MINUTES OF MAY 10, 2012 RETIREMENT BOARD
CITY OF ALEXANDRIA FIREFIGHTERS AND POLICE OFFICERS PENSION PLAN
DUE DILLIGENCE MEETING

PRESENT

Members	Others
Michael Cross [3, 5,6]	Carlos Asilis, Glovista
Michele Evans [1, 2]	Steven Bland, Retirement Administrator
Tom Gates, Deputy City Manager	James Bland, BS Economics U. Wyoming
Bruce Johnson [5]	Barry Bryant, Dahab Associates
Shirl Mammarella [3,4]	Nathan Carrick, Finance Department
Ed Milner [1, 2,6]	Al Chan, Brandes
Morgan Routt [4,6]	Arthur Lynch, Retirement Specialist
Al Tierney [5]	James Pontone, Johnston Asset Management
Laura Triggs [3, 4 ,5,6]	Theresa Nugent, Communications Specialist
Michael Wimer	

Absent:
Pat Evans [1,2]

[1] PLOP/DROP Committee
[2] Purchase of Service Credit Committee
[3] Technical Corrections Committee
[4] Training Opportunities Committee
[5] Vendor & Service Provider
[6] Adjustment Mechanism

CALL TO ORDER

The meeting was called to order at 8:39 AM.

Chairman Cross mentioned the transition of Ms. Orr leaving the Board and, Mr. Routt moving from alternate to voting member, and welcoming back Mr. Gates as an Alternate.

Chairman Cross would leave for a portion of the meeting. He suggested Mr. Bryant lead the meeting during this period. There was consensus amongst Board members.

Chairman Cross recognized Ms. Orr for her participation on the Board for three years.

Mr. Johnson arrived at 8:45 AM.

APPROVAL OF MEETING MINUTES

There was a motion by Ms. Triggs to:

> Approve the minutes of March 8, 2012.

Mr. Milner seconded the motion. The motion passed 8 – 0.

There was a motion by Ms. Triggs to:

> Approve the minutes of April 12, 2012.

Mr. Milner seconded the motion. The motion passed 8 – 0.

FINANCIAL REVIEW

Mr. Bryant and staff discussed financial results for the quarter. It was spectacular, and it followed a rather strong fourth quarter 2011. First quarter 2012 was the best quarter for markets since the 1990's. On balance our managers did very well in a strong market. It remains to be seen how they do in a difficult market.

The economy slowed to a 2.2% growth rate. Unemployment is coming down slowly. Some of this may be the way data is processed. That the unemployment rate is coming down slowly may not reflect new jobs and increases in employment but that many people are giving up on looking for jobs and no longer considered part of the workforce.

Industrial capacity is below 80%, yet companies are highly profitable.

Conditions in Europe are holding back markets. Spain is approaching a recession. Austerity measures are being questioned.

Growth continued to outperform value. Staff questioned if Growth was outperforming because of weak currency. Mr. Bryant said housing, education, and government were drags on the economy. Mr. Tierney asked if less government might lead to less spending for the technology sector. Mr. Bryant said the largest loss was to blue collar jobs that were not going to be reinstated after an economic recovery.

Mr. Johnson and Ms. Evans left the meeting at 8:57 AM.

Mr. Bryant reflected enthusiasm for the farm sector.

Herndon underperformed in the fourth quarter of 2011. The drag on their performance was companies with large exposure to Europe. Herndon stuck with those companies and they did well in first quarter 2012.

Mr. Bryant discussed Apple Computer. The company stock gained 48% in the quarter. Its impact on quarterly performance is profound. Tracking error – a measure of not following a benchmark – can be significant if a manager under-owns a security that is a dominant part of an index. Mr. Bryant and staff will discuss tracking error at an upcoming meeting.

Another issue with Apple Computer is that it is held by Polen, the growth manager and Herndon, the value manager. Polen owns it for its growth in earnings. Herndon owns it because of its valuation metrics.

Mid cap and small cap underperformed. This was expected in that both had a history of somewhat conservative investing that led to downside protection at a cost of smaller upside participation.

Hamilton Lane's primary private equity had initial weak performance because of the "J-curve" phenomenon.

Prudential Real estate (PRISA) was doing well and core real estate is being bid up, possibly too much.

PIMCO did well. They continue to outperform the market following a significant underperformance in mid-2011.

Chairman Cross asked about the delayed reporting of limited partnerships. Mr. Bryant said the protocol Dahab Associates had established was to enter in zero for the period in which no data was available. Then, when data became available they were restated for these periods. Staff asked if this meant the manager performance alone was restated, or was the total portfolio performance also restated along with peer rankings. Mr. Bryant said these measures were all restated.

In discussing the defined contribution plan Mr. Bryant said the Lifetime funds were better than the stable value funds for those who did not wish to review their investments.

There were ten to twelve respondents to the Request for Proposal (RFP). There would probably be three brought to the Board for consideration. The Board expressed a preference for Dahab associates to select the three or four finalists.

Fees are sometimes difficult to identify.

Ms. Triggs suggested it would be good to bring ICMARC and two others. Chairman Cross said it would be okay to bring more.

Mr. Johnson returned at 9:44 AM.

There was a discussion of QDIA (Qualified Default Investment Account).

INTERNATIONAL INVESTMENTS

JOHNSTON ASSET MANAGEMENT
Mr. Pontone of Johnston Asset Management (JAM) joined the meeting at 9:50 AM.

Mr. Gates left at 9:52 AM.

Mr. Pontone said JAM invests in high quality growth stocks that are priced at a discount, usually because of a one-time event. An example of a one-time event might be the Japanese tsunami that caused significant damage last year but many overestimated the impact. Their target hold period is 3-5 years. They typically hold 20 – 30 stocks. They said they had downside protection. Staff suggested that the valuation metrics at the time of purchase at a discount would provide downside protection, but that as a security begins to recover and approach an “average” price the downside protection would be less. Mr. Pontone agreed. He also said they were very strict about their sell discipline.

Mr. Cross left at 9:56 AM.

Mr. Bryant asked if the JOHNSTON was a GARP (Growth at a Reasonable Price) manager. Mr. Pontone suggested there was a focus on price, but that growth had to meet high standards. (GARP is sometimes thought of as paying a modest premium for modestly above average growth).

2011 was a difficult market, but JAM did well in the second and third quarters, which were down markets. They did okay in the 4th quarter.

Staff asked if JAM’s growth bias called for a benchmark of EAFE Growth rather than EAFE. Mr. Pontone and Mr. Bryant agreed there is a very small difference between the two. It is probably not worth distinguishing.

The Euro is getting cheaper, Germany, being the biggest exporter, did the best.

LTRO (Long Term Refinancing Operations) were providing significant help to the impacted banks.

Ms. Evans left at 10:08 AM.

Mr. Johnson referenced the Greek and French elections. He asked how JAM is positioned for changes. Mr. Pontone said the results were anticipated. The exposure to Europe had gone from 75% to under 70%. He was also concerned that profit margins had peaked. The 24% weighting to companies domiciled in the U.K. may be misleading. The portfolio has only1% of sales in the U.K. The U.K. investments are largely selling to emerging markets.

Mr. Tierney asked about the European versions of our Federal Reserve Board’s Quantitative Easing. One of the concerns of the Germans is that if they do not bail out the countries like Greece then they will have to bail out their own banks.

Inflation is less of an issue in emerging markets. China targeted inflation in 2011 by tightening their money supply. The Indian equity markets rallied after inflation was brought under check.

JAM had a 27% weighting to healthcare. They sold all of their Novartis holdings as they feel growth will slow. They cut their Roche holdings in half for the same reason. Jam disposed of its

Qiagen holdings. Healthcare is now down to an 18% weighting, but it is still above the benchmark weighting. JAM is comfortable they continue to find innovation in testing, biotech, and pharma. They underweighted financial companies, and that took a toll. Recently healthcare underperformed the EAFE index.

Repsol, the Spanish oil company, had its holdings in Argentinian oil company YPF expropriated. This may well hurt Argentina as foreign investors will be reluctant to invest in Argentina. Repsol may still be attractive. Staff asked if they would buy more. Mr. Pontone said as long as the growth profile remains attractive.

SGS is in a fragmented industry and it is consolidating.

ASML spends more on R&D than the revenue of its next leading competitor. It will remain state of the art. Ms. Mammarella asked where they are headquartered. Mr. Pontone said Netherlands.

Mr. Pontone expects prolonged periods of slow growth.

GLOVISTA
Mr. Asilis joined the meeting at 10:48 AM.

Mr. Bryant discussed the use of Exchange Traded Funds (ETFs).

Mr. Asilis discussed how the fund has been run since July. The European debt crisis is an event without precedent. It is a global risk event. Its ultimate resolution will impact the value of the dollar and global liquidity. In this context the portfolio has aimed to keep tracking error below 4% where the usual strategy is to limit tracking error to 15%. They use a very tactical strategy.

Long term Mr. Asilis is very constructive. However, he does expect volatility.

India has done well recently. He had been cautious, and then increased weightings in December.

He had underweighted Korea.

Malaysia did well, but he underweighted it because it was already expensive.

He is focusing on Taiwan, and likes the currency and interest rates.

Referring to page nine, Mr. Asilis discussed emerging markets as a whole. The use of capital in emerging markets is more effective than in developed markets. Graphs on page ten demonstrate that debt has a large spread and equity valuations are modest.

Correlations between emerging markets are higher than they have been in years.

Mr. Asilis has a top down strategy. Once he selects macro themes his partner, Mr. Bhatt, does bottom up work.

The fund overweights China and underweights Brazil which is cyclical, and Mexico whose companies are too defensive.

He believes the Japanese Yen will weaken.

The selloff in emerging markets has been too much. He has been deploying cash. He likes those producing materials, Brazil being the largest. He also favors energy, Russia being rather attractive.

Mr. Asilis said copper was tied to the China of the past growth. However, going forward he believes much growth in China will come from consumer goods, an internal market rather than export driven.

He seeks more clarity on the Euro zone. He believes markets are worrying about restoring a financially sound footing. Spain, Italy, and Portugal are not competitive. The answer is that the currency, the Euro, will collapse. Historically there must be a combination of debt restructuring and financial repression. Currently there is financial repression in the United States. The last time this took place followed the money center banks lending too much to Latin American countries in the late 1970s and those countries getting into trouble in the 1980s. To help the money center banks recover the Federal Reserve Board manipulated the yield curve.

Mr. Asilis worries about the financial sector. If Greece exits the European Union, what is the mechanism for doing so?

Mr. Asilis believes change is fast approaching. A major debt matures soon and this may force the issue of restructuring. Greece needs resolution of the European collation. The French election may limit the amount of austerity.

BRANDES
Mr. Chan of Brandes joined the meeting at 11:24 AM. They are a bottom up focused company. Page five of their presentation shows how they assemble a portfolio. The analysts are assigned industries as opposed to countries. This facilitates better comparison between competitors.

Brandes focuses on the sell discipline.

Emerging markets look cheap today. Institutional investors are used to there being crisis within emerging markets. Individual investors may move money in and out of the asset class, but the institutional investors know the countries and companies are more stable.

The Emerging markets as a whole have better funding than they have had in the past. They are borrowing with longer terms and with narrower spreads. This creates more stability.

In the last five years forty million Brazilians have moved from poverty to the middle class.

Brandes added India in 2011. They had no exposure in 2010.

Cemex, the Mexico based cement firm, did very well.

South Korean investments have not done well. KEPCO, the electric utility, has not been granted the rate increases they are due.

They find Brazilian water and waste utilities attractive.

Panama is not in any index. This is an attractive market.

Saudi Arabia is a frontier market. Brandes has gone from 0% weighting to 5% over 12 months.

Page eleven shows a huge spread between the valuation metrics of some companies and those of the MSCI emerging market index.   Usually spreads are much smaller.

Page twelve displays the flexibility of the mandate to invest in small, mid, or large cap. Mr. Chan discussed the conservative nature of the mandate and their expectation to outperform over market cycles by outperforming in down markets, though that may mean underperforming in up markets.

Chairman Cross returned at 11:45 AM.

GROUP DISCUSSION
Mr. Bryant said he believed the United States is lagging behind Europe in austerity efforts.

Mr. Asilis said that in 2009 the new government revealed the hidden debt of the old government.

The true debt of the United States is 500% of GDP.

The action of the Federal Reserve board in 2008 was correct.

Mr. Bryant asked if Europe should have a more stimulative fiscal policy. Mr. Asilis said the European finance and labor market are inflexible. The U.S. has more flexible labor market and favorable demographics. The dollar is weakening, making the U.S. more competitive.

The dollar, by virtue of having a single and independent Federal Reserve Board, is better managed than the Euro.

The U.S has the advantages of leadership in media and I.T.

Mr. Pontone asked if the European leadership should have been more stimulative in the very beginning.

Mr. Asilis said growth must exceed the inflation rate. Greece will exit the Euro. Mr. Pontone asked how that can be done. There is no mechanism for exiting the E.U. Greek debt is due in June. This will force a resolution, soon. French and German banks are getting out of trouble as the ECB buys Greek and Spanish Debt.

Mr. Tierney asked for a scenario analysis. Mr. Asilis said the most likely case is that the Euro survives without Greece or some other country. He looks forward to the next crisis as it is a buying opportunity.

Mr. Pontone said the Euro will survive. Growth will be challenged for a long time in Europe.

Mr. Asilis is looking outside of Europe. He expects vicious markets, and that the strong will survive. He stresses a strong balance sheet.

Mr. Pontone said multinationals are in fabulous financial shape.

Mr. Milner returned at 12:24 PM.

Mr. Tierney asked if Greece and Spain were to quit the European Union. The consensus was Greece leaving would be a non-issue, but Spain was large enough to be a significant issue.

Mr. Chan said Brazil had inflation as high as 6,800% per year. The emerging markets are now a safe haven. People change. Companies change. Countries change. Policies and governments will adapt, they have too.

The meeting went into recess at 12:30 PM for lunch. The meeting reconvened at 1:01 PM.

NEW BUSINESS

Chairman Cross, Ms. Triggs, and Mr. Milner discussed the 2011 efforts of the Ad Hoc Retirement Benefit Advisory Group ("the Group"). The Group delivered an oral report to City Council in October. It delivered a written report in November. There remains a need for the Fire & Police Board to work with City Management to come up with a recommendation to City Council in time for developing the fiscal year 2014 budget. The Group may make recommendations for changes in employee contributions, changes in benefits, what event(s) triggers the change, what event(s) may lead to a restoration of the benefits, etc.

There was a motion by Mr. Milner to:

> Create a committee composed of one Firefighter, one Police Officer, two management representatives, and staffed by the Pension Administration Division to continue the efforts of the Benefits Advisory Group and recommend an Adjustment Mechanism.

Ms. Triggs seconded the motion.

Discussion included a question of expense for an actuary. Staff and Ms. Triggs said funds were previously approved for this purpose and that was enough to get started.

Mt. Tierney said there may be a lot of plan participants who become very unhappy to hear of these potential changes. Mr. Tierney and Mr. Johnson both asked that employee communication be specifically added to the Committee's tasks.

The motion passed unanimously, (7 – 0). The representatives will be: Ms. Triggs, Mr. Routt, Mr. Cross, and Mr. Milner.

ADMINISTRATOR'S REPORT

REGULAR INVESTMENT REPORTS
Staff discussed the cash flow report. The pension component is cash flow positive. The disability component is cash flow negative. Staff tied this to the monthly rebalancing report. Staff recommended $300,000 be rebalanced from the large cap domestic funds to fixed income which is used to pay monthly disability benefits. In anticipation of the ongoing monthly drawdown of fixed income the consensus is to move the recommended amount plus a cushion for the next several months' benefit payments.

There was a motion by Mr. Milner to:

Rebalance the disability fund by moving $500,000 from large cap.

The motion was seconded by Ms. Mammarella.

Discussion: The rebalancing would be done so as to leave Polen and Herndon with equal balances.

Hamilton Lane's annual meeting September 11-12 was discussed. Ed Milner may attend.

Hancock recently extended its acquisition period an additional year. A purchase has been hinted, but as of the meeting nothing definitive is known.

Volatility has remained low. In the absence of a significant market event the volatility report will be created and distributed quarterly.

COMMUNICATIONS/SEMINARS/CONFERENCES and TRAINING
The upcoming International Foundation of Employee Benefit Plans (IFEBP) meeting in Boston was mentioned. Several will attend the IFEBP's CAPPP training and certificate program.

A local program in Washington D.C. was mentioned. Its focus will primarily be on administration of pension programs.

REPORT FROM AMRSVA SPRING MEETING
The spring 2012 meeting was help in Charlottesville. A summary of meeting notes is included in the meeting packet. Staff mentioned a few highlights.

PLAN RESTORATION PLAN
The discussion of the Restoration Plan (Excess Plan) is deferred until the June meeting. This is informational and no action called for.

FOLLOW UP ITEMS – ELECTION
Staff reported that election announcements were posted on line. Letters had been sent to the Fire Police Departments to be forwarded to all active participants.

ASSET ALLOCATION

Staff discussed the difference between a long only manager that is measured against an index as a benchmark and other investment strategies and techniques that might operate in the same space. Two examples are: 1) Long short, and 2) arbitrage.

MANAGER MEETINGS
Staff recently met with representatives from PRISA (Prudential Real Estate). May 16th staff will meet with Distressed Debt Managers. Staff discussed Eddie Lampert, a hedge fund manager who bought Kmart bonds as a way to take control of the company. The underlying value of the company was Kmart's real estate. This was a blending of fixed income and real estate. He then sold the real estate and bought sears. This action was in the equity universe. Some managers cross traditional boundaries making more opportunities possible. Board members are invited to attend this meeting May 16th at 10:00 AM in room 1600.

COMMITTEE REPORTS

The PLOP/DROP Committee reported that the proposed plan amendment had gone to council committee on compensation and pensions. Mr. Smedberg said the amendment should go to council.

The Purchase of Service Credit Committee has not recently met but may do so soon.

The Technical Corrections Committee has not met recently and no report was provided.

The Training Opportunity Committee has not met recently and there no report was provided.

The Vendor & Service Provider Review Committee had not met recently and did not provide a report.

OLD BUSINESS

The RFP for the defined contribution provider was discussed during Mr. Bryant's comments in the Financial Review.

NEW BUSINESS

There was no new business to report.

Prior to each Fire & Police Board meeting Pension Administration staff sends a meeting announcement to Mr. Smedberg and Mayor Euille. This announcement should also be sent to the employee representatives of the Benefits Advisory Group who are participants in the Supplemental Retirement Plan.

Ms. Mammarella asked staff to review the election rules is only one candidate signs up for a given position.

NEXT MEETING

There will be a special meeting June 27, 2012 at 1:00 PM to see finalist for the defined contribution component's third party administrator.

There will be a Board Retreat June 28, 2012 at 8:30 AM. Lunch will be provided. There was a motion by Mr. Cross to:

Authorize reimbursement to staff for providing lunch to the June 28th meeting.

Ms. Triggs seconded the motion.

ADJOURNMENT

There was a motion by Ms. Triggs to:

Adjourn.

Mr. Wimer seconded the motion. The motion passed unanimously (6-0).

Ms. Evans returned at 1:52 PM.

The meeting adjourned at 1:53 PM.

<u>Handouts distributed in advance</u>

1. Agenda
2. Minutes of March 8, 2012 meeting [1 (a)]
3. Minutes of April 12, 2012 meeting [1 (b)]
4. Investment performance Review, First Quarter 2012, Notes & Questions [2]
5. Dahab Performance Review March 31, 2012
6. International Equity Managers – Panelist Questions, [3(e)]
7. Monthly Investment & Rebalancing Report [4(a)(i)]
8. Notes of April 26, 2012 [5 (a)]
9. Prudential Retirement Plan Strategies, March 31, 2012

Handouts distributed during the meeting

1. Johnston Asset Management
2. Glovista Investments LLC
3. Brandes Investment Partners
4. Cash Flow Report – Part 1
5. Cash Flow Report – Part 2