POLICE & FIRE PENSION INVESTMENT BOARD

May 14, 2020

Summary Minutes

The information in these meeting minutes is intended to assist Police and Fire Pension members in understanding the activities of the Investment Board. The information is not intended to provide investment or financial advice to any individual or organization and should not be relied upon for that purpose. While we attempt to keep the content accurate we cannot guarantee that all information is current, accurate or complete.

Members present: Doug McDaniel – Human Resources Director (Board Chairman)
Brandon Kauffman – Finance Director
Becky Ferguson – Mayoral/Council Appointment
Steve Hubka – Mayoral/Council Appointment
Greer McCurley – Mayoral/Council Appointment
Steve Niemeyer – Police Electee
Guy Pinkman – Fire Electee
Eric Augustin – Fire Electee

Members Absent: Matt Franken – Police Electee

A quorum is any five Board members.

Human Resources Staff: Paul Lutomski – Police and Fire Pension Officer

Others present: Dale Connors, CFA – Ellwood Associates

Unless otherwise noted, meeting materials were provided to Investment Board members in electronic format, or printed format, a few days preceding the meeting for their advance consideration.

Documents:
Agenda
April 3, 2020 draft meeting minutes
U.S. Bank quarterly fees from inception 3Q2014 to 1Q2020
Elwood quarterly fees from inception 1Q2014 to 1Q2020
Ellwood 1Q2019 Performance Report
Ellwood April 2020 Preliminary Update
Ellwood Asset Allocation Study and High Yield Manager Recommendation

Doug McDaniel calls the meeting to order at 2:00 pm.

Doug McDaniel asks for a motion to approve or amend the April 3, 2020 minutes.

Becky Ferguson moves to approve the minutes.

Steve Hubka seconds the motion.

Doug McDaniel calls for discussion, there being none, calls for a vote.

All members vote in favor.

Doug McDaniel calls the for next agenda items, the US Bank and Ellwood fee amounts.

Paul Lutomski reviews the quarterly invoice amounts paid to the plan's directed trustee, US Bank, and the quarterly invoice amounts paid to the plan's investment advisor, Ellwood Associates. The amounts are as expected according to the agreements with each.

Doug McDaniel calls for the next agenda, the 1Q2020 Performance Report.

Dale Connors provides a Markets Review including a discussion that stocks declined on Covid-19 fears. The first death was in China on January 10. From Feb 19 the S&P 500 lost 34% in the next 23 trading days. The US cut interest rates, implemented stimulus plans and passed CARES act providing $2 Trillion of support for individuals and businesses. $2T is about 10% of the US GDP. Equity markets had the fastest decline and highest volatility since the great depression. A 30+% drop has occurred seven times since 1928 with the average recovery taking 6.7 years, 3.6 years if the great depression is excluded. Credit spreads widened with below investment grade bonds having the widest dislocations since 2009. Unemployment claims for the last two weeks in March numbered 10 million. Now the number is 30 million. U.S. monetary response was fast and varied. It included cuts in rates and backing for many credit markets to relieve banks, corporations, small business and consumers.

Dale reviews the pension asset allocation vs targets, noting allocations are within policy ranges. Cashflows are reviewed and noted as similar to other mature pensions with outflows the norm. He reviews the return of the portfolio. Market value dropped from $260M to $225M during the quarter. Asset return was a -12.5% for the quarter, but the plan performed in the top 25% as measured against peers. Total fund performance compared to index are reviewed for quarter, FYTD, 1, 3 ,5 and 10 years. The Policy Index was down 13.8%. It calculates a return as if plan's assets were invested in indexes per the Investment Policy targets. The Actual Allocation Index was down 13.5%. It calculates a return as if the actual amount of assets were invested in their corresponding index.

Asset class and manager performance is reviewed. It is noted that manager Parametric Defensive Equity strategy does not work with the high levels of volatility experienced recently in the market.

Equity returns are reviewed. Growth performed better than value with value index down 27% and growth index down 15%.

The April Preliminary Performance Update showed some recovery with the S&P 500 up 12.8%. The Russel 3000 value index was up 11% and the growth index was up almost 15%. The total portfolio was up 6.4% in April, putting the Fiscal YTD return almost flat with 4 months left in the fiscal year. Asset allocation vs. target policy is reviewed. Cash flow is reviewed. Market value increased $225M to $241M. Asset class performance is reviewed. Fee schedule for each manager shown individually and in total was 0.58%.

Referring to the Asset Allocation Study.

The objective of this study is to invest assets with the lowest risk for any given expected return. The plan's current assumed return is 7.45% and scheduled to decrease .05% each year until attaining 7.25%. The current asset class target percentages and ranges are reviewed. 10 Year capital markets assumptions are discussed noting these assumptions were updated several times in the last few months due to changing market conditions and expectations. Only two asset classes are expected to return above the plan's 7.45% return assumption. Factors considered in developing the equity assumptions include expected earnings and GDP growth, share buyback trends, current and expected dividend yields, projected multiple expansion or contraction and inflation expectations. Fixed income factors include interest and currency expectations with yield, duration and convexity. Alternative assets factors include correlations and return premiums relative to public markets and overlays from research.

Current target asset allocations are not expected to earn the 7.45% assumed return rate, therefore other allocations were researched. Ellwood cannot support the 7.45% assumed return target. More risk acceptable asset class allocations are presented for the lowest risk portfolios with expected return of 6.75, 7% and 7.25%. Volatility and probability of earning at those rates are explained. An Efficient Frontier is shown that graphs the current and new target portfolios. A Volatility Risk Analysis show a plot of the standard deviation (SD) for each asset allocation scenario. 6.75% return with 9.23% SD. 7% return with 10.34% SD. 7.25% return with 12.49% SD. The 7% target mix has a 50% probability of earnings above 7% and an 44% probability of earning above 7.5% over the next 10 years. The 7.25% target mix has a 52% probability of earnings above 7% and an 47% probability of earning above 7.5% over the next 10 years, but would require maximum allocation into the two asset classes with expected returns above the target and minimum use of other asset classes.

Ellwood's proprietary asset allocation process is presented.

It is recommended the 7.25% allocation mix with more diversification be adopted. Specifics are detailed in a recommendation table showing how the current targets are changed to new targets. The table includes the elimination of the defensive equity subclass and the addition of a fixed rate high yield bond subclass.

Dale Connors presents The Case for Credit Strategies detailing outsized dislocations across liquid credit markets due to Covid-19 markets shocks. The number of corporations with bonds issues trading as distressed levels is the highest since 2009. The profile of market cycles and phases of a distress credit opportunity set are discussed. Basically, the early phase is dislocation. The mid phase shows liquidity and function returning to markets. The late phase is mostly business as usual.

The special case for High Yield Corporate Bonds is discussed as resulting in favorable valuations relative to history. Investing at high yield at current levels have historically given an outsized positive return over a 12 month period.

Dale provides information on BlackRock's High Yield Bond fund. He recommends adopting the asset allocation changes that include eliminating the defensive equity asset sub-class and reinvesting the proceeds into the BlackRock's High Yield Bond fund.

The Board members ask questions and discuss regarding investing in high yield bonds and BlackRock.

Doug McDaniel asks for a motion on the recommendation to change the asset allocation targets.

Guy Pinkman makes a motion to adopt the asset allocation changes as shown in the recommendation table on page 13.

Steve Niemeyer seconds the motion.

Doug McDaniel asks if there is any further discussion.

There being none he calls for a vote.

All members vote in favor.

Doug McDaniel asks if there is any further discussion or a motion on the BlackRock recommendation.

Guy Pinkman makes a motion to sell all holdings of Parametric Defensive Equity and reinvest the proceeds in BlackRock's High Yield Bond fund.

Becky Ferguson seconds the motion.

Doug McDaniel asks if there is any further discussion.

There being none he calls for a vote.

All members vote in favor.

Doug McDaniel asks if there is any new business.

Guy Pinkman states he would like a special meeting in about a month to discuss Private Credit. It is agreed to have this meeting.

Doug McDaniel adjourns the meeting at 3:16 pm.