Retirement Plan Administration Commission Minutes

April 26, 2016 – 6:00 pm.
Administrative Conference Room
City Hall, 1930 S. Germantown Rd, TN 38138

MEMBERS PRESENT: Daniel Dent (Chairman), Alderman Rocky Janda, Sammy Jobe, Matt Keathley and City Administrator Patrick Lawton

MEMBERS ABSENT: Mayor Mike Palazzolo

STAFF PRESENT: None

ALSO PRESENT:
▪Bart Reid and Steven Francomaccaro with Gerber/Taylor Associates
▪Ralph Gabb

CALL TO ORDER

Mr. Gabb called the meeting to order at 6:07 p.m. He then called the roll and announced that there was a quorum.

CHAIRMAN COMMENTS

No comments.

GERBER/TAYLOR—CITY INVESTMENT POSITION:
a) Amended & Reinstated Employee Retirement Plan (Old Plan)
b) Defined Benefit Plan (Cash Balance)

Mr. Bart Reid of Gerber/Taylor Associates advised that this has been a bit of a frustrating period for diversified portfolios. He said investing in anything except for the S&P 500 and the Barclays Aggregate fund could cost investors a lot near term. Looking at the last nine months, the S&P is up by 1.5% and the BC Aggregate is up by almost 4%, given that the ten year treasury today yields about 1.7%. He further advised that the Russell 2000 is down 10%, International stocks (MSCI EAFE) are down 9%, MSCI Emerging Markets stocks are down over 12%. Hedge Funds overall did not do well being down -3.9% (Conservative Index) and -7.9% (Strategic Index), MLPs were down -27.4% and MSCI Japan were down-9.6%. Mr. Reid said fortunately, we have seen a little bit of a recovery in some of these different asset classes near term. In the April MTD, most of these are now outperforming the S&P, at least for the month that is. The Russell 2000 is almost up 3%, International stocks are up 3.5%, MLPs thankfully are now up 10.7% for the month and MSCI Japan is up by 6%; this indicates that diversification has started to work again. Referring to an allocation model of Germantown's retirement plan, Mr. Reid said that it is somewhat similar to the allocations of the some of the larger endowments over $1 billion which tend to be the best performers, long-term. Private Equity (21%) is essentially U.S. Equities, bringing the portfolio up to 34% for the endowments; the International Emerging Markets (19%) compared to Germantown's allocation to International is 17.5%. Fixed Income is at 7% versus ours which is 15% and Hedge Strategies are at 22% versus our allocation at 35%. Mr. Reid pointed out that most importantly is energy, labeled as Real Assets through the MLPs (5%). He stated that we are not trying to copy the endowments by any means; it gives us a little more confidence by knowing that we are not way off with crazy ideas in diversifying these different areas. Mr. Reid referenced a chart know as the "Clairvoyant" Perspective that shows seven different investable asset classes with very different risk and return parameters (i.e. stocks, gold, commodities, real estate). This chart gives an exact return of investment if you have the perfect knowledge or knew exactly what the market is going to do next year. In 2015, perfect knowledge of the market would have given us a 2% return. Reference to a second chart, the Agnostic Allocation shows what would have happened by taking an agnostic approach and allocating the same amount to all of these different asset classes; our return would have been -6.2%. Looking at the long-term return of the

60/40 mix of stocks and bonds that rate in the top 1% of endowments and foundations (better investors), should we just capitulate and index everything? Per Mr. Reid, no and the main reason why is because these asset classes are viewed as some of the most expensive and advantageous in today's market. Different valuation metrics include various price earnings, yields, book values and cash flow ratios; these are very expensive based on their histories of being in the seventh, eighth, ninth and tenth deciles. Mr. Reid said going back to 1926, we rank in the eighth decile of expensiveness today. The seven year return on the S&P 500 (dating back to the near bottom of the crisis) is approximately 17% with returns on average being about 16%; today, the average return on these valuations is 7.7%. Another metric to consider is based on the past four "Bear Market Lows" and "Bull Market Highs." Based on the valuation metrics Median Trailing P/E, Median Normalized P/E, Median Price/Cashflow and Median Price-to-Book averaged with Bear Market Low gives us a return of -33.9; the return to get to the Bull Market Highs is -7.7% . Mr. Reid stated that rarely is there a year in which the annual return equals the long-term return. He further stated that U.S. stocks measured by the S&P 500 are average while International and Emerging Market are at a pretty attractive place today. The 10-Year Treasury today is at 1.7% which is a historical and all time low; going forward, the only way to get a yield above 1.69% on Treasury is to have lower interest rates. If interest rates go up or stay the same the result will be a return rate of 1.7% or lower. With government bonds today, there is a 60% yield below 1% with about 30% resulting in a negative yield (not very attractive to bond investors). Per Mr. Reid, the most shorted stocks have actually outperformed the most long-held stock. In other words, the most unattractive stocks are up 6% while the more attractive stocks are up a little over 1% making this an extreme combination that does not happen very often. This type of outcome is somewhat driven by liquidations such as massive market moves within the first quarter and lowering the net position of the portfolio. He further explained that long-term, we have seen really good results from hedge fund managers—Forester Diversified long-term has earned a 5.7% return with roughly a third of volatility of the stock market capturing only 37.5% of the upside and 25.9% of the downside of the market. As for Alternative Investment Institutional, there was a 6.9% return with once again, approximately a third of the S&P 500 Index capturing 32.3% upside and 10.6% downside of the market. And lastly, there is Drake Capital Advisors yielding a 7.4% return and outperforming both equities and bonds with much lower volatility again capturing 44.0% upside and 22.7% downside of the market. Mr. Reid said that Government bonds, Corporate bonds, Large Cap stocks, Small/Mid U.S. Cap stocks, Municipal bonds, etc. are most of the traditional asset classes that have in the past 7 years done really well in a driven market performance. In today's market however, these all have proven to be very unattractive. Some of our more attractive asset classes today (past couple of years) include MLPs, Emerging Market stocks, Japanese stocks and Japanese yen. With a best or educated guess based on valuations, returns going forward seven to ten years show that the most unattractive asset classes will be U.S. Equities and Fixed Income; with low bond yields the expected return is approximately in the 4 to 4.5% range. Diversifying assets such as International Equities, Emerging Markets Equities, Hedge Strategies, Private Equity, RE/Real Assets and MLPs add significant value and has an expected return rate somewhere in the 6.5% range. Mr. Reid commented that diversifying works long-term but hasn't worked near-term; historically per Mr. Reid, we were at 65% U.S. Equities and 35% Fixed Income. Mr. Gabb advised that U.S. Equities were once even higher due to a shift of

Fixed Income. He said that since inception, we are now at 8.4% *and* a year ago we were even higher at 9.1%. Alderman Janda and Mr. Gabb both agreed that a different type of strategy should be considered. Mr. Reid said if Fixed Income is lowered than what it is today, there will need to be another defensive part of the portfolio such as hedge strategies. Issues will still exists as they did horribly these past nine months; although there for protection, they were down more than the market.

Mr. Reid then discussed performance. He started by saying that it has been somewhat frustrating so far being down by -1.1% for the quarter, almost 6% for the year and a period where the 60/40 was down only 1%. If the City would have only had 5% bonds during this period the fall could have been even worse. Mr. Reid re-stated that bonds are still not an attractive place to be however, they definitely serve a purpose as they were up by 3% last year. He further stated that the City's fixed income is divided among a short duration that won't have as much volatility with a rising interest rate environment and closed end bond selling which has added significant value to the traditional bonds. The long-term portfolio has done well with an 8.4% return; with lower volatility in the market, 88% of the upside of the market and approximately 75% of the down has been captured. Per Mr. Reid, in approximately 1,024 different defined benefit plans in this Universe, the City of Germantown ranks in the 68th percentile while the 65/35% ranks in the 30th percentile. As for asset allocation there was 5% in short duration, 5% in "core" bonds and then another 5% in 1607 which is a fund of closed end bonds that trade at a discount (approximately 15% at the time) to their NAV; simply put, bonds at $100 sell for 85$ which is pretty attractive in a very unattractive bond market. Mr. Reid advised that an allocation is made to the 1607 to take advantage of these type discounts which by now have largely gone away. He recommends that this allocation be cut in half and move approximately $1.5 million to our short duration fund which is the PIMCO Short-term Fund. He further advised that a yield of approximately 1% is what would be given up. Mr. Reid said his thought process going forward with bonds is that there is a risk of rates going up and with that, the potential return will likely be negative. However, if it is short duration bonds especially with a duration of zero, then there will not be much effect from a rising interest rate. He said that Gotham did very well over the quarter with a return since inception of -2.2%; compared to the global stock market over that same period of time, its down 5.2% proving they have done exactly what is supposed to be done which is to protect capital. Mr. Reid's recommendation that all allocations remain the same; $1.7 million of Fixed Income will be taken out of the 1607 Bond Fund and split between Metwest Total Return and PIMCO Short-term.

****MOTION****

Mr. Jobe made a motion to approve that all allocations remain the same and that $1.7 million of Fixed Income will be taken out of the 1607 Bond Fund and split between Metwest Total Return and PIMCO Short-term. Alderman Janda seconded and the motion passed unanimously.

Mr. Reid advised that although near-term performance for Harbor International has been per allocations for the quarter, it has been beneficial for the past three years but also has hurt performance because of a very small allocation to Japan (approximately 8%). Per Mr. Reid, allocating to First Eagle at the end of last year really helped out as well—First Eagle is now up by 4%, the EAFA index is down by 4.2% and Harbor over that same period is down 1.8%. The allocation for Japan with Nippon Value has worked out really well; at the three year mark, Nippon is up 4% and the EAFE is up 2.7%. Mr. Reid said probably the most devastating thing to happen near-term is the MLP allocation. Although we do not have a "view" of where the prices of gas and oil goes, we do know that contracts backing up to these MLPs, revenues, yield on the portfolios and businesses are *all* intact. Even if there is zero growth, the yield on this portfolio today is about 9%.

APPROVAL OF MINUTES

Mr. Gabb called for the approval of the minutes.

****MOTION****

Mr. Jobe moved that the minutes from the April 26th, 2016 RPAC meeting be approved. Alderman Janda seconded and the motion passed unanimously.

AMENDED & RESTATED RETIREMENT TRUST—City Projected Cash Needs (6 Months)

Mr. Gabb said that most of the funds have been kept for investment in an up or down market. We've looked at the City's cash needs over a six month period. *Projected* as of March 31, 2016, Cash on Hand was $809,849; April through June Retiree payments ($848,376) and Employee Contributions of $148,053 give us a *projected* Cash on Hand at June 30, 2016 of $109,526. Going forward per Mr. Gabb, a beginning Cash on Hand balance of $109,526 along with payments of ($1,696,752) for the months of July through December, 2016 will be paid to retirees. Also for this period, there will be $296,106 of Employee Contributions resulting in *projected* Ending Cash as of December 31, 2016 of $50,000. Mr. Gabb recommended that the City currently sell funds in the amount of $1,341,120 which then would be re-allocated by Gerber/Taylor Associates in order to meet the City's required targets.

****MOTION****

Chairman Dent made a motion to approve funds in the amount of $1,341,120 be sold and then reallocated by Gerber/Taylor to meet the City's required targets. Alderman Janda seconded and the motion passed unanimously.

OTHER BUSINESS

Per the Board of Mayor and Aldermen, the Retirement Plan Administration Commission is obligated to meet once a quarter. Mr. Gabb stated as this is the fourth quarter, it is recommended that this body not meet again until the fourth quarter; if we were to meet next month, it is possible that duplicate material will be covered all over again. It was Mr. Gabb's suggestion that Gerber/Taylor furnish material (electronically) to Commission members in the meantime.

****MOTION****

Chairman Dent made a motion to meet in the fourth quarter and for all related material to be electronically furnished to Commission members until then. Alderman Janda seconded and the motion passed unanimously.

ADJOURNMENT

Having discussed all items on the agenda, Chairman Dent called for the meeting to be adjourned.