MINUTES OF JUNE 28, 2012 RETIREMENT BOARD
CITY OF ALEXANDRIA FIREFIGHTERS AND POLICE OFFICERS PENSION PLAN
SPECIAL MEETING

PRESENT

Members	Others
Michael Cross [3, 5]	Ben Alibrandi, Credit Suisse
Michele Evans [1, 2]	Steven Bland, CFA, CAIA, MS, Retirement Administrator
Patrick Evans [1]	Barry Bryant, Dahab Associates
Bruce Johnson [5]	Kadira Coley
Shirl Mammarella [3, 4]	John Drury, Credit Suisse
Ed Milner [1,2]	Brian Giuliano, CFA, Brandywine
Al Tierney	Arthur Lynch, Retirement Specialist
Laura Triggs[4]	Theresa Nugent, Communications Specialist.

Absent: Morgan Routt, Michael Wimer

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

CALL TO ORDER

The meeting was called to order at 8:42 AM.

Ms. Triggs made a motion:

I move approval of the May 10, 2012 Board meeting minutes.

Mr. Johnson seconded the motion.

The motion passed 5 – 0.

Staff distributed an email from Cheiron (the actuary) about the recent adoption of the new GASB pension accounting standard. This was informational, no action was called for.

Ms. Evans and Mr. Milner arrived at 8:44 AM.

FIXED INCOME

Mr. Bryant distributes his booklet, *Bond Alternatives*. Page 2 creates a historical perspective.

Page 3 shows the weighting of the Barclay's aggregate by sector. The weightings are somewhat outdated. Mr. Johnson said the Board had Bond managers to address the issue of allocation between sectors. Some sectors are excluded, such as TIPS (Treasury Inflation Protection Securities), municipal bonds, foreign bonds, and high yield.

TIPS trade more due to unexpected inflation than steady inflation.

Page 4 illustrates why a long term bond will decline in price if interest rates rise.

Page 5 addresses risks of fixed income investing.

Page 6 addresses interest rate risk versus credit risk.

Page 7 is to illustrate normal yield curves and inverted yield curves.

Page 8 addresses a "Risk Off" environment in which highly rated secure bonds would do well compared to equities. Page 9 reviews a "Risk On" environment in which most equity investments will outperform quality fixed income.

Page 10 reviews recent actions of the Federal Reserve Board. Operation Twist bought long term securities. This made the shape of the yield curve a little more flat than before the announcement. Investment managers make money by: 1) Credit, 2) the shape of the yield curve changing, or 3) the entire yield curve moving up or down.

Ms. Mammarella asked what happens if the Federal Reserve Board prints more money. Mr. Bryant said that in the short term nothing because unemployment is high and factory utilization is low. As these change the increased money supply might cause inflation.

Mr. Bryant referenced PIMCO's often used phrase the "New Normal." This suggests an environment in which there is an extended period of subdued economic growth.

Page 11 begins a discussion of bond alternatives to address the decline in bond values should interest rates rise. There are four broad groups: 1) Equity alternatives, 2) Fixed income alternatives, 3) Absolute return strategies, and 4) Real Assets.

Page 12 mentions dividend paying stocks, preferred stocks, and convertible bonds. Each of these is typically less volatile than equities and have higher yield than quality fixed income instruments in the current environment. However, they all are correlated to equities.

Page 13 mentions low volatility fixed income alternatives: 1) Laddered bonds, 2) TIPS, 3) Short term bonds, and 4) International bonds. The first three would have lower volatility that the Barclays aggregate.

Page 14 mentions more volatile fixed income alternatives: 1) Variable rate notes (bank loans are typically volatile), 2) Emerging market bonds, and 3) Distressed debt.

Page 15 explains shorts sales as an example of Absolute return strategies. Page 16 explains covered calls and long short funds as two more examples of Absolute return strategies. Page 17 explains managed futures and market neutral as two more examples of Absolute return strategies. Page 18 explains risk arbitrage and Tactical Asset Allocation as two more examples of Absolute return strategies.

Page 19 discusses real estate and timber as examples of real return. Page 20 discusses agriculture, energy, and Commodities as examples of real return.

The fund invests in fixed income through the PIMCO Total Return fund. This is a core plus fund benchmarked to the Barclay's aggregate. The PIMCO fund has modest exposure to sectors outside the benchmark. Staff distributed an excel file which displayed the PIMCO holdings at quarter end for over a decade. It did show frequent changes in weightings. However, the average holdings in these sectors outside the benchmark were very small.

Mr. Bryant introduced Mr. Giuliano of Brandywine Global Investment Management. Mr. Giuliano followed up on a comment of Mr. Bryant as to how fixed income managers earn money. On page 21 the illustrations points to: Currency decisions, sector/credit decisions, and duration decisions. Investors have been reaching for yield in the current low yield environment. Ten year treasury yields are:

1.5% Germany
1.6% U.S.
.8% Japan

Incremental yield may be found going abroad.

The Federal Reserve Board has loosened loan rates to banks, but banks are restoring their balance sheets and not making loans to new customers. The velocity of money is down.

Ms. Mammarella initiated a discussion of Quantitative Easing 1 & 2 and Operation Twist.

Brazil is going through growing pains as its economy expands and some feel not all citizens are participating enough in the gains.

Interest rates might stay low for a while, but they can't get much lower.

Mr. Giuliano discussed currency. At Brandywine:

80% of investments they own the bond and the currency
15% of investments they hedge the currency into dollars
5% of investment they hedge into another currency

Mr. Giuliano went through his booklet. Page 3 attests to the growing economic importance of non-G7 countries over the last 25 years. Page 4 conveys a similar story in a different fashion. Page 5 shows the improved credit quality of these countries' debt.

Page 7 shows the average American fund underweights international debt. Staff commented that some funds of regulated institutions such as banks and insurance companies have reserve requirements that discourage holding international debt.

Page 8 was discussed. The ten-year treasury yield is below inflation. Even ignoring taxes the investor has a negative real return.

Page 10 highlights real returns. Page 11, Mr. Tierney asked about inflation.

Page 13 reflects that in any given year international markets can be varied and there is dispersion between the best and worst markets. Page 17 indicates how benchmarks are constructed.

Pages 18-19 focus on active and passive bond management. Mr. Giuliano discussed the overweighting of developed markets. Staff agreed with the issues mentioned, saying the other side of the coin is that in troubled times the developed markets would be more liquid.

Mr. Tierney said PIMCO is a very active manager, shifting weightings often. Mr. Giuliano said Brandywine is too. Their lowest exposure to the U.S in their global fund was 5% and highest 70%. It is typically 20% - 40%.

Mr. Giuliano left at 11:25 AM.

At 11:30 AM Ms. Triggs made a motion to enter Executive Session for the purpose of discussing legal issues. Mr. Tierney seconded the motion.

At 12:29 PM the Board exited Executive Session. There was a motion made by Ms. Triggs and seconded by Mr. Tierney affirming that the subjects discussed were fitting and proper and in compliance with state open meeting laws.

The board recessed for lunch.

The meeting resumed at 1:03 PM

Staff referenced handout 2c, *Bond buyers should be mindful of history*. The article discusses the history of bonds since the last time ten-year treasuries yielded 1.5%. Staff mentioned several parallels to 1946, in addition to treasury yields.

The meeting went into recess for lunch at 12:33 PM

The meeting resumed at 1:03 PM

ABSOLUTE RETURN FUNDS

Mr. Bryant introduced Ben Alibrandi and John Drury from Credit Suisse. They distributed their booklet, *Investing in Hedge Funds*.

Page 4 covers the fundamentals of hedge funds: structure, liquidity, fees, and strategy.

Page 5 shows the broad range of mandates within the very broad term “Hedge Funds.” Staff asked that the presenters take time to fully explain the very broad range of diversity of risk and expected return within these classes.

Page 6 shows the growth of the hedge fund industry.

Pages 9 - 12 cover risk and return characteristics. Pages 10 & 11 highlight hedge fund performance during some recent down markets. Page 12 shows how hedge funds correlations change in periods of high or lower volatility.

Pages 14 – 16 discuss hedge funds in a portfolio context as opposed to an individual investment. Mr. Bryant emphasized the importance of the information provided on page 15. Hedge funds added to a traditional portfolio mix of 60% equities and 40% fixed income will be enhanced by adding hedge funds and proportionately reducing the other investments. The enhancement is a risk reduction and return improvement. Page 16 discusses some different ways to implement a hedge fund strategy.

Page 18 details the manager selection process. The focus research and due diligence both pre and post investment.

Page 19 discusses risks.

Page 21 compares characteristics of Mutual funds, hedge funds, and private equity funds.

Pages 22 – 24 provide some added detail to the topics highlighted on page five.

Staff asked about fees and the Credit Suisse representatives discussed a hurdle rate in private equity and compared it to a high water mark in hedge funds.

Leverage was discussed. Staff said cash flow was positive so the plan was somewhat more tolerant of illiquidity compared to the average pension plan. They mentioned tactical trading. Managed futures do best when there are trends, not in choppy markets.

Mr. Johnson said hedge funds are not transparent. Mr. Drury said get information or walk away. It may require a non-disclosure agreement, but the fund should disclose details of their investments. Mr. Drury said his research into a fun would involve: audits, brokers, securities listings, and background checks. They measure risk using a third party reviewer because the hedge fund would not release all securities in detail to a customer, but they would to a third party reviewer.

Credit Suisse would have 35 – 45 funds in 8 – 10 or 11 strategies. They also have sector funds such as distressed debit (credit) and tactical trading (global macro).

Staff asked the presenters to distinguish funds of hedge funds from multi strategy funds.

Mr. Drury and Mr. Alibrandi left at 2:07 PM.

NEW BUSINESS

In the past lunch was provided for long board meetings and expense was authorized on a case by case basis. Staff asked that a general motion be made that authorized reimbursement, and to protect the fund: limited the amount, required the draft agenda to include lunch, and permitted reimbursement from the fund.

There was a motion by Mr. Tierney to:

> Authorize reimbursement expense to staff for providing lunch at board meetings if lunch is on the agenda, limited to $150 per meeting, and reimbursed from the pension funds.

Ms. Triggs seconded the motion. The motion passed unanimously (7-0).

Ms. Evans left the meeting at 2:10 PM.

ASSET ALLOCATION

Staff referenced handout #3, Asset Allocation. This specific illustration compared ten-year treasury yields to those of utility dividend rates. Income could be increased by overweighting the higher yield asset. This was generalized to point out an issue the Board may consider soon, should one manager be given a broad mandate and move assets between sectors, or should mandates be smaller, and the board move assets between the managers.

OVERVIEW of INVESTMENT MANAGER & CUSTODIAN REPORTS

Staff referenced handout #4, Overview of Investment Manager ad Custodian Reports. This described and provided examples of many resources available to trustees.

Chairman Cross asked about the I.T.S. department installing the “SharePoint” software package that would facilitate intranet access for board members to documents as the type just discussed. I.T.S. is working on many projects and has not been able to place a high priority on the SharePoint effort.

CORE and SATELLITE INVESTMENTS

Staff referenced handout #5, Core & Satellite Portfolio Management. This addressed the concept of splitting a mandate into more than one manager, as is being done by with the emerging market equity portfolio. The advantages and disadvantages were mentioned.

DIVERSIFICATION and VOLATILITY

Staff distributed handout #6, *Diversification and Volatility*. This schematic represents expected returns under three conditions: a) A generic portfolio with a normal distribution, b) A more diversified portfolio with a normal return but a smaller standard deviation than the previous example, and c) The more diversified portfolio from the previous example but it is not normal, it has fat tails. The key points are:

1) Diversification will usually help, and
2) In times of deep distress diversification will not help once correlations change.

ADMINSTRATOR'S REPORT

Staff communicated Prudential has declared a credited rate of 2.35% for their Guaranteed Income Fund in the defined contribution component for the next 6 months.

The Founder of Polen Capital Management, David Polen, recently passed. It is best practice to bring to the Board's attention any significant change in portfolio management. Staff distributed handout 7 (b) (i) which displayed the performance of the fund since the current manager Dan Davidowitz took over. He has outperformed in both up and down markets. Staff suggested that since the portfolio has always had low turnover, so a discussion could wait until the September 13 meeting.

Chairman Cross emphasized the need to discuss the topic of a watch list. Some would provide a manager a warning of their performance being substandard and that the board is monitoring the performance. Some believe that a manager is either pulled or not pulled, and that a warning or a watch list is meaningless. There is not a best practice or universal standard in this regard.

Staff referenced handout 7 (c), Appendix B, Restoration Plan. This involves a modest amount of under $7,000 per year. None the less, the assets and management should periodically be reported to the Board. The beginning of the handout is a citation from the Plan Document. The balance is key statistics from the Restoration Plan. No action was called for.

Staff distributed 7 (f) (1) the Private Equity Cash Flow Report, Hamilton Lane (Secondary). The fund recently had a call for $300,000. The fund has called almost 80% of its commitment. In the not so distant future the fund will be winding down it will be time to discuss a follow on investment.

Staff distributed 7 (f) (2) the Private Equity Cash Flow Report, Hamilton Lane VII (Primary). The domestic fund recently had a call for $105,000. The fund has called 30% of its commitment. The international fund recently had a call for $100,000. The fund has called 34% of its commitment. These funds are not as mature as the secondary fund it will not be time to consider follow on funds for several more years.

Staff distributed the Cash Flow Reports, Parts 1 & 2. These are handout 7 (g).

Staff referenced handouts 7 (h) (i) and 7 (h) (ii). Hancock has now called the last of the $7,000,000 commitment for its Timberland X fund. Staff pointed out that the commitment was made several years ago when the fund was smaller so what was then 5% is now a smaller part of

the fund. The fund is 40% invested in Australia and 60% in the U.S. Leverage is about 15%. These are within the parameters described when the fund was being marketed.

Staff said that timber is one of several limited partnerships that may be ready for follow on funds in the next few years. The Chairman and staff will do some strategic planning, beginning with a calendar of projected contract expirations.

TRACKING ERROR

Staff referenced handouts 9 (1) & 9 (2). These are both follow ups to prior discussions of Apple Computer's weight in the fund.

OLD BUSINESS

There was no old business.

NEW BUSINESS

There was no new business.

NEXT MEETING

The next meeting will be July 13th at 8:30 AM in Room 2000 of City Hall.

ADJOURNMENT

There was a motion by Mr. Tierney to:

Adjourn.

Ms. Triggs seconded the motion. The motion passed unanimously (7-0).

The meeting adjourned at 2:58 PM.

Handouts distributed prior to the meeting

1. Agenda
2. Election Procedures
3. *Bond buyers should be mindful of history*, article from the Financial Times. #2C

4. Asset Allocation #3
5. Overview of Investment Manager & Custodian Reports #4
6. Core & Satellite Portfolio Management #5
7. *Diversification and Volatility* #6
8. Large Cap Growth Manager Search 7 (b) (i)
9. Appendix B, Restoration Plan #7 c
10. Private Equity Cash Flow Report, Hamilton Lane (Secondary) 7 (f) (1)
11. Private Equity Cash Flow Report, Hamilton Lane VII (Primary) 7 (f) (2)
12. Cash Flow Reports, Parts 1 & 2. 7 (g)
13. Tracking Error 9 (1)
14. Tracking Error 9 (2)

<u>Handouts distributed during the meeting</u>

15. E mail from Cheiron to Staff (June 26, 2012), "Cheiron Pension Alert"
16. Dahab Associates, Inc.: *Bond Alternatives*
17. Brandywine Global, distributed by Brian Giuliano, CFA
18. Credit Suisse, *Investing in Hedge Funds*
19. Large Cap Growth Manager Search 7 (b) (ii)
20. TPA Interviews