# TOWN OF PALM BEACH

**MINUTES OF THE INVESTMENT ADVISORY COMMITTEE MEETING HELD ON DECEMBER 7, 2009 AT 10:00 A.M. AT THE EMERGENCY OPERATIONS CENTER (EOC), THIRD FLOOR, CENTRAL FIRE-RESCUE STATION 355 SOUTH COUNTY ROAD**

I. CALL TO ORDER AND ROLL CALL

The Investment Advisory Committee Meeting was called to order on December 7, 2009 at 10:00 A.M.

**ATTENDEES:**

Chairman Michael F. Andrews
William John Mikus
Dr. Heinz L. Gundlach
Benton P. Bohannon
Bernard R. Panfel
Greg Coleman, CFA – Partner, Atlantic Capital Management
Dustin Heintz – Investment Services Managers, Florida League of Cities
Jane Struder, Finance Director
Cheryl Somers, Assistant Finance Director
Melissa Morgan, Recording Secretary

II. PLEDGE OF ALLEGIANCE

Chairman Michael F. Andrews led the Pledge of Allegiance.

III. APPROVAL OF THE AGENDA

**Motion by Chairman Andrews for approval of the agenda.**
**Motion seconded by Mr. Bohannon**
**Motion carried unanimously**

IV. COMMUNICATION FROM CITIZENS – 3 MINUTES PLEASE.

There was none.

V. FLORIDA LEAGUE OF CITIES.

Mr. Heintz: Gave an overview for the new board members and discussed the handout.

Mr. Heintz: Gave an update on the securities lending. One year ago we were in a difficult place and we were trying to figure out what was going on with Wells Fargo and the securities lending positions. We had everything marked to market. We were trying to get a positive handle on it so we could know how to manage it. In the last year they have turned over all the investments to us in a separate account. It is about a third of the size since that time. We have about 65 million out on loan and we keep unwinding that. We anticipate being out of the securities lending program and will be out around the second quarter in 2010. We are doing it this way because the securities had staggering maturities dates and will be almost matured by March 2010. Also by that time we will be mostly liquid and we will be able to manage out of the program.

Chairman Andrews asked Mr. Heintz: Are you assuming they go to par?

Mr. Heintz replied to Chairman Andrews: Yes, a majority of them are. We discussed three of them, Lehman, Victoria and Gryphon that are going to be outstanding. We talked about these three at our Investment Advisory Committee meeting how we are going to move forward. The others we are assuming will mature at par.

Chairman Andrews asked Mr. Heintz: What percentage of the portfolio are the toxic ones?

Mr. Heintz replied to Chairman Andrews: The toxic ones are about 21 million total and we are at 65 million. Right now, marked to market, and we have about 7 million. Therefore, we are getting about $.30 for every security. The rest are priced at $.99 or $1.00 because they are short term maturities.

Mr. Bohannon asked Mr. Heintz: I am a little confused you mentioned the security lending program with Wells Fargo and now you mentioned the investment holdings within the funds. Is this the same subject or a different subject?

Mr. Heintz replied to Mr. Bohannon: The portfolio participates in a security lending program and those securities are in a different account by itself.

Mr. Heintz asked Mr. Bohannon: Are you familiar with the securities program?

Mr. Bohannon replied to Mr. Heintz: Yes I am.

Mr. Heintz replied to Mr. Bohannon: When we originally invested in the Wells Fargo security program they were investing in pools with the cash around 2004.

That time frame was when everybody was saying money markets are safe. Therefore, they were not releasing the holdings to us. We were finding it difficult to find out what was in those portfolios. We did not find out until fall of 2007 what was in there.

Mr. Bohannon asked Mr. Heintz: So the trust did not turn over all to Wells Fargo?
The trust was not making direct lending arrangements?

Mr. Heintz replied to Mr. Bohannon: Wells Fargo did that as the custodians for the trust.

Mr. Bohannon asked Mr. Heintz: Where did the toxic arise from in this process?

Mr. Heintz replied to Mr. Bohannon: Wells Fargo

B. PRESENTATION BY ATLANTIC CAPITAL

Mr. Coleman: Discussed handout with the Committee:
Town of Palm Beach Investment Review & Economic Outlook.

Mr. Coleman: Discussed the chart showing the Town of Palm Beach comparative return

Chairman Andrews asked Mr. Coleman: I thought you were going to send this net of fees?

Mr. Coleman replied to Chairman Andrews: It is net of fees and you are not in that fund. It was added on and when we do it against the benchmark it will be gross of fees. It is another measure of comparison if you were to go against just government or just treasuries.

Mr. Coleman: The rating agencies have become stricter and have downgraded tens of thousands of securities. They are in our office once a year and take a look at our process and all the securities as well as the consultant to make sure we are in compliance. The fact that you did not get downgraded speaks volumes about your investments in place. Their performance measurement is on going but they do a formal one with Fitch that does some of the longer ones and S&P.

Mr. Bohannon asked Mr. Coleman: What work does Atlantic Capital do on the asset backed pools?

Mr. Coleman replied to Mr. Bohannon: We go the next level and look at all the data. For example say you buy a Toyota asset backed security pool. There is billion dollars of loans and they have divided it into two - a 900 million senior pool and a 100 million in a junior pool. The junior pool takes all the losses first. We at Atlantic Capital invest in the top tier. The beauty of the autos pools they were the first to become an asset backed. They were the first to come out of asset back and they did not suffer and there were no adjustable mortgages. We did not assume the 25,000 Toyota four years from now is going to appreciate to 32,500.

Dr. Gundlach asked Mr. Coleman: The trades in values have been falling drastically for all models. How this being ascertained for the quality for the asset is backed loans?

Mr. Coleman replied to Dr Gundlach: That is the last factor, only about five percent on Toyotas and three or four percent will default. You get about 50% and it runs between 40% - 60% of the loan balance. Let's say they did not recover anything and the balance was zero for example and there were used cars or SUV's. We get paid first, we are the senior class and we get the principal before the others but they get a higher yield than we do. To answer your question if it was 10 to 15% off the loan balance of the used car values and it would not matter.

Chairman Andrews asked Mr. Coleman: Every month we get a break down of all the investments in your portfolios and my favorite is Countrywide Homes Loans which is in the one to three but it shows it as an AAA and it is showing that we have an unrealized capital gain. Can you just explain that for me?

Mr. Coleman replied to Chairman Andrews: What is the maturity date 2003 or 2004? Well Countywide was the originator. Before they got in the sub-prime business they did a lot of high quality fixed rate loans.

Mr. Mikus replied to Chairman Andrews: It says 2018.

Mr. Coleman replied to Chairman Andrews: A follow up question would be, if you are seeing all these in one to three year and zero to two years and intermediate, how is it that I am seeing a 2018 maturity? The answer is the last loan in the package is 2018. It is a 15 year loan and we take those cash flows and some insurance companies have the cash flows that are 20, 15, 16, 17 and others like Atlantic Capital, get to claim the cash flow first, that is why we get the shorter piece. Also they are fixed rate loans and the loan to value is 60% today and they have high FICO scores and they are not sub-prime and they are not backed by adjustable rate mortgages.

Chairman Andrews asked Mr. Coleman: Are all of your holdings at least a rating of "AAA"?

Mr. Coleman replied to Chairman Andrews: The trust will allow us to purchase an"A" or better. On the intermediate we have some that are "A" and a few "AA" but not that much. In order to maintain the AAA rating from Fitch for the intermediate bond fund, it is limited between A and AAA. Unlike in the shorter term fund it does not look like we own anything in the zero to two. It is AAA or government.

Chairman Andrews asked Mr. Coleman: The long term fund has outperformed your short term. I also think the interest rates are as low as they can go. Although as interest rates rise, what is your policy?

Mr. Coleman replied to Chairman Andrews: This is the longest fund we manage for you. Notice the duration is 3.1 years and the benchmark, basically the money managers are usually 0-20% below the benchmark or at the benchmark in terms of maturity, or zero to 20 % above. We are short the benchmark between 10 and 15% It is as low as we think the rates are going to go. Also as the dollar goes lower that does not help the bond process either.

Chairman Andrews replied to Mr. Coleman: So the short answer is basically you have a short term policy or procedure you need to implement to mitigate?

Mr. Coleman replied to Mr. Andrews: Yes.

Chairman Andrews asked the Committee: Are there any more questions for Mr. Coleman and Mr. Heintz? I think this was very informative especially for the new board members. Thank you for the information.

Mr. Clomen and Mr. Heinz: Thank you for the invite.

**Chairman Andrews asked the Committee to take a five minute break.**

V. PRIME BUCHHOLZ-QUARTELY RESULTS FOR OPEB TRUST

Mr. Higman discussed handout with Committee:
The November results show the fund is up 15% net of all fees which is ahead of the actual index, meaning our managers are beating the benchmark as a group for the one year period. We have some work to do on the two year basis because that is when we see the decline of Western and we also had Long Leaf that was under performing. If we look first at our target index, one of the reasons we are behind on our one year target index is because we had a strong upward rebound in the long only equity market and if you recall we have a little bit of an overweight. Our alternatives are semi liquid and we were unable to rebalance and most committees were hesitant to do that in January and February. The policy index allows you to be able to do it and gives you the convictions to do it we think over the long term we will catch up and out perform our expectations.

Mr. Higman: Discussed an update on Brandywine funds. Brandywine is on the internal watch list. Prime Buchholz will comment on Brandywine if we recommend them for termination. The Brandywine issue is not a timed event. It is relative to the market. We have been there and we are doing monthly phone calls to analyze to see if the process has changed and if they are doing something different. They are quality managers and their process works and their process has worked. There has also been a period of time when they have underperformed and they cannot find stock and the market is not rewarding stocks which has the quality cash flows which these guys seek. Therefore, most of their underperformance is in the last eighteen months and it is relative to the rebound in quality. Therefore, what we have said to them as we see the market rotate toward quality as it always does, if they do not outperform to a similar magnitude to the same regard to their underperformance we will terminate them.

Mr. Bohannon asked Hr. Higman: Does this mean they are sitting in cash?

Mr. Higman replied to Mr. Bohannon: No they have some cash.

Mr. Bohannon asked Mr. Higman: We have two benchmarks that we are using in the asset allocation. One is the fund to fund strategic and the other is conservative and you also have T Bills plus 500 basis points in the investment policy statement.

Mr. Higman replied to Mr. Bohannon: That is going to change and that was applied to the real assets.

Mr. Higman replied to Mr. Bohannon: No, you are right and the idea there is it is a tough benchmark because T Bills plus 500 has no volatility, but on a risk adjusted basis it gives us a sense especially for the Archstone strategy, because over time the alternative strategy should be a plus spread business over time. It is a bit of an unfair benchmark but it does give us some information.

Mr. Bohannon asked Mr. Higman: Are you still going to stay with the T Bills plus the 500?

Mr. Higman replied to Mr. Bohannon: We would put it as the secondary benchmark we would put the primary as the fund to fund conservative.

Mr. Higman: Discussed fixed income portfolio with the Committee and market research.

Mr. Higman: Guggenheim informed the Committee that they are closed for redemptions and they will continue to be closed for redemptions. We view their closure as a positive to all their shareholders because it could have gone another quarter and distributed another 100 million and the rest of us would be at a disadvantage. Closing the gates gave them the opportunity to conserve their cash flow and improve their dynamics of the portfolio. They have not been able to have any liquidation and they have been able to refinance their mortgages in 2009 and it looks like they are going to be OK in 2010. They informed us for 2010 they are going to continue to market this.

Mr. Bohannon asked Mr. Higman: Are you saying that if their gates did not go up you would have stayed in it anyway?

Mr. Higman replied to Mr. Bohannon: At that point we were not recommending a sale of Guggenheim and what happened is that in the second quarter they had a about a little more than 40% in redemptions. However a large amount of those redemptions actually were coming from two bank entities that are not participants in our pool because our accounts are co-invested in a separate account. Those two entities are Bank of America and Wells Fargo. I am here to provide recommendation and I recommend we put the redemption paperwork in to get priority in the queue there.

Chairman Andrews asked Mr. Higman: How do they get their monthly evaluations?

Mr. Higman replied to Chairman Andrews: Well they do not do monthly they do quarterly. Every building has its own process.

Mr. Higman asked Mr. Struder: I will ask Jane if she can put in the full request so it can get in before the full 90 day cycle?

Chairman Andrews asked Mr. Higman: How much is this fund?

Mr. Higman replied to Chairman Andrews: $870,000

Chairman Andrews asked Mr. Higman: Can you go over what we have in each commodity for me and our new members. For example, in the handout it says total real assets were 13%. What was our guide?

Mr. Higman replied to Chairman Andrews: Total real assets are 15% policy index, fixed income is 20%, the alternatives, the international are 17.5% and the domestic equities are 27.5%. The next time we get together we need to discuss asset allocation because it has been over two years since we discussed it. It will also allow the new members to have their input.

Chairman Andrews asked Mr. Higman: Will you bring a recommended allocation? Is that how we are going to start it?

Mr. Higman replied to Chairman Andrews: That is how we typically do it, but every Committee is a little different, if you want me to have a specific recommendation we can do that. If you would like me to bring a number of options and have a conversation, then you can ask me what is my recommendation I will be glad to give you a specific recommendation.

Ms. Struder asked Mr. Bohannon: Have you modeled this portfolio yet, the current asset allocation mix?

Mr. Higman replied to Ms. Struder: No, I have not, but it is easy to do. The expected rate of return from just looking it over I would expect the expected rate of return on a nominal basis with 2-2.5% inflation would be somewhere around 8%.

Chairman Andrews asked Mr. Higman: The 8% looks nice but we are looking at cash because that is what we have to us to pay these retirements from.

Chairman Andrews asked Mr. Higman: But in summation is the portfolio roughly set up and roughly in balance so we will be at 8%?

Mr. Higman replied to Chairman Andrews: Yes, I will verify that when we re-run the current.

Mr. Higman asked the Committee: Do we need a motion for the liquidation on Guggenheim.

Ms. Struder replied to Mr. Higman: Yes

Mr. Higman replied to Ms. Struder: It is a recommendation is to request a full redemption from Guggenheim with the understanding the board will have an opportunity to review the actual liquidation if it should occur.

**Chairman Andrews made the motion to approve Mr. Higman recommendation**
**Mr. Panfel seconded the motion**
**The motion was approved unanimously.**

Chairman Andrews asked the Committee: Is there anything else for Mr. Higman at this time?

Ms. Struder replied to Chairman Andrews: Mr. Higman included the revised investment policy including the Sudan amendment in his back up and I will take it, along with the other investment policy to council for approval next month.

VII. MONTHLY INVESTMENT REPORTS

Chairman Andrew asked the Committee: Does any member on the board want to fully go into details on the investment report? Hearing none let's move on to the next item.

VII. DISSCUSSON ON BEANCHMARK FOR PFM INVESTMENTS

Ms. Struder replied to Chairman Andrews: At the last meeting you wanted to discuss the benchmark in greater detail. In the handout PFM brought on section 14 it shows what their recommendation is for a performance benchmark.

Chairman Andrews replied to Ms. Studer: I would like to defer this discussion to the next meeting.

IX. NEXT MEETING DATE

Ms. Struder asked the Committee: I have February 15, 18, or 19 these dates are for Mr. Higman benefit because these dates are around the same time as the pension meetings he attends.

X. ANY OTHER MATTERS

Mr. Chairman asked the Committee: Are there any other matters to be brought before the committee at this time?

IX. ADJOURNMENT

**The meeting was adjourned at 12:16 p.m.**
**Chairman Andrews made a motion to adjourn the meeting**
**Dr. Gundlach seconded the motion.**
**The motion was carried unanimously.**