Lower Saucon Township
Pension Advisory Committee Meeting
March 11, 2010
Minutes

Roll Call:

Present: Molly Bender, Michele Hirner, Priscilla deLeon, Council Liaison; Mary Curtin, Jack Cahalan, Township Manager; Cathy Gorman, Director of Finance; Lou Mahlman, Township Representative who is also the Township Controller; Peter Butera from Merrill Lynch filling in for Chris Cap. The time was 11:09 AM.

1. **MRT Report – Peter Butera** – Peter said if you have any questions, please ask. Usually the interaction and the questions are the best part. He will go over the last two years, and then go up to the present. If we start on the right hand side, he put the whole plan on one sheet of paper and highlighted at the top for 2008 and 2009. The last time he was here in 2009, the markets were still dramatically lower in 1Q09 and there was a lot of concern. If you look at 2008, you can see we had interest and dividends of $4 million and the investments dropped by $30 million. We lost about $26 million in 2008, which was a negative 18.16 return. In 2009, percentage wise, we gained 19%, which sounds great and sounds like we gained it all back, but it doesn't work like that. Mathematically, we recouped about $20 million. We're still down about $6 million from where we were in 2008. Cumulatively from 1997, we're up about 100%, which over a thirteen year period if almost 7% per year. The plan has done very well long term. You can see $37 million in interest and dividends and $16 million in principal growth, which is about $53 - $54 million in cumulative growth. Jack said Lou is new to this so maybe you can explain to him about the PSAB. Peter said PSAB runs a pension plan for any borough who wants to join. There are about 400 some boroughs in Pennsylvania and 210 of them are in this plan. We are a township, so we can still be in this plan. You don't have any cities, but cities can also join. Merrill Lynch serves as the consultant, the advisor. What they do is help draft the investment policy statement which says we could invest in, what we can't invest in, what should be in stock, what should be in bonds. He went over that in great detail a year ago and made changes to it. They haven't made any changes in the past year. They also help PSAB pick and choose who manages the assets. They don't manage the assets, they hire outside managers. Those managers have independent contracts with PSAB, so they don't work with Merrill Lynch, they work with PSAB. You kind of have a separation of duties. Merrill Lynch serving as the custodian of duties and consultant and you have the managers managing directly with separate contracts with PSAB and you have PSAB serving as the administrator. They do all the accounting, the referral, make sure the actuarial studies are done, the audits are done, and any recording with the state is done. That's kind of physically how it works. Priscilla said at one of the meetings, was not a very good meeting as the market was really bad. Now we're getting monthly reports that Cathy is emailing. If anyone sees anything they want to ask about, they don't have to wait until the quarterly meeting to ask a question. Things are going back up, which make our meetings more pleasant. Peter said PSAB themselves gives Lower Saucon their own monthly report, your actual pension plan, what it grew, what it didn't grow, it's all on there. Priscilla said Cathy is the resource person. Peter said on the sheet behind that, you can see what the world did in 2008. The standard cores index, which is the stock market, lost 37% and in 2009, it came back 26%. Mathematically, we're not anywhere from getting back to being even, but it increased in the right direction. We need to have a balanced account because we're almost half in bonds and balance accounts dropped 26% in 2008, and again, if you look at that sheet, we dropped 18%, so we did protect on the downside and the balanced accounts went up 23% on average and we went up 19%. What do we see going forward? Earnings for a corporation are going up significantly and are very, very profitable and it's due to layoffs which are the bad side of the economy, unemployment, but it's made corporations extremely lean and profitable now. We are having economic growth. Inflation - there is no inflation. We feel that is going to continue. A big factor of inflation is labor costs, and with the high unemployment rate, there are no labor increases. There's no benefit increases, no salary increases. As a matter of fact, there have been take-a-ways. Interest rates are extremely low right now, the lowest in our country. They are going to go higher. It's not a question if they will; it's a question of when. Federal Reserve, which got us through the banking crisis in 2008, they did a lot of thing to help the crisis and they are doing a lot of things to undo those things now.

Basically what they did was buy a lot of bonds and they pumped a lot of money into the system. They are now selling those bonds which are taking cash back out of the system. That's been going on for months and months and months. The Federal Reserve doesn't get a lot of press, but they are shrinking their balance sheet. That is the first step. The second step is they will actually start increasing their interest rates. They kind of did that a couple of weeks ago as they increased one of their rates which only affect banks. Banks need to borrow from them at a discount rate and they increased that discount rate to 1/2 %. That is another step they took. In the next couple of months, you are going to see them take more steps. Interest rates will be going higher. Because of the profitability in corporations and the interest rates going higher, which is a negative for bonds, stocks should be better in cash investments going forward. The next page, we talk about allocation, how much we have in stocks and how much we have in bonds. He encourages you to read this article as it really talks about what he does for a living and basically asset allocation through your investment policy statement is more important than what stocks and bonds. Asset allocation is going to dictate about 90% of your results. Take a look at that article. The next chart is rolling ten year periods in the stock market. If you look at the low dot on the left, that is the great depression and it was the 30's. It was the first time the market was ever negative for a ten year period. In the middle circle is 73 & 74 and that was the last bare market until now. That was when Jimmy Carter was President and we had the oil embargo, coming off the Nixon administration, a lot of negative things were going on. The stock market didn't go negative, but it was about break even for ten years. The decade of 2000 to 2009, you had the tech bubble burst, the Iraq war, the recession of 2001, which was triggered with the 911 attacks, and then you have the OA banking crisis and the dramatic drop in the market. For the last ten years, the S&P is a negative 1% per year. We are lower today than we were ten years ago which is hard to believe. A lot of people talked about the stock market average growth rates of 10% per year. That's the mean line right across the middle, but you can see how many years we are below that and how many we are above it. These boxes in the center with the ten years averages, 1939 to 1949 and 1940 to 1950, these are the ten year periods after the Great Depression and the average returns were between 9% and 17% for those decades. After the 73, 74 bear market, you have the average returns between 15% and 17% per year. When you drop that low for a decade, you have to compound dramatically higher to get back up to the mean average. Why does he say this is the good news? We're so far below, we have to compound an excess of 10% per year for the next decade to get anywhere near the average. The next decade should look much better than what we already looked like at the last decade. When you are in finance classes and they talk about the 10% average, it's not an accidental average, it's basically, historically, it seems to be in our country, and corporations could grow their profits about 8% a year. Normally they pay out a cash dividend of 2% per year. The 8% profit growth plus a 2% payout equals your 10%. The 10% is a meaningful figure of which could be achieved over a long period of time. Obviously, we are talking decades now. To him, that is the good news. On the left hand side of the packet is the update through the year. This is through February 28, 2010. The bonds are up to $136 million now. We're at negative 0.31%, so we lost a fraction of a percent this year so far. He did want to point out a couple of things. One, we do have an allocation alternative investment and they are up 1%, so they are doing their job in a negative stock market. They protected last year on the downside and now they are protecting again this year. Going right above that, we have two different sleeves. We have a core bond which is maturities between five to twenty-five year bonds. Then we have a short term bond for $5 million which maturity is basically twelve months out, the most is five years. Those managers are doing much better than their index. They've done well for us throughout the history of the PSAB. This platform that he's been describing goes back to 1997. They've actually worked with PSAB since 1989. They only have the data and formats since 1997. These bond managers have been with them since inception, a long time. The international managers, they have an allocation of national stock. They are more conservative managers and that's why he highlighted them. The international stock actually dropped 5% this year. Priscilla said several years ago, when did we start using you? Jack said 2003. Priscilla said prior to that, we didn't have advisors. Jack said there was an investment firm. After that it was Smith Barney. Priscilla said we weren't happy with what was in place because people that sit on this board really were uncomfortable making these decisions, so that's why we got them involved. It has worked a lot better. Molly said they had representation with the bank; they just didn't have all of the investment opportunities as we do now. They were limited. Priscilla said we are much happier now. Jack said the Council also adopted and brought together some consultants who were on this committee and they put together the investment policy. That's something Council adopted prior to going with PSAB. What we discussed last year is PSAB has their own investment policy that they follow as far as how they invest the member allocations. Last year, this group voted to go with that investment policy as it's basically similar to how we operate. The allocation, the split between stocks and bonds, all those types of things are in the PSAB investment policy. Peter said there are actually two differences from his policy to your policy and that's because your Township was a few years older. They have an allocation of international stocks, which you do not and they have an allocation to alternative investments which are investments other than stocks and bonds. Those are the two differences. Priscilla said this committee makes recommendations to Council for the final decision. She's the liaison to Council. If you go to the February report, look at Asset Allocation, he highlighted on the left side of the pie chart, the international. They do have 10% international stock which was lower and they just added to it. When the market started to recover in 2009, they added a little bit more in stock to get away from bonds. As interest rates go higher, our bonds are going to do poorly and under perform. The alternative investments are 5%. They have not added to that, it's kind of their core. The percentage their are looking for is kind of high at 4%. The next page is the Asset Allocation Rebalance. On the right hand side, we always have the investment policy ranges. The investment policy statement itself is probably about 20 pages long. It has a lot of detail on what the managers can and cannot buy. The key thing for them is to stick within their targets. If they drop down to Total Equity, their target is 55%. They can never go above 65%. If the stock market, like in the tech bubble was doing dramatically well, before the bubble burst, if their stocks grew to 70% in our portfolio they would be forced to sell stock. It kind of keeps you in parameters so you can't get outside of the box. That's where risk comes in and you could have accidents. That's really why they only lost 18% in 2008. When he goes to these meetings, he's actually more proud of 2008 than of 2009 as they lost 18%. If you look at other portfolios, a lot of them lost close to 30%. If you look at the orange column, they are targeting about 40% and that's where they were in 2008. That's what protected us as we had about 40% in bonds. We are positioned for bonds to do worse and stocks to do better going forward. They haven't really changed their cash levels or their alternative investments much. That pretty much stayed the same. For the year, we increased stocks about 4% and decreased bonds 4%. That's really the only changes they've done in the last year. Mary said how often do you do that? Peter said as needed. We could call for a conference call with the Trustees if we feel a need to. They have a conference call scheduled every quarter or every three months. They've been doing it monthly, now they are doing it every two months. They'd done it monthly because of the crisis. The last page is the indexes. You can see that the stock market is down about 6/10th of a percent. The international stocks are down a full 5%. Bonds on the whole are a positive 1.8%. If you blend your mix, most portfolios are slightly negative just like yours - .3% negative. It's changed already. The stock market is up about 2% today. This portfolio is at positive 1% also. He likes to have the exact numbers of where we are at. Mary said do you see this upward movement continuing in the next decade? Peter said yes, it has to, to get back to the norm. If you think about our economy is bigger and larger. It's harder and harder for the U.S. economy to grow 10% a year. It will grow at a slower rate, maybe 8% compounded per year. He's talking about interest rates going higher. A ten year treasury bond is at 3%. It may go to 4%. The alternative is a 4% to 4-12/% versus an 8%. That's why you want stock for longer term. Calpers, the biggest pension plan in California, they lowered their actual real assumption to 6-1/2%. Ours is around 8%. When he saw Calpers did that, he was pleasantly surprised because we are not going to grow like we used to. Jack said there's an article you must have seen about corporate pensions going more to bonds. The corporate pension plans go more to fixed, long term which is lower returns whereas the state pension plan is going to more riskier types of investment in order to hit those 7% or 8% returns. Peter said the two things he would pick up on that article is there's very few pension plans left on the corporate side. The ones that are left are just trying to lock into liabilities. He would disagree on going heavier on the bonds as it's not going to work. He doesn't think it's right either to take more risk to get to your higher actuarial assumption. When you have a balanced portfolio, it should be 60% stock, 40% bond. If you start changing that, you are going to start going outside your parameters. Instead of a negative 18%, you will have a negative 30% if you start fooling around with that mix. The actuarial assumptions have to come down and contacts and promises are going to have to be changed. That's his opinion. Mary said 8% is too much. We're not getting it. She asked what needs to happen in order for that actuarial assumption to change? Peter said the Trustees of the plan have to agree to it. They've been talking to the Trustees, and they have to agree to it. He's not sure, but each Borough and Township has to adopt it also. Cathy said our board would have to make a recommendation to lower the assumption value and get it approved. This was discussed before regarding actuarial assumptions. When Chuck started, he said in a couple of years we should start looking at our assumptions. Priscilla said can we do it without all the other people? Cathy said yes. Priscilla said it would be costing the taxpayers more money and she would have a problem with that. Cathy said you are changing the promises and she doesn't know if you have to change the contract promises with your employees. You have to cut the benefits. Look at Social Security; they went from 65 to 67 years of age. You are going to see that again. They are going to increase the age, reduce the benefits and increase the payroll. If you think about it, Social Security is a federal pension. Mary said she'd like to see 8%. Peter said he'd like to see 8% also but doesn't know if that is realistic. Jack said the article is talking about state pension systems going into riskier investments to hit that target that Peter is talking about, the 8% return. They don't even mention Pennsylvania in here. Mary asked if Chuck finished the latest analysis of the pension fund? Cathy said Chuck has and it has been filed this year. The Executive Officer has to sign it and file it by March 31, 2010. It's done, it's already in. Mary said does the report go to Council? Cathy said no.

2. **<u>Vacant seat – replacement announcement</u>** – Cathy said our vacany has been replaced by Lou Mahlman.

3. **<u>AG 385 Filing</u>** – Cathy said the AG 385 has been filed and it was filed on time. AG 385 is filed with the state and they base their unit value on those reports. Once all the municipal governments file, they assess and determine how much we get in state aid every year.

4. **<u>Killed in Service Insurance Update</u>** – Cathy said we still haven't got a response from the police association. The State has required that we carry a policy on the uniformed pension plan in the event an officer was killed in service. A death would deplete the pension because the benefits of killed in service is a large amount. That started in 2003 when state legislation was passed for an officer killed in service. The state has now passed a law stating they will cover those costs. It was around the same time Act 44 came out. There were issues with the Social Security offset, but basically the state was going to pay for the pension of any officer that was killed in service, and in that way the pension plans wouldn't be harmed. This was a negotiable item under our uniformed contract and we still haven't gotten an okay from our union. Jack said the police association works until the FOP, which is state wide represented by the Lightner Law office. They asked us to give them a draft of how we would revise the pension ordinance of the uniformed plan with the language to change this. We did that and he thinks they are clearing that with Attorney Tony Caputo. We haven't gotten a response back. When they do, they have to take it to Council for an ordinance change and that will remove our responsibility to continue this insurance policy. Cathy said the insurance is about $3,700 a year.

5. **<u>G. Williams – COLA increase effective 03/01/2010</u>**

6. **<u>V. Koszi – COLA increase effective 05/01/2010</u>** – Cathy said retirees can receive cost of living increases (COLA) up to 30% when they retire and it was a year and a half ago when it was established that COLA increases would be dependent upon the Social Security index. Our actuary sent us notification that the percentage amount of Social Security index that we send to our representation of PSAB, to notify them that the officers increases are a certain amount. We received two of them. Williams was effective 03/01/2010 and his COLA was increased to .1%, so now he's at 7.2%. Koszi's as of May 1, 2010, his total was 3% as he just retired last June. Jack said the difference is due to their retirement date. The actuary asked if we could do it January 1, but that was discussed with this group

and the police wanted to keep it in line with their anniversary date. That's why you'll see different effective COLA dates. Cathy said we had four uniformed officers retire in the last four years.

7. **Financial Reports** – Cathy said the reports are a list of the checks that they paid for administrative fees. PSAB sends us our monthly statements. This is just to advise the board the fees have been paid. The Township pays them when we get a statement from PSAB. PSAB takes it out of the fund and the Township reimburses the fund as quickly as they can.

8. **Settlement Filings**
   a. **Marvell Technolog Group (Feb. 27, 2003 to October 2, 2006)**
   b. **NTK Holdings Bankruptcy**
   c. **Stone Energy Corp. (May 2001 – March 2006)**
   d. **Quest Software (November 2001 – July 2006)**
   e. **Marsh & McLennan Companies Inc. (October 1999 – October 2004)**

   Cathy said as she told you before, she would list any settlements that we'd be getting which is basically anyone who has a lawsuit from the SEC. Occasionally, we do get small amounts of money. All of these companies had our pension plans listed as a stockholder at one point. Whoever was handling our accounts at that time was responsible to do the paperwork that needs to be filed with the SCC. We did get payment from NTK and it had been deposited.

9. **Approval December 16, 2009 meeting minutes** – Jack said if the minutes are approved, they go under the Finance button, under Pension Advisory Committee meeting. Cathy said if there are no corrections, they will post them on the website.

   Cathy said she is emailing everything over to Scott, all the minutes and all the papers handed out and when the Police decide to appoint someone over there, she will let everyone know. Hopefully Scott is letting the rest of them know.

10. **Set date for next meeting – June 9th at 11:00 AM**

11. **Adjournment** – The time was 11:55 AM.