sorry. You were able to negotiate down the piece even on not this asset class, even on the U.S. equity piece?

MR. GOLDSMITH: Not related to this RPF. I was just saying, you know, they currently -- if you look within international equity, Rhumbline has the developed international index right now.

MS. HOWARD: Right.

MR. GOLDSMITH: That's what will be replaced by this strategy. They're currently charging ten basis points for developed and they've brought that down to six for this one. So I'm just using that as an example. They're adding in more securities in a broader universe but are still reducing the fee schedule.

MS. HOWARD: Got it. Okay. The only thing I was just looking at is it seems as if we already have like about 30 percent of total allocation of the portfolios to Rhumbline today, so it's not necessarily a vote on, you know, Rhumbline or not and certainly if you pass it makes sense here.

And maybe not necessarily for this particular vote but to the extent that we expand, you know, the passive allocation portfolio, it may make sense to continue to shop around for other providers just so we don't have any concentration risk of one manager.

MR. GOLDSMITH: Yes. I mean, I agree with that, I think. You know, certainly you don't want a lot of concentration with a single firm regardless of whether it's different strategies. I mean, there could be business risk, not that there -- we don't view that there is any at the time, but things change and there could be.

You know, I agree with Chris, his explanation for why we haven't seen a lot of responses. So, you know, perhaps in the future if there are additional RFPs, we can, you know, go after players like State Street. But certainly, I think Vanguard is really off the table, Blackrock for the time being as well. So, you know, it was a limited universe but --

MS. HOWARD: Fidelity also is strong and I'm sure you guys have explored that.

MR. GOLDSMITH: I agree. I think that we can hopefully try to diversify when it comes to additional searches in the future but I think right now, Rhumbline represents the best option.

MS. HOWARD: Yes.

MR. SCOTT: Is there a motion?

MS. REINHART: Motion to approve.

MR. SCOTT: Motion to approve Rhumbline as our international index manager. I second it. All those in favor?

MS. REINHART: Aye.

MR. SCOTT: It's kind of interesting we only have two people.

MS. REINHARD: I know.

MR. SCOTT: Thank you. Next item on the agenda is fixed income rebalancing, Sky Harbor funding.

MR. GOLDSMITH: Sure. So, Donn, obviously you may remember this, but back in October 2017, there was a special meeting held where we interviewed some managers for high yield allocation. The decision to add high yield to this plan really goes back even before that. I think all the way back to 2016, we were brought on as a consultant. At that point, there was only core fixed income, full duration, and intermediate duration in the portfolio.

We wanted to add additional corporate exposure, both investment grade corporate, high yield corporate, and as well, you know, eventually down the road some actual fixed income exposure as well. So you might recall we interviewed some investment grade managers. Logan's Circle was approved for that the middle of last year. And then we went through a high yield RFP as we usually do and conducted semifinalist calls with a number of those funds, and then brought three managers in to interview in October and Sky Harbor out of Connecticut was selected.

You know, really most of those managers I would say were similar in that they were focused on the credit analysis portion of their portfolio construction and that's particularly important when it comes to high yield and below investment grade. The level of analysis is almost like that which equity risks conduct. There's less macro level, sector allocation within high yield.

And again, more on the focus on the strength of one credit versus another. Coke versus Pepsi, for example. They're not high yield things. But, you know, they demonstrated superior credit processes and also I think they proposed one of the most attractive fees at 35 basis points. And, you know, they are, let me see, 43 percent currently women owned with an intent to bring that up over 50 percent in the near term. Again, so they were approved back in October.

The contracts, discussions ran away over the last several months.

Those I believe have been completed. And so if you look actually on the back of this memo, we've proposed a long-term allocation of three percent to Sky Harbor. But given I think some duration bounds that are included in the investment policy statement combined with the lower duration overall of the high yield universe, you know, we felt it was better to scale slightly into Sky Harbor so that we don't bring the plan out of compliance with that duration requirement.

And so again, I think, you know, we've proposed an initial application of 2.6 percent increased to three percent over time through rebalancing of some of the longer duration managers. Even with that allocation, you know, I think Sky Harbor's duration is about 3.2 percent whereas the duration of the Barkley's aggregate is about 5.1, I believe off the top of my head. And that is a significant difference.

So even with, you know, funding at 2.6 versus three percent, you know, we realized we had to shift some additional assets into the longer duration of fixed income to make sure the plan remains in compliance. You know, the only way we can do that and, again, lengthen the duration of the portfolio was shifting some assets from equities into the longer duration fixed income. So that's Weaver Barksdale and Logan's Circle.

So if you have the allocation chart in your -- it looks like it wasn't included in every packet. We have some extras here. So you can see here that this is really where the parts come together. So down towards the bottom of this page, you can see under the credit component of fixed income, that's the new sub asset class that was added with the additional Logan's Circle and now Sky Harbor. We're proposing again initial funding to the far right of 2.6 percent, 14.5 million.

In the third from the right column, rebalancing action, that's where you can see the other moving parts. So I tend to think about it like this. We prefer that the credit component, the high-yield component, was sourced from the lower duration of fixed income, the intermediate managers, Lazard and Garcia Hamilton. But again, as I mentioned, even with moving those assets, it still would be the overall duration of the portfolio below the bound requirements.

As such, we had to add additional funding into the longer duration of fixed income managers, Weaver Barksdale and Logan's Circle. So that's why you can see a bit of a negative -- you know, negative 17.5 million coming out of the intermediate plus 12 million coming in to the core plus. And then that 12 million, an additional rebalancing amount was taken. You can see from equity a proportionate amount from domestic equity and fixed income both from the Rhumbline index funds.

And I mentioned there are some additional rebalancing of cash rebalance. You'll notice down at the very bottom there's an additional four million going into cash. This just demonstrates, you know, not just the Sky Harbor funding but the March benefit raise as well as recouping the February benefit raise which was paid out in cash. So it looks like there's going up to ten million in cash but two million will be paid out in the near term for benefits and so that would be back around the eight million or so target which has been our target, staff's target, over the intermediate term.

So, you know, certainly lots of moving parts there. It does bring the overall equity allocation. You can see I guess the second line overall at the top of this page. Currently, it's 69.6 percent, 4.6 percent over the target allocation to equity. It brings that down to 67.25 percent. So, you know, you'll see this when we get into the performance of the plan and a big contributor to performance has been the overweight in equities.

We've received questions throughout 2017 based on valuations, et cetera. You know, when does it make sense to rebalance? We continue to favor equities particularly given, you know, the outlook for fixed income with rising rates. That being said, we have seen some volatility injected into the markets to start this year. Markets are up -- the equity markets are up, even in the year to date as of yesterday, but they've been up six percent. They'd been down ten percent.

We feel that it is an appropriate time, especially given that we have to do a little bit to maintain compliance to take some of that equity overweight off the table. It's still maintaining a 2.25 percent overweight to equities but, again, lowering the overall risk at a time when volatility has increased. There's a lot going on if there are any questions or reviews?

MR. SCOTT: I think this is the first time that I'm participating in a meeting where we've actually done rebalancing; is that accurate?

MR. DIFUSCO: Yes. I think the reason why in this case is because it's in initial funding for Sky Harbor. And my recollection is that when you and the commissioners, Rasheida and the prior controller, approved Sky Harbor, we had indicated that when we funded that, we would come back and discuss the sources and the timing and, you know, when we would do it.

There was that caveat when we approved it. That's my recollection, that we indicated -- you know, we weren't going to fund them the exact amount without coming back and talking to the commissioners.

MR. GOLDSMITH: And that's how we typically do most of the -- one of the managers approves the manager and then we approve their funding.

MR. DIFUSCO: As opposed to the normal benefits draw where I'll send out an e-mail around the time we make the benefits draw. That way if folks have concerns or questions, they can come to me or PFM, you know, prior to taking money to pay the pensioners.

MR. GOLDSMITH: One thing I will mention on Donn's statement, while I know this -- it does represent I would say a little bit of rebalancing, again primarily to the funding of Sky Harbor. Every time -- not every time but for the, you know, most of the recent periods when we were drawing to pay benefits, we have drawn on the margin from equities. And so that represents significant rebalancing but it represents -- you know, if we hadn't been doing that, I think the allocation would've gotten significantly out of whack.

And then the last thing I'll say, you know, again even given the relative performance of equities and fixed income this year, our outlook, I'm a little -- I'm comfortable doing this because equities and fixed income are highly correlated. The most highly correlated fixed income asset class to equities is high yield.

You know, that's related to -- again, it's overemphasis on the quality performance of these companies. And so you're again taking a little bit of the risk off from equities but, you know, still adding a riskier asset class within fixed income. So I think that helps make the case a little bit.

MR. SCOTT: So there's an action step that we need to take to rebalance here? I'll make a motion that we approve the recommended rebalancing. Is there a second?

MS. REINHART: I second that.

MR. SCOTT: Motion has been made. All those in favor?

MS. REINHART: Aye.

MR. SCOTT: All right. Thank you very much. Now we're going to do item number five, the Investment Performance Review.

MR. AMMATURO: I'll start with the fourth-quarter report. I was going to go very high level. I'll start with the December 31, 2017, just very high level on December. We'll spend more time on February but I was going to start with that just so you know how the year closed out. So there should be a report in your book that's labeled December 31, 2017. I'll be very high level.

Just by way of introduction, Marc Ammaturo.

I've been at PFM for 13 years. I'm a managing director at the firm. Thank you for the confidence in PFM. Just again, I'll go over high level December 2017. I'll hand it to Alex to go over January and February in a little bit more detail. But in terms of 2017, just so you know how the year ended, I'm going to flip ahead to 2.1. It looks like everyone is there already.

So the market value for your pension plan, PGW's pension plan, at the end of last year was $500,433,661. The year of return, if you look at the 2017 column, it was almost 17 percent last year, so 16.97. A very strong fourth quarter as well; the number to the left there, 4.3. So again, the fourth quarter, the plan was up 4.3 percent for the year. Your plan was up almost 17 percent, 16.97. So obviously strong on an absolute basis.

It's also noteworthy to see the relative outperformance so if you look at the quarter, 4.3 versus 3.9. If you look at the year, 16.9 versus 15.8. The main driver of that relative outperformance is what Alex just mentioned, the overweight to the equity market. So your overweight domestic equity, your overweight international equity, and your underweight on the bond market, and I'll show that to you in a second. But that overweight, that positioning is really where PFM concentrates.

Where do we want to be overweight? Where do we want to be underweight? And that drove the relative outperformance. And if you look out longer term, you know, your trailer returns are fairly strong. The one year, as we just talked about, 17 percent. But even if you look at the three-year column, almost eight percent and the five year at 9.6. There's a couple more pages I want to -- I'm not going to go through the managed. I think Alex may take you through that. But I think it's important to talk about the cash flow of the plan, the 2.5.

I think you should have an understanding of not just the investments but what's going on in terms of payments to retirees relative to contributions, so that's what you see on 2.5. So if you look at the bottom row, 12 months ago this plan was $488,840,000. This plan was cash flow negative; 26.9 million last year. Again, that has nothing to do with investments.

MS. REINHART: So when you do cash, do you do -- what do you use? You don't take into account the investment return? So you keep that at zero?

MR. AMMATURO: Yes. That's essentially --

MS. REINHART: So this is the same way that, Chris, we look at it from the large fund? Okay. Which has much larger negative --

MR. DIFUSCO: Correct.

MS. REINHART: Okay.

MR. AMMATURO: So that flows column is simply how much is being contributed to the plan relative to how much is paid out to retirees. That's the only two numbers that factor into that net flow figure. The column to the right of that is 100 percent related to investments and how did your investments do last year. So from a cash flow perspective --

MS. REINHART: Interesting.

MR. AMMATURO: Yes. So from a cash flow perspective, you're negative 26 million -- almost 27 million last year but that was completely offset on an investment that may be one million. So that's how we got to the 543 million dollar figure I quoted earlier. That's important to keep that in mind in terms of the growth of the plan. The other important slide is on 2.6. I mentioned --

MR. SCOTT: Where do you see the fees? Where are the net fees?

MR. AMMATURO: The fees -- if it's a mutual fund, it would be netted out in that return on investment column. So if you have the mutual fund vehicle in your pension plan, Donn, there's a net asset value struck every day. When they strike the NAV, they're taking out the expense issue so that would be kind of netted out. That doesn't include, and correct me if I'm wrong, but this doesn't have separate account fees. This doesn't have PFM's fee if that's what you're asking.

MS. REINHART: Oh, yeah. That is a good question.

MR. AMMATURO: No, that's not in this.

MR. SCOTT: So if we're looking at 81, that 81 is actually a return to 81 net fees?

MS. REINHART: Some of the fees but not all of them.

MR. GOLDSMITH: I think we have -- I would like to confirm about that because the number that's shown -- you know, performance numbers are in net of manager fees. They are not net of the PFM fees so this number may be net of manager fees as well.

MS. REINHART: Wouldn't that be in the net flows though, the fees, because it would be an outflow?

MR. AMMATURO: My understanding is net flow is simply contribution and is relative to retired payments.

MS. REINHART: So there might need to be like another column here?

MR. AMMATURO: We have some clients that actually customize the sheet and add expenses.

MS. REINHART: Yeah, that would be great.

MR. DIFUSCO: I agree. That's a good idea. Alex will confirm but I agree with that.

MR. GOLDSMITH: I would like to confirm because there may be some and others elsewhere so we'll pull all the expenses out.

MR. AMMATURO: So 2.6 is the other important page before I hand it over to Alex to go into an update, but 2.6 again, I think Alex mentioned this but it's important to understand. If you look at the bar chart on the bottom of 2.6, it shows you how your pension plan is allocated relative to your investment policy statement in terms of targets to individual asset classes.

So if you look at domestic equity, the darker bar if you will is 47.6 so this is just demonstrating your overweight in domestic equity by over 2.5 percent and that's of year end. And that's one of the big reasons why you outperformed last year on a relative basis because equity market obviously was up over 20 percent last year. International equity, you're overweight by about two percent as well. Again, international markets were up even more in domestic last year. That's another reason you outperform on a relative basis.

And then commercially, underweight in fixed income and asset class was, you know, up but nowhere near as strong as the domestic international stock market. So this is really kind of where PFM spends a lot of time and effort into how should your portfolio be allocated relative to targets that are in your investment policy statement. So just want to reiterate that.

MS. REINHART: A question that, Chris, you might have -- it has a little bit to do with this but also the City's main pension fund.

MR. DIFUSCO: Okay.

MS. REINHART: Obviously, this plan is -- the returns have been good and there's zero real estate here, right?

MR. DIFUSCO: Yes.

MS. REINHART: And I'm just curious about, you know, we have sort of this -- a big ramp up expected on the City's pension plan on real estate but there's zero. And what makes the difference -- is there a rationale for the different target allocation or is it more just like different boards came up with -- and different advisors came up with different suggestions?

MR. DIFUSCO: So I would say it's a combination of things. Historically, to the best of my knowledge going back, there's being very little exposure in this plan to alternatives. There is one very old real -- I mean, very old real estate investment that's down -- I think you and I talked about it last year, Donn, it's under $50,000, if that. It's 10 to 15 years old.

So there was -- historically, for whatever reason, there has not been. I think some of it, as you and your staff had asked yesterday, has to do with the funding level. Historically, this plan has been better funded. At one time, and not -- you know, 10, 15, 20 years ago, I believe it was over 100 percent funded so there wasn't the need necessarily before, you know, alternatives and private equities.

MS. REINHART: You mean there wasn't the need to get the additional yield --

MR. DIFUSCO: Correct.

MS. REINHART: -- the attempt to bring in the additional yield which brings in the additional risk?

MR. DIFUSCO: Correct, because it's been better funded. I believe the other thing that I would bring up is that some of the alternatives that were suggested by particularly prior consultants didn't ever even make it in front of the board in large part because I had a strong feeling that they were inappropriate. You know, I had no interest in asking the commissioners to entertain hedge funded funds, for example, with double layers of fees and other things.

Now, I know the longer term asset allocation, and I know Alex or Marc may want to discuss this, would possibly include some introduction of alternatives. They would be at a much smaller level and I believe we had discussed with Donn and some of the other folks previously during an education session around the risks and the merits of various asset classes in that space. I don't know if folks want to add to that or if there's follow-up?

MS. REINHART: I mean, I was coming from the perspective actually of it's nice to see -- it's almost -- you know, there's a lower risk level and there's good returns and there's some -- and I think I feel a little anxiety around some of those for the main pension plan so I was just curious. It wasn't as a -- that I was going to push for alternatives here.

MR. DIFUSCO: Oh, no.

MR. GOLDSMITH: I can maybe speak a little to some of the history of discussions at least since we've been involved over the last two years. I mentioned a couple of initiatives that have already taken place that are still underway, among them going from value growth to core, diversifying within fixed income, et cetera. So these have been the issues that have taken place.

You know, on that initial list I think when it was presented, like I said, two years ago and then last year updated, down the line was a discussion around the possible introduction of alternatives. Our firm view I think in general might be a little different than others. You know, we don't view alternatives as just the class that could enhance return overall. I think there's a lot of different types of alternative investments for trustees, for fiduciaries.

I think you certainly need to understand exactly what you're getting into and what reason. Alternatives can, like I said, can be used to enhance return overall. They can also be used as pure diversifiers, you know, uncorrelated asset classes that, you know, don't move with broad equities or fixed income. And they can also be yield providers. And real estate tends to fall into the yield bucket but there are also private debts which is, you know, like a private equity that is a locked up period. But these are, you know, negotiated loans not traded, et cetera. When we looked at alternatives, we looked at it for one of those specific reasons.

MR. AMMATURO: We're very, very

skeptical about alternatives in general.

MS. REINHART: Okay.

MR. GOLDSMITH: I think the reason needs to warrant whether it's the additional fees or the additional lock up on liquidity.

MR. AMMATURO: Do you want to transition to the January, February update? I think I went through that. This was the 2017 kind of rundown.

MS. HOWARD: If it's possible to add duration as a column on performance, if that's a customizable thing that you can do, it would be great to see that.

MR. AMMATURO: I'm sorry. What page?

MS. HOWARD: Well, any of those performance pages would be great. It seems like we're making investment decisions about Sky Harbor based a bit on duration and specifications of the IPS. And so it would just be good to see especially like, you know, given the volatility of interest rates that we might be anticipating if we could add like a weighted average duration column to monitor that as part of this.

MR. AMMATURO: We look at it on a manager level. It's in the report, actually.

MS. HOWARD: Oh, it is?

MR. AMMATURO: At the manager level, yes. So if you look at, for instance, 5.8 like last of the quarterly report, all the way in the back, there's individual manager pages. So if you look at like Logan's Circle, their effective duration is actually the first characteristic listed there.

MS. HOWARD: Oh, great. Okay.

MR. AMMATURO: So it's by manager in the back of the book.

MS. HOWARD: Okay, great. Do you have it also just rolled up for all of fixed income?

MR. AMMATURO: We look at that internally. That is not part of the deck today.

MS. REINHART: It doesn't have to be today.

MS. HOWARD: Yes, it certainly doesn't have to be today. It's easy enough to add.

MR. GOLDSMITH: Off the top of my head, I believe it's 4.88 right now. But, yeah, I think we can add a role of exhibit to the future reports.

MS. HOWARD: Thank you.

MR. GOLDSMITH: All right. I will transition -- you all have the handout that was passed out, the color copy of the February monthly flash performance. We discussed -- actually, we did not discuss January because it was sent out at the prior meeting, but I think I'll focus on February and include the January returns.

MR. AMMATURO: Does everybody have a copy?

MR. GOLDSMITH: Just really to set the context because if you look at this handout, you know, it's a negative return for the total plan for the month, negative returns across domestic international equity and fixed income. So, you know, it provides some context for why those returns look the way they do. You know, obviously Marc gave an update through the end of 2017. We started off 2018 with, you know, equity markets up, you know, around six percent in one month alone.

Towards the end of the year, the tax plan was passed and while a lot of I think expectations of that were already factored into market performance in 2017, there was a very favorable reaction from participants in the market and equities were up about six percent. You might recall then in early February, I think it was the first Friday of the month, a jobs report was released.

I would say it was mixed news but some investors took some elements of that negatively, particularly I think, you know, the evidence that -- or there have been additional jobs and there are a lot of hirings but hours overall were down. So you've got a larger employment pool competing for, you know, fewer hours, et cetera. So maybe that adds some weakness into what people had been perceiving as a strong jobs market.

There was a selloff in the market that Friday followed by, you know, a bit of a rebound and then an additional selloff to the point where in one point in early February, U.S. stocks were down 10 percent from their highs at the end of January. So that's officially -- that's correction mode. I think in the ensuing week prior -- the following week, it was the middle of earning season. Earnings results continued to be released that were at or ahead of estimates.

Economic data continued to be released that was positive here in the U.S. And so, you know, value investors, investors that had cash on the sidelines used that downturn as an opportunity to get -- to add some allocation to equities to the point that, you know, mid-February, towards the end of February, markets had rebounded. So in fact, they were at or slightly ahead of the figure where they were at the end of 2017.

So I mentioned that that's the volatile ride we've had; up six percent, down 10 percent, then leveling out somewhere in between. That's continued I think in late February into March. Certainly there was another Friday I believe when it was the president's announcements of possible steel and aluminum tariffs. That injected a lot of volatility in the market. Certainly, even members of his own party, a lot of economists and I think Micro 101 that when you add a tariff, that's passed on down to consumer prices, et cetera.

So that was the next round of volatility we saw in the sharp selloff followed by a rebound. And then the last several days, you know, once we were back into positive territory for the year within equities, but daily volatility even over the last three days here. So I think that exhibits -- that further provided some rationale for us to again draw from equities to fund the fixed income allocation.

Where we as of the end of yesterday, just for some context, the Russell 3000, the total U.S. stock market, is up 3.8 percent year to date. So again, even with that rough ride, it's still in positive territory. International markets are slightly lower, up 1.4 percent. Again, I think that they had a significant outperformance last year. There are some I would say increased geopolitical tensions.

That's been one thing we've considered one of the higher risks to the overall global equity market. Certainly, our relationship with Russia has become more volatile this year, Syria as well. There's been some issues around the cease fire there and then continued fallout from any potential British exit. So, again, we continue to look for those but positive equity markets at this point in 2018.

Within fixed income, interest rates were raised three times in 2017. It's expected that that will be the case again this year. And there was actually a very positive employment announcement last Friday. And again, the Fed, when they look to raise rates, they look to inflation, employment. And, you know, I think with an inflation check and unemployment looking positive, it's expected that the Fed will act to raise rates.

So interest rates, you know, especially in the shorter end of the curve, have picked up so that's why you see that Barkley's aggregate is down two percent in 2018 to start the year. So that's, you know, the context that we're looking at in this February performance. So you've got -- based on the way of the end point, you've got a month where the plan was down 2.88 percent. Fortunately, even net of all investment manager fees, that outperformed the benchmark slightly.

You know, again, I think moving through the managers, broadly at the allocation level again as of the date of this report, the overweight to equities did detract relative to fixed income, but again, if we were to fast forward to looking at this as of today, the overweight to equities again would've been contributory. So again, you're looking at this as of the end of the day on February 28th with market volatility with the situation changing week to week.

Particularly, we're looking at the shorter term as one month, one quarter. But I'll move through some of the active managers and point out some highlights. Pine Ridge, one of the newer managers, was funded towards the end of last year so they've really just got one full quarter in of performance essentially right on top of the benchmark. They are more closely aligned with that benchmark.

And you can see again from the corner the slow lag fees. With the small cap managers, you know, you can see some performance from Vaughan Nelson. You might recall that Vaughan Nelson is on the watchlist. They've had their own watch list for the last two quarters. Largely --

MR. SCOTT: Where should I be at?

MR. GOLDSMITH: I'm sorry, Donn. We're looking at --

MR. SCOTT: Still here? Okay.

MR. GOLDSMITH: We're just moving through these managers.

MR. SCOTT: Okay. I got it.

MR. GOLDSMITH: You know, Vaughan Nelson, their watchlist was really just tied to I would say a rough year of performance in 2016. They were pretty significantly overweight to the energy sector. They are a valued investor looking to commit to undervalued sectors that they view as attractive valuations. That was the wrong call and they underperformed their benchmark by 10 percent in 2016.

Now, that being said, they still did better in calendar year 2016; a positive 21 percent return. The benchmark was up 31 percent so I think that a 10 percent miss is not ideal. We prefer to see them, you know, miss on the upside and add value on the down side. That's positive to see they've done that. So far year to date in the down market as of the end of February, you can see down 3.8 versus the benchmark down 5 and for the last quarter down 2.6, you know, two percent higher than the benchmark.

So they do remain on the watchlist. You know, they had some -- again, I speak to 2016. I also speak to, you know, they had some selections issues through the first three quarters of 2017. That precipitated their addition. But they've exhibited, you know, I would say good performance in a volatile market since then. There's been no change to the team, their style.

And so again, we were going to leave them on the watch list for monitoring but this is the type of performance that we like to see from managers that are being highly scrutinized. When it comes to Eagle, again, this is the small cap growth manager. You know, again, they demonstrated nice outperformance when in strong growth markets. They've also demonstrated downside protection, at least in the month of February.

When it comes to international equity, again, you can see a bit of a greater negative absolute return. Here, you have down four or five percent versus three or so in the equity markets. Therefore, I would say it's a mixed bag of active outperformance and underperformance essentially right on top of the benchmark. You can see monitoring lags slightly, you know, for the month and the quarter. Harding Loevener, you know, slightly outperforming its growth benchmark, the MSCI, Etha growth. That's the second one under that component.

And then you have Rhumbline obviously as the passive component. And DFA Dimensional is the dedicated emerging markets manager. You know, fairly slight positive performance for the month, lagging by about a percent for the quarter and, you know, about a percent or so on the year-to-date basis of the plan and calendar year to date. Dimensional is -- I'll call it an enhanced index strategy.

It's a pragmatic portfolio, you know, run in part by some quantitative models and it's designed to generate a higher quality portfolio than the benchmark. It does have a bit of a value bias as a result. You know, they're looking -- really the models are designed to look for attractive pricing in the stocks that they have. And in a period where over longer, you know, the one year number certainly when growth stocks and sectors have outperformed, their value bias will be a detractor slightly.

But again, going back to sort of what sort of roles we're looking for here, you know, DFA generated a 26.6 percent net return in a period where their benchmark was up 30 percent. I think we again prefer to see defensive downside protection when markets are down even slightly.

MR. DIFUSCO: I know we talked about this briefly at the beginning, but it's also just important that that portion of the portfolio come May is --

MR. GOLDSMITH: Yes, thank you.

MR. DIFUSCO: -- will look completely different because you'll have Rhumbline assuming -- and I shouldn't be that presumptuous, assuming the Commission accepts the recommendation, you'll have Rhumbline, you'll have one index manager, and then you'll have one active manager.

So you'll have presumably lower fees, you'll have less managers, and you'll have an index manager and a core active manager. So less monitoring and hopefully lower fees and a more streamlined, simplified portion of that.

MS. REINHART: When are we voting on that?

MR. DIFUSCO: May. We'll bring in two or three candidates for folks to interview and ask questions, 20-to-30 minute presentations, deliberations, et cetera. We're going through the -- Alex and I are calling the lists down now, you know, to be more manageable. We'll do phone interviews and then bring usually three acceptable candidates in.

MR. AMMATURO: That's the same thought that we're going to have for small cap going forward actually. Right now, you have a value manager, Vaughan Nelson, and a growth manager, Eagle. The thought is kind of you're investing on both ends of the spectrum, you know, value and growth so why not hire a core manager that's going to have maybe characteristics of both and that would dampen the volatility and would definitely lower fees because you're moving a lot of assets to one manager as opposed to splitting assets between two managers. So that's coming as well.

MR. DIFUSCO: And we have -- it's not on here because they haven't been funded but we do have Rhumbline approved as a small cap index option. I know I talked a little bit with Rosemund too about the fees and I shared -- I've talked to Alex as well and I do agree with Alex. I've also talked about this before. I do find Vaughan Nelson's fee in small caps to be high.

MR. GOLDSMITH: Yes.

MR. DIFUSCO: I think 20 percent is high. Just by way of comparison, the three small cap manager -- well, two small cap and one mid cap that we have for large funds, one is 63 basis points, one is 81 basis points, and this Smith cap manager is 45. So being at one percent with a manager that has some volatility has I think exhibited some periods of underperformance as folks, you know, at the table are noting, I think looking for the core approach coupled with the index manager is probably appropriate. That's just my two cents on that.

MS. REINHART: When will that come up

for --

MR. GOLDSMITH: Well --

MR. DIFUSCO: The index is available.

MR. GOLDSMITH: The index is approved. I think given -- I mentioned that Vaughan Nelson has exhibited a pretty nice turnaround and performance the second half of last year and year to date this year. That is netted fees so that's netted at a one percent investment fee. That certainly is high.

You know, I think our recommendation is to maintain the current allocation but to fasttrack the issuance of that small cap RFP so that we can see what active managers are in the market, what sort of fees they are willing to propose, and perhaps, you know, hold a vote for that, not in May but it would probably be July.

MR. AMMATURO: The second half of the year, summertime.

MR. GOLDSMITH: I'll just -- really quickly to get back to -- this has been a theme that again was put in place when we started about two years ago. We've accomplished this in the domestic large cap. There was a value manager and a growth manager that was combined and replaced with Pine Ridge.

You know, again, we're in the process of doing that with international equity. I think that would be our recommendation for fixed income as well. So I don't know if there needs to be a motion to issue an RFP?

MR. DIFUSCO: If we're going to fasttrack it, yes, we traditionally ask for a motion before we approve an RFP.

MS. REINHART: Is that what you're asking?

MR. DIFUSCO: Please.

MS. REINHART: Oh, okay.

MR. DIFUSCO: I'm sorry.

MS. REINHART: No, that's okay. I wanted to make sure that's what you wanted.

MR. DIFUSCO: Assuming we're in agreement with that, we'd like to flow the small cap quarter of RPF and attempt to fasttrack it.

MS. REINHART: That makes sense.

MR. SCOTT: So there's a motion to flow the small cap domestic RFP. Is there a second?

MS. REINHART: There's a second, yes.

MR. SCOTT: A motion is made and properly seconded. All those in favor?

MS. REINHART: Aye.

MR. SCOTT: Okay. Thank you.

MR. GOLDSMITH: Again, that you for reminding me, Chris, that again the international equity component of this plan, you know, the changes are in process. And at some point when that decision is made and the contract is approved, these mutual funds, Mardrian, Harding, and DFA, will presumably be out of the portfolio.

I'll flip to the back of this and speak to the fixed income managers very briefly. You can see for the overall component within fixed income outperformance, you know, for the months, for the quarter, year to date and the overtrailing periods. That's again based not on the allocation because it's not taking into account just for the asset class only. But the active investment managers have incremental value, you know, in the intermediate term.

Largely through diversification and the addition of corporate credit that the Barkley's benchmark is really a government and agency security benchmark, adding the diversification and higher yield of corporates has generally benefited these managers. And then, you know, I think certainly the addition of some of the intermediate duration managers over the longer periods has been as well. So a more muted, you know, lower volatility is just inherent with fixed income so you can see it there.

MS. HOWARD: The performance on fixed income is really impressive. That was the first thing I noticed about this portfolio is all active management. I mean, this is a space where people fight over, you know, one or two basis points.

MR. GOLDSMITH: Right, exactly.

MS. HOWARD: So I guess my only comment is you've brought on some managers that are really proven especially in like interest rate volatility environments and finding out how to seek out tiny returns being short the yield curve which is hard to do. That's what Logan's Circle made a name for itself doing.

So, you know, I know that they're held to the investment policy statement of being 80 percent of the duration of the index but it may be worth just talking to them about what limitations they, you know, may put on their investment strategy, especially given, you know, it sounds like PFM's own predictions on interest rate volatility going forward.

MR. AMMATURO: We don't like to be in the business of interest rate movements to be quite honest so that's a very risky proposition. So we'd rather hire managers with risk we can get our arms around which is more like credit risk. So that's why we're layering high yield today.

That's why you have a corporate only manager. We really as a firm do not like to make bets on interest rates, what the direction of interest rates are going to be over the next one or two years.

MS. HOWARD: But Logan's Circle makes those bets and that's why they were brought on as a manager. So I guess what I'm saying is if you guys were to basically compare their public strategies, so their, you know, mutual funds with the SMA strategy and you see that the same SMA strategy that they're using to adhere to our IPS is very different from their mutual fund strategy, then that may suggest that, you know, we're not necessarily playing with their strengths and the value that they could deliver for us.

MR. AMMATURO: So you're implying giving them more rope to make the --

MS. HOWARD: No. All I'm implying is

that perhaps now we don't know if we are like limiting their ability to deliver on the short end of the yield curve with our IPS.

MR. GOLDSMITH: I can actually add some color there. So the IPS restriction applies to fixed income as a whole not every individual manager. So there are individual investment management agreements outside of the investment policy statement that govern things like credit quality, diversification, and duration guidelines.

So Logan's Circle, I believe -- I think they're typically wider than the overall IPS constraints so that allows for any one manager to take active bets on duration or sectors or even within equities against, you know, if you have a concentrated investment manager that wants to significantly overweight a sector or stock.

The constraint -- by having the constraints at the investment policy level, it allows for those concentrated types of managers and it still usually works out well because of the high indexing component, particularly within equities obviously, that the overall still looks similar to the benchmark but it allows for again those managers who do what they want to do.

MS. HOWARD: Yes, but there is no indexing in the fixed income.

MR. GOLDSMITH: You're correct. But I think it still allows -- I think you've got to be more let's call it defensive managers within fixed income. I think Garcia Hamilton, Weaver Barksdale, they are a little more conservative than their components and they have their power parts. They have less overweights to credit for corporates, et cetera.

So, you know, again, that allows the more traditional fixed income managers and you've got some -- a little more aggressive managers. PFM can allow for that again because the constraints apply to the allocation as a whole, not any one manager, if that makes sense.

MS. HOWARD: Okay.

MR. DIFUSCO: That being said, if you have -- when you review the -- well, you have reviewed it, but when you look at the IPS, if you have specific suggestions, concerns, things you want to talk about that you think that might be appropriate or that we should have a discussion about, by all means I'm happy to do that before the meeting and then if you'd like to have it as an agenda item at a future meeting if there's things in your opinion that should be discussed and tweaked, we should do that.

MR. GOLDSMITH: Just real quickly just getting back to Logan's Circle in general. I know that they have in the past made some correct duration calls and that's added value there. I think the rationale behind their recommendation in hiring in this plan was actually the superior quality of their credit analysis. They employed a large staff of pure credit analysts and that's their specialty, reviewing corporate credits much like an equity analyst would. So that's the role that we see them playing in this portfolio.

MR. DIFUSCO: The only other thing I wanted to add on to performance is just as an FYI that the total fund value as of this morning is significantly higher than it shows on the February report so before the markets open, we were just at under 555 million.

MR. GOLDSMITH: So, yes, things change day to day.

MR. DIFUSCO: Things change day to day.

MS. REINHART: Can we join this pension

plan, the City pension plan?

MR. DIFUSCO: Well, you know, it's funny that we're discussing the cash flows and such before. I mean, you have -- not to go too far down the road but you do have a little bit more -- I don't want to say flexibility, but in my opinion you can tolerate a little bit more volatility in this pension plan because this plan is only needing to draw about two million dollars.

I know it's a smaller plan but we only have to push out two million dollars a month. The City fund, which is obviously significantly less funded, we're pushing out anywhere from 60 to 70 million dollars a month in benefits. So when you have a massive hit, you know, it makes it that much more difficult if you're having to sell off assets towards the bottom, right, because that's money you're never going to get back. You're never going to -- when it bounces back like this, it's gone.

MS. REINHART: Right.

MR. DIFUSCO: So I think -- again, not to push for one strategy more than the other, but my own personal view is we can tolerate a little more volatility and we can give the cash flows the size and we'll be able to push out.

MR. SCOTT: So you're saying the value of the funds today --

MR. DIFUSCO: Correct, as of this morning.

MR. SCOTT: -- was 555?

MR. DIFUSCO: Correct. It's about a 12 million dollar, 11 million dollar swing in the value of nine, ten business days.

MR. GOLDSMITH: That's the end of my prepared remarks but I tend to -- I think seeing where we are, we've been very pleased with the performance of this plan over the last year, year and a half and even with the year to date now. So we continue to move ahead with the initiatives that we've talked about. And if there are any questions related to those, related to the investment policies statement, please reach out to Chris or reach out directly to us. We have to address those.

MR. SCOTT: So let me just ask a very simple -- this is a generic question. In terms of your crystal ball for this year -- last year was outstanding, right? So we can't duplicate that?

MR. AMMATURO: No. We're not going to

do that, no. But we're still -- as Alex already said, we're still bullish on the equity markets on a relative basis so that's why you see the positioning in the portfolio. If we were concerned about economic fundamentals and about the economy slowing down, about a recession on the horizon, the portfolio would not be positioned like this.

So we're still -- that's why you're overweight in the equity portion of your portfolio because the profitability is still strong. At the end of the day, profitability drives stock prices. So we can't sit here and say the stock market is going to be up X percent but we can sit here and say we're more bullish with the equity market than the bond market and that's why your portfolio is structured like that and you need that.

Obviously, incremental return, that's going to be generated from the equity market to reach your extra income which is north of 70 percent. But it's hard to say, you know, what the number's going to be. I'm not going to venture to guess that.

MR. SCOTT: No, no. Not what the number's going to be.

MR. DIFUSCO: That's not part of your

contract.

MR. SCOTT: Is there any new business that we need to address?

(No response).

MR. SCOTT: Then I guess there's a motion for adjournment?

MS. REINHART: Motion to adjourn.

MR. SCOTT: All right. All in favor?

MS. REINHART: Aye.

\- - -

(This concludes the hearing at 11:09 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 upon the foregoing matter dated March 14, 2018 and that this is a correct transcript of the same.

Amy Marzario
Court Reporter - Notary Public

(The foregoing certification of this transcript does not apply to any reproduction of the same by any means, unless under the direct control and/or supervision of the certifying reporter.