Town of Palm Beach Retirement System
Board of Trustees
Minutes of November 20, 2015 Meeting

I. Call to Order and Roll Call

Chair Ross called the meeting to order at 9:05 am in the Town of Palm Beach Town Hall Chambers, 360 South County Road, Palm Beach, Florida 33480

In Attendance:

TRUSTEES:
Wilbur Ross, Chairman
Gerald Goldsmith, Chairman Pro Tem
Brett Madison, Secretary
Tom Bradford, Town Manager
Dan Stanton
J. Patterson Cooper
Daniel Wilkinson
Michael Marx
Bradford Kaufman

ALSO PRESENT:
William P. Hanes, Retirement Administrator
Jane Struder, Finance Director
Danielle Olson, Human Resources Director
Rosemary Guillette, Segal Rogerscasey
Daniel Westerheide, Segal Rogerscasey
James Linn, Attorney

II. Administer the Oath of Office to newly appointed member, Susan Owens, Town Clerk

Ms. Owen administered the oath of office to Mr. Kaufman prior to the start of the meeting.

III. Approval of Agenda

Mr. Goldsmith made the motion to approve the agenda. Mr. Stanton seconded the motion. The trustees unanimously approved the motion.

IV. Comments by Trustees

None

V. Public Comments

None

VI. Reading of Resolution honoring Mr. James McCartney Wearn

Mr. Ross read the resolution that was requested by the board at its last quarterly meeting.

Mr. Bradford made the motion to approve the adoption of the resolution. Mr. Stanton seconded the motion. The trustees unanimously approved the motion.

VII. Approval of Minutes: August 21, 2015

Mr. Goldsmith made the motion to approve the minutes of August 21, 2015. Mr. Cooper seconded the motion. The trustees unanimously approved the motion.

VIII. Financial Report and Disbursements, Jane Struder, Finance Director

Ms. Struder presented the quarterly financial report as of September 30, 2015. She noted that the numbers in the report are unaudited and that the auditors have started the 2015 audit process. She commented that the Audit is not yet completed. She reviewed the statement of changes in net assets and the operating expenses for the funds. Ms. Guillette confirmed that most of the Towns funds are either Institutional comingled funds or Institutional mutual funds and that they do not have 12B-1 fees.

Mr. Ross made the motion to approve the adoption of the report. Mr. Bradford seconded the motion. The trustees unanimously approved the motion.

IX. Quarterly Investment Report, Rosemary Guillette and Daniel Westerheide, Segal Rogerscasey

A. Performance Report

Ms. Guillette reviewed the Investment Performance Report for the month of September. She reviewed the financial market condition, including international equity, commodities, real estate, private equity, hedge funds, S&P 500, and fixed income funds.

Ms. Guillette reviewed the target allocations that were selected by the board in early 2013. She stated this was a tough quarter. She reviewed the performance of each manager.

Ms. Guillette reviewed the Investment Performance of the portfolio for the month of October and noted that there was a significant improvement from the end of September. She added that International, Emerging Markets, Hedge Funds, Commodity and Real Estate did very well against benchmarks. She noted that some of the managers that did poorly in September came back strong in October. Ms. Guillette stated that T-Rowe Price's New Era fund was up 10% for the month, although still negative since inception.

Mr. Stanton asked Ms. Guillette to discuss the thought process regarding the selection of managers that have performed incredibly poor. He commented that over the last ten years very few of the annual returns were at or above the rate assumed. Mr. Cooper asked Ms. Guillette to comment on some of the risk positions with the asset classes represented.

B. Overview of Defined Benefits

Ms. Guillette introduced Mr. Westerheide, head of the ALM practice, who discussed the details behind the asset allocation models recommended to the board in 2013. She commented that Mr. Westerheide performed the ALM study in 2013. She reviewed the defined benefit's overview booklet and commented that to see how an asset allocation fit, one needs to know how the DB plan works. She provided an overview of how the DB plan works.

Ms. Guillette provided an overview of how assumptions and an actuarial rate of return specifically are established. Mr. Ross stated that one repeated occurrence that has been proven very important historically is that when the Town of Palm Beach in earlier years experienced very good investment performance, the subsequent decisions of town counsels were to raise the benefits of the pension plan resulting in underfunding.

Ms. Guillette reviewed the fiduciary role of The Board of Trustees, staff, advisors and Segal Rogerscasey. She discussed the meaning of being a fiduciary as it pertains to the trustee duties of prudence and loyalty. She added that she as well as the Town are fiduciaries and both have a duty to act in the best interest of the plan over the long term, and the benefit of the members, retirees, and beneficiaries of the trust.

Ms. Guillette stated that only two people from the present board were on the board when Segal Rogerscasey presented to be hired in 2012. She commented that prior to Segal being hired the Town made the decision to move to one plan and one board, and benefit changes had just been enacted. She explained that Segal Rogerscasey was hired at the end of 2012, and upon being hired they had to analyze all existing managers including those that were under contract with the Police Officers Board, Firefighters Board and General Employees Board. She stated that the allocations between the three plans at the time were completely different and they were all thrown together into one plan. She stated that Segal Rogerscasey performed a summary analysis and made recommendations on what funds should be kept and what funds should be fired. She commented that multiple searches were performed, and that the portfolio included 28% in hedge funds once fully combined.

She stated that Segal Rogerscasey developed an investment policy statement that the board adopted, and terminated and consolidated managers right away. She commented that Segal Rogerscasey conducted an ALM study that considered risks. She reviewed the current mix with 25% fixed income 47% Equity and 28% in alternative, mostly with hedge funds. She noted that many searches had to be performed with the Segal Rogerscasey and with the board to build a portfolio for Real Estate and private equity. She discussed that there were numerous reductions and increases with managers and allocation classes that had to be executed. She stated that equity became more global and that their idea with equity is that everything should be more global and that the global capital market should be captured with the portfolio. She added that core was overvalued and the board felt that it was not the right time to invest in core.

Ms. Guillette discussed that at the last meeting the board asked her to bring alternative mixes, and it was discussed that the expectation of the 10-year return was different than the 20-year return. She brought about 7 different mixes together to discuss at this meeting. She noted that her goal is to provide as much information as possible so the best decision can be made when choosing an asset allocation for the plan. She commented that the board needs to be comfortable with the asset allocation.

Mr. Hanes made inquiries regarding the statement made by Ms. Guillette at the prior meeting about different mixes, and the projection of less than 7.5 over a 10-year period versus the forecast over the next 20-year period that is expected to be fully funded. Ms. Guillette answered that all mixes are different and the report identifies for each mix the expected return over the 10-year period and the expected return over the 20-year period. She discussed changes she can make to the mixes either by bringing down or increasing the asset classes. She stated that the Town's current target mix over the next ten year period is expected to achieve a 7.2% return, while the goal is 7.5%, and their projection is that over the 20-year period it will achieve approximately 8% return. She confirmed that she brought down the allocation for International equity and emerging market, and she could make mixes that can bring it down some more. She noted that their firm believes that commodities are good to have over the long term because it has diversification effects over time.

Mr. Stanton questioned the report's statement regarding a best guess return over the next ten-year period. Ms. Guillette answered that the return achievement comes over time and that most pension plans since inception receive 7.5 to 8.5% long term although it is believed that it will be hard to get that going forward. Mr. Kaufman asked how the return assumptions are being reached. Ms. Guillette answered that Segal Rogerscasey has a 25 member dedicated group that do the research. Mr. Bradford asked Ms. Guillette to explain the Sharp ratio. Ms. Guillette explained that Sharp Ratio is the ratio between return and risk, and the higher the sharp ratio the better, and that it means for the unit of risk that is taken, there is more return received.

C. Asset Allocation Model

Mr. Westerheide introduced himself as the co-head of the beta asset liability modeling and risk management group at Segal Rogerscasey. He explained the meaning of beta, which is looking at the 3 tools in the investment process and finding investment management that have skill sets to allow them to outperform the market. Mr. Westerheide discussed that the focus of his group is to look for passive investment structure and what is the expected return, risk and how does it all interrelate in a portfolio level. Mr. Westerheide presented looking at passive index funds. He discussed the capital market assumptions and stated that the assumptions are internally researched and are forward looking. He discussed examples of indicators, and reviewed the core fixed income historical returns.

Mr. Ross questioned the conclusion Segal Rogerscasey made from the correlations. Mr. Westerheide answered that they looked at a 7-year horizon at the end of last year with a roughly 2.25% expected return on the broad investment grade US bond market. Mr. Ross asked if it is reasonable to use old data to make these assumptions. Mr. Westerheide answered that these assumptions were made at the end of 2014, and that the capital market assumptions gets updated annually and monitored quarterly. He added that he expects the yield to be similar to last year. Mr. Stanton discussed the stress on the other 80% that needs to be 10% per year to hit the 7.5% assumption if 20% is invested in fixed income. Mr. Westerheide answered that they cannot control return expectations, they can only provide by what the market is giving them. He stated that the Federal Reserve for very important reason has implemented quantitative easing for short-term rates. He commented that they feel that their expectations are unbiased expected return for fixed income.

Mr. Ross questioned why not use a more logical strategy to be very short-term for the time being by choosing an intelligent entry point into both fixed income and equity. Mr. Westerheide answered that their house view is timing interest rates and tactically move to cash and wait for rates to spike up and move in at lower prices and higher yield, and have a higher expected return. He explained that it is very difficult to time the bond market. Mr. Kaufman questioned staying in cash and getting to the 7.5% benchmark with the world changes. Mr. Westerheide answered by reviewing the time varying returns. He noted that their expectations over the next decade is that the feds will increase short term rates and they will be normalized at about 4% which is significantly lower than the last two rate hiking cycles in the early mid 90's where it was higher. He stated that their expectations is that 10 years from now the Town will be earning 4% in cash and that as the environment normalizes there will be higher bond yields and longer term returns will be higher. He stated that we need to be mindful of the environment we are in today, but be conscious that this is a long term system, and the expectation is that the environment will normalized and that means higher bond yield off the curve.

Mr. Ross stated that he does not understand the conclusion, and asked Mr. Westerheide to finish discussing fixed income. Mr. Stanton asked Mr. Westerheide to comment on the composite duration of fixed income. Mr. Westerheide answered by discussing investor's anticipation. Mr. Ross stated that he does not understand that on a reasonable amount of years risk reward, why the effort is not made to maximize the return within their forecast and he does not believe that what is being done now will produce the best result. Mr. Kaufman asked what the average duration is. Mr. Westerheide answered the duration of the AGG is about 4.5 to 5 years and the managers are pretty close to that. Mr. Ross asked if it is not known what the duration is. Mr. Westerheide answered that they can get that information sent quickly. Ms. Guillette stated that they are benchmark to the AGG. Mr. Kaufman commented that what he understands from what Mr. Ross is asking is that if the average weight of duration should be lowered to a shorter period of time. Ms. Guillette stated that most pension plans are not making tactical decisions.
Mr. Goldsmith commented that it should be considered that more and more of the Town's obligations is going to require more cash. Ms. Guillette discussed that it is based on the assumptions. Mr. Westerheide discussed the Capital Market Assumptions as of the beginning of 2015, and that their firm's view is that the market rates will rise slowly and will be controlled over the next 5 to 10 years very consistent with the yield curve and moving to cash, and that waiting does not give more value than being in bonds today. Mr. Ross asked for further comment about this agnostic view. Mr. Westerheide answered that Segal's view is that you should have more credit exposure than treasury exposure. Ms. Guillette stated that the mandate in the Towns policy guideline is to keep very minimal amount of cash and be fully invested. Mr. Ross asked why municipal bonds consistently yield more than the core fixed income, which he does not believe to be true historically.

Mr. Westerheide answered that the long term fixed income asset class is a treasury, and does not have the spread product that the core fixed income has and that is the underperformance. Mr. Ross stated that he has a problem with the labeling of this as long term fixed income if in fact they are simply treasury. He commented that the board cannot understand what these tables are and there is inconsistency in bond assumptions versus commodities assumptions. Mr. Westerheide answered the commodities beta to the equity market and the overall action classes. Mr. Ross made inquiry that in a world where commodities are going up what are the correlations among the assumptions that are being made. Mr. Westerheide discussed the historical assumptions and the attractiveness of ratios of the equity market. Mr. Kaufman asked if they rely on other people's research for the firm to compare with other firms. Mr. Westerheide answered that there is a survey done by an actuarial firm that surveys 20 different investment firms and Segal Rogerscasey is one of them and he will supply the comparative paper to the board. Mr. Ross asked him if he can provide the trail among the various classes. Mr. Westerheide discussed quantitative and qualitative thinking and the use of the return assumptions, risk, correlation and the global market portfolio. Mr. Ross questioned how the assumptions were developed. Mr. Westerheide discussed. He stated that their views are to be underweight international fixed income. Ms. Gillette commented they do every year on an annual basis and on the quarterly basis they present the Outlook and how they feel about the US, Japan, Russia, Private Equity, Hedge funds, Real Estate and Infrastructures. She noted that she has a bias for Real Estate and Private Equity. Mr. Ross asked if the chart on the report was from last year. Ms. Guillette answered that the chart is from the end of 2014, issued March 2015. Mr. Stanton commented there are challenges to deliver 7.5%.

D. Review of administrator's memo to Segal Rogerscasey

Ms. Guillette stated that she was going to answered all the questions that were sent to Segal Rogerscasey by the board. She read the questions to the board and provided an answer. Mr. Stanton noted that the predisposition of emerging markets in general should be re-evaluated considering the number of countries that are not politically stable. Ms. Guillette answered that their research group takes that into account. Mr. Stanton commented about the poor performance of the benchmark for the asset class. Ms. Guillette expressed that her years of experience with several states reflects on what she understands is needed for the Town to have the best performance. She stated that new strategies need to take place and some changes need to be made to make performance better for the Town.

Mr. Wilkinson asked Ms. Guillette what investment return assumption rate is being used by her other pension fund clients. Ms. Guillette answered that many pension plans have different rates, but that the average assumption rate is 7.5%. She commented that the average in Florida is a little more than 7.5%. Mr. Kaufman asked if it is a function of a realistic view or a political function. Ms. Guillette answered that it is a function of both. Mr. Linn commented on the state statute and that there is a political overlay, but legally the board is supposed to hear from consultant and that the assumptions need to be made within a ray of reasons.

Ms. Guillette answered questions regarding the return assumption rate. She stated that the board has gone through a program re-design. She stated that she works on public pension plans and that the corporate world acts a little different. She stated that she thinks that it is reasonable for the Town to get 7.5% in the next 20 years and that TIPs and commodities were modeled originally into the portfolio back in 2013. She commented that T-Rowe's fund and Wellington's fund were not modeled. Mr. Westerheide confirmed that it was explicit thinking of Segal Rogerscasey to introduce inflation exposure into the plan. Ms. Guillette stated that the report shows the correlation matrix to the Towns actual managers and how they correlate to each other. She discussed future considerations.

Mr. Ross asked the trustees that given the level of complexity of this topic, should there be another meeting among the board of trustees in the following couple of weeks. Mr. Goldsmith agreed. Mr. Kaufman stated that he is available the first two weeks of December. Mr. Stanton asked Ms. Guillette regarding the rate of return of assumptions, and if hedge funds are too low. Ms. Guillette stated that for hedge funds they were looking at 10% to 20%. She agrees that is low.

Mr. Armstrong introduced himself for the new trustees. He stated that he is the actuary for the retirement system. Mr. Armstrong stated that his retirement benefits expertise from the Town of Palm Beach is based on proprietary information received from the retirement board. He commented on what is reasonable for what is the expected rate of return and that there is a 46% likelihood of risk. Mr. Ross asked Mr. Armstrong how comfortable he is with the stated longevity assumption. Mr. Armstrong answered he agrees with the 7.5% decision. Mr. Ross asked Mr. Armstrong if in his view the big variable is the rate of return, and not longevity. Mr. Ross asked Mr. Bradford if he is comfortable with the rate of increase in salary assumption. Mr. Bradford agreed. Mr. Armstrong discussed matters before the finance and taxation meeting. Mr. Ross noted that the town has not made any decision on changing the benefits. Mr. Armstrong assured the trustees that he will make the board aware of his activities. Mr. Ross stated that they are counting on Mr. Armstrong to inform them of any implications. Mr. Bradford commented in regards to the mortality table, that the impact to the Town is approximately $870,000 and they are trying to do a $300,000 3 fiscal years smoothing or a step-up process so when that year comes the taxpayer does not get a big hit. He commented that the total impact in 2018 will be $875,000 (before consideration of a final 2015 actuarial experiences). Mr. Ross asked at what rate is that calculated. Mr. Bradford confirmed that is at 7.5%. Mr. Armstrong stated that he agrees.

X. Attorney Report, James Linn, Attorney

Mr. Linn followed up on items from the last Retirement Board meeting. Mr. Hanes asked Mr. Linn to report on the status on the investment hire from the last meeting that has been sent for review of subscriptions. Mr. Linn answered that a satisfactory side letter agreement has been reached for the two firms hired.

XI. Administrator's Report, William P. Hanes, Administrator.

Mr. Hanes commented that there are two new DROP participants and one retiree in the report that needs to be ratified.

Mr. Stanton made the motion to approve and Mr. Goldsmith seconded the motion. The trustees unanimously approved the motion.

XII. Other business

None

XIII. Adjournment

Mr. Madison made the motion to adjourn the meeting. Mr. Ross seconded the motion. The trustees unanimously approved the motion.

Respectfully Submitted,

Brett E. Madison, Secretary
Town of Palm Beach Retirement System