Lower Saucon Township
Pension Advisory Committee Meeting
Meeting Minutes December 11, 2019

Roll Call: Present – Thomas Schatzman, Morgan Stanley, Joe Scott, PSAB, Chris Leidy, Molly Bender, Brian Courtney, Priscilla deLeon, Council Liaison (via Phone), Leslie Huhn, Township Manager, Cathy Gorman, Director of Finance 11:05

Absent: Mary Curtin

Cathy thanked everyone for making the attempt to come in today. It is nice to see people come in especially since we have people coming in from Harrisburg so, thank you. First on the agenda is Mr. Schatzman.

1) Morgan Stanley Report –
Before he gets into the performance he wants to talk about a few things. A few things that affect the way we are positioning the MRT. These things explain the good performance we are seeing. We are up 15.2% as of last night, well ahead of our actuarial assumption. It should help funding. We are trailing the market by about 1% and the reasons are reasons we have not seen in a long time. On page two on the lower left hand side, we see the performance since last market peak in October of 2007. Large value stocks were up 113% and Large Cap Stocks were up 238%. That is an enormous difference. To put that in perspective on the next page, the difference in returns between large growth stocks and large value stocks is more extreme than it was in 1999. In 1999 there was the dot.com bubble and the bursting of that bubble. We have a little more positioning in these companies right now in the MRT because we think they are really cheap versus their benchmark. That has cost a little bit of performance but at some point these two asset classes have the same rate of return over a long period of time. What happened in the 1999 bubble, you saw almost a 10 year period of outperformance of value stocks versus growth stocks. At some point we are going to turn, we don't know at what point that will happen but we are positioned more heavily in value. Page four we see that the market is not that extensive at 16-17 times earnings, but price to sales is very expensive. It is only a few stocks; Amazon, Netflix, it is companies that people say the stocks are trading at 5 or 6 times the multiple the market is, people were paying much more for these companies. Cannot justify by earnings but can justify by sales; the sales are great the earnings will come later. Sometimes they never come. This is another 1999 like situation. They are watching. On page 5, far right hand side second column in there is a 10 year rate of return on all different asset classes. US stocks by far the best at 13.1% per year; the worst place was anything that touched a commodity; oil, gold. It is very rare for that to repeat. One of the things they are trying to get their clients to do is maintaining our overseas investments. If you look at page 6, it is just another way of saying the same thing. The past 10 years the large cap growth stocks have an amazing performance at 15% a year versus anything else. We are about to enter into a new decade, and we are questioning whether this is sustainable, not for the entirety of the next decade. If you look at the previous market peak, which was 1997 – 2007, it was almost anything but US stocks. We try to remind people we do not want to anchor in on what worked in the previous 10 years. We want to be more diversified and yes it cost us about 1% in performance. Something compelling on page 8, we do have international equities, we do have European equities. A good way to read these charts is on the left hand side we are seeing the valuation of European stocks. They are at a 60% valuation to our stocks. So there is a 40% discount to our market. We have never seen a 40% discount in those companies; we can go back to 1973 when we started keeping records; you wouldn't find that big of a discount. We understand why it is a mess over there. They have negative interest rates, the Brexit is coming, there are lots of reasons, but these companies are cheap. And if we look at the valuation in the next 10 years, it is suggesting a 12% annualized rate of return for the next 10 years in these companies. We don't think we will realize 12% for the next 10 years but we do think it is reasonable to assume we will do better there than just having the S&P 500. If we look at the S&P

500, its value on page 9, it is suggesting a rate of return of only 3% over the next 10 years. Valuations do matter and we want to be more global. That is why we are there. On page 11 it notes that these cycles can last a really long time. Right now the US has been outperforming the International market since 2008. We know when that turns it will last 10 years or so. If there were an elephant in the room it is on page 13, while we are talking about large growth stocks that we have not seen since 1999, we have never seen this. There are some studies that go back years on interest rates and they have never been negative. This is distorting the valuation of everything. It is one of the reasons people say I don't care if Uber does not make any money this year, maybe they will make money in thirty or forty years, they can borrow so cheaply to stay in operations and eventually they will make money so I will pay a lot for it. Same with Tesla. They make no money. Negative interest rates are ½ the debt in the world right now which is mind boggling. On page 14 it give you an idea as to why our rates are so low. Our Federal Reserve, our cash rates we cut to 1.75% but if you compare it to the rest of the world our rate looks amazing. So if you are a Japanese or German investor, you are buying our bonds. Interest rates are really low and it has distorted the value of things. On page 16, another concern we have, is take a look at the rate of return on a 30 year investment bond. This past year it is 18.5%; those are eye popping numbers got bonds. The MRT, the way we are positioned, we do not own 30 year bonds. We own bonds that pay the bills, ones that make sure we have the monthly payments ready to go out. The way our liability looks is how our portfolio is structured. These terrific returns are a little bit of a mirage. If you take a look at a long period of time in bond holdings, it is just your yield that is all you get to keep. We don't get to keep that 18% return on a 30 year treasury. I am holding it, not selling it. I am just getting my yield. Negative rates are causing this. This is abnormal. In the MRT we want to be a little more conservative. On a positive note, we are in a good economy. We are going to see a good Christmas we think. We look at the sales of Christmas trees through a survey. Christmas tree sales last year were 8% and are now up 25% so we are predicting a good Christmas. We are not sure if it is because of how late Thanksgiving was, we are trying to figure out what caused this. It should be a good season. That is it for positioning. Through October 31st we are up 15.2%, year to date up 13.4% this is because we like value stocks more than growth stocks and we like international companies. We are trying to position ourselves for the next 10 years. Over the last three years, 8.1 this is in line with the median at 7.8 which is close to target. We are doing this on purpose. Did we hurt ourselves this year, yes but we think it is the right thing to do. We just do not see this large growth and tech rally continuing for the next several years. At some point it will matter what we pay for things. In terms of compliance with policy, we see that on page 32. We are right within all of our ranges in terms of policy compliance. We are showing that we are taking far less risk than the market. The down market capture is at 70%. This portfolio is not built to outperform the market that is going straight up. It is built to make sure that we have money to pay the bills. We are conservatively positioned. We do not have any issues with the managers.

Mr. Courtney asked if we are within our percentages are any changes in the allocations from last time. Mr. Schatzman said he does not have that exhibit but he can bring it. Any changes would have been changes done naturally, stocks outperforming bonds. Nothing is outside of target. He can get that exhibit. We did not go into the portfolio and change anything in this period. Mr. Countney asked if their shift from growth to value was adjusted slowly. Mr. Schatzman said in June of last year we took 18 million in profits in the large growth sleeve of the portfolio. I look at that now and say we moved to early. We had 18 million in gains over a two year period and put it in value stocks. Large Value is 12.7 % of the portfolio Large Growth is 9.3%. That drove most of the underperformance. No changes other than that. No changes in manager selection. We are mostly indexed, a lot of money in VanGuard. So we are not paying much for that exposure. We like to be active in international. We want to be active in bonds and fixed income. We do not want to index bonds. Not in this environment. We need to structure the bond portfolio in a way we know we have money coming due every month to make benefit payments. We try to have between 7 and 9 years of liability payments in the MRT in this fixed income portfolio. We did not just come up with the number 35%. 35% is what is needed so if we have a really bad market, we do not need to take equities down at a loss. We have been funding from gains and stocks which is the perfect environment. It can flip flop and we need to take it from fixed income and leave the equities alone. That is the strategy. Page 34 is the fixed income but you are not in fixed. It has done well. Same manager, Wedge. They have done well this year.

Joe Scott has nothing to report.

Mr. Courtney asked if we are going to adjust next time out of growth as time goes on. Mr. Schatzman said I don't think so, what I think we will do is the kind of growth stocks that we own, is what we will change. We do index large cap growth but we have an active manager in here and that manager under owns some of the popular stocks, Facebook, Netflix, Amazon and Google. We are approaching it that way rather than moving entirely. We think it is the right thing to do, we think it is conservative. There is no reason why value stocks are this cheap relative to growth stocks other than low interest rates. At some point all the central banks in the world are saying we think inflation is too low, so we are going to try to create it. And they do it by printing money. Fear is always that they overdo it. If they overdo it we get inflation. If we get inflation then you are going to see large growth companies underperform massively. I don't know if or when that will happen. It is always the risk when they may overdo it. It creates a bond bubble. We don't want to own.

2) Member Resignation – Cathy said we received an email from Mary Curtin stating she is resigning from the committee. Council has already been notified at their last meeting. What we will be doing is reaching out by advertising and putting on our website that we are looking for another resident member. Priscilla asked Leslie to send a letter to Mary thanking her for her service. She has been here a long time. Cathy said she indicated last year that this would be her last term. She is hoping for replacement before our next meeting. Priscilla asked when that was. Cathy said if we are going to keep the same schedule, March 11th. Priscilla said at Reorganization is when we make appointments if we have applicants. Cathy said we have time.

3) Act 44 Compliance - Cathy wanted to note for the minutes that we have received the forms from our consultants and they are posted on line as required by law. Anyone who wishes to find that information they can access it on our website.

4) Financial reports - Cathy provided the listing of the paid administrative fees and MMO payments. Throughout the year we have made the final MMO payment which was the Township's funding in November and based at least on the October report we have exceeded our actuarial assumptions so hopefully by the end of the year we will have enough gains to cover any shortfalls that might happen next year so our valuations won't be so high. Joe said we would all like to see that.

5) COLAs – We have colas for Ron Jones an increase payment pf 1.5% getting him up to 18.53% increasing his amount to $3,739.63 a month. Mr. Young's increase is also 1.5% getting him to 17.01% increasing his monthly payment to $4,351.28. And Glenn Williams is due in March and his increase will be 1.7% increasing his monthly payment to $3,495.50 and he is at 27.1% almost at the maximum permitted. If you remember, we would have normally had Mr. Sfredda as well, however, he has reached is maximum cola.

6) Settlement Filings – There are none.

7) Approval of September 11, 2019 minutes. If you have had an opportunity to review she will post on the website.

8) Next meeting March 11th at 11:00 AM. If there are anyone who has any suggestions of changes of date, time or how often. The consensus was to keep the all the same.

Adjournment – 11:30 AM