Lower Saucon Township
Pension Advisory Committee Meeting
March 18, 2009
Minutes

Roll Call:

Present: Jack Cahalan, Township Manager; Priscilla deLeon, Michelle Hirner, Mary Curtin, Molly Bender, Fran LaBuda, Cathy Gorman, Chris Cap from PSAB Municipal Retirement Trust; Peter Butera from Merrill Lynch; and Vic Koczi, Police Pension Fund Representative. The time was 11:06 AM.

1. **MRT Report – Chris Cap** – Chris said he wanted to go over your net asset statements which were just mailed out two days ago. Through February 28, 2009, our markets did pull back a little bit more - the first two months of this year, as reflected in your income and dividend, and unrealized losses for the year. If you look there, the non-uniform plan year to date is $753,208.13 through February 28. The police pension plan sits right now at $2,885,644.07, through the period ending February 28, 2009. There isn't much activity on the statement. State aid doesn't come in until September or October. For the most part, a very challenging year. Peter is here to talk today about some of the economic points. Our Board of Trustees is meeting on Friday through Saturday at the Hershey Lodge for a conference and there are going to be some pretty hot topics up for discussion. He doesn't foresee any major changes to the portfolio, but there have been some changes to the investment policy statement which Peter will touch on today. We are trying to make some adjustments in this tough economy and we do have the Endowment Fund coming in and Wedge Capital Bond manager coming in on Saturday. We continue to have dialogue with each of the ten manager's we have employed. It's a very tough period, and we are trying to monitor it. We increased the frequency of our conference calls to once a month. We have full participation from our Board. We try to monitor every little development. Right now the news has significant impact on you and we are trying not to get too hostile in the way we approach the portfolio. We try to monitor it day by day.

Molly asked if we could get a time schedule to see how long it will take to make up the $313,000.00 loss from last year? Is there anything being done? Chris said if you look at last year, the Dow Jones Industrial lost 35%, and S&P lost 38%. Molly said nothing has been changed, and we haven't been put into anything safer. Chris said you do have that option. There is risk exposure involved any time you have exposure to equities or bonds, for that matter. Last year, a fixed bond was 5-3/4% for the full year, which was 100% invested in bonds. Treasuries was the only asset class to be in last year. Thirty of the thirty-one asset classes in 2008 were down. There weren't really any places to make any money last year. We lost 19-1/2% last year on your balanced account. As compared to the S&P and the Dow, we try to beat the market by at least half, which we did. The state employer retirement system lost 28.3% last year. The school employer retirement system lost 25.4%. We lost significantly less than other plants. Are we proud of that? We've done our job in the case of benchmarks, and never like to show red numbers in our statements, so the $312,000 you brought up, he can perfectly relate.

Mary said as Molly asked, is there a way to recover? Chris said yes. Priscilla said when is that recovery going to happen? Michelle said will this be a factor for the employees to contribute because we are losing so much money? Chris said it will depend on demographics later on. If you opened the newspaper on January 1, 2009, and if you looked at all the mutual funds for a twelve month period, all of them have losses unless you were in a bond portfolio. We're trying to make sure your portfolio right now is positioned. We're prepared for that upswing in the market - when, and if it comes, but in the meantime, we are losing. The general concept is buy low, and sell high.

Vic said is there a way to take the $2.8 million we have now and put it in a safe spot? Chris said what we did for you last year was actually increase the bond holdings to 52% and still maintained a 44% allocation in stocks. That still wasn't enough for that downturn. Mary said that was a lot in stocks.

Chris said yes it was, but it was significantly lower, a more conservative posture than in previous years. In previous years, we've been up to 70% in stocks.

Mary said why didn't you take some money out and convert it into cash as we're going through this downturn? Peter said we did. October 07 was the highest and it was at $14,000. We didn't have any of these conversations in October of 07. When things are an all time high, we didn't need to be more conservative and pull back, but now that things are at a historical low, when we go through the information, it's the lowest point in the history of our country. Now we need to be more conservative and pull back. It's all hindsight. Priscilla said right now it's not all hindsight, we're in it. We need to do something. Mary said she's not saying hindsight, she's saying two months ago. Peter said since October 07, we've been shifting stock to bonds. Back in 07, the plan was about 60% equity, 40% bonds. Now it's reversed. The key thing you have to remember your actuarial plan is now based on a 7% growth rate. There are only three financial investments you have a choice of. Keep the money in cash, historical return on that is 2%; put it in guaranteed bonds and the historical return on that is 4-1/2%, or put it all in stock and the historical return on that is about 8-1/2%. Those are your three choices. Molly said we lost 19%. Mary said she would think we would want to preserve and if you look at 8-1/2% as a historical return, 4-1/2% in bonds, or 2% in cash you are still retaining your complete principal. Peter said for a pension plan, you can't average 7%. Vic said you are guaranteed 4-1/2% right now in bonds and stocks, but we are losing. Peter said your hindsight. Vic said that should have been seen months ago when we started to lose money, and yet, instead of moving all that money we are losing out of stocks into bonds, where we're guaranteed 4-1/2%, instead of losing 17%. He moved his money and got rid of stock. Peter said what was your average return last year? Vic said he started losing a lot each month and he had to change. Peter said that's the problem. You start talking to people and they can't tell you what your return is. He can tell you what your return is last year, he can tell you what your return is through February. Vic said looking at the reds, we're not getting much of a return.

Chris said if we did take all the money out, even in hindsight, and put it all into 4-1/2% bonds, and suppose the market did recover significantly, and if other portfolios that had stock exposure had 8% or 9%, two years from now, you would likely criticize us for not taking enough risk and not meeting the assumption rate you have for your pension plan, and therefore, Lower Saucon Township would have to reach into their own pockets or go back to the employees or the taxpayers. Michelle said that's what's going to happen. It's not fair to the township or to the employees. We're losing too much money. Chris said exactly, but if we took an ultra conservative approach, you run the risk if there was a recovery in the stock market, we could lose out in some significant gains. That's the difference. Michelle said we didn't. Vic said wouldn't it be more feasible to secure your money in something that you'll guarantee 4-1/2% and as the market starts to rise, then you start sinking that money back into stocks and hope it continues to rise. Peter said when is that time? Vic said you are the guys that do that stuff. He's just asking as to why we're paying $2,000 to $3,000 a month for you to manage the money and you aren't doing a good job of managing our money. Our pension funds is losing money, and we're in negotiations right now and are being asked to give more of our money to contribute for it, plus we're being asked to pay for some other things. He has a deferred compensation pay which is $80 a pay and he's thinking about stopping and putting it in his pocket because it's getting blown away as soon as he puts it in there. Chris said he can assure you that 90% to 100% of all police departments in the country, not just PA, right now, are in a position inside and outside of this pension plan, regardless of the who is managing the money, are being asked to contribute for health insurance as well as for their pension plans. Right now the earnings are simply not sustainable. No money manager out there anticipated when they woke up January 1, 2008, that Fannie Mae and Freddie Mac would collapse; Leeman Bros. would collapse; AIG would collapse; nobody knew that Bear Sterns would collapse. Molly said when they all started to collapse, maybe that was the sign we should have started to move our money.

Chris said Warren Buffet lost 10.5% last year, and he's the smartest investor in the world. You do have an option, Jack, if you wanted to – the other choice is to convert into our fixed fund, which are 100% bonds. The danger to that is when the upswing comes, and two years from now, if there is an upswing, we would be subject to criticism why didn't you shift them into stocks? We do give you that clear choice between the two vehicles. Jack said what are we talking about. It sounds that the group is talking about what they are willing to do. This is an Advisory Committee and makes recommendations to Council, and Council makes the decision towards the investment policy, on how the money should be invested.

Mary said she understands what Chris is saying and everybody wants to be positioned to take advantage of the stock market as it begins to rise, but in this case, first we have to make up whatever that percentage is in the market before we begin to make the money, so we're looking at lots of dollars. Peter said we really need to go over the numbers and see what the universe did, and then you need to make a decision whether your advisors are doing a good job as compared to what's out there, but he thinks you need to understand the numbers and what went on.

Peter said he was here in December. He brought the cover sheet for the end of the year and if you drop to the middle, the total balanced accounts, they dropped 19.46%. Vic said that's the average of all of the red and the green? Peter said yes. You are in the balanced portfolio. There is the fixed option right below that, the last line. The fixed account was up 5.78%, it's all U.S. Treasury Bonds and CD's. That is your other investment option. In December, on the left hand side, look at Wedge Balance, it's the bond manager which has $59 million, which has roughly half of the account is in Treasury Bonds, guaranteed bonds. They were up 6.32% last year and their index to the right of that is 6.2%, and they did outperform their index. That is a positive. Vic said so we put it in the Wedge balance? Peter said as it went on, we did put more in there. We went from 40% to 50%. Chris said the problem with the bond market is there's a question as to whether or not it's overbought, and right now there is so much cash on the sidewalk. There were some money market funds last year that were in the negative. Even in cash, in a lot of cases, there weren't as many safe havens as you would imagine. Last year, looking at the Wedge Balance, it was a long bright spot and the Endowment Fund at the bottom, which were the only two green numbers, but we had significant holdings in those two of about 60%, and that's what prevented the 25% to 30% losses. There's no way to anticipate the additional hemorrhaging of what is happening to the economy. In February, there were 651,000 jobs lost and that seems to be accelerating. There are some analysts that are saying it's going to slow up by 3Q09 or 4Q09. First quarter 2010, we'll probably be arguing if that was the correct course or not and that's where the anticipation comes into play right now, that's why we increased our frequency in the amount we've been talking about. January was the worst month in the history of the market. Michelle said we've been losing money for how long? Over a year – 14 months? Peter said we're getting off track again. Let's stay with the report. On the sheet, we lost 19-1/2%. If you turn to the February booklet, the last tab, the mutual fund yardsticks as of February 27. The next page, it's December 31, 2008. He marked the average balanced portfolio and it lost 26.9%. Chris alluded to the state of PA plans and they were negative 28% or so. Most of his portfolio's he runs have been coming in negative 26% to28%. This portfolio lost 19% because at the end of 07, we started switching into bonds, 40% bond allocation to almost 60% bond allocation. Under the one year mark, the average taxable bond manager lost 7%. You can look under that one year column in any category you want and the only place that had a positive was short term treasury bond, and U.S. treasury bonds. You can pick the category you want to be in hindsight. That was the only category that made money. First time in his career in 23 years, when the stock market went down, bonds in general did not go up and were not positive. Even if you look at municipal bonds issued by municipalities like here, general municipal bonds lost 9%, and that includes the interest, so most municipal bonds pay about 4% to 5% interest, and they lost, so you lost about 13% of your principal if you were in municipal bonds. That's how bad the year 2008 was. What you have to ask yourself is you have a 7% actuary assumption rate and the only way you can achieve that is with the balanced portfolio. Your balanced portfolio lost 20% last year. The average balanced portfolio lost 26%. If you are going to try to hit your actuarial assumption, you have to find a balanced manager and you have to be comfortable with the way we run a balanced portfolio.

Peter said the first tab, looking at the first two months of the year, 2009, he has highlighted just the managers alone lost 7% for the first two months of the year versus their benchmarks were a negative 12%, so if we're perfectly indexed, we would have lost 12%, but we only lost 7%. Once you introduce the alternative investments and cash, we lost a 6.45%. If we turn to the last tab, the first page, it was February 27 figures. The average balance fund lost 10.5%. We lost 6-1/2%. That is dramatically less. The average bond manager lost 2/10% of a percent. Bonds in general have started to correct themselves and are starting to fix themselves. Municipal bonds are very positive for the year, so you are starting to see some positive numbers in the bond categories, but dramatically double digit numbers in the stock category for the first two months of the year. If you go to the February page, there is a pie chart of how much each manager has and how much is in each category. Going to the next page, which we call Asset Allocation Rebalance, this is where his partner and him spend the bulk of their time when they do the monthly conference call with the trustees. This will answer some of the questions you have brought up earlier. He highlighted the bond managers, fixed income is bonds and it's at 52%. That was 40% at the end of 07, so we have been allocating more to bonds on a steady basis. Your investment policy statement to the right, your target allocation is 40%, and the most we could go to is 60%. Why do we set the maximum at 60%? That's not an accident. You need to be at least at 40% in equities to hit a 7% actuarial assumption return. If you are going to stick with the 7% actuarial return, you either have to change your pension plan, but he doesn't know how you change an actuarial assumption. You have to change your pension plan, which is somehow contracted, but the only way you are going to average that is a 40% stock exposure. Priscilla said this number is in the contract? Peter said the actuarial assumptions are in the contract. Priscilla said in both contracts? Vic said not in our contract. Michelle said the employees contract. Priscilla said who gets to change that? Jack said the actuary would have to come to Council. Peter said you would have to change your benefits if you are going to change the assumption rate. His point is, and you are not the only ones, why not put everything in cash and bonds and be guaranteed. A pension plan is forever, and you cannot make the promises you are making to pay people unless you change your promises. You can't do it with the 4.5% bond and that's not a guarantee every year. Bonds do go negative some years. Chris can show you a 10% fixed on the accounts, and there's some years it is flat. We also have alternative investments at 5.5%, so roughly 60% of the plan is not in stock. It's either in cash, bonds or hard assets – real estate, commodities. If we go back to the first tab, February, you can see on the left side there is the Endowment Fund, it was positive this year and it's up 1.43%. That has been helping us. Vic said it was down 23% last year. Peter said yes, the index was down 25%, but it did outperform all alternative investments, in general. That would have been stock money. We took money away from the stock managers, so most of the stocks were in the negative 30's, so that did help us. How did you get a negative 19 instead of a negative 26 like the universe – that's how we did it – with more in bonds and more in the alternative. Vic said we went down another 6% in the last two months. Peter said yes, and the universe went down 10.5%.

Peter said the second tab, this is the quarterly report the trustees get and it's through December 31, 2008 and he has the three year number at the top. Our average return is ½ of a percent for the last three years, which is a 12 percentile rank. We're in the top 12% of all plans in the country. The ten year number is a 4.2% which again is a 12% rank. The numbers below that is the median, which means the median is negative 1.7%. That means half the pension plans in the country were above a negative 1.7% and half were below 1.7%. For the ten year number, half of the plans and universe were above 2.4% and half were below 2.4%. You can see on the three year and ten year number, we're outperforming dramatically. That's because of how little we lose on the downside. Nobody enjoys the downside, but you try to lose less than the averages and when you capture the upside, you will hit the upside assumptions. The ten year number was rolling along at about a 10% clip before the last six, twelve, fourteen months. The next page shows you how much risk you are taking, and again, this comes to some of your questions – why aren't we more conservative. The bottom access is your standard deviation. That is a calculated statistic of how much risk the portfolio is taking. The balanced portfolio is the letter A. The S&P stock market is the letter F. If you are 100% stock, your risk is a 13, which means your rate of return could fluctuate from the average index rate of return 13 full percentage points in any given period. The portfolio we are running is a 7, so we almost have less than half the risk of the pure stock market. B is the policy index, and that is if you are perfectly indexed based on our asset allocation, how much risk and return you would be getting, so basically the same amount of risk is purely indexed and quite a bit of a higher return. Priscilla said we went over this last time and it made sense. Peter said and it didn't change much. That would have been September 30, 2008, it actually shifted towards the left and up higher, so it looks similar, but is actually in a better position now. Peter said the next tab are the February numbers, we went over 08 numbers, the next page we really didn't look at. What this is telling you is the ten year number for the S&P is a negative 1.38% that is per year for ten years, so for the past decade, the stock market is now a negative 1.38% for the last ten years. What does that mean? The chart on the next page, the first year is 1810, so not long after our country began, the stock market was started. What this is showing you, is the U.S. stock market rolling ten year average returns through December 31, 2008. It doesn't include the last two months we just lived through which were dramatically poor. If you look at the ten year average, it's almost a negative 2. That hasn't happened since the 1930's. On a relative basis, stock prices are the lowest in the history of our country, right now. Now when you sit in positions like you are sitting in, you have to ask yourself, do we take our 40% in stock and sell it all now at the historical low in the history of the United States and shift it into bonds, which have been positive and interest rates are at a historical low, so do you want to sell at a historical low and buy bonds at a high. Is this the time to do it now? Molly said you are saying we have until 2010. I don't think we can lose $300,000 for the next two years. We'll have a zero balance. Peter said that's a decision you have to make. On the left, 8.4% is the average, that dotted line, so there are ten years periods where the stock market averages close to 20%, which is abnormal, and there are periods of time when the stock market is slightly positive to a zero return, and that's not normal, when you even out the patient, the patient averages 8.4%. That 8.4% is not an accident. That is the average rate that U.S. businesses can grow their profits on a sustainable basis. The only thing that drives stock prices in the long run, is profits, the earnings per share of the company. Short term fluctuations are perceptions, reactions, people panic and sell which depresses the prices. The long term price of a company is based on how much profit it can generate on a continual basis. It's about 8% a year. Eventually, our economy will recover. Corporate profits will start averaging 8% a year and stock prices will grow on average again at 8% over the next ten years. How do you get back to an 8% growth rate? You have to average dramatically higher per year to get back to an 8%. We just have a negative 2% per year for ten years. There is a possibility we have higher dramatic returns over the next ten years. He doesn't know when, three months from now, or three, four, five years from now. If you look at the boxes above, it talks about twelve months after the low, the average return is 45% in twelve months. That's a huge number. Let's just look at recent history, the first one is 36.15% which was October 02, and everyone here lived through the tech bubble. This portfolio was managed by us during the tech bubble. During the tech bubble of 2000, 2001 and 2002, the stock market lost 50%, very similar to what happened in the last twelve moths. We lost very little during those three years because we won't be overexposed to technology stocks and everything else that was going bad at that time and then the portfolios did recover the following years. The very first twelve months, there was a 36% recovery. If you go back to 98, Russia defaulted on their own government bonds, and there was an investment firm called Long Term Capital that collapsed and it caused a banking crisis and the stock market dropped dramatically and twelve months later it went up 39%. October 1990, somewhat similar crisis to what we're going through now, is the S&L crisis, 500 banks failed, so far we've had 50 banks fail. Twelve months later, 33% return positive. That is the possibility of what the upside could look like. He doesn't know if we hit the low a couple of weeks ago, or if the low is going to come in a few more months, but this is a twelve month snapback, and if you could find someone smart enough to shift everything to bonds, wait for that low, shift it back to stocks, hire them. The only thing you could do is gradually over a period shift more conservative, and we have done that. What he and Chris are talking about now – we are having the opposite discussion you are. Our concern is how do we shift back into more stock and not miss whatever upside is coming. What if we miss the upside and a year from now we're sitting at this table and the average balanced account went up 10% or 12%, and we went up 4% or 5%. That's what we're worried about. Chris said if you are a real visual person and you look at the graph at the bottom, 1920, the little point and then the decade following the recovery, it kind of goes back to what Peter was saying. How do you catch that upside? Look at 1940, look at 1978. Then you go further into

12/31/08, is that going to continue to dip down or is there going to be an up tip? It's something Peter and his partner are looking at very closely. If you look at it in hindsight, back at previous decades, that's what encapsulates the whole thought process, what we're discussing here. Is that graph going to go up over the next decade.

Peter said the last handout is an update from Bob Doll, you can read that on your own. The next one is a handout from Jeremy Siegel from the Wharton School, right here at Penn. He follows Jeremy Siegel and he's one of the top economist and strategists in the country. When Ben Bernackie was appointed to the federal reserve, Jeremy Siegel was one of them in line to get that position. He wrote this in December, but if you look at his forecast in 2009, so far he's dramatically wrong – totally wrong. He didn't put it in there because he is wrong, he feels eventually he is going to be right. It's just going to take longer. Our country, our economy, always recovers. Our companies always get back to a profitability rate of about 8% that they could grow their profits. We've recovered every recession we've been through and we will recover from this one. It's just a matter if you participate in the recovery, having patience and being conservative. You have to realize we had made shifts. We were doing quarterly conference calls in 2007, and in January 2008, we went to monthly calls. We don't make changes every month, but we have them making changes. Even our managers have been making changes. This sheet for 08, it's all red, and it's terrible, but let's just look at this. The YTD negative number, 31.08%, the last column on the right is its index. That's what they are competing and comparing themselves to, so Chase was a negative 31.8% and their index was a negative 38%. Go down each manager and look at the index. Almost everyone outperformed their benchmark - some of them dramatically. If you get down to NWQ, they lost 24%, and international stocks lost 45% last year. How did they do that, that's something he needs to talk about with the investment policy statement. Even the managers are in the realm they deal in, are changing the way they do business and have become more conservative to try to preserve portfolios.

Vic said the last column is what they expect to lose? Peter said this is what the universe lost – who they are compared to. Chase buys U.S. large growth so the average large company lost 38%. Vic said that's the problem, they are investing in U.S. countries who are not making any money. Peter said we have to own U.S. companies in the portfolio. It's prudent. Chris said it's a matter if diversifying the assets amongst different buckets. Vic said he understands diversity. Peter said we had another international manager in there who was losing dramatically the beginning of 08, when all this started, and we fired them and took all the money away from them and didn't give it to another international manager, we put it in U.S. managers and some of it went into the Endowment Fund. Vic said how much of this was with Madoff? Peter said zero. Vic said he's concerned that some of these manager's may not be properly managing the money, but we are paying $30,000 a year. That's a lot of money. Peter said if you look at the Endowment Fund, which is alternative investments, they are compared to an index which is First Boston, which is the Hedge Fund Index. This is a mixture of Hedge Fund managers, and real estate managers and commodity managers. We immediately wanted to know if that fund we're in, was invested with Madoff, and they had none at all. There was another one, Stanford, a bank in Antigua, and they had no money with them also, so we do monitor that as it's a possibility. These managers are pure stock managers, pure bond managers. We see their portfolios every month. It's impossible for something to happen there. They are big name managers.

Fran said he has a few items he wants to go over. You said you are keeping all these managers. Peter said we fired two in 08. Fran said these are all the ones we have now and you want to keep all these that you have? Peter said yes, right now. Fran said what power do they really have on changing their portfolios. If they want to move any money around or buy or sell, must they come to you first? Peter said no. Fran said they have that power to do this on their own. Peter said they have the power to buy and sell in their category and a lot of them are going to cash. When you look at the December statement, we list the cash account. That is a bank account that accepts deposits coming in and wires money going out to PSAB back and forth. When you get your allocations from the state and you pay your retirement benefits, it comes in and out of there. The managers don't affect that cash account. Every manager keeps part of their portfolio a little bit in cash. They could become as defensive as they want and put as much in cash as they want. The managers right now have about $5 million in cash out of all that stock money. They are being more defensive, and they have the power to do that. Fran said do they invest that money in anything like short term, the cash? Why would they just let it there, what interest would it be drawing, how does that work out? Peter said it's just a savings account, which is about one-half of a percent. It's just a simple money market like you and I would use. Fran said I wouldn't use anything for a half of a percent. Peter said what are you earning on your checking account. Fran said I know what the managers do and what power they have. You're not going to change any. You said you meet once a month, the board, a conference call, what does that really pertain to? Peter said we produce this every month, so we have the February one, and email them or fax them the monthly report and go over it and decide if we are going to hire or fire manager or if we are going to shift money from stocks to bonds or bonds back to stock. Fran said you don't have any emergency meetings like when we're looking at these papers, do you have anything that you break the protocol instead of once a month – immediate action? Peter said yes, we did that in the end of December 07. We weren't comfortable with how high the stock allocation was. It was getting to sixty percent and we called the reallocated into stock and a little more into bonds. We called for that meeting. Fran said the foreign investments, the 20%, they lost 45%? Peter said the index did. One of the managers Wentworth, did lose 46%, but the other one, NWQ lost 24%. Fran said you are taking the average? Peter said yes. NWQ has more money, so the loss is probably in the high 20's. Fran said don't we have in our policy the risk type of protection in our investments? He knows from being in this for 35 years, we never invested in anything that took a risk. Some of the board members were talking about putting everything in bonds. He doesn't think that's a smart policy. If we are paying somebody, they should be doing this. You could come back and say you guys told us. He doesn't want that. Priscilla said that's why we hired somebody. Peter said the whole point of his presentation and what he wanted to get across today was we lost 20% last year and universe lost 26%. Fran said he doesn't worry about the universe, he wants to know what we are going to do with the 20%. How are we going to make it back? Peter said you hired us and you are paying us a fee. If he's sitting in your shoes, and he's paying these guys a fee, and they did 20% and their peers did a negative 26%, you have to make a decision whether it's still worth paying them or could you find somebody to do a better job than we did? Fran said he would wait a little bit longer before he makes that decision. If you keep coming in with 20% and tell me the other guy lost 26%, there's something wrong. Peter said you do have a three year and ten year number. Fran said you know who the little guy is. That guy never gives me a number, the actuarial presumed retirement age. Does he crunch numbers with this 20% loss? How often does he do this? Jack said every two years, which is required by state law. Fran said eventually Council is going to have to put more money in. Priscilla said that's why when we are doing the MMO, she wants it to be based on real numbers, not pulled out of the sky numbers, and it has to be done every two years to get those numbers. Priscilla said he signs that pulled out of the sky numbers. We're not making them up. They are based on his interpretation. Vic said I can show you were he submitted one pulled from the sky to the auditor general and provided documentation or his other actuarial study to the police association, that show two different sets of numbers. Jack said you raised an issue, and he's not sure. There are two separate reports and they picked out two numbers. Vic said they were supposed to be the exact same report, whenever we had that arbitration, which was last year. He provided that testimony. Jack said he was questioned at the arbitration about what the numbers were. He said he had to check into that. He didn't provide an answer and no one said you are right, you are wrong. Priscilla said there was paperwork that might have been an estimated one, not based on real evaluation. Jack said evaluation is based on real numbers. It's looking back. What Chuck was saying, in the evaluation, you can look at the five years previously, and can say, here's what happened, here's what the costs are for the pension plan, and if you want to do that immediately, and make up for the losses, you can do that or you can blend them and spread them out over several years, which a lot of pension plans are doing because as Peter points out, historically when there is a decline, there's also an increase to cover this money, five years, ten years down the road. The actuaries try to spread the down with the up into a long term. That's what Chuck was saying. Priscilla said she remembered this scenario. When do we have to do that, January 1 of a certain year. Jack said he's preparing the valuation now. Priscilla said when is that due? Jack said in September. He has to do the valuation and complete it by some date in this spring or sometime in June. Priscilla said she remembers something about whenever that date was and then we start preparing the budget in August and September, and by the end of September, we have to approve that MMO. If we didn't have in possession that report, that was being worked on, that MMO would have been based on the two previous years. She was flipping out about that as he was in the process of doing that, and he wanted that done so we could make a more realistic MMO forecast. Jack said Chuck will have the valuation done. We will have a meeting with the Pension Advisory Committee sometime in the summertime to look at that before Council looks at the MMO. Priscilla said that wasn't happening one year, and he objected to that. Jack said what happened once, was it was a previous actuary and he didn't have the valuation done in time for Council to look at the MMO. We will look at that and have that discussion probably in June, and talk about it and make a decision.

Mary said she just wants to know now that we have this information today, how is it going to be integrated with Chuck. Certainly this is going to play an important part now in what the actuarial is going to look at the next time we see it. That could be horrible. That might be the time to look at the percentage he is using to make it actuarial sound. Once that happens and if that percentage is going to be changed, let's say the percentage is going to be increased, that's a whole other thing for you guys to think about. She's just doing that as a for instance. If that happens, based upon what we have suffered this year, based upon the graph you gave us with the stock market going crazy for years and years, based on all of that, then do we still want to keep our policy that says 60/40? To answer your statement, Peter, do we want to go ahead and sell everything and put it all in bonds and cash. My answer to that is, you are the people who are supposed to be telling us that, certainly not us. She knows about the stock market going up and down, she's seeing it, she experienced it. How much negative experience can this uniform and non-uniform pension fund handle? In real dollars, those people who are going to retire, is the money there, is it going to be there? Jack said the answer is yes, it will be there. We are talking about, infinite; the pension fund is here longer than Lower Saucon Township has been here – one hundred, two hundred years. The pension fund is going to be here. What we are talking about is keeping it liable. As far as immediate retirements, it's funded, and we're talking about the next five to ten years, absent any end of the world thing. Mary said like this? Jack said no, worse than this. If it continues, the whole country is going to be up the creek, not only our pension system. Mary said she agrees that the pension system is going to be funded, but by whom? Jack said it's funded by its current assets. It's funded for the short term five to ten year return. Mary said are you basing that on the last actuarial that was based on the last total investment numbers that we had and not these. Jack said based on what the actuary tells me if everybody in the next couple of years, even the retirees took a cash withdrawal, instead of paying out the annuity, it still would be funded. Priscilla said if we keep going down the line, what happens when there is $100,000 left? Jack said there's not going to be $100,000 left, because we are trying to do long term in investment and growth for the pension fund instead of what was here previously and that was a real risk, a year to year risk. This is long term growth. Yes, it's down, but in the long term, it will be productive and will be positive for this pension. This is why we are working with these professionals. Mary said she'll be interested to see the actuarial for this year. Jack said the actuarial report is based on a five year assumption, it's not just looking at 2008. The previous one we did in 2007 covered the period in 2002 and we carried that for a couple years. Now we will be looking back five years to 2004. It's going to take the highs in 04, 05, 06, and 07, and the low in 08, and it's all blended in there. It's not going to be as bad as you think it's going to be. Mary said she understands the actuarial. Peter said he's seen some county ones already, and they are dramatically higher.

Fran said change the policy. We do have an alternative, and the City of Bethlehem used it. You have other state pension funds that you could have new employees go into. Since they pay no money into the fund, you can do that. Jack said close this one out for the current employees and anybody new goes into another one. Fran said Mary's concerned about the funding which he is also concerned. You said about this pension fund will be here a long time. The City of Bethlehem has one and since they initiated it, the only people that could get rid of the pension fund and stop paying into it, they would have to put it on a referendum, a third class city code. They are the only people that could stop the pension plans, they could cease them. He doesn't know about the second class that we're in to. The main question here today, do we want to change the policy or do we want to give it more time? He wouldn't change it at this point, he'd give it more time to give these guys an opportunity as changing the plan would have to change everything. You'd have to do a lot of things, and that's a lot of work, and unions wouldn't except that readily. Fran said he requested it before, he'd like to get the packets out sooner. Peter said he emailed it to the township.

Jack said are there any plans to increase the exposure to the trustees? Peter said the first half of the February report, it's your investment policy statement, and there's a minimum and a maximum. The target is what we advise, so the target is what we're giving as advice, but let's drop down to the bonds fixed income. We could go as high as 60%, we're almost there, we're at 53%. We could go to 60%, or as low as 30%. We were at 40% in 07, now we're almost at 60%. If you look at the total equity, we could go as low as 35%. Right now we're at 41%, almost as low as we could go. The trustees can go in and change the investment policy statement. We just changed it in January and we do have the latitude and we do have changes. If the equity market is up here, to be negative, we are going to keep more in bonds. If we are starting to see a true upside, we don't want to miss that and we will gradually go back and go to a minimum type equity type allocation, well above 40%. There's no plans to go back to 60%. Jack said let's say we continue to lose 19% for the next three months, what we've been talking about, what we heard, is there any way we are going to lose, lower it to 15% in stock. Are there any steps to be taken to minimize the loss. When we come back here in June, and you say we lost 19% average, are there any steps that can be taken that it could have been 19%, but based on what we did, it's just 14%. Peter said we could be shifting more in the bonds and more in the cash. We still have a log of leg room to shift. Jack said are there any plans? Peter said that's what we talk about every month. Chris said we are offering two choices between the fixed and the balanced. There are a number of municipalities out there and there are different actuaries that advise different municipalities and many of them insist on some exposure to equities. Right now, we're at 41% equities. Others insist on 100% bonds, and that's the more extreme. Those are two viable alternatives that you have in place. If you are all together opposed to any exposure to equities, you have that fixed option where we could make that effective the first of the following month. If conditions became even more extreme, yes, we do have the ability to further decrease the equities to zero. Peter said we did this in December, the last time he was here, we received the investment policy statement. If you look at small to mid capitals, U.S. stock, right now we have 8% in there. The minimum is 5% in the investment policy statement. That was the change. It used to be a 10%. We used to always require 10% in small mid U.S. We lowered it to 5% and fired one of the small managers and didn't give it to another small manager. We went to bonds. We could go in and change the investment policy statement if we have to, to become more conservative. Right now, we don't plan on going more than 60% or going below 35% in equity right now. If we did, we could change the investment policy - if the trustees allow it – if they take our advice. Chris said a good example from last year, this portfolio now has exposure to precious metals and commodities. We've never had commodities and precious metals up until last year and that's because the economy has changed so significantly. We're trying to find some safer havens for municipalities to be positioned, and that's an extreme change as it was five years ago when we went into international stocks. Now there's a lot of speculation that gas prices are going to go back up. There are a lot of monetary concerns. These are all factors that all mix in. Years ago, with the weak dollar, we got significant returns with the international funds.

Mary said how do you know when the market is on the upswing? Peter said you don't. No one does. Mary said what do you look for? Peter said we look for positive days like we've been having like when you have four or five in a row. There are important events, and one that we are waiting for. One of the major things that needs to be done is what we are living through, and basically, everybody realized we lived through a tech bubble, and that was pretty easy to identify. We just went through a credit bubble. There hasn't been one since 1929 – 1930. No one knew what it looked like and no one knew what it was to live through one. This is what it is like and it's world wide. There's too much home mortgage, there's too much credit card, too much auto loans, too much corporate debt to buy other corporations. All of that is spread throughout the whole world and now it burst. What that did, is it triggers a banking crisis, what is exactly what happened in the 1930's. Now you have the banks failing, and the bank crisis. What we are waiting for is how are you going to take care of the banks. How are you going to get rid of the insolvents ones? There's about 100 more insolvent banks that need to be shut down. How are you going to do it? We're waiting for that plan to come out. The Treasury Secretary should roll that out in the next three to four weeks. We want to see what that plan is and what the reaction is to it. Once that plan is out, and the reaction seems to be positive and everybody knows the game rules are, what banks are going to be shut down, how they are going to be shut down, then we may make a better allocation to stock and that could be a good sign. It could be a negative sign, and then we make a bigger allocation to bonds. Peter said he gets a lot of talk about we are going to go through the great depression again. Ben Bernacki at the Fed, is a student of the great depression. That's what he got his doctorate in, he spent his life studying it. When the credit bubble burst in 1930, the federal reserve at that time thought the best thing to do, and they had never went through a credit bubble, they increased interest rates and thought that would help. They shrunk the supply of money and shrunk the system and thought that would help. They were worried about inflation. What did Ben Bernacki do – he cut the interest rates, even took some to zero and pumped hundreds of billions into the market. He did the opposite. What did the federal government do? They raised taxes, they started restricting the economy, they passed the international trade laws. What's our government doing? They are not raising taxes, and are pumping money into the economy. They did the exact opposite. That should prevent us from another 1930 cycle. It's not easy and it wasn't easy in 08. We could have shifted more into bonds, but it's hindsight. Things happen real quick. Most of the negative numbers came in September and October of 2008 – how quickly could you react, how do you know even as it was hard to tell which ones were going to fail. It set off a chain reaction throughout the whole world. It's difficult. The good thing is we'll never live through another credit bubble. It's every 50 to 100 years and they are devastating. It's not going to be over with because you have to pay down the debt and it's going to take another three years or so. Companies will recover and that's where profits will start coming back up sooner. People getting their balance sheets in order and paying down their debts, that is going to take years. House prices might stabilize, but they aren't going to go up for three years or so.

Peter said they made another change – this is really technical, and it's not easy for him to explain, but he'll try. If we go to the first sheet in February, the second NWQ on the left hand side, mid/small cap, you'll see they have $3,513,023. They lost 5.23%. The small cap index dropped 21% so far this year. What happened was in December 08, they came to us and he wants to show you the change in the investment policy. This talks about what type of investments we allow the managers to buy. The second category is convertible securities. They are like a high bred of a bond and a stock. They are high securities that are convertible in the common stock, U.S. based companies. We do consider them equities, so we do count them as stock even though they pay an interest rate like a bond. The only ones that buy them are our stock managers. They came to us and wanted us to add language to allow them to buy different types of convertible bonds, so we added in language talking about PERC's and chips and elks in Rule 144a. Rule 144a is small companies when they want to buy the convertible bonds. Once we allowed them to do that, what they were basically saying was companies aren't doing well, stocks are doing very poorly and small mid cap companies are doing worse than the large companies. The one way we could protect that was by generating interest on a bond, so let us buy more convertible bonds of small to mid size companies and that's what they did in January and February and you could see they made a loss of 5% and their peers were losing 20%. We even fired one of their peers in 2008 because of the 20% loss they were generating and we wanted to reduce that space. That's the type of technical changes the managers will make with our permission. Page 11, there was an update to that. The managers do have some flexibility and they will ask for leeway at times. It's very rare, but they do ask. The biggest thing the manager's do is they go to cash. Normally they run with little cash, but now they are running about $4 to $5 million in cash.

Fran said he posed the question, are we going to just leave everything the way it is. He personally would leave it the way it is because of the responsibility and the risk. He doesn't want the risk on his side. We are paying these people to do the job and he says give them more time. Priscilla said prior to them, we didn't have anyone and the committee would just come up with it and we had some issues back then and we decided to hire professionals to give us recommendations. If we counter their recommendation and say we insist on doing that, and then it takes a dive, then it's on us. Mary said she doesn't think we would ever insist, but would look to them for alternatives and directions. Chris said we accept that responsibility. Vic said we pay for that and we hope you manage our money that we only lose 15%, not 30%. Jack said that's what Peter is talking about they are doing. They are trying to keep it lower. Priscilla said the people that it affects, aren't all sitting at this table. They are the employees, the taxpayers, and we feel obligated. Chris said the hot shot managers are a dime a dozen. Peter said there is tremendous turmoil in what he does in his industry and you are starting to see a lot of firms fold and people leave the business. The reason being you pay us a flat fee on the assets. It's a percentage of the assets. The assets went down 20%, so our fees went down 20%. We want to preserve the assets and want them to stop shrinking so our fees will grow again. He's in the same position as everyone that this board is in, and he has a vested interest that this works. Priscilla said what about bonuses for the CEO's? Peter said there was, but not for him. Peter said his assistant did get $1,000. Those are legitimate questions.

Jack said we talked about what we were concerned about and they will be back on June 17th. The next meeting will be in September regarding the MMO.

2. AG 385 Filing – Completed

Jack said the AG 385 filing has been completed.

3. Retirement of G. Young (Uniformed Plan)

Jack said Sgt. Young retired. His retirement documents have gone through and he has his payments. Mary asked if there was going to be a retirement party. Jack said he didn't want one.

4. Update on Plan Documents

Jack said the plan documents, this is something that Cathy has been working on. They contain all the information about the pension plans and they have not been finalized yet. She still needs some additional information from the solicitor. She will probably have that ready for us at the next meeting.

5. Financial Reports

Jack said Cathy prepared this report and it shows what payments have been made to the uniformed and non-uniformed fund. Vic said he noticed the administrative fees are still being taken out of the pension fund. Jack said this is what payments are being made from the general fund to the police pension fund and to the non-uniformed. The money taken out of the police pension fund stopped in 2008. Vic said it's been taken out since they have had the arbitration. Jack said are you talking about administrative fees? That's year to date and shows what's been taken out. Vic said month to date have been taken out. Jack said that's what they are charging. Every month we cut a check and Michelle prepares it to the police pension fund and the non-uniform fund for the amount that is listed. Since the beginning of 2008, that money has been paid out of the general fund. It has not been taken out of any pension fund. Michelle said it's deducted initially from the fund, but we reimburse. It's a wash. Vic said November fees were paid on March 10. Michelle said she went over all the fees and noticed November's was not paid. Vic said December's fees were paid at the end of January. Michelle said you have to give us some slack. She doesn't get that right away. Vic said it seems the arbitrator said don't take the money out, and the money is still being taken out and it's taking a month or two to get back in. Jack said the money is not coming out of the employee's pension fund. It's being paid from the general fund. That has been done since January 1, 2008. Let's get that correct on the record. It's not coming out of your fund. Molly said it's initially coming out and then being reimbursed. Jack said then we'll have to check it out. Molly said they sat here and said there was no other way to do it. They take it out of the fund and then it gets reimbursed. Jack said they are getting the money back, it's being paid from the general fund. Priscilla said it doesn't show up on this paper. How do you get it to show up on this paper? Vic said it does, but it shows up three months later. Michelle said from what she recalls from their previous meetings, they told us they couldn't do it any other way. Priscilla said you really need to have the fees there, so you know what they are five years from now. Vic said even though our fund went down, they are charging more money for January. Jack said these are administrative fees. Michelle said these are different. Vic is talking about investment fees. Michelle said we really don't know how much, but he said 20% of the assets. Jack said whenever they make a transaction, we are showing the fee. This is the administrative fees and they are being reimbursed by the general fund the following month. At the end of the year, all the money that came out for the administrative fees is reimbursed dollar for dollar. Vic said we're losing money two ways. Michelle said it takes about a month until it goes back in.

Fran said are we paying anything out of township money to these people or are we using soft money or hard money? Jack said their investment fees come out of the pension fund. Fran said then that's soft money then, that's when we don't lose it. Fran said he doesn't know how many funds they have. If you divide the next meeting into the number of funds we had, they'd have to go over one fund every day. How do they keep up? For instance, General Motors, does everyone and their plan have a General Motor stock or how could they possibly go over every inch of this. They say once a month, that's impossible. Jack said if we had more good news to go over, and not 95% of bad news, then we could bring Peter in and he could go over that with you. Fran said we have too many managers. They do that so we don't take a beating. Vic said in the packet, there's a listing of every stock they are invested in. It's a pretty diversified package.

6. Settlement Filings

- **a) United Health Group – January 20, 2005 – May 16, 2006**
- **b) American International October 28, 1999 – April 1, 2005**

7. Approval December 17, 2008 meeting minutes – Jack asked if anyone had any questions about the minutes. Mary said they should have reduced those equities of 40% and should have been reduced. We shouldn't be at 40% right now. It should be at least 10% lower than that and position ourselves to go back into the market. That was too high. She's not going to argue, what's done is done, the market is turning around, so it looks like it's going to increase. Who is going to argue now. We've already lost the money and there's no way to recoup that. It shouldn't have been at 40%. Priscilla said when we met in December, we were talking about what was going on in September, and it got worse after that. Priscilla said it was a hot meeting last time. Fran said in the equity, what would they change, what would they take out. How would they be able to change it. Mary said they would convert it. Priscilla said they walked out of here with the message if we aren't happy, we can look for someone else. Mary said she did not like the comment, well, go ahead, you can do it. They are the experts, and supposed to be telling us. Priscilla said how would you find another group? Jack said we'd have to RFP that and right now we have to wait until the smoke clears and see what is going on. Mary said she's not even suggesting that. What she is suggesting is that she doesn't agree with what they did in December and January. They should have made some moves, but now it's too late. Maybe it's because our policy said 40/60, however, our policy, they can make changes. They weren't rigidly boxed in to our policy. Molly said they made us change our policy to adhere to their policy. Pricilla said and ours was more stricter. Jack said we are under the PSAB, and when you say, change the policy, that's for the whole municipal retirement trust. We are part of the investment trust policy. Mary said you did hear him say that there were some municipalities that decided they weren't going to risk anything, so they are in 100% of bonds. Jack said he knew he said that, but he didn't know if they switched in mid stream or have they been there all along. They are looking out for 212 different accounts and it's all under this allocation. He thinks they did make a change, but didn't make it as rapidly to stem the loss. Mary said the one change they made, did have a positive result. Jack said yes, they did do some rebalancing.

Molly said in the minutes, regarding the attendance it's not that she was too busy to attend, she had issues to clean up because she was scheduled for a medical leave a week later. It's on page 8 at the top. It's only like the third time she missed the meeting. It seemed to be an issue. Jack said that's what he was told when he was on the way in to the meeting.

Vic said he never got a notice that he was approved to the board. Jack said Council approved it.

Jack said on the minutes, it should say Molly and Michelle were absent.

Vic said what guides the amount of members on the Advisory Committee? Jack said it's a resolution from Council. One from each fund – Molly and Michelle – one is appointed, the other is an alternate. Vic said is it feasible for the police to have an alternate in case one of us can't make it? Jack said he didn't care. He doesn't think Council would mind. Vic said the Chief would have a problem with him sitting in here if he was on day shift and working. Jack said if you can come up with someone as an alternate, give him the name and he'll bring it up with Council. Fran said he doesn't think that is fair. Just like you people – why aren't you at your desks working. He's on duty, that one hour isn't going to kill anyone. Jack said that's up to the Chief. Fran said it's up to Council. Jack said he also has to have the men out on duty. Vic said they are short handed, and there are three guys on a shift, and he doesn't see it as a problem for him to sit at a meeting of an hour. He might not be able to make the next meeting depending what his schedule is. Molly said other times, they did have an alternate come.

Fran said when he went to a meeting, he had his radio and if they needed him, they called him and he left the meeting – simple as that.

Michelle said in the minutes, Fran said one year we didn't get a raise because of the…Fran said that was when Ankaitis was here. Molly said he proposed that to us. We would not allow that. Molly said we stopped paying the fund. Michelle said it's on page 8. Fran said what year did you stop paying into it? Molly said we stopped paying into it in the 90's. He tried to use it as a crutch by us not contributing, but that never went through as our union did not allow that. Fran said when did it start? Molly said the late 90's or early 2000's.

Minutes approved with changes that Molly and Michelle were absent.

8. Set date for next meeting – June 17th at 11:00 AM

9. Adjournment: Meeting adjourned. The time was 12:56 PM.