

**MINUTES OF MAY 21, 2015 RETIREMENT BOARD  
CITY OF ALEXANDRIA  
FIREFIGHTERS AND POLICE OFFICERS PENSION PLAN  
DUE DILIGENCE MEETING**

**PRESENT:**

<u>Members</u>	<u>Others</u>
Jack Browand (Management)	Barry Bryant, Dahab Associates
Michael Cross <sup>2</sup> Chairman (Fire)	Bryan Cahey, Franklin Templeton
Titania Cross <sup>3</sup> (Management, Alternate)	Bryan Capelli, Retirement Specialist
Patrick Evans <sup>1</sup> (Fire)	Shane Cochran, Supplemental Board
Jean Kelleher, Secretary <sup>1</sup> (Management)	Kadira Coley, Retirement Administrator
Shirl Mammarella <sup>3</sup> (Police, Alternate)	Charles Curia Supplemental Board
Ed Milner <sup>1</sup> (Police)	Brenda D'Sylva Supplemental Board
Rick Muse, Fire & Police Board	Rafaello Distefano, Loomis Sayles
Laura Triggs, <sup>3</sup> (Management)	Jason LaRocco, Franklin Templeton
	Daniel Lass, Standish
	Arthur Lynch, Retirement Specialist
	John Meyer, Loomis Sayles
	Brendan Murphy, Standish
	Michael Stewart, COA Deputy Finance Director
	Lillian Vagnoni, Supplemental Board
	Valarie Wright, Supplemental Board
	Sergey Zelensky, Retirement Specialist

Absent:

Al Tierney<sup>2</sup> (Police)

Terms: 1/1/2014 – 12/31/2015

<sup>1</sup>Purchase of Service Credit Committee

<sup>2</sup>Technical Corrections and Plan Document Review Committee

<sup>3</sup>Vendor & Service Provider

**CALL TO ORDER**

The meeting was called to order at 8:35 AM on May 21, 2015.

**FINANCIAL REVIEW**

Dahab distributed their quarterly report booklet. Mr. Bryant noted the following items:

- page 4 – GDP from end of April – number is very weak – 0.2
  - Fed may not raise rates as soon as expected, may not raise at all this year
  - Market returns were strong and cyclical – shift from Domestic to International stocks
  - Domestic equity up 2%, Foreign equities up 4%, Domestic bond up 1.5%, foreign bonds down 4%
  - Domestic stocks have outperformed foreign stocks for past 7 years
  - Domestic market is currently overvalued, foreign developed markets are slightly undervalued along with emerging markets

Ms. Vagnoni arrive at 8:39AM, Ms. Wright arrive at 8:41AM

Manager Performance Summary (page 10)

- Composite return 2.7% in quarter; in the 32<sup>nd</sup> percentile (vs other public funds); shadow index is 2.7%
  - Mid cap and small cap equities achieved returns equal to international returns
  - Real estate returns were positive which helped portfolio returns
  - Portfolio's asset allocation worked in our favor this quarter

Mr. Browand arrived at 8:44AM

Investment Manager Follow-up Items

- Herndon – had a very good quarter, but returns are in the 97<sup>th</sup> quartile in 3 year, 5 year and since inception periods.
  - Mr. Bryant noted that Herndon got oil wrong last year – invested in oil just before the price dropped
  - An underlying concern for fund may be that Herndon got too much money to fast. Around the time that the City began investing with Herndon their numbers were really spectacular and now spending money on marketing. Now they are refocused on investing.
  - Mr. Bryant recommends the plans retain Herndon but continue to watch them closely
    - When boards fire managers they hurt their performance long term because of reversion to the mean
  - Ms. Wright inquired how long we are expected to keep them.
    - Mr. Bryant replied that we have held them for 3.75 years. It is typical to evaluate managers over a market cycle (peak to peak or trough to trough) typically 3-5 years. He recommends waiting through 5 years to fully re-evaluate them and to re-evaluate passive management.
  - Herndon is requesting an exception to the statement in the IPS, “The top ten holding will typically not exceed 30%”
    - Mr. Bryant is recommending extending the exception as requested. He noted that Herndon has a model portfolio so to not do so could cause issues. He also noted that the language says typically and that could be highlighted in our response to Herndon.

Ms. Kelleher made a motion to:

Grant Herndon the requested exception to the language in the IPS statement.

Ms. Triggs seconded the motion.

Discussion:

- The language in the IPS say typically, thus the board does not consider this to be a violation. This will be noted in the response to Herndon.
- Board will monitor the allocation on quarterly basis and requests Herndon to provide quarterly reports on their top 10 holdings.

The motion was unanimously approved (7 – 0).

- Hancock – performance expectation and expected completion
  - Timber is included in the portfolio as a bond alternative

- Is the investment doing what was expected? – Long term return assumption (benchmark return is 6.3% fund return is 15.4%)
- Goal is to beat bond returns by 3-4%. Fund is outperforming by about 6-8% thus exceed expectations
- Returns have been affected by currency issues
- Expected completion of investment is expected in 2024.
- Inflation in housing market then expects timber to do well again.
- Question - Will timber be affected by interest rates and the Fed's decision?
  - Mr. Bryant responded if dollar goes up relative to Australian dollar than could help returns. Could indirectly affect performance but is not a direct relationship.
- PIMCO
  - Total Return Fund
    - Mr. Bryant was to research the differences in flavors of PIMCO Total Return managed by Comerica & Prudential. Both managed in the same style with multiple portfolio managers.
    - Comerica performed better this quarter but not as well over the past year.
    - Last quarter – the lower number earned by Comerica matched PIMCO's reported returns.
    - Mr. Bryant noted that these discrepancies may occur occasionally but not concerning. He will continue to monitor the two funds.
  - Virginie Massonae – one of 7 newly appointed staff upon Bill Gross' departure
    - PIMCO eliminated 2 international stock strategies and one was her specialty
    - Ms. Massonae was not fired but rather elected to leave. She is still managing the transition at PIMCO
    - PIMCO lost a lot of revenue; approximately \$100 billion flowed out total return fund, When Gross left.

Mr. Muse arrived at 9:12AM

- Staff mentioned a transition that is occurring at RAFI.

Ms. Triggs made a motion to

Enter Executive Session.

Ms. Cross seconded the motion. The motion was unanimously approved (8 – 0).

The Board entered executive session at 9:13 AM; The Board exited executive session at 9:25 AM.

Ms. Triggs made a motion to:

Mister Chairman, I move that the Board adopt the following resolution:

WHEREAS, the Alexandria City Firefighters and Police Pension Plan Board has this 21<sup>st</sup> day of May, 2015, recessed into closed executive session pursuant to a motion made and adopted in accordance with the Virginia Freedom of Information Act; and

WHEREAS, § 2.2-3712 of the Code of Virginia requires a certification by the Board that such closed executive session was conducted in accordance with Virginia law;

NOW, THEREFORE, BE IT RESOLVED that the Board does hereby certify that, to the best of each member's knowledge, only public business matters that were identified in the motion by which the closed executive session was convened, and that are lawfully exempted by the Freedom of Information Act from the Act's open meeting requirements, were heard, discussed or considered by the board during the closed executive session.

Mr. Muse seconded the motion. The motion passed (8 - 0).

## **GLOBAL FIXED INCOME**

The Firefighters and Police Officers Pension Board added International/Global fixed income to their asset allocation. Dahab issued an RFP. The board heard from the three finalists.

Mr. Bryant provided some background on global fixed income.

- Global fixed income is newer in the “market” than global equities
- Outlook for domestic fixed income is not very positive in the short term
- Some international countries actually have a better balance sheet than the US (i.e. Brazil or Germany) as they cannot maintain the amount of deficit that the US maintains
- All firms who do global fixed income are giants in the industry.

### Franklin Templeton (“FT”)

Jason LaRocco, CFA, CAIA, CIMA – Vice President

Bryan Cahey – Senior Vice President

- Page 3
  - Overview for entire organization – large global investment manager
  - \$880 billion dollars in assets
  - Large presence in institutional markets
  - Global headquarter in San Mateo, CA
  - Strictly investment manager
  - 9 independent investment strategies
- Templeton Global Macro (No returns from 2008 because new strategy)
  - Manages unconstrained bond fund
  - Fund was started in 1986
  - Manage \$180billion in assets

Mr. Milner arrived at 9:50AM

- Why Global Fixed Income–
  - Over \$44 trillion in available investments
  - In last 10 years US fixed income market at top only 1 time
  - Added diversification with low correlation

- International vs Domestic has a correlation of .5 or .6 = low correlation
    - Strategies seek no or negative correlation
- Tab 3 – Why Franklin Templeton - 3 key features:
  - Unconstrained world view – FT constructs portfolio based on your their view of the market and is not tied to benchmark
    - Concentration risk if track benchmark – over weighted in 3 countries
    - FT look at 100 countries when doing research
  - Global research strategy
    - Team 18 people including 7 Ph.D.
    - Slide 17
      - Offices all around the world – 9 local asset management firms around the world – provide research to team in California.
      - Valuable in times of political change
      - Integral to research process
    - Slide 19 – Team
      - 10 research analyst and country analysts
      - Model interest rates and currency risks
      - 2 – quantitative analysts
      - 3 traders – all trading done in San Matos, CA but done at a 24 hour basis. 12 trading desks around the world – all done in countries
  - High conviction process
- Contrarian view point – FT is known for this (i.e. included Ireland bonds in 2011 and made 70% to 80% on their investments)
- Slide 21 – Investment process
  - Multiple lenses
    - Macro view
    - In-depth country analysis
    - Local management perspective (boots on the ground)
  - Sources of Alpha
  - Implementation
    - Expected returns and risks – risk modeling and management
    - Team supported by risk team
    - Portfolio monitored daily – formally done every 2 weeks
- Portfolio Characteristics - tab 5 (slide 28)
  - Strategy highlights
  - Only government bonds
  - Strive to keep volatility with 6-8% of index
  - Will not go above 25% of bonds below investment grade
  - Duration - .12 (compared to the index duration of 7.35)
  - Interest rate risks – FT yield 2.35 (index 1%) – global fixed income can attain higher yield without interest rate risk of domestic market.
- Currency Allocation (slide 30)
  - Fund is defensive on interest rate exposure
  - selective on emerging markets in portfolio
  - Currency
    - Short on yen and euro
    - US dollar position will strengthen against yen and euro

- Offer hedge to risk
- Calendar Year Returns (slide 32)
  - 6.5% return in 2008 and able to position portfolio to get positive returns in following years
  - Two of the funds higher weightings
    - South Korea – low debt & government manage inflation.
      - Strong ties to China and US
    - Mexico – big in manufacturing – 70% exports are to US
      - Low debt or path to reduce debt over time
- Central Bank purchasing
  - ECB will keep interest rates low – but not a large impact because not a lot of demand to take loans out.
- No exposure to Greece – as it gets closer Greece may leave Eurozone
- What limitations exist on the fund?
  - 25% on non-investment grade
  - Otherwise fund is unconstrained - Sized based on risk of portfolio

### Loomis Sayles (“L/S”)

John Meyer, CFA, CAIA, FRM – Vice President

Rafaello Distefano, CFA – Vice President, Product Manager

- Background on Loomis Sayles
  - Founded in 1976
  - 2<sup>nd</sup> oldest bond rating system
  - Headquarter in Boston
  - 750 employees
  - \$250 billion in assets
  - Significant asset growth – purposeful growth plan
  - Good investment ideas in a portfolio that gives investors what they are looking for
- Pursuit of Alpha (slide 4)
  - Emphasis on research
  - Macro strategies – analysis – quantitative team, sovereign research
  - Low turnover – lots of experience
  - \$22billion in assets – \$2 billion growth in last year
  - Favorable diversification to current holdings
  - Benchmark aware but diversified
- Team (slide 7)
  - Extensive international experience and tenure with L/S
  - Global Bond Team – manage \$38 billion in assets
- Benchmark to Barclays Global Agg.
- Philosophy (slide 9)
  - Macro factors – country, currency and duration
  - Micro factors – sector and security
  - Long term attribution is bottom up, 40% from macro factors
  - Style – value manager – do not chase performance
  - Choose investments strategically based on value
  - Emphasis on spread products – not just corporate – could be government bonds
  - Opportunistic – will not buy markets when rich just to have exposure

- Investment Process (slide 10)
  - Portfolio managers make final decisions
  - Sector team – idea generation teams – come up with best ideas within their sector
  - The way manager, trader and research analyst work together is unique
  - A lot of research is done on the individual security level
  - (slide 21) – quantitative - not risk policy – collaborate with investment teams to show where risk is coming from – custom risk reports
- Portfolio Review
  - (slide 31) – historical performance
    - Long term performance – beat index this year and 10 year period (outperform by 120 bps)
  - Short duration compared to Barclays Agg
  - Sector breakdown (overweight corporate 28% compared to benchmark 18%)
  - Portfolio contains treasuries – but minimum exposure to US treasuries the exposure they have is short
  - Underweight in government related sector; Overweight securities
  - Currency Breakdown (slide 28)
    - 25 currencies
    - Strong alpha from currencies on consistent basis
  - Performance based on attribution (slide 35)
    - security selection and currency drive portfolio returns to beat benchmark
- Questions
  - What is the prediction for rising interest rate environment?
    - Portfolio is defensive in duration. Anticipate rising rates in US but not expecting a large rise globally (i.e. not so much in Europe and Asia)
  - Are there any specific limitations on the fund?
    - 20% high yield
    - No specific limits in emerging markets – historically has been at 25% of portfolio, but currently 10%
  - Any limit to exposure to domestic market
    - typically less than 40%

### Standish (“St”)

Brendan Murphy, CFA – Director of Global Fixed Income & Senior Portfolio Manager  
 Daniel Lass, JD – Senior Vice President

- Background on Loomis Sayles
  - Formed 80 years ago
  - \$170 billion invested in bonds (only do bonds)
  - 131 investment professionals in US, London and Singapore
  - Clients in 41 countries –
- Investment Team (slide 5)
  - Perform their own credit research
- Assets Under Management (slide 6)
  - \$16 billion assets in global strategies – slow steady growth
  - There is a mutual fund version of strategy with 5 star ratings from Morningstar
- Risk/Return Profile (slide 7 & 8)

- global fixed income markets – face liquidity challenge – being a smaller fund allows the fund to be more nimble
- Majority of returns from bottom up selection.
- Lots of efficiencies they can capitalize on by being smaller
- Track record back to 1991 – most years outperform index (outperform in both 2008 and 2009)
- Slide 8 – shows divergence from benchmark
- Balanced, nimble tactical – fund strengths
- Strategy Parameters (slide 9)
  - limits on sector exposures
  - duration with 20% range of index
- Investment Team Details (slide 10) – focus on investment team resources
- Investment Process (slide 12)
  - Key inputs
    - Values – is it cheap?
    - Cyclical/Fundamental Factors
    - Market sentiment (supply and demand, fund flows affecting prices)
  - Macro strategy – look at 6 month horizon for allocating risk
  - Factor risk opportunities – best opportunities within specific space/sector
  - Security selection is important – portfolio does not rely on a specified percentage to a sector
  - Allocations are close to benchmark by weight but focus on security selection
  - Portfolio construction – meld previous ideas together
- Risk Management (slide 14)
  - emphasis on downside protection
- Portfolio Characteristics (slide 17)
  - Focus on developed markets
  - shorter duration
  - investment grade
  - modest currency risk
  - no one source of alpha – best risk adjusted returns
- Questions
  - What portion of performance is from currency hedging? approximately 10% to 20% - (see slide 18 - FX allocation & hedging) – St present hedged strategy – more consistent return (less volatility)
  - Are there limits to exposure to domestic markets? – US exposure currently at 30%. No strict limits.
- Fund structure – institutional shares of mutual fund or bank co-mingled fund available to government funds (could result in lower fees)

### **Global Fixed Income Manager Discussion**

Dahab distributed and discussed their Global Fixed income Manager Search Book (dated 5/21/2015). Mr. Bryant highlighted the following items:

- Page 6 provides direct comparison
  - Focused on comparison of total assets, turnover, duration, quality and fees
- Franklin fund is all government bonds in the strategy they presented– they do have an unconstrained option.

- Page 7 - all funds performed fairly well in 2008. This is by design as the search eliminated all who did not do well in 2008.

What happens when there are international events – does it affect these investments? Mr. Bryant confirmed that international events do affect these funds.

- Mr. Bryant briefly discussed the PIMCO Total Return Fund (plan’s current core+ fixed income exposure). PIMCO fund does not have a lot of foreign exposure. Majority of exposure is to the domestic fixed income.
- If target allocation to international fixed income is 5% is it recommended to invest at 5% or something higher given that the fund will be global rather than just international? Mr. Bryant recommends allocating 5% since this is the fund’s first exposure this category of assets.

#### Manager discussions

- Franklin Templeton
  - Concern about not being able to articulate investment
  - Should not choose the government only strategy
  - Is bigger better or is it to many heads? - A larger group can research easier
- Standish
  - Gain 25 bps off top based on fees
  - Smaller fund that can react to issues quicker
  - Cheaper than other strategies
- Loomis Sayles
  - Returns are lower than Franklin and Standish
  - During presentation Loomis noted a large number of local clients.
- Mr. Bryant’s recommendation is Franklin because of the large amount of research they are able to bring to the table.
- Mr. Bryant noted that duration is a big difference – if interest rates rise quickly than Franklin Templeton could react quicker.

Mr. Milner made a motion to

Select the Standish Global Core Plus Fund via their co-mingled fund.
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Ms. Triggs seconded the motion. The motion was unanimously approved (8 – 0).

Ms. Wright and Ms. D’Sylva left at 12:48pm.

## **ADMINISTRATOR’S REPORTS**

### Regular Investment Reports

No rebalancing is recommended.

### Cash Flows Reports

Reports are included in the Board Packet. (Hamilton Lane Fund II)

### Other Items

Education

- Ms. Wright shared her experience at the IFEBP Wharton Investment Class.

- AMRS-VA – staff provided notes and recap of the spring 2015 meeting. Reminded trustees of the upcoming session in October 2015 which will include trustee focused sessions.
- Manager Staffing Updates
  - Staff provided details in the packet on the staffing transition at Landmark.
  - PIMCO staffing update was covered during Dahab’s financial review.

Follow-up Items

Hancock – this topic was covered during Dahab’s financial review.

**MEETING RECORD**

Mr. Milner made a motion to

Approve the April 9, 2015 minutes.
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Ms. Triggs seconded the motion. The motion was unanimously approved (8 – 0).

Ms. Triggs left at 12:55 PM.

**COMMITTEE REPORTS**

Technical Corrections and Plan Document Review Committee

No report was given.

Vendor & Service Provider Review Committee

No report was given.

**OLD BUSINESS**

COLA Update

Staff noted that COLA letters have been mailed. The COLA will first take effect in the June 2015 checks and retirees will see a double COLA in June. Regular payments, after the negative COLA, will resume in July.

Investment Policy Statement (IPS)

Staff provided the current IPS in the board packet. Board members are asked to review. Revisions will be taken up at a future meeting.

Staff noted that they needed board direction to begin the process of reallocating funds per the updated asset allocation.

Mr. Milner made a motion to

Direct staff to begin the process of implementing the new asset allocation as approved by the Board during the November 13, 2014 board meeting.
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Ms. Kelleher seconded the motion. The motion was unanimously approved (8 – 0).

**NEW BUSINESS**

None.

## **NEXT MEETINGS**

1. Thursday – June 11<sup>th</sup> at 9:30 AM, Sister Cities 1101, Annual Educational Retreat
2. Thursday – July 9<sup>th</sup> at 8:30 AM, Sister Cities 1101, Interim Meeting
3. Thursday – August 13<sup>th</sup> at 8:30 AM, Sister Cities 1101, Interim Meeting

## **ADJOURNMENT**

The meeting adjourned at 12:48 PM.

## **HANDOUTS**

Distributed to Board members in the Board Packet:

Agenda
Minutes of Prior Meeting [1(a)]
Monthly Investment & Rebalancing Report [4(a)(i)]
Private Equity Cash Flow Report [3(a)(iii)]
AMRS-VA – Spring 2015 notes [4(b)(i)(3)]
Herndon Capital – IPS – 30% exception request [5(a)]
Investment Manager – Leadership Transitions [5(c)]
Investment Policy Statement (F&P) [7(b)]

Distributed to Board members at the meeting:

- Dahab’s Deferred Compensation, Defined Contribution & ROTH IRA Performance Review
- Dahab’s Global Investment Grade Fixed Income Manager Search – May 21, 2015
- Dahab’s Performance Review Report – March 2015
- Franklin Templeton – Templeton Global Bond Fund – May 21, 2015
- Loomis Sayles – Global Fixed Income Presentation – May 21, 2015
- Standish – Global Fixed Income Presentation – May 21, 2015