Lower Saucon Township
Pension Advisory Committee Meeting

Meeting Minutes June 11, 2014

Roll Call: Present – Jack Cahalan, Township Manager, Cathy Gorman, Director of Finance, Priscilla deLeon, Council Liaison, Mary Curtin, Chris Leidy, Lou Mahlman, Joe Scott, PSAB, and Thomas Schatzman, Morgan Stanley

Absent: Molly Bender

1. MRT Report

Thomas Schatzman said our positioning within equities is that we like the US market and the S& P 500. We don't think it's cheaper or overly expensive. We like Europe a little more. Europe has a good opportunity to outperform the S&P 500 over the next 5-7 years. We are incrementally adding to those areas. We have underweighted emerging markets right now. The currencies are the issue, not the growth occurring overseas. We don't want to own those currencies.

Thomas said this is a straight up market. We are higher today because this report is as of the end of March. It would not surprise us at all to get a 10% correction for a sell off. This has been a good market and we have exceeded our all time high.

Thomas said high risk stock is one of the things that MRT does not participate in. The riskiest stocks are measured by balance sheets, earnings, leverage, and safety rankings. The risky stock outperformed the safest by 30% last year. We have not seen a difference like that since 1999 with the internet stocks. We don't participate there and if you trail a little through April, this is most likely the culprit.

Thomas said the EAFE is the Europe Australia Far East index and the biggest components are Europe and Japan; we like both. This market has not returned to break even from the financial crisis because they have not cleaned up their banking systems yet. The catalyst for our economy and markets to get better was cleaning up our banks in 2008-2009. It is an 11% rate of return over the next 3 years if Europe gets back to break even. It pays to invest in Europe when it is cheap.

Thomas said fixed income is the bond side of the equation. We like investment grade credit. We don't like inflation linked securities because we can't find the inflation. You don't own high yield or emerging market bonds. You own a lot of credit and short term, 1-3 year, bonds. The thesis here is if rates don't rise, we have a much bigger issue than if rates stay where they are. We didn't grow at all in the first quarter. We are projecting that we will grow by 3.5% on an annualized basis in the second half of the year. It is a market where rates have gone lower and everything with a yield has become more pricy. We are telling clients to be ready when interest rates normalize. We have a problem if they don't normalize. If they do, which we think they will, you are looking at 10 year rates going from 2.5% to 3.25-3.5%. In that case, everything that benefited from these lower rates will get hurt, namely bonds, real estate investment trusts, and high dividend stocks like utilities. REITS are overpriced. We Like private owned real estate, any real estate with a yield. Buying private gets a 6% yield on rents, leases. Going to an REIT market you are getting a 3.2%. They are moving on from them.

Thomas said the total balanced account is up 2.08% ytd, which trails the 2.79% vs. the index. We suggested to MRT things that are being implemented now and are counter intuitive. For example, Schafer Cullen is at 6.7% vs. 4% and we are terminating them. They have benefited enormously from lower interest rates, which is not stable. We are positioning the MRT for next 3-7 years, not for the now. Shafer Cullen has not out performed over a long term history. A very conservative, high dividend strategy will not do well when rates increase.

Thomas said we also terminated Neuberger for performance reasons. We indexed that part of the portfolio, which improved your performance and reduced your fee. Luther King was terminated because we reached out to do research and they were not responsive and their numbers as of late were not good. We are going to keep real estate, however, when REITS were up 10.3% that was a great exit point because that is the best performing asset class over the last 20 years and overvalued. We are exploring ownership options. None of this makes sense if rates are going down, but it all makes sense if rates creep up.

Thomas said these are not big changes and do not affect equity allocations or fixed income; 85% stays the same. We made changes in indexing, which is a good and efficient use of capital, taking away the interest rate risk, as best we can, in your portfolio. We upgraded your European and Japanese exposure, adding to those areas. We are stress testing the portfolio to see what it looks and acts like in a higher interest rate environment. We are removing those parts that looked good when rates contracted because we think the economy is going to grow. I would not be surprised if we got a pullback because the market was up 30% last year. It would be a natural thing and there is no reason to fear it because we do not see another financial crisis in the future. Mary said are we in good positioning for a pullback. Thomas said pullbacks happen. We react by looking at your asset allocation, which is where all your volatility comes from. We prefer to have managers that have good downside characteristics and you do. The history of MRT is 1% net out performance, net of all fees, and do both with less risk. The reason you performed was you had less risk. You did not take the enormous hit that the rest of the world took in 2007-9, but you took a big hit. A lot has to do with the way you are positioned going into bad times. We prefer mangers with good downside characteristics.

Thomas said we added the longer term numbers. The total balanced managed account in 1999 was 6.92 vs. the policy index of 5.96. It is 6.9 vs. 5.9 with a risk of 8 vs. 10 in March 2014. You did better and you did not take risk, which is the reason you did better. We are keeping that posture for MRT, which is making it successful. We are in good position.

Jack noted the ones terminated, did they go to the MRT for selection or approval. Joe stated that the terminations do go to the MRT Board. They have 50 – 60 choices and the Board narrows it to three or so. Thomas said the biggest move is from Schafer Cullen to Boston Partners, who does not advertise, which is why no one has heard of them. They have terrific numbers and a stable management team that owns half the company. The portfolio managers have substantial amounts of their own money in the product, which we look for, and they have very good long term numbers. The firm that replaced Luther King is 100% employee owned Apex Asset Management. Very good Thomas said Joe Scott can provide performance and research on those companies for you.

Jack said it sound like the decision was made already. Joe Scott choices were made. He said Tom's group took over in January, but they had from November to January to do the research and provide a plan. Thomas said the task was to move the portfolio in-tact, but review the managers at the same time. Your short term fixed income is the majority of the portfolio, almost $50 million in assets. The core is $12.6 million and it came over that way. Thomas said the short term gives you an opportunity to do well, in the 1-3 year space when rates rise, because we have something coming due every month. We would welcome an increase in rates there.

2. Financial Reports

Cathy said as of June we issued payment of administrative fees to the non-uniformed plan for $7,412.79 and to the uniformed plan for $20,071.16. Note that we did miss March's payment, but we have caught up as we are contractually required to deposit and issue payments monthly.

3. **Act 205 Filing – Preliminary MMO's**

Cathy said I have been working with our actuary on the preliminary numbers and wages for the end of this year. The possible 2015 MMO for the non-uniformed plan is $84,866.00 and for the uniformed plan is $277,181.00. The comparison to 2014 is that the non-uniformed obligation is $88,862, making our requirement for 2015 lower, and the uniformed plan is $272,162, which is an increase of approximately $1000. The reason is due to the actuarial evaluation and our projected returns which lowered our amortization payments on the liability end.
Mary asked in the employment agreements are in place. Cathy said the non-uniformed is being negotiated and uniformed will start negations this year for 2015.

Priscilla questioned the about the expiration of the Non-Uniform contract. Jack advised that several dates had been scheduled and we have been trying to sit with them but we have not been able together. Priscilla asked who is the Council members working on the contract and who is representing the workers. Jack stated it was Tom Maxfield and Ron Horiszny and Pat Connelly is representing the Non Uniform employees. Priscilla said that the contract has been open for a long time. Mary added that any retroactivity would have a big impact. Joe noted that any retroactivity would possibly impact the plan. Jack stated that the union was advised that there will not be any retroactivity.

Cathy said we are estimating that our state aid will be a little over $190,000.00, which is what we received last year and what we typically budget. This year we are looking at paying close to $170,000.00 towards pension plans, on top of state aid. Cathy said I will bring this back with updated wages to the September meeting for final approval. Cathy said in comparison to other municipalities, we are 86% funded and in good shape. Our actuarial evaluation came in pretty well. There was a huge deviation because we changed our assumption and life expectancy time table changes. We did have a larger increase initially, but now have stabilized. Our target is to get rid of our liability, primarily with the uniform plan.

4. **Settlement filings**

a.) None

5. **Approval of March 12, 2014 meeting minutes-** All in favor

6. **Adjournment:** The meeting adjourned at 12:01pm.

7. **Next Meeting:** September 10, 2014 @ 11:00 am