Lower Saucon Township
Pension Advisory Committee Meeting
Meeting Minutes June 8, 2016

Roll Call: Present –Cathy Gorman, Joe Scott, PSAB, Thomas Schatzman, Morgan Stanley, Mary Curtin, Leslie Huhn, Molly Bender, Priscilla deLeon, Council Liaison.

Absent: Lou Mahlman, Chris Leidy

1. **Joe Scott, PSAB:** Joe Scott from PSAB said the market for the past 18 months has been a little flat. A few months ago, they modified the report they present. The content was too narrow focused. It really looked at a month to date basis, they wanted to present a report that covers a longer period, as pensions are for long-term periods. The first page focuses on the return as a whole for the Trust. We want to look at the long term. They are meeting their benchmarks. Graphs shows they are taking less risk in the market to get the returns received. We are taking less risk in making their benchmarks in the long term. The two color-coded pie graphs show the allocations/styles and the other shows the investment of funds. It shows where we are doing well and where we are not. What managers need to be looked at? We show the down market capture which is important to show and we are at 64%. So if the market goes down 10% the 64% is protected. We take a moderate approach; we are selective with our managers. We are ok with modest returns on the upside and protected on the down side. With all the measurements, we look pretty good. This report will be the standard. If we see something in terms of the measurement, please let them know. We can send him an email and he will look into our input. Priscilla asked how we compared to other municipalities. Joe said we are up there in our involvement with the plans. He appreciates our involvement. Priscilla said spoke with a stockbroker, he asked her what she was doing this week, and she said I have a pension meeting. She said we go and they tell us what is going on; they give us all this stuff and we are just there because they do all the work we just ask questions of what we can think of. I did not know if everyone did that. I am glad we did this over 20 years ago; she hopes the employees appreciate this, because we are on safer ground. Joe said you have reports to clarify any questions your Council may have; Cathy prepares an extensive list, which is more than most, which is fantastic. We get more compliments on that one page report because it shows every dollar in and every dollar out. It is so easy to recognize discrepancies. Cathy said that they have new forms now where we note what the check is for and submit with the check so there is no question how to account for the money. Any errors made are caught and corrected. Mary asked Cathy what reports are provided to Council after these meetings. Cathy said in the semi-annual report we report to them where they are at in regards to their pension. In September we discuss the the MMO and there are some questions then. It is also reported in our financial statements prepared by our auditors that they need to make notes on but not to the extent that they are auditing those funds and our budget document. We are at a level that if the State requires us to do more GASB reporting, we are prepared to do so. Joe asked if we are required to file pursuant to GASB 67. Cathy said no, we are modified cash basis. There is a legislative issue regarding GASB 67 regarding the auditing of the report. Cathy asked where the manager's benchmark page in the report was, did they take it out? Joe confirmed they did, since it was month to date. Cathy asked if they can get a print out of the managers' performance if asked and he confirmed that they can provide that and will report it at the meetings. At year-end, they can provide that information as well.

2. **Tom Schatzman, Morgan Stanley:** Two managers have been replaced, for subpar performance. One was Atlanta Sosnoff Capital, large growth manager and Herndon, large value. The reason they get in the program is not necessarily that they outperform; it is their risk adjustment performance. 65% of the downside, 100% of the upside, because we are not looking for managers to shoot the lights out, we are looking for managers are steady. We are ok with managers that underperform the market a little bit, not a lot. Atlanta presented their self as defensive. We did not necessarily agree but we gave them until we had a down market and they did worse. Herndon had too many financials in their portfolio and the Dept of Labor is going to come out with a long list of items that would affect some of the needs in their

portfolio. They did nothing so we left them. We gave them the research and they did not use it. When we are pointing out something wrong in their portfolio and they are not addressing it then we are going to have a problem. When we fire them, we fire them in all plans. 80% of the large growth managers underperformed the benchmark in the last year. What used to be a low risk stock that we liked to own is now a higher risk. Like energy companies, great dividends, earnings you could put in the bank. We know they are going to make money. Now they have morphed into high volatility stocks. Utilities; cannot get more stable than utilities, a 3% growth, mandated by the PUC, a 5% dividend; what could be less risky than that? They are enormously risky right now, they are trading a two times book value which is it 80% more than their normal valuation. People buy them for their yield. Real Estate investment trusts, we sold all the Trust's real estate investments trust over a year ago. We went into private equity real estate; we had double-digit rates in return. Public real estate has done just as well but real estate investment trusts are as expensive today as they were pre-housing crisis when they were expensive. These are dangerous places to be. When we look at the performance and we know why the lack of it is; we do not own utilities and we will not. Telecom stocks, do not want to own them. They do not grow. We like to own private real estate. Now with the MRT having 240 million, we have the capacity to buy very high quality corporate real estate for the MRT. Again, with double-digit rates of return with less risk than we do see in the public market. This is what happens when a whole market is staving for yield. The whole world is searching for yield and they are finding it in real estate investment trusts, utilities and telecom stocks. We are good in April and May but in February not so much so. We are suffering a little bit but we think these stocks are overvalued. Last time the real estate investment trust was overvalued they went down 57% in the next three years. I do not think that will happen. When things are overvalued because it happens to pay a dividend, it is not because are not worth 16% more today than they were at the beginning of the year, but the stock is trading higher. It is detached from reality. The utility companies, telecom companies, banks are not low risk stocks anymore. Where can we go? Who are the dividend growers? Who has cash? Who can provide dividends? We invest in the Johnson and Johnson, McDonalds, Proctor and Gamble, and Coke a Cola's. They do not quite keep up with the market but they are very high quality companies. Just last year for large growth managers, a lot of us struggled; the large index was flat. It had a zero percent rate of return. The average growth manager was up six. Some did really well; some did not. There were four large growth stocks up 62% last year; Facebook, Amazon, Google, and Netflix. Just 4 drove one thousand stocks. Therefore, the index, Dow and Russell has 670 or so stocks. If you owned those four good for you. You did amazingly well. However, if you hesitated to buy Amazon, which has not made money, yet; we all love Amazon, but I do not know how to value a stock that does not make money. A lot of managers do not like to own companies without earnings. Google was the exception. We do own Google. We did not buy into the frenzy; the stock with the least amount of volatility is Facebook. How is this, a stock that does not budge when the market goes down? Low volatility means something different today than it did three years ago. That does not mean we are going to load the books on Facebook but things are changing. It is all happening below the surface. You watch TV and you hear the market it up ½ a percent, who cares. However, below the surface, is carnage and many companies are doing well and many companies are doing poorly. We are indexing more so your large cap will be about 50% indexed, which will bring your fees down. We will not always be at 50% indexed but right now, we think it is smart to be 50% indexed in large cap. The small cap market doing well and international; active and doing relatively well. Fixed income active and doing well. Where we struggled was with the two managers that contributed to the all the underperformance that we had. They just did not recognizing that maybe oil is not the best place to be. Maybe financials are not the best place to be. With Atlanta, they just did not follow their mandate of buying companies that lost less than Dow markets. We are ok with a little less than that market. We want investment returns. We are optimistic. Bonds are at 2%. You have Memo's, you have assumed rate of returns, the market could come in at 6% and bonds at 2%, it is difficult to get to that 7.5 - 8% assumed rate of return right now. We could risk up in a market like this, terrible idea. We are not going to take that risk. At the end of the day, we have 35% in bonds because we are a benefit-paying machine. Benefit payments have to go out; there is no question on that so we have to have a certain amount of liquidity. We are just taking the 2%, it is terrible. Just think in

06-07 Money Markets were at 5%. It was ok to have 35% in bonds. You could pay the bills with 35%. We do not want to buy junk bonds and put your benefits at risk. So it is tough right now. Reminds me of 1984 when stocks did nothing, bonds lost money, and anxiety was high. Two years stocks have done nothing. Not being paid for risk. The psychology of this market is not good. The best crystal ball is that we are not spending. We used to spend 4 % more year after year. People are not going into debt. No one is getting a home equity loan as we used to. We are spending 2% year. Federal government is -1% a year. Corporate spending has been flat; finally, it is slightly going up. That is the silver lining. It is because we have the lowest natural gas prices in the world right now. Natural gas in China right now is $11 in US it is $2.50. So if you have a plant in China, you would be considering relocating to US. If you are in Europe - $11 per cubic foot. The biggest battery place in the world is being built in Texas because of battery-powered cars. We are finally seeing investment and that is good for the economy. The best thing that can happen is to have the Federal Government stop negative spending and start positive spending. The government has gone from 20% of our economy to 17% of our economy. Maybe that will change in the next election cycle. We do have the two most unpopular candidates of all time running so we are seeing a little bit of a relief rally. We are sticking to our dividend growth strategy it is starting to help by removing the two managers. Our biggest challenge is not taking the risk. There is really no inexpensive place to go. Everyone hates Europe. Some of the best high quality companies are in Germany they have great earnings, great dividends, great management and they are unloved and trading at great discounts. They are not in trouble. We do keep our toe in the market over there. Right now, there are no emerging markets. We are seeing more investments in future development. Warren Buffet said it best. He is holding billions in foreign banks and pay 1% fees there with no interest earnings because he does not want to be charged 30% tax on profits. It is punitive. There are imbalances that Congress and the Administration need to agree on some things. It is not all doom and gloom. Pipelines and fracking are a big deal. If we can find a way to transport natural gas, we will get the plants. Fracking may not be the answer; looking at Oklahoma and Nebraska. In this part of Pennsylvania, we are floating on natural gas. If we can only tap into it without hurting ourselves, we might have an amazing opportunity on our hands. There are real bright spots. When they tell us, unemployment if 4.7%, we know it is 9%. People stopped looking. This is why our anxiety level is high, because it doesn't feel like a great economy but it is not a recession. In PA we have a stable housing market, we will take it. Some states don't have stable housing markets, or a stable business growth.

3. **Financial Reports**: Financial reports we have deposited $6,202.41 in the non-uniform plan and $16,122.47 in our uniform plan for the administrative fees.

4. **Non-Uniform Contributions:** We have also determined that there will not be a required contribution for the non-uniform people for their plan; as negotiated in the last contract. Due to their May to May contract, they will not be a requirement based on the payroll for the calculation of the 2016 MMO. 2018 MMO may be different depending on the valuation and the state aid.

5. **2017 MMO's** -. Based right now on the figures we have we are estimating that the MMO for next year for the non-uniform plan to be $83,720.00 which is $107.00 more than the 2016 MMO by and the Police plan is $290,414.00 which is 522.00 more than the 2016 MMO. The Non-Uniform amount differs as the Manager's position salary and the increase in the non-uniform plan pretty much was an offset. The Police will be required to contribute their 2.5%. If the State Aid projection comes out there may be a $500.00 shortage from the MMO and we will then determine the percentage requirement. It is more difficult to determine the Non Uniform, as they do not have a liability anymore, just normal costs. What I do is take the estimated payroll and what the probable State Aid will be. I then apply the 3/7th – 4/7th rule application to come out with the amount due the plan. The Township is required to pay the 4/7th and the balance would be the other employees contributing. This year it came to a negative amount so no contributions are required. I checked with our actuary and he is okay with it. If I do not

do it that way, it is more guessing. Then the employees can say that they contributed too much. There increases are May to May and their MMOs are in conjunction with the MMO process so that I can tell them what they will be required to contribute the following May. My goal is to get it as consistent as possible. I do estimate payroll a little more so that it is more stable. If for whatever reason State Aid is more or our valuations come in well; we are better off and contributions will not be required. Police know they have a shortfall in liability. I can check how many years that is. The valuation will be done next year so the numbers for 2018 may increase. Our assumed rate is 7.5 and our wages are assumed at 4% but our contract fell below so we may be ok. Thomas Schatzman said those assumptions are difficult to maintain. Cathy said that she has been discussing the assumptions with the actuary and we will soon need to make an adjustment. Mary asked if the the non-uniform employees have representation? Cathy said they left their union representation and are now their own collective bargaining unit. They have the ability to contact the Department of Labor if there is an impasse, they do collect dues and have legal representation.

6. **<u>J. Killo Benefits:</u>** Cathy said if you remember we started a policy, a recommendation by the Auditor General's Office, that we notify members of that are active but not employed of any benefits available to them of our plan. We did that at the beginning of the year. We have one previous employee that is eligible for benefits as of January 2017. Mr. Killo is entitled to $35,218.86 lump sum payment or a $296.19 monthly payment. Mr. Killo is reviewing his options and he will forward his paperwork to me when he has decided. I will submit the paperwork to PSAB when received. He left employment in 2006 and he will reach the age of eligibility in January. Mary asked if Jack Cahalan was settled. Cathy confirmed that it was.

7. **<u>Settlement findings:</u>** No Settlement findings received.

8. **<u>Minute Approval</u>:** March 9, 2016 minutes approved.

9. **<u>Meeting Schedule:</u>** Next meeting is scheduled for September 14th at 11:00 am

Meeting adjourned at 12:15 PM.