Lower Saucon Township
Pension Advisory Committee Meeting
Meeting Minutes June 10, 2020

<u>Roll Call</u>: Present – Thomas Schatzman, Morgan Stanley, Joe Scott, PSAB, Sgt. Chris Leidy, Molly Bender, Brian Courtney, Jonathan Mull, Priscilla deLeon, Council Liaison, Leslie Huhn, Township Manager, Cathy Gorman, Director of Finance 11:02 via Zoom.

Mr. Schatzman had difficulty so meeting started with Joe Scott.

PSAB MRT- Joe has been getting a lot of questions in the last month or month and a half. In 2008 – 2009 the State did some things to give us relief through legislation. Some of the questions now, due to the drop in the market and everything else going on, are they planning on doing anything. The word is from legislative affairs is that there is nothing on the table right now. I think what is going on right now that they may not have had a chance to think about that or they are waiting to see how the stock market rebounds. My theory is that they will wait until the end of the year to make a move about something like that. Cathy said she thought they would wait until the end of the 3rd quarter. Joe agreed, at least. Right now it is not even on the table. Even in the subcommittees they are not even discussing it. Jonathan added that we are down 2 -3 % for the all-time high of the market so there is not a lot of rebounding left to do. Joe said exactly. He thinks they are going to wait and see what happens at the end of the year. Brian said they are going to wait for all the defaults to roll in.

Cathy said we did not lose as much as we thought, so even it if 0 return, with last year's 12%. Joe said he does not remember where we ended last year maybe 12.5%. It rebounded nicely. We may still meet our valuation numbers. Brian said it is not going to hold. Jonathan said it will be ok in a long term perspective, not what is going to happen in the next 12 months. Brian said if you are looking out 15 years, I agree.

Morgan Stanley – Tom Schatzman began by reviewing his prepared report. Tom said we have had through May, through the quarter we are up 15%. We had a nice rebound but that is through April and May. This is just showing you through April. The type of portfolio we have with PSAB is that we are not going to own certain names. On the left hand side, May 2020, the best returning stocks are high-beta or higher risk companies. What we really like are quality companies, and we have some value companies. Some of those factors, minimum volatility names, all of those sort of underperform. What is performing best are the names that have high volatility, some have very low earnings or no earnings. We have always under-owned, Netflix, Facebook, Amazon and Google. We own them but not to the extent that the market likes them. One of the things that is happening is, our GDP growth forecast for the second quarter which is scary, is down 51.1%. We don't know where it will be but it is certain to be around 40% maybe as much as 50%. We have never seen this before. What happened was the stay at home stocks, such as Zoom, a perfect example, of a company with no earnings but the stocks did great. We won't own that kind of a company. We had some companies that had some economic sensitivity that are not tech stocks. Netflix did incredibly well, Amazon is doing incredible well in this stay at home economy. But we do not think this is going to remain a stay at home economy for very long.

Why is the market positive at all? If we are down 51% GDP, it is because what the Fed has done is that they have taken the interest rates to 0%, they have provided a lot of liquidity to the markets, but more than that is the economic or fiscal stimulus that has come from Congress is about 13% of GDP. To put that into perspective; the Great Depression stimulus was about 8% of GDP. So we have lower interest rates then we did during the Great Depression, and we have massive stimulus greater than what was done in the Great Depression. This is why the market is up when the economy looks terrible.

If we look at quality versus junk; what we see in this rally is a large underperformance in quality versus junk so this is a junk rally; we hate junk rallies. We participate but not as much as the market does.

This is important. We haven't had much of a performance issue, but we have lagged in these tech names. We are more suspicious of them. The five largest companies in the S&P 500 is the blue line, and we got to 20% concentration during the DOT.COM bubble. It was Cisco, Intel, Dell, Microsoft, and General Electric were the top five. If we fast forward to today it is Facebook, Amazon, Netflix, Google, Microsoft are again the top five, those concentrations rarely reach where we are today. We only saw this in 1999 and the aftermath of that was terrible. But it also shows you something else. The next 25 largest stocks in the S&P 500 are not doing anything. So it is just those five names. So if you have owned them, and we have done some indexing, we are fine. Where active managers have gone, they are just not going to own 10% in any of these names. All of these names if you own 7-8-9% you are under lining index. We are suspicious of that. When we hit these peaks, you tend to see big leadership shifts, you go from large caps to small caps and we go from growth to value. We continue to think we want to own value names. We do not over own them but they have been a source of negative returns.

Brian said he has a question. Last time you presented a similar thing, and I kind of agree with shift, have you made any shifts to your portfolio as a result? Jonathan said, Thomas was there but Brian was talking about growth, questions about growth at our last meeting versus value. Am I right Brian? He is asking have you shift any assets from growth to value? Brian said last time there was barely a shift. I was arguing to stay in growth. Had we done that, it would have been nice. Tom said what we did in March was neutralize our growth value and we neutralized our international domestic. We had a slight overweight to value, coming into this year that we neutralized. We had a slight overweight to international that we also neutralized. Just given market dynamics, in a normal market environment, value stocks were very cheap. They have been doing very well the last couple of weeks, but we are equality distributed between the two. Brian asked so you did not take advantage of the value being knocked down at all and shift? Thomas said we had taken advantage of value, 50% of your large cap portfolio is in value stocks so we gotten the benefit. Thomas said we just do not want to make big bets. Brian said he was not asking for a big bets, he is agreeing in theory but the question is are you doing anything to show that you believe what you are saying? Thomas had difficulty hearing. Brian said if you believe that the next opportunity is in value, why are we not shift more into value? I am not saying sell everything, I am just asking if you had done anything to shift more into value. Thomas asked to shift more into value? Brian said yes. Thomas said we were overweight in value. Now we are equal in value. We do not want to overweight value. Brian said so what you are doing is justifying why you were so heavily weighted in value. Thomas said but we are not. We have equal amount in both. Brian said ok, continue.

Thomas said here is what we are watching for. We are being careful with past strategies. Value and small cap should being to outperform in the next phase. We are starting to see the beginning of that. Again, we are not making big bets one way or another. Jonathan said small caps have weathered this well, wouldn't you say? Tom said small caps took a big hit but they are coming back. Small caps are the best performers. I do have your May numbers. As I go through some of these managers I will talk to you about. Wedge was the worst performer. Wedge made value; was our worst performer and they are up 30 percent in the past two months. Small cap, by far, has been the best performer. Year to date growth is still well ahead in value, but, especially in the last month, value is well ahead of growth. Some leadership changes among managers; that we have benefited from. If we take a look at the year to date, through April, we are in line with policy and ahead of the median balanced account. We are sticking to our allocations here, we are tight around our allocations. We have a little bit of an elevated fixed income position right now. That is the equity portfolio. Losing ground based on the fixed income portfolio. We always keep three months in cash for the outflows in the MRT. Brian asked if the real estate investment is commercial. Thomas said the real estate is private, it is a combination of warehouse, multi type family housing. It has no retail exposure, no malls, it has some commercial real estate but it is not in New York City but in San Francisco, Austin, Texas; higher growth areas, and it held up incredibly well in this sell off. Jonathan asked how did the fixed income portfolio hold up? Is it an actively managed portfolio? Thomas said we were down about 4 – 4 ½ percent in fixed income, the

reason being is that a lot of liquidity dried up in these corporate names. They weren't downgraded, there were no bids for them. Jonathan said the spread was significant at certain times, right? Thomas said it was, still it is not as significant as it was. There still is a pretty good spread between Treasuries. What happened was basically people went to sell all their front end; one to three year corporate bonds, and a lot of companies needed to raise cash. They hit that front end very hard; as much as down 5 for the VanGuard index. Short term corporate bonds were down 5% which is incredibly rare. We regained through the end of May. Jonathan said it wasn't worth selling at that point, you did not need the cash or did you? Were you selling at that point at all, any of the fixed income positions? Thomas said this is the importance of that three month cushion in cash. We did not sell a thing to meet what was spent. The liquidity of the fund did exactly what we needed it to do. For the most part not every bond was down. If the MRT needed more than 1.5 million, we would have been able to raise it easily, within our fixed income portfolio at profits. Some of the bonds were down. The liquidity component does hold us back, it does hurt our returns, but we have to have it. It is 7 to 10 years' worth the outflows; represents that 35-36%. It is not an allocation that we are backed into; we need this. Jonathan said it makes total sense.

Let's talk about these managers. Large amount of indexing which has worked out really well as we all know. Robeco/Boston Partners is having a terrific year; up about 24. Winslow is up around 22. Wedge which was our underperformer is now just up over 30 for the quarter. Both small cap managers up over 20%. Mid Cap Growth up over 20. One of the managers that we had concerns with which was Causeway. They are out performing their benchmark. Then there is Wedge Core fixed income and Short term. That short term pool is pretty big at 59 million. That is the source of liquidity, if we go beyond the 1.5 million. We did add CS McKee in fixed income and Bentall Kennedy, a private equity real estate manager. Anyone who wants to go deeper in the managers, I will be happy to do so. I will be happy to have the call. Brian said he is more interested in what you are shifting, why you are changing. Joe said that he thinks that Jeff Herb had spoken about that positioning that you did earlier, that there was shifts to the portfolio prior to the drop in March and how that has effected positively or negatively, and what we did on the back side of that. Thomas said adding private equity real estate was definitely a big benefit for the funds. We are getting about a 3.9% rising income stream from that portfolio, it held up incredibly well. We have taken your indexing from 0 to a majority of your single manager positions are index funds; that we brought in and that has worked out really well. There were some detractors in terms of manager selection; Wedge and Causeway, that in a normal world those managers do very well but in a world of a forced shut down of everything, they got some economically sensitive names in there. Causeway had some airline stocks, bank stocks that were doing incredibly well but are very leveraged to the economy. That is where we missed in that 1st quarter. It was so fast we had no ability to adjust. Even if you said you wanted to be more defensive in a sell off, the offensive names provided the defense. Jonathan said the shift in energy was dramatically quick. You are adding insult to injury, you have one issue with Saudi Arabia destroying energy prices, those dividend payers like Exxon, everyone likes in their defensive portfolio, pummeled. Thomas said anything with a dividend got hurt really badly. In March we were saying it is the virus plus oil. Oil is trying to resolve itself. To own the defensive names was the worst thing you could have done. What you really wanted to do was load up on the really aggressive stocks with no earnings like Tesla. Those were the home runs. Brian said that was why he was arguing more growth last time. Thomas said right. Jonathan said the objectives of the portfolio are that you just cannot take huge swings at volatile companies in the near term for results, it won't work. Thomas said here is why we are equal with growth and value. Performance had some market peaks in 07, values up 58. Performance level in 09 dives 280. Those are differences of 150% let's say. We have never seen a difference that great. We have seen similar to this, the DOT.Com bubble. What we are not going to do is make a bet on one or the other. Having growth would have been great during the 1st quarter. Having value is great right now. We have yet to find an active money manager that is consistently good at deciding when to add growth or when to add value. What we really like to do is own both and then have some manager selection within that. Today if you wanted to have growth in the portfolio, my only response is it is there and it is always there. And

to pit one against the other, to go all growth, is a terrible mistake. Brian said you never go all. Just a shift in the percentage, that is all. Jonathan said hind sight is always 20/20 in this business. Brian said we all predicted they go to 0%, we knew it was coming. Thomas said if we look at growth at 21 x's earnings, and value at 11 times earnings, growth is very expensive. Jonathan said chasing it is not good. Brian agreed, now is not the time, that is why he is asking. Now that we know growth has popped, what are you doing? Are you going to keep the same percentage even though you know growth is going to take a hit or are you going to keep the same percentages? That is all I am asking. Why not move 1% out of growth and move to value. You know that value is the right long term thing, why not move now? Thomas asked why would you think that we know that? Brian said based on your presentation. Thomas said you can always find a flaw in any portfolio, we are not the firm for you if you want to make bets. Brian said that is not a bet, he is asking why you are not putting the money in where the opportunity was. Thomas asked what are we supposed to be doing now. You tell us what we are supposed to be doing? Brian said if you are going to present the opportunities here, all I am asking is if you are shifting to accommodate that or is the strategy to sit and hold the whole time, no changes? That is all he is challenging. He is not saying sell all growth and go in to value. He is saying did you move a percent or a tenth of a percent, what is the allocation? Thomas asked where is the allocation? Brian said are we shifting anything? Thomas said let me say it again, we neutralized growth and value, we neutralized international and domestic during the sell-off. We took off the value tilt added to growth, we took off the international tilt and added to domestic. Both added value. Brian said ok. Thomas said so those are what we did but I already went through that. So right now we have repositioned and this is where we are. Brian said his question was what did you reposition? That was his question. Thomas apologized he misunderstood. He did not know what you were looking for.

Thomas said dollar wise we were at 284 we are getting back to the 300 million balance. We continue to do well. Joe said are we still in the red? Thomas said we are not in the read, we are slightly ahead for the year. We are going to add a quarter to date column. It will show quarter to quarter which will be a little easier to see. That number was plus 12 at the end April it is like plus 15 now. I know you (Joe) and I have talked about revamping this a bit. We are going to make the report a little more user friendly in terms of where are we today. As of today we have a pickup of around 10 million. Brian asked if he thought they still believed that a big part of that would go away once the bond prices fall back. Thomas said he cannot imagine that we are not positive right now. Jonathan said his numbers were as of 3/31. Joe said we probably do not have the most recent numbers yet.

Cathy said while we are waiting should she continue. Cathy said she provided the Uniformed and Non-Uniformed preliminary MMO's in the packet. Our potential obligation for the Non-Uniform is $138,308.00 and the Uniformed is $456,672.00. It is a little more than $9,000.00 than what we are obligated for this year. We are at the point where starting January 1, our actuary will be doing his valuations based on the last two years, and coming up with the new valuation which will increase or decrease #5 the amortization payment for the liability of the plan. Hopefully it will decrease it. From the last valuation the liability was 1.4 million for both plans; 1.1 for the Uniformed and about $300.000 for the Non Uniformed. So depending on how the end of the year looks, it will determine what the MMO's will be for 2022 and 2023. I have not heard anything about State Aid. We usually get around $230,000.00 based on our reporting to help us pay for this. I will come up with numbers closer to the date with the 2020 payroll records when we need to forward to Council in September to be approved by Council. Priscilla said her usual questions, this is what we will be looking at for the budget. The actuary will be looking at this for the valuation this coming January, looking backwards to see what we get. Cathy said yes. Line two is the estimated payroll, this is where we always want to be, we need to work on lowering #5, the amortization payment; that is the big issue. Cathy said this is based on our current retirees, employees, assumption rates, mortality table and status of investments. When our actuary applies his science to these items, and includes what the plan has gained or lost in the last two years, he comes up with an amount needed for the plan. Obviously if we have two good years that line

item would go down. If the COVID 19 pandemic impacts the third and fourth quarter, we may be looking at similar MMO's for the next cycle. We just don't know yet.

The financial reports were provided. Cathy noted that we are making payments on a monthly basis as recommended. We are a little behind due to COVID and the shutdown. I will report the projected state aid when received. This won't come out until September. Again, we are trying to maximize the investment returns by periodically spreading out the required funding. Report on file.

Cathy reported that there were no settlement filings received.

Cathy requested approval of the March minutes and to schedule the next meeting for September 9th.

All agreed

Cathy said that is the conclusion of the meeting unless Mr. Schatzman had an answer. Tom said that yes, we are at 304 million today, we are up 16.13% for April -May- June; that is quarter to date, June. Our one year number is plus 432. Year to date down 144, we picked up about 6% in the month of May. Again the one year is now positive 432 from a minus 2. We have seen a significant recovery in the portfolio. We were down 14.3 in the first quarter. It has been tough, it has been a rough ride. Joe said we appreciate the effort.

Meeting ended 11:48