MINUTES OF JUNE 16, 2014 RETIREMENT BOARD
CITY OF ALEXANDRIA
FIREFIGHTERS AND POLICE OFFICERS PENSION PLAN
ANNUAL EDUCATIONAL RETREAT

PRESENT

Members	Others
Patrick Evans[1] (Fire)	Barry Bryant, Dahab Associates
Tom Gates, [3] Chairman, (Management)	Bryan Capelli, Retirement Specialist
Jean Kelleher [2] (Management)	Shane Cochran, Supplemental Retirement Board
Shirl Mammarella [3] (Police, Alternate)	Kadira Coley, Acting Retirement Administrator
Ed Milner [1] (Police)	Bill Eger, Supplemental Retirement Board
Rick Muse [3] (Fire, Alternate)	Bob Gilmore, Supplemental Retirement Board
Nelsie Smith (Management)	Arthur Lynch, Retirement Specialist
Al Tierney [2] (Police)	Nancy McFadden, Supplemental Retirement Board
Laura Triggs [3] (Management)	Marietta Robinson, Supplemental Retirement Board
	David Sharer, ICMA-RC

Absent:
Michael Cross, [2] Secretary, (Fire)

Terms: 1/1/2014 – 12/31/2015
[1]Purchase of Service Credit Committee
[2]Technical Corrections and Plan Document Review Committee
[3]Vendor & Service Provider

Note: This meeting was a joint meeting of the Boards for the Supplemental Retirement Plan and the Firefighters and Police Officers Pension Plan. The discussions reported in these minutes include comments from members of both Boards. All discussions are of value to each Board, even if the following motion did not apply to one Board. However, the motions noted in these minutes only relate to the Firefighters and Police Officers Pension Plan Board.

CALL TO ORDER

The meeting was called to order at 9:34 AM on June 16, 2014.

MEETING RECORD

Mr. Evans made a motion to

Approve the April 10, 2014 minutes.

Mr. Muse seconded the motion. The motion was unanimously approved (7 – 0).

ICMA-RC - EDUCATIONAL PLAN PRESENTATION

Mr. Sharer provided a brief overview of the plan demographics for both the 401(a) and 457 plans. He also provided details on the asset allocation of each plan split by age and percent of assets. Board members requested that ICMA-RC provide updated charts with information as of 6/30/2014 to analyze any changes that have occurred to asset allocations. Board members also requested that the asset allocation charts be presented by counts of participants rather than only by % of assets.

ICMA-RC presented some potential approaches to educating employees. The chart provided on slide 9 lists the various approaches, costs and anticipated impact.

ICMA-RC described the outreach they made to participants invested in the PLUS Fund. Individuals were contacted via telephone by Gloria Moody or Steven Taylor. They were challenged to think about diversification. Many participants have made a conscious decision to invest in a low risk fund. ICMA-RC does not anticipate a large change in asset allocation based upon their outreach. ICMA-RC presented the dates of upcoming (and past) on-site education and 1-on-1 sessions held by both Steve Taylor and Gloria Moody. It was noted that when Steve Taylor was on-site for 1-on-1 education in April he voluntarily set up two additional days of sessions to handle the volume of employees wanting to talk with him.

Mr. Sharer discussed the idea of the "Brainshark" and "Hands" videos with the Board and previewed one video for the group.

A board member asked if a participant is in the VRS Hybrid plan can they utilize the City's 457 plan. Staff noted that they could participate in the City's 457 plan but current efforts are being focused on getting Hybrid participants to maximize their contributions to the VRS plan since they have the opportunity to have their contributions matched under the Hybrid plan. Participants are also being encouraged to consider the Payroll Deduct Roth IRA.

Mr. Sharer left at 10:07 AM.

ASSET ALLOCATION DISCUSSION –DAHAB ASSOCIATES

Mr. Barry Bryant led a discussion about asset allocation and the upcoming asset allocation study. He spoke from his presentation booklet, "Selection of Asset Classes."

Page 2 highlights two camps of thought, simple approaches yield better results vs complex financial engineering manages risk.

Page 3 and 4 highlight author David Swensen who wrote two books about investing, one about the sophisticated investor and one about unsophisticated investor. The sophisticated investor chooses between 4 asset classes: equities, fixed income, real assets and currency. All others investments fall into a diversified category which is a combination of the other asset classes. This investor is skeptical of active management because 9 out of 10 active managers get it wrong. The success of the unsophisticated investor lies in the asset allocation. Mr. Bryant noted that the City of Alexandria falls in the middle of the sophisticated/unsophisticated spectrum.

Page 6 talks about risk statistics. Mr. Bryant noted that one downfall of risk statistics is that they look at a series of 1-year periods and our fund is invested and planning for a much longer time horizon. Some risk for City exists because we know we will never match actuarial assumptions and short term volatility will cause us to stray from long-term course.

Mr. Gates arrived at 10:30 AM.

Page 8 talks about the different asset classes the Board may consider. Mr. Bryant noted that ERISA requires divarication of risk as a means of controlling risk. As a result of this requirement new asset classes have an immediate built in market as funds seek diversification. Page 9 lists some alternate asset classes the Board may wish to consider.

Page 10 highlights asset classes the Board likes (equities, fixed income & real assets) and a few reasons why they are favorable to us. Page 11 highlights the asset classes the Board may not like (hedge funds, complex financial situations, risky fixed income, tactical asset allocation) and reasons why we typically do not consider these asset classes.

Page 12 talks about other local jurisdictions in Virginia. Mr. Bryant also distributed a handout titled, Virginia Plan Returns and Asset Allocation Comparisons. He noted that the City of Alexandria ("COA") had average risk control amongst our peers as our returns remained level. The star performers were Newport News and Falls Church whose ranking increased during the study period. Mr. Bryant's handout also compared COA plan to other jurisdictions with large alternative investments. In each case COA was better in comparison.

Based on the research presented above Mr. Bryant is recommending a broad asset allocation not much different from how the plan is currently invested.

Mr. Bryant took some time to discuss how the asset allocation study works and the expected outcomes. On page 15 Mr. Bryant listed the asset allocation choices split by yes, no and maybe.

Tactical Asset Allocation ("TAA") is in the maybe category. One of the TAA managers being considered is run by PIMCO. A Board Member asked if there is concern that the TAA fund run by PIMCO may change given the changes in management. Mr. Bryant noted that Rob Arnott runs the TAA fund and is remaining with PIMCO so he did not anticipate any changes to the fund based on the other changes at PIMCO.

Mr. Bryant noted that the asset allocation study will guide the Board in selecting asset classes. Once we know this we can update our investment policy statement and then move forward with selecting specific managers and strategies within each asset class.

Mr. Tierney made a motion to

> Direct Dahab Associates to run the asset allocation study using the “Yes” and “Maybe” categories as document on page 15 of the Selection of Asset Classes presentation.

Mr. Milner seconded the motion.

The motion was unanimously approved (8 – 0).

Page 16 is an outline of future steps and milestones.

ECONOMIC OVERVIEW – ALLIANCEBERNSTEIN

Scott Howe and Erin Bigley, AllianceBernstein arrived at 11:20 AM. Mr. Howe provided introductions and noted that AllianceBernstein produces an annual Capital Markets Outlook.

Ms. Bigley walked the Board through their presentation book. Page 1 gives a big picture overview of future markets. Ms. Bigley noted that now may be a good time for active management where passive management would have been the top option one year ago. Active management is recommended right now because the US market is expensive but certain sectors or industries may have bargains. She pointed to page 23 which show the correlation is low and indicates that now is prime time for active management.

Page 2 is a chart of the central banks around the world. Ms. Bigley noted that a year and a half ago most central banks were doing things to try to get growth going so the outlook was fairly simplistic. Today there is more variety as some banks are still trying to get growth while others are managing liquidity.

Page 3 shows developed markets growth is improving. The middle chart highlights that the projected average growth in GDP is around 3%. US is slightly above this level at 3.2% but emerging markets are well above the average level. All major markets are forecasted to have some sort of growth.

Page 4-6 demonstrate an improving US economy. The private sector’s GDP continues to remain strong and the public sector outlook is improving. Ms. Bigley noted that the labor market is healing as tax receipts increase and unemployment is slowly decreasing. Page 5 continues to highlight the US economy and the increasing consumer confidence. It was noted that US household net worth is at an all-time high. Page 6 points out that more credit is available as business lending increases and the amount of loans for housing is increasing as the required credit score is decreasing.

Mr. Bryant asked where they see the stock market going. Ms. Bigley recommended that in current environment she would overweight stocks because bond returns are so low, hedge risk with alternatives and in a bond portfolio she recommended overweight corporate bonds versus municipal bonds. She referred to the chart on page 24 which shows corporations have high amounts of cash on hand and low debt. She mentioned that we may see more mergers and acquisitions in the near future which may decrease amount of cash on hand.

A board member asked if profit margins can improve or will they stay where they are. Mr. Bigley responded that they may be as good as they can be and would not expect to see them increase.

Page 12 starts illustrating the current bond market. AllianceBernstein projects gradual increase in interest rates. A board member asked if bond rates continue to increase should we get out of bonds? Ms. Bigley responded that long-term bonds would not be recommended but medium and short term bonds should continue to have modest positive returns. The bottom chart on page 12 speaks to the multiple components to affect bond returns. Page 13 illustrates the range of bond offerings. Ms. Bigley noted that not all categories of bonds are correlated to treasuries. She also advocated diversification to corporate and global bonds. Page 17 highlights high yield bonds. Ms. Bigley pointed out that the returns on these bonds are not currently justifying the risk so it may not be the best time to be in these bonds. She also pointed out that approximately ½ of the high yield bond market defaults every 5 years.

Page 19 focuses on emerging market debt. Ms. Bigley pointed out the yields look positive relative to other markets. She mentioned that now is good time to have actively managed exposure to emerging markets. She pointed that passively managed funds may expose you to more risk than expected. A board member asked if there are some political concerns related to emerging market debt. Ms. Bigley noted that there is some risk but that risk is slowly diminishing.

Page 20 points out that it may be a good time to invest in global bonds. The left hand charts shows that US does not currently have the best returns. Ms. Bigley recommended shying away from currency risk, invest globally and hedge with US currency.

The overall conclusion: expect positive global growth, now is a good time for risk, expect average returns from equities, active management is the way to do. Bonds focus on mid to short term and go global.

Ms. Bigley and Mr. Howe left at 12:10 PM. The meeting recessed for lunch. The meeting reconvened at 12:55 PM.

ADMINISTRATOR'S REPORT

Regular Investment Reports
See reports in packet. No rebalancing was required.

Other Items

Education: conferences, seminars and training

Ms. Smith made a motion to

Send Mr. Milner to the annual Hamilton Lane Investor's meeting on September 11th and 12th in Philadelphia, PA.

Mr. Evans seconded the motion.

The motion was approved (7-1).

For	Against
Evans	Tierney
Gates	
Kelleher	
Milner	
Muse	
Smith	
Triggs	

Old Business

None.

New Business

None.

NEWSOUTH PRESENTATION

Ms. Burn-Patti arrived at 1:00pm. Ms. Morrow was conferenced in via telephone.

Ms. Burns-Patti began by introducing herself and Ms. Morrow. She noted that NewSouth is a bottom up stocking firm. They are independent boutique firm with internal ownership of 83%. NewSouth last presented to the Board approximately 16th months ago. They currently have 21 employees in their firm. The currently operate a small, mid and smid cap offering. Their small cap offering is closed to new investors. They are active manager and expect to beat the benchmark, on average, by 2%. They did note that they will occasionally underperform the benchmark because they are a bottom up stock picker.

Ms. Burns Patti walked through a portion of the presentation book. On page 13 she noted that the composite performance for the fund since inception has outperformed the benchmark. Page 14 shows the returns for rolling periods. The 3-year returns outperformed 100% of the time and the 5-year returns outperformed 81% of the time.

Ms. Burns Patti noted the 2013 performance themes

- Growth stocks outperformed value stocks
- 4 specific stocks had poor performance and were a drag on the portfolio
- 23% cash exposure – 14% of cash is due to 3 stocks being bought out. NewSouth noted that the City of Alexandria has a maximum cash holding rate of 10% and any cash above that level would be invested in a shadow index.

Ms. Morrow presented the details of the portfolio. Page 21 shows the list of stocks in the portfolio. She noted that there are a small number of stocks in the fund and they do not do a sector analysis. NewSouth feels that the broad classification of assets in Russell may incorrectly categorize some stocks in their fund.

Page 27 highlights the stocks that were performance contributors and distractors. Ms. Morrow talked through the stocks identified as mistakes and any lessons learned. Ms. Morrow spoke a bit more about why the cash holding is so high. She described the criteria they use before investing in stocks. She noted that there have not been many opportunities which why cash holding are high. She also noted that cash holding have not been this high since 2008. Ms. Morrow noted that cash will decline over time as the portfolio corrects. NewSouth recognized that cash is a drag on returns but noted that they will continue to stick with their identified strategy.

Ms. Burns-Patti and Ms. Morrow left the meeting at 1:50pm.

ACTIVE VS. PASSIVE DISCUSSION - VANGUARD

Ms. Meghan Davis and Mr. Walter Lenhard from Vanguard arrived at 2:00pm.

Mr. Lenhard walked the Board through an introduction of who Vanguard is and the history of the firm. He specifically noted that Vanguard is client owned (see slide 3) thus profits go back into the fund. He noted that a focus of Vanguard is low cost (see slide 4-5) and positive cash flow. Slide 5 illustrates that they have been ranked 1 or 2 in terms of long term cash flow since 2005.

Mr. Lenhard noted that Vanguard led the industry when it created the first index fund in 1976. On slide 8 Mr. Lenhard noted the stability of the firm. He pointed out that the members at the top of firm have been with Vanguard for at least 15 years.

Ms. Davis spoke about the history of index funds. She noted that index funds now represent 30% of equity fund assets (see slide 9). She projected that this rate will continue to increase but will top out at 50-60%.

Slide 10 illustrates the advantage of passively managed funds. Ms. Davis noted that most active managers fall within +/- 5% of the benchmark but once you net out fees there is a negative sum gain. Slide 11-13 provide real world examples of active management versus passive management. Ms. Davis noted that 65% of large cap managers lag the benchmark, 79% mid cap lag the benchmark and 81% small cap lag the benchmark. It was noted that this is the opposite of what most people expect but the difference is due to the larger fees and transaction costs in the small size investments.
Slide 16 illustrates the fate of active managers who were in the top quartile in 2008 and where they ranked after the 5 year period as of 2013. Only 12% remained in the top quartile.

Slide 17 illustrates that EFT offerings have steadily increased over the past years. Slide 18 shows some random index funds that have come to market. Vanguard warned us buyer beware.

Slide 21 – 26 talks about Vanguards approach to indexing. Vanguard prides itself on keeping their expense ratios low. They noted that their expense ratios have decreased over time. Slide 24 shows the share class structure and how the funds differ.

Mr. Lenhard and Ms. Davis left at 2:55 PM.

NEXT MEETINGS

1. Thur. July 9th 8:30AM, Sister Cities Room 1101, Interim Meeting
2. Thur. August 14th 8:30AM, Sister Cities Room 1101, Interim Meeting
3. Thur. September 11th 8:30AM, Sister Cities Room 1101, Joint Due Diligence Meeting

ADJOURNMENT

The meeting adjourned at 3:05 PM.

HANDOUTS

Distributed to Board members in the Board Packet:

Agenda
Board Packet Details
Minutes of Prior Meeting [1(a)]
Capital Market Background – Alliance Bernstein [3]
Monthly Investment & Rebalancing Report [7(a)(i)]
Private Equity Cash Flow Report [7(a)(iii)]
Timber Estate Cash Flow Report [7(a)(v)]
Administrator's Follow-Up Items List [7(b)(ii)]
Action Items/Recommended Motions [7(c)]
Active vs. Passive Discussion [12]
Active vs. Passive Article, The Relentless Rules of Humble Arithmetic – John Bogle

Distributed at the meeting:

1. Selection of Asset Classes – Dahab Associates
2. Virginia Plan Returns and Asset Allocation Comparisons – Dahab Associates
3. Capital Markets Outlook – AllianceBernstein
4. NewSouth Small Cap Equity
5. Vanguard Presentation