MINUTES OF THE INVESTMENT ADVISORY COMMITTEE
MONDAY, NOVEMBER 26, 2007 AT 10:00 A.M.
TOWN COUNCIL CHAMBERS

I. CALL TO ORDER AND ROLL CALL

The Investment Advisory Committee Meeting was called to order on Monday, November 26, 2007 at 10:00 a.m.

PRESENT:
Chair Michael F. Andrews
Vice Chair Edward L. Hennessy, Jr.
Stephen L. Brown
William J. Mikus
Bernard R. Panfel
Dustin Heintz, Florida League of Cities
Greg Coleman, Atlanta Capital Management
Jane Struder, Finance Director
Cheryl Somers, Assistant Finance Director
Betty Cotton, Recording Secretary

Sean Higman, Prime Buchholz (via phone)

II. PLEDGE OF ALLEGIANCE

Chair Andrews led the pledge of allegiance.

III. APPROVAL OF AGENDA

Chair Andrews stated he wanted to add an item to the agenda between Item IX and Item X where the committee is to discuss the possible effects of SIV's (Structured Investment Vehicles) in both the Florida League of Cities and the SBA funds.

IV. COMMUNICATIONS FROM CITIZENS (3 MINUTE LIMIT PLEASE)

No citizens attended.

V. APPROVAL OF MINUTES FROM THE APRIL 26, 2007 MEETING

MOTION BY VICE CHAIR HENNESSY FOR APPROVAL OF THE MINUTES.
MOTION SECONDED BY MR. BROWN.
MOTION CARRIED UNANIMOUSLY.

VI. PRIME BUCHHOLZ QUARTERLY PERFORMANCE UPDATE (VIA PHONE

Sean Higman thanked the committee for accommodating his long distance presentation.

He stated he will make some brief comments about Market Environment – Historical Returns on page 4 of his presentation. The period ending September 30, 2007 ended as a very strong quarter. In the middle of the quarter, he never would have guessed the quarter would end with the S & P up 2% and the broad market up 1.5%. In equity returns, strong returns in large cap lead the way, large cap growth particularly in their annual survey of the managers in their client portfolios, and this is something that has been expected for a number of years. On a one year basis, the large cap Russell 1000 Growth has now beaten the Russell 1000 Value. It still has some work to do coming out of the tech bubble and with about 4 or 5 years of out performance by value stocks. On a 5 year basis, there is still an 18% versus 14% advantage to value stocks. Long term investors know that going through these cycles. The mean reverts over time and they expect that. He can recall several times in his career as an investor both as a consultant and as a plan sponsor, the declaration of the death of value or the death of growth. For example, there are a number of paths to get back to mean, the kind of violent changes seen in the early part of this decade or get back to mean reverting by growth beating value modestly over a long period of time. They do not have great insight into which path they will take. They tend to have portfolios that are as much as possible style neutral because they do not have a good crystal ball.

Also, the mid cap stocks are off. In general weighted, they were down about .4% but growth stocks were also up 2% while mid cap value stocks were down for the quarter. Notice the strong one year numbers across the board. Really of note in this market was the strength of the emerging markets up in the quarter at 14.4% and trailing 58.2%. He stated "It is often said that you don't know whether you are in a bubble until after it has burst. It sure gives us pause and he will talk about that in a few minutes."

The lower left gives a sense of which sectors worked and which sectors did not work over the recent periods. Shown is a very profound lever effect where energy continues to perform well based on the commodity price and an inverse relationship with consumer discretionary because now more and more consumer discretionary spending is being crowded out. He has a client who owns most of the Wendy's in the upstate New York area and he can predict now fairly accurately what his store sales are going to be by the gas price at the pump. Likewise, in this quarter, financials were hurt badly. Some of them were deservedly beaten up by their presence in the sub prime mortgage area. Others were beaten down just by being a financial stock and there will be some buying opportunities for good strong active managers over time. That exposure will be seen in, for instance, Longleaf and in hedge funds looking for opportunistic buys there.

In the middle of the page in the upper box, there is a sense of the returns in the fixed income markets with LB Aggregate for the quarter at 2.8%. Note, with ten years trailing experience, it is now at 6% total returns. As discussed when doing the asset allocation modeling, gone are the days of the double digit bond returns. While bonds will continue to add some value to the portfolios, they will, based on current return assumptions, not be a component of a total return portfolio. Hedge funds were up 1.1% but it depended upon which areas of the market one was invested in. Fund to funds are shown at the bottom of the page. Strategic are generally fund to funds that are long short equity. Diversified are a combination of long short equity and absolute return. Conservative are the absolute return. Note the conservative managers were down for the quarter but much of that is what was underneath their portfolios to the extent they had statistical arbitrage managers that had some leverage in their portfolios that did better.

In the upper right, note the real assets and inflation protected. It was a strong quarter for commodities and continued demand related upward pressure on commodities. Prime does not predict short term but on a long term basis, they think there is a value in having inflation protection in the portfolio. REIT's had a good quarter although their year to date performance is actually negative as the retail investors started to get nervous about valuations. In the lower right of the page, note the illiquid investments. They have an investment in the Guggenheim Fund which is a combination 30% in REITS and 70% in the private real estate area. They think that is a great combination to get the advantages of some of these illiquid investments without being locked up for five to seven years. They are locked up for the first eighteen months of the investment and that is it and they have quarterly access to the money.

On page 7, International Equity Markets, in the upper right chart, note where the relative weights to the countries in the developed areas made a difference. Having a relative weight to Japan was down during the quarter versus some of the other developed countries. That was important but far less important than on the lower chart. He pointed out that they were up 14.4% for the quarter and 58% for the trailing year in emerging markets and that is seen in China, Brazil and India and if Russia is added in which is the other strong emerging market economy, now the brick economies, the kind of common term in investment vernacular, returns will be in excess of 20% and China at 42%. The value of having these kinds of returns and the special situations involved in investing in China and India, is it is wise to have active managers who will make valuation judgments and not necessarily follow the index into these countries. Their international managers who technically go into these markets own a relative to the very broad index lag but he does not have a particular issue with that.

Pages 10 to 12, note that the fund has total assets of 16.3 million dollars. The other thing that should be noted on an asset allocation basis is the approximately 2.3 million dollars of cash. Prime had proposed, because of the volatilities in the markets and because they were essentially investing cash, that they dollar average in over the period of time from last spring until the last investment is made at the end of this month spending the balance of the cash essentially and that has worked out fairly well. Note in the upper box that the total fund for the quarter was up 2%. Note the sixth column over that is marked return, that is the inception to date return and the next column states what time frame. As history is built with this fund, they will be constantly going back to that inception date and looking to see where value was added. The portfolio in general is up 2% since last June. That is versus the target and the actual indexes of 1.3% each.

Chair Andrews said, "If our bogey is 8% for the year which is 2% per quarter, explain how we arrived at the target index being below the 2%."

Mr. Higman said the target index is not targeted off of the actual rate of return. The target is composed of their policy index, their policy targets times the index for each one of those targets. They know in any given one year period that 8% is on average, they might get an 8% return but in any given observation 66% of the time, it is probably plus or minus 10%, upwards of 20%, it would be as high as 20, 21% any given year and as low as negative 66% of the time. So keep in mind that their return assumption is 8% but the target is essentially saying what if they had used their perfect targets times the index instead of where they had used active management, what would the result be? The actual index reflects the actual asset allocation by manager by fund or by asset class times the index alternative.

Chair Andrews asked would it be safe to assume that the actual index, although a quarter is 1.9% but if multiplied times 4 on an annual basis, it would be slightly less than 8%?

Mr. Higman said yes, and he would caution that they do not put too much weight on the annual return number. The market gives what the market gives. On asset allocation, there is really not a way to get to an 8% return without taking on some volatility.

Page 13 shows where their performance from an asset allocation came from. If they are up 2% for the quarter and their target index was 1.7%, where did that performance come from? Domestic equities exceeded its benchmark slightly. Remember that the actual performance is net of fees. The indexes do not have fees attached. The return is a little bit better when you say 1.7%. Russell 3000 index might cost 15 or 20 basis points to buy. The performance was pretty good. On the international, they did not perform as a group quite in line with EAFE. The alternatives were up .5% versus .3% for their benchmark and the fixed income lagged a little bit. Their index and real return was up 3.1% versus the Consumer Price Index plus 5%. That comparison probably has the least correlation because over short periods of time, the Consumer Price Index tends to be more stable than the underlying investments in that real assets portfolio.

Page 14, Asset Allocation, is one they will review every quarter whether or not they are in policy ranges. Here, they know they are not in policy ranges because they are still in the implementation phase. By the end of this last implementation, they will be at or near their targets and each quarter will review how closely they are to those targets and if they are violating any of the boundaries, they would recommend rebalancing. It would not be likely that they would recommend rebalancing if they are not outside those policy ranges. They would let the disciplined rebalancing strategy work for them.

Page 15 shows where performance by manager is in the equity segment. When they built this, they built with a base of the index and then supplemented with two active all cap managers meaning that they will have the characteristic of investing Longleaf in value stocks but will tactically allocate between mid cap and large cap, likewise Brandywine is similar on the growth side. Note the S & P Index is up 1.5% and over the two quarter term has actually been down. He showed that because rounding shows that they will always be slightly behind the benchmark because of the fee difference. Longleaf Partners was off 1.5% versus the benchmark and that has a lot to do with the fact that they were overweight to consumer discretionary. That is where they are finding value.

One of the things that they are talking a lot about with clients is to remind them that when investing with value managers, they very often will be investing in consumer discretionary. As in this case, Longleaf was long consumer discretionary. Other value managers these days have been long financials. The financial stock is getting beaten up often. These value managers can tend to be contrarian, the market is pricing down these assets and they are buying them by definition. Sometimes cheap stocks get cheaper. They still think there is nothing here and on a longer term basis for the two quarters they have beaten the index. They just caution about using short term returns to evaluate Longleaf or even Brandywine. On the upside Brandywine is up 5.9% versus their benchmarks and Brandywine was overweight to technology. His guess is in the October numbers, Brandywine will have given back some portion of their relative value added.

Julius Baer was up 1.8% versus 4.6% for the MSCI AC World. They used xUS. That benchmark includes emerging markets because Julius Baer will have some emerging markets in there, and as he commented earlier, Prime would not be too concerned about under performance in the short run, particularly managers who have some exposure to the emerging markets, because they would not expect a manager who is doing true valuation work to put a lot of value in buying stocks in China, for instance, given the historic returns there. They may miss something but over time they think using their valuation criteria will add value.

In Dodge & Cox, on the other hand, they do not use the extended because they tend to have less of an emerging market investment.

The next two pages show some attribution analyses or at least statistics. Pages 15 and 16 are probably two of the more important pages in the booklet as the returns are reviewed. On page 16, they are taking the characteristics kind of valuation criteria up in the first section. In the middle section, where were their sectored bets and in the lower section where were their capitalization bets? Note that in Longleaf, they are overweight to consumer discretionary, likewise in the international areas where these were on a sector analysis and where they were making their bets. He pointed out how complimentary Julius Baer and Dodge and Cox are.

On page 17, the internationals, shows what countries they are allocated to. Here's to his comment about how having a market weight to Japan hurt Dodge & Cox during this particular quarter. Shown is a much relatively lower investment in emerging markets that Dodge & Cox makes in the fact that most of that is in Latin America and in emerging Europe and not in the high areas which were China and India.

Page 18 shows their alternatives portfolios, Forester Offshore, and Archstone Market Neutral. The Forester portfolio is up 2.3% for the quarter. The performance that is reported here lags a little bit in the September quarter numbers and the June inception numbers. They did not make that investment until this quarter so this shows how those investments line up. Forester did very well. The key there was that they stayed away from the quantitative strategies that did relatively poorly in the quarter. Renaissance and other quantitatively black box driven hedge funds tended to perform poorly and continue to struggle largely because they are by nature black boxes and their specific signals are not seen. Prime believes that there are only a handful of valuation criteria in that they were in large part getting sell orders and trading against each other. Actually, one of the interesting things that the large cap active managers learned from this period of time was to pay closer attention to who else were holders in their stocks particularly if they were a large cap relatively concentrated manager. If a long only manager and the other holders in that particular security were a series of these Renaissance black box quantitative managers, there could be very fundamental reasons for holding the stock and getting totally decimated by these black box trading systems trading against you in the quarter.

Archstone was off 1.4 but nothing to be concerned about. They had a small position in a statistical between 2 and 3% position that hurt them and some other managers who had some difficulty during the quarter but very, very strong line up at Archstone.

Page 19 shows an analysis of the leverage on portfolios as well as what underlying strategies they were involved in. On this page both Forester and Archstone's leverage and their strategies are exactly as he would expect them. Archstone had a gross of 233% as an absolute return manager and is where they expected. They did not have any exposure to the names that melted down during the August crises.

Page 20 shows their fixed income portfolio and shows Western Asset Management Core Bond portfolio. Here, they struggled a little bit in the quarter because of their duration and because they had some credit exposures. Prime continues to feel very good about Western Asset Management short term.

They use Income Research as a bond fund because it is a convertible bond and Income Research is primarily a bond shop that manages convertibles with a bond discipline so they actually have a higher credit rating in discipline than typical convertibles and over time Prime thinks this will give great diversification and added return to the portfolio.

Page 23, Real Assets portfolio, Guggenheim was up 2.5% for the period, a very strong long term performance for Guggenheim. Western Asset Management is the commodity index with the underlying collateral in the bond. That is why it is called Commodity Plus. To recap, Western Asset invests in commodity futures that requires about 5% investment with the remaining 95% held in the collateral pool. They invest the collateral pool in their bond strategy and that is why it is lagging the commodity index, the impact from the relative underperformance of their bond strategy.

Mr. Higman said they are making the balance of the cash investment to the index, Longleaf, Brandywine, Julius Baer, and Dodge & Cox at the end of the month, November 30th.

Mr. Brown said it is a couple of months past September 30th now. Do you have any comment post September 30th?

Mr. Higman said some of the hedge funds numbers are not final yet but it looks like their return for October should be somewhere around the1.4% range, which for October the broad market, Russell 3000, was up 1.8% and a simple blend, 65/35 portfolio, was up 1.4% so it is in line with where they expect it to be.

Chair Andrews thanked Mr. Higman for his presentation. He also stated he appreciates the Prime Buchholz handout materials. He thinks they are very thorough on the Town's investments in the Trust.

VII. FLORIDA LEAGUE OF CITIES AND ATLANTA CAPITAL PRESENTATION

Dustin Heintz thanked everyone for the invitation to speak. He will talk about the SBA, the Florida League of Cities and their investments in SIV (Structured Investment Vehicles) after Mr. Coleman's presentation. He turned the meeting over to Greg Coleman.

Mr. Coleman said his goal will be to answer any questions as they come up and bring the committee up to date on performance in both the long term and short term perspective. Then, he has four pages about their outlook on the economy and where they think they are headed if the committee would like that discussion.

He started with the Town of Palm Beach Comparative Returns. These are now net of fees per the committee's request. Over the last 4.5 years, the performance of the intermediate, even in a period of rising interest rates because of its longer maturity, steadily outperformed the SBA net of fees. This is through September 30, 2007. He has separate numbers through last Friday, November 22, 2007 for this quarter. The 1 – 3 trails the SBA over that period and on the next page under Comparative Returns, Current Economic Cycle to Date, there is a number of ways to look at historical performance, ten years, five years or how long they have been in the fund. which is a very relevant one.

He likes to start in the economic cycle and since the Fed changed gears. There is no right or wrong. He just offers these up for analysis. He has one that goes back to the rolling 12 and 36 months. He has a fair amount of information on this report. This is a variation on the Town of Palm Beach report. He went back to the start of the economic recovery which was officially September 2001. In any event, over this period, the net of fee returns both for the intermediate and the 1 – 3 are pretty much positioned as one would think they might be. With the longer period of time, it has outperformed money markets and during the course of the last several months, the committee asked that they compare the returns of the Florida League of Cities two portfolios with that of a similar maturity treasury only portfolio. Of course, there are two ways to get extra return from money markets. One is extension of maturity, one is in owning something besides treasuries, so called credit spreads. The little crosses or snowflakes are how cumulatively one would have done owning similar maturities, not exactly the same, treasuries only. In certain periods like the last three or four months, treasuries have done very well versus everything else. But unbalance over time, the fact that they yield less than the kinds of things they purchased for the Town, it ultimately comes up a little bit short. The gray snowflake showing treasuries only is a little bit above the SBA and that is with the same maturity profile or similar profile as the 1 – 3. The red snowflake is that of the intermediate treasury. He thinks this puts in perspective the economic cycle to date, or ten years or five years, these are what one would expect the shape of these lines to look like even though the absolute numbers may change.

Mr. Brown asked if the gray cross as indicated is the Merrill Lynch 1 -3 year treasury and if Mr. Coleman knows what their fee structure is?

Mr. Coleman replied to buy maybe three years ago, there really were not any index funds that would mirror this. Now, there is a Lehman. The answer is it is approximately 12 basis points in fees. However, if bought today, as an asset value it is a premium. The premium is a little bit more than the underlying individual securities are worth. Normally, in bond funds, it is a little bit less. In the broad measure bond funds, it is a little bit more. It runs between 12 and 20 basis points if adding those two in.

Mr. Brown said if he bought the 1 – 3 year treasury at par, then there is an expense charge against the assets of 12 basis points? Is that correct?

Mr. Coleman said yes. The Lehman equivalent of that but it is very close. There is not one available now that is Merrill but it is the same thing.

Mr. Brown said he is still having trouble understanding. Does the gray snowflake have any expense charges taken out of it?

Mr. Coleman replied no, it does not.

Mr. Brown said so there are no expense charges?

Mr. Coleman said that is correct.

Mr. Brown said the other actual annualized net of fee returns are shown in the top left hand box with the other three lines but not for the snowflake. He asked if Mr. Coleman has that for the snowflake?

Mr. Coleman said on the following page, he did not put the numbers but it is apples to apples and that is gross to gross. The differential would still be the same. He can get those numbers.

Chair Andrews asked if it would be comparable?

Mr. Coleman said yes, the 12 to 20, and he thinks the League is 22, in counting their fees, custodian, etc. At the end of the period, it would be very equivalent.

Mr. Brown said he has one more comment. On the chart itself, it looks very close but maybe that is just a diagramming problem.

Mr. Coleman said in other ways what would happen if done as net of fees again, on that page, it says versus the 1 – 3 treasury index, both the green and the red lines would be lowered a little bit. Neither of those has fees in them. The next page where it compares versus the intermediate shows the same thing. And also, it is 12 to 20 basis points. They add in where the net asset value is versus the fee charge. He does not believe there is a Lehman Intermediate. There is a Lehman broad. The S&P equivalent in bond land is the Lehman aggregate. There is a Lehman aggregate exchange traded fund and that is 12 basis points. So far in the presentation, it contains some of their standard reports that the committee asked for with a little bit of historical perspective put in cycle to date that he has added.

He moved on to Quarterly Performance Since the Tightening Cycle Ended. This is another way to look at expected returns and how things pan out. He did not know the tightening cycle had ended June 29, 2006. He hoped that was the last bit of tightening. As it turns out, it was. Oftentimes, once the Fed stops tightening, and even at the time, when the yield curve is pretty flat or maybe inverted, short term looks extremely attractive because they are yielding the same as 4 and 5 year securities. Oftentimes, history would show this is the best time to lengthen out a little better or diversify away from money market. Of course, it is easier to say in hindsight than at the time. The Fed went a long time without easing but they did not tighten any more. Shown next are the five quarter returns by quarter since the Fed stopped tightening. Shown at the top are the Fed funds rate target and then at the September meeting, they cut it 50 basis points and then they cut another 25 basis points at the October meeting. Even with an environment that is right, one would think out performance, it still is not a straight line. The red bar, the intermediate, is at a very good run. Yet, in the second quarter of 2007, it posted a negative return. Step back and look at the net returns over this five quarter period. The SBA is at 5.53%, which is basically the coupon that they earned through that whole period, the 1 – 3 was 6.01%, and the intermediate was just over 7%. It was a good time to get in. Note the over 3% return in the third quarter for the intermediate. He thinks the Town added bravely in the second quarter to the intermediate portfolio. In hindsight, that turned out to be a fine move.

Chair Andrews said in hindsight when interest rates that are going down, one would expect that the longer term funds would be affected the most?

Mr. Coleman said correct.

Chair Andrews said in the League's portfolio, the 3 to 5 year consistently outperformed the 1 – 3 year. He asked Mr. Coleman to explain why.

Mr. Coleman said for the given change in interest rates, if interest rates in the two year area all go down by a half of 1% in that collection of assets that are out in the average 4 years compared to the investments that average 2 years, the coupons will be roughly the same. It is a little bit higher in the 4 year investments but the capital appreciation, that market run up, will roughly be 2 times of that of the short term just because of the length of the maturities. So in technical terms, the value of the basis point is kind of like double jeopardy. The value of the basis point is increased the further out you go. That is the same reason that when rates went up, unbalanced for the quarter ended June 30, 2007, there was a negative return in the intermediate which has an average duration of about 4 years. It works both ways. When rates are going down, the further out the better, and what they would try to do when they are in the 1 – 3, it is not like they could then take the investment duration which is a better proxy but they can use a monthly interchange. They would take the maturity profile maybe on the benchmark to 10% longer than the benchmark. But they would not be two times longer than the benchmark because their constituents that invest in the 1 – 3 know they are going to be plus or minus 10% on that particular bogey. If more risk or potential return or longer term assets are preferred, that is why they have the intermediate and the broad that just keeps up the spectrum. While they tried to shade as best they can, and shade it the other way when rates are going up, it won't be by leaps and bounds versus the benchmark.

Mr. Brown said the October report is in their material and was a pretty good month. He noted that Mr. Coleman said earlier that he had some figures all the way up to last week and asked him how November is going so far?

Mr. Coleman said through November 20th was actually a little bit more than the whole month of October. So quarter to date, short term is up about 1.5%, about 1% of that came in November. The intermediate is up a little over 2.15% of which about 120 basis points came in November. It was a good October and so far a great November mostly because rates have continued to go down. In most money market rates, treasury bills, Vanguard or the SBA, the yield on any money market is pretty closely tied to what the Fed funds rate is. They are currently at 4.5%. If that raises again, that will gravitate that 4.5%, it they ease some more, it will gravitate something lower than that.

Chair Andrews asked if the market remains relatively flat or if interest rates went down a little bit, if he believes the quarters will look more like the third quarter of 2007 where they had the SBA, the 1 – 3 and the 3 – 5 years? That is a nice grouping on the third quarter. And they have had this type of market place in that quarter. He asked if Mr. Coleman sees going forward about the same proportions given a relatively flat market and possibly slight decrease in interest rates?

Mr. Coleman said yes and it wouldn't be that amplitude because what is seen here are bigger moves in interest rates but the yield on the portfolio would be a little bit of coupon plus. The coupon yield or the investment yield on both portfolios is currently above the Fed funds rate. They had no move and then if they had another easing or two, which he thinks is going to be the case, it would look similar. He does not think the differential would be as great because these 3% quarters are pretty good quarters for an intermediate fund.

Chair Andrews said but the red and green lines are above the blue line.

Mr. Coleman said that is correct. The shape would look the same. The differential between the blue and the green and the green and red would be less.

Mr. Brown said another way to say what the Chairman is saying is that the Town's diversification is starting to pay off.

Mr. Coleman said yes. He noticed in the minutes of the last meeting that there was an improvement in the calculation of $80,000 for the quarter ended September 30, 2007. If the quarter stopped today, that would certainly be the case as well. It would continue to move along those lines.

He said the pie chart page is an Update on FMIvT Mortgage Holdings. He presented a similar analysis at the meeting of April 26, 2007. It is basically the mortgage holdings and how they look and why he is comfortable and why they have not had any credit surprises either in credit or the mortgage securities that they own. In most of the big debacles that have been seen from some of the who's who and the best and the brightest on Wall Street and around the world from Goldman Sachs to Citi Bank to banks in Germany, it is amazing that the so called sub prime debacle is now into 23 countries, from Norway to New Zealand. Typically what they hold are CDO's (Collateralized Debt Obligations) and he could bore the committee to tears with some of the rigors of that. But it is a securitization of a securitization and in some cases it is a securitization of a securitization of a securitization called CDO squared.

Atlanta Capital does not own any sub prime AAA mortgages. One of the ways Atlanta Capital has avoided having any of the investments seen in the headlines is they do not own any CDO's or any mortgages backed by sub prime. How are those individuals that have mortgages that are fixed rates doing? They were underwritten with reasonable credit and they had 20% down. The mortgage loans are at 15 years. They are doing remarkably well. They should be doing remarkably well. The unemployment rate is only 4.7% and they are doing well.

It is not to minimize the sub prime and the CDO crises that has happened but about a quarter of the mortgages that were issued in 2006 were the sub prime, poor credit scores, low down payments and low documentation or some combination of those. If those were sliced up, securitized and put into CDO's, they would get a little dicier. Atlanta Capital does not have any of those and all of the mortgages they own are guaranteed by Fannie Mae and Freddy Mac. Loan value averages about 70% and they are all based on fixed rate loans. Atlanta Capital feels very comfortable with those holdings.

One third of the people that own homes in this country do not have any mortgage at all. Another third are renters. Most of the home loans in this country are 15 or 30 year fixed rate. Still of about a trillion dollars issued in 2006, a lot of sub prime mortgages were issued. The default loss on prime credits at all mortgage lenders is about a half of one percent. That is up from .4 of one percent. But it is not 3, 4, 5 and 6% and some of the numbers seen on the CDO's.

Mr. Brown congratulated Atlanta Capital for avoiding this particular investment.

Chair Andrews said one of the issues that seems to be prevalent right now is the rating agencies are changing the rating sometimes very fast. They are going from AAA to almost nothing. How often are the securities in Atlanta Capital's portfolio rated?

Mr. Coleman said monthly. One of the advantages of asset backs and car loans and the mortgage loans, it is very uniquely qualified. It is easy to analyze. They can tell where the loans are, who is 30 days delinquent, how many are now 60 days delinquent, etc. Those numbers get looked at both by the consultant and by Fitch ratings. Aren't these the same people that brought us AAA ratings now downgraded to, in some cases, junk status or default? The answer is yes. Take some comfort in the fact that they have reviewed all of the AAA, non CDO's. The downgrades being referred to were virtually all CDO's. The models that they use were based on real estate values being stable to increasing. In the early 1990's, that is what happened and they built in extra levels of subordination but still underlying was the default and delinquencies that roughly mirror what they have done in the past times two. Mostly values would be stable to slightly increasing which seemed to them at the time conservative. When both the underlying defaults and delinquencies increased and real estate values went down, that is when they had to redo their CDO ratings. They have looked at thousands, even sub prime stuff. The ones that were rated AAA, the ones that were rated BB and B have been downgraded. In many cases those that were issued in 2006 and 2007. But the first level the AAA's and reason they are AAA is when they divided up the billion dollars of loans that they are doing and divided them into six parts, there may be six equal parts as it relates to interest payment but as it relates to credit loss, they are not equal. It is the unequal sharing of risk and so the lower pieces absorb all the risk at first. On the sub prime pieces, the rating agencies have not had to change very many at all. Even some of the loans and the securities that are in the SBA that have recently come under scrutiny are not sub prime or CDO's. Consequently, the ratings on some of those have not been changed. The lion share of the problem is just in the CDO's and sub prime rated below AAA. So Atlanta Capital has to submit it every month.

Chair Andrews asked if an issue is downgraded from investment grade BBB to BB, which falls out of the area where it can technically be held in the portfolio, how long can that degraded position be kept before it has to come out of the portfolio and be changed into something either cash or something else which is investment grade?

Mr. Coleman said in the short and intermediate, they are not even allowed to hold BBB securities. That is Atlanta Capital's investment policy as well. Usually, but not always, the security will go from A to BBB and if it is going to get downgraded further, they get a little bit of help there. If it went from A to BBB, they are required to notify the Florida League and the consultants as soon as that has happened. The first line would be to sell it at market value and they do have some leeway. But then they would have to go back and have a plan as to why they were going to continue to hold it. On the broad market, the pension asset, they can go down to BBB but the same rule would apply if it went below BBB, they would have to either sell or make a report on it, what its strategy is, etc.

Chair Andrews said he was just interested in what would happen if it was downgraded outside of the zone that was allowed. That would require acting fairly fast.

Mr. Coleman said correct. At the minimum, they have to notify and have a plan. More than likely, they would just sell it.

Mr. Brown said he has one question on the portfolio. Obviously, Atlanta Capital has a lot of Fannie Mae and Freddy Mac. They have been in the headlines also recently with some problems and it looks like they are going to have to raise fresh capital, etc. Does that in any way impact the Town's portfolio? He is not worried about collecting on those funds but he just wondered if it might impact the market value of the holdings.

Mr. Coleman said basically a year ago, 5 year Fannie Mae and Freddy Mac were yielding 4.30%, and now they are yielding 6%. The reason the returns are so robust still is because they were yielding 5.7%. They have gone up in value by 1% for every year of duration. That is a good thing but it has not moved as much as treasuries have. The same thing if the Town's portfolio had A rated finance paper, which in his example if treasuries were 4% and CitiBank was 5%, now it is at 4%, a year ago it would have yielded 4.80%, now it is yielding 5.30%. They have come down in yield but they have not come down nearly as much as treasuries. When headlines are like those seen the last couple of days, it widens the spread but if the Fed is lowering interest rates and the economy is slowing down, instead of falling in yield and going up in value by 2%, it only goes up in value by 1.5%.

Mr. Brown asked if he expects as they do succeed in recapitalizing themselves that, at some point, the spreads will narrow again?

Mr. Coleman said yes. Atlanta Capital finds those attractive and in the interest of full disclosure, he thinks this is the greatest for the bond guy. He bought Fannie Mae stock on Friday. He could be wrong but his belief is that is the case. Most of what they have to do in terms of extra capital is shrinking the balance sheet. The stock people shudder at that because that is the engine of growth. The bond people are happy if they are shrinking the balance sheet. The bond holders usually get takeovers, stock buy backs, that is all good for the stockbrokers. It is not very good for the bond holders. One of the things that has happened with the malaise over the Fannie and Freddy over the last four or five years is that their disclosure has gotten much better. In delinquencies, somebody that is one, two or three payments delinquent, it is 27 basis points. That is up from 22 basis points. The single family high quality mortgages is alive and well in this country. They are going to be subject to headline risks for a while. He does not like to rely on the government implied guarantee. He likes to have it free standing. If the Federal government was to bail out of long term capital and provide funding, it is not a leap of faith to think that they would do something for Fannie and Freddy. He does not think it is ever going to come to that.

Chair Andrews said in the information that Mr. Coleman sent to the committee, he noticed in some of the holdings, that Atlanta Capital has Countrywide. He does not know what the rating is but is it AAA?

Mr. Coleman said it is AAA.

Chair Andrews asked if that does not fall in all the publicity seen about the other Countrywide?

Mr. Coleman said if they owned the Countrywide bonds, which over the years they have, they do not now, it would affect that big time. They are now rated BBB by one agency so if Atlanta Capital owned it, they would have to sell out in their own discipline. But the mortgages that are the backup to Countrywide are not backed by sub prime, but backed by fixed rate, 15 and 30 year loans that are performing smashingly. That is why he put not only are they AAA, but they are not on anybody's watch list. Typically, what the rating agency did because they got beat up so badly, is if things look like they are starting to go south, they may not downgrade it but they will say negative or positive implications. All of the non agency that is not backed by Fannie and Freddy are all pristine. They are doing wonderfully. They are not part of that.

Chair Andrews asked Mr. Coleman if he still feels very comfortable that the credits that he has in both the 1 – 3 and the 3 – 5 are high quality portfolios where he does not anticipate any short term surprises?

Mr. Coleman said that is correct. Scenarios can be invented certainly, that if anything happens with Fannie or Freddy, etc., spreads can widen, but as far as the day in day out cash flow coming back as planned, he feels very good about these securities and all of the asset backs as well. Virtually in every asset back that the Town owns, their default delinquency characteristics keep performing as expected.

On the page titled "Short-Term Bonds Benefit From Riding the 'Sweet Spot' of the Yield Curve", this is the average shape of the yield curve and by investing in that green circle, the investments are capturing the extra returns versus something that has a maturity of a week. The additional bonds that they own add to that. Look at the next page, this takes credit out so this is just how well the investments would have done investing in treasuries only and going back a number of years through June 30, 2007, these are the rolling 12 month periods. A 12 month period has lots of iterations and for a 12 month record, as shown here and with their returns also, you are not going to get it every single month. Seven months out of ten, expect to outperform but not always. Atlanta Capital has beaten this index so that gives a little bit of extra protection. For periods longer than that, 36 months, those are even more compelling so this ties in nicely with some of the other charts he has shown. Obviously, the longer, the more likely it is to outperform.

Mr. Coleman said the next four charts tell Atlanta Capital's story. They think the economy is going to be weaker than most, maybe not even 2% in 2008. The biggest reason is the consumer is going to be weak because of the decline in housing prices and high cost of energy. The chart is the most objective measure of home appreciation or lack thereof. One has condos and jumbo mortgages and the other one does not. He thinks what is also interesting is that the current rate of sales is still adding to inventory. That is about 10 ½ months. That is not that there are a growing number of houses but a growing number of available inventory at today's selling rate. He expects that to turn around real soon. These statistics are pretty remarkable on how well the consumer is holding up given the housing and given what the cost of energy is. Preliminary indications for the first weekend are that it is a little slower than last year but it is 10% of Christmas season sales. It is doing okay, maybe better than anticipated. The reason he does not think a recession is near and he does not think this gets much press, is there is a lot of data on this chart but it is a bond person's dream. Small business in this country continues to add employees.

Understandably the thing that gets the headlines is the large companies because they are publicly traded but they have been shrinking by about 6,000 a month for over a year. They only make up 17% of the workforce and small business is adding over 60,000 a month and they continue to do so. It is slower than it was but it is still meaningful and that is one of the reasons the unemployment has held in there and that is one of the reasons that he does not think they are going to go below 2%.

The last page is their forecast for GDP. The backdrop is such that the economy is going to be weak and the Fed will likely be easing. Maybe nothing will happen because the rates have affected it in or they gradually work their way a little bit lower. He also thinks the yield premiums will actually narrow a little bit and that would also be good for the Town's portfolio.

Chair Andrews thanked Mr. Coleman on behalf of the committee for doing a very good job. The committee appreciates all the information given, and appreciates that he has stuck to his philosophy in times when it was not considered advantageous. He thinks that will come through in the future to prove very beneficial to the Town of Palm Beach's investment report.

VIII. <u>INDEMNIFICATION UPDATE</u>

Mr. Brown said he is happy to say that at the November Town Council meeting an indemnification ordinance was approved unanimously by the Town Council. That is the first reading. Mr. Randolph does want to add an amendment to it which will happen at the next meeting. It will take a couple of more months for the first and second readings to get done. There was virtually no discussion, no questions, no controversy, and he thinks this will get done.

He said there was a lot of negotiation over a number of months between Mr. Guttman and Mr. Randolph. Mr. Guttman provided a tremendous amount of effort and expertise. The Civic Association also hired a Florida lawyer to provide input on Florida law because Mr. Guttman is a fine lawyer but he is not a Florida lawyer. Mr. Guttman provided many hours of pro bono work for this cause. The Civic Association paid for the Florida lawyer. As in any negotiation, there were compromises and while he thinks this is probably the strongest indemnification ordinance in Florida, there are cases but most of the time it does exactly what he had always hoped which is any time a committee member is accused of something, it pays up front unless proven guilty at the end. There are a couple of exceptions to that. One is for criminal activities and the other would be for ethical lapses that involve self dealing. If that ever happens, a member of a committee would front his/her own expenses but would be reimbursed at the end if proven innocent. Those are the compromises involved. He thinks it is a great step forward and it clarifies once and for all who is responsible for how things work and what the Town does to support its committee members which he thinks was very vague.

Vice Chair Hennessy asked what sort of amendment Mr. Randolph wants to add?

Mr. Brown said it has to do with those ethical lapses. There is a section in the Florida Statutes about a hundred pages long that spells out all the ethical lapses that one might have and they basically all have to do with self dealing. He wants to make an exception to that similar to the criminal exception and that is okay. That is not the main issue. He thinks all in all this is turning out to be very successful.

Chair Andrews said the committee would like to extend its thanks to Mr. Brown for all the work he did and asked him to pass their thanks on to the people that he worked with outside. It was something that was done in the true spirit of cooperation to makes their jobs easier and also other individuals that are in the same position.

Vice Chairman Hennessy said once it was brought up, it certainly got the attention of the Town Council.

IX. MONTHLY INVESTMENT REPORT – OCTOBER 2007

Cheryl Somers reported the Town's investment balance is approximately $84,200,000. The cumulative negative return continues to improve. It improved about $24,000 over the prior month.

Chair Andrews asked what was the maximum they were down in relationship to the SBA at any one particular time?

She said look at the second page of the investment report in the right hand column in the center section. They started out positive calendar year 2003, then 2004, and then ended up cumulative negative through 2005 of about $65,000. Through the end of calendar year 2006, the cumulative negative was $330,000. Calendar year 2007 is on the positive upswing now.

Chair Andrews asked if those are year end numbers? They don't have to do with any particular month?

Mr. Somers said right. She said the month to date dollar comparison on the first page of the investment report, the third section down, the $427,000 compared to the same month for last fiscal year, dollarwise is very close, percentage wise it is quite a bit higher but they had the OPEB money invested in SBA last year at this time.

Mr. Brown said it was not that long ago that they were closer to $100,000,000 in total. Now, it is $84,000,000 so obviously there have been some allocation of reserves for certain purposes. He asked her to summarize what those were.

Ms. Somers said the fluctuations mostly deal with the way property tax money is received. On Wednesday, about $6,000,000 was received, the first installment of this year's property tax money. In December, another maybe $22,000,000 or something along that line will be received and then a few million dollars through January, February, and March. They draw that down starting in March and April through November.

Mr. Brown said that was explained before but he had forgotten.

Chair Andrews said from a committee standpoint, he would like to say thank you to the Town Finance Department and to Mrs. Struder for sending the committee the information that she sent recently. He thought that was very interesting and he thought it was prudent to the discussions today.

X. POSSIBLE EFFECTS OF SIV (STRUCTURED INVESTMENT VEHICLES) ON BOTH THE FLORIDA LEAGUE AND SBA FUNDS

Chair Andrews said since the Florida League of Cities has given their presentation, it seems that they do not have any exposure at this time to any SIV's.

Dustin Heintz said he wanted to clarify that is with the 1 – 3 year and the intermediate that the Town is invested in. They also have an enhanced cash fund which the committee said they might be interested in discussing a little bit more. It is a dollar par similar to the SBA. It is invested through Columbia which is a subsidiary of Bank of America and it acts very similar to the SBA. They do have a piece in there that is an Exxon financial that was recently downgraded to below A and they are connected to Structured Investment Vehicles somewhat but it is a very small piece, .7 of a percent of the overall fund. So the Florida League of Cities does have in one of their funds a slight bit.

Chair Andrews said in that situation when it got downgraded, what was done at that point?

Mr. Heintz said as of last week they were still holding it because it just happened the previous week. The idea is they are looking for the right market timing to get out of it. It is going to happen rather quickly but if sold immediately when it is downgraded, the value will be lost. They are trying to time it just right so that they can always get some value out of it.

Chair Andrews asked Mr. Heintz to give a brief explanation of what he means by enhanced because that word concerns him considering what is possibly going on with the SBA.

Mr. Heintz said they named the fund Enhanced Cash with the idea that it was going to outperform money markets. The expectation is that it is going to perform above a 90 day T-bill more in line with Fed funds or slightly above. Over time, the strategic cash is actually underlying the fund from Columbia. The strategic cash has been available to the public for ten years and they have outperformed money markets over that time.

Chair Andrews asked how has enhanced cash done compared to the SBA?

Mr. Heintz said Ms. Struder sits on their Advisory Committee. In the September meeting, the discussions that surrounded the Enhanced Cash suggested actually getting rid of it. The primary difference that they like to point out to people is that they are AAA rated and that even though they did contain a few pieces of the SIV's, etc., they do try and focus on more of the AAA investments. The credit analysis from Columbia did not find the value in extending in August when the SBA did and others did kind of reaching for yield. Their yield has been below the SBA especially in the time of rising interest rates over the last couple of years which is why their Advisory Committee had said maybe it is time to just allow Florida cities and municipalities to utilize the SBA since it is there and it is outperforming. Since that time with everything that has happened, they have paused on that and are starting to get people actually asking because they are AAA rated. To answer the question, their yield has been lower but that has been because they have taken less risk and see it as a dollar par fund. They do not expect it to return excess amounts just to perform where it is supposed to.

Chair Andrews asked, based on recent comments of possibly not having the fund anymore, and then again in this environment possibly reconsidering it, if he would advise the Town of Palm Beach to consider the fund at this time as an alternative to the SBA?

Mr. Heintz said yes and no. He said their fund is available twice monthly. It is not daily liquidity. It is not available if it is being used for a strict operating cash fund. For longer term investment, the fact that they are AAA rated, they will share their holdings with the Town and they are a little bit more forthcoming with what is happening. He likes that aspect of it. One comment he would like to make, the Town of Tallahassee recently put 25 million from the SBA into the League's 1 – 3. The Finance Director in Tallahassee commented he would really like to see more information from the SBA. He would feel a lot more comfortable if they were rated AAA. With that being said, the sentiment shown here and the reason for this discussion is echoed across the state with everybody right now.

Mr. Coleman said he views enhanced cash as a competitor. The performance has been there over the ten years versus everybody but the SBA. It is always in the top quarter when the consultants do the reports and looks very good. To him, the difference was the SBA charges so little. That's why their numbers are as high as they are. He does believe that they also ponied up monies for those small holdings because the last thing they want is breaking the buck. General Electric felt no such inclination and they said it is worth about 96 cents on the dollar and if you would like to get out, they will pay 96 cents on the dollar and cannot guarantee that 100 cents on the dollar. That would be death to Fidelity, Vanguard or Bank of America to do something like that. They have actually set aside reserves to cover the two tiny holdings.

Mr. Brown said he just wondered on this subject and related subjects whether it would be a good idea to have the SBA come to a meeting. He does not think they have ever had the SBA in here to talk about their investments and now might be timely to do that.

Chair Andrews said now would be an excellent time. They tried one time. They had somebody from the SBA to talk and did not know what their position was. They were not very user friendly from what he remembers.

Ms. Struder said they had a conference call via phone with them a couple of years ago.

Chair Andrews said he thinks it would probably be a good idea to have them there. He stated he is a little concerned at this time that things may happen fairly fast before another meeting is held. There has been a lot of information. Some of it was forwarded by the League about third parties' opinions about what was going on with the SBA which was vastly different from what the SBA itself has put out. He is concerned that if the SBA comes to a situation where they are forced to address some of the issues, it is going to dramatically change their yield. If it is true, it might dramatically affect the amount of money that is in the pool.

Mr. Heintz said he would like to add two things. One, in the newsletter in the handouts, they did say that their yields will be coming down more in line. As of this morning, it was 5.1% versus the League's funds of 4.99%. So they are coming back, the spread is narrowing quite a bit. That is on an annualized basis so it is actually on top of each other on a daily basis. It might happen quite fast, the September 30th holdings of the SBA were about 27 billion according to the newsletter and there was an article in the St. Pete Times last week that said that over 6 billion had already been pulled out since that time.

Chair Andrews said he believes the SBA said there was an issue with the SIV loans of somewhere around .4 to .5%. The article says 4 to 6% which is a huge difference.

Mr. Brown said he is a little confused with that information. He thought all the information came from the SBA itself. Where did the information come from?

Ms. Struder said the Florida League sent an email that attached information from the SBA.

Chair Andrews said this is SBA information.

Mr. Brown said so all the information ultimately came from SBA about SBA? This is in conflict. He is a little confused about that

Mr. Coleman said in the SBA Newsletter, all the pools invested have maintained a high credit rating. The only disappointment has been with accelerated credit downgrades accounting for 3.4% of par value of the pool.

Chair Andrews asked how does the par value equate to the actual dollar amount?

Mr. Coleman said actually very close. Of the initial investment, that is roughly 2.4%. It looks like it around 886 million. Maybe the difference in why the number was so much lower. Maybe they are looking at, with retirement funds and lumping all that together that they might do, versus just the local government investment pool. He is not sure about that.

Chair Andrews said the big holding is the Florida retirement fund.

Mr. Coleman said that is correct.

Mr. Heintz said he believes the other difference is most of the downgrades have already been renegotiated to pay out. So they feel comfortable that they are going to get a hold on those payments due in February and March. He believes the .4% was one that they are still worried about.

Mr. Brown said he thinks it is fair to say that SBA has at least been forthcoming in discussing their problems. Whether it is fully forthcoming or not, one can speculate. All the material received has been from SBA itself and his inclination would be to give them a chance to explain themselves and tell us what they are going to do. Otherwise, it is like operating in the dark.

Chair Andrews said on page 6 of their proposal, which is exposure to CDO's backed by sub prime mortgages across the SBA, investment mandates were limited to collective trusts managed by third party fiduciary and was immaterial. He thinks it is material and they are in that particular area. He would like to ask the Finance Department if there is some issue with the SBA where it loses value and they are looking for an alternative, where could they go?

Ms. Struder said one of the areas is the Enhanced Cash with the Florida League and she is sure they could talk to Wachovia to find out what some of their money market funds are and check other money market type investments

Mr. Brown said if it is quality they are after, they could also do some part of it in treasuries and they now have a Finance staff that has some experience in that regard.

As long as they did not have to trade the treasuries and held them to maturity, he thinks it is fairly simple to do even in a fairly large quantity. But he wants to be sure that is true in Ms. Struder's mind as well as his.

Ms. Struder said they could certainly do that, buy treasuries and hold them, and the Town does have a custodial account set up for that purpose.

Chair Andrews asked if there is any discussion by the Committee on this issue?

Mr. Panfel asked if they can just move the money out of the SBA?

Ms. Struder said yes.

Chair Andrews said perhaps at the next meeting, possible alternatives besides treasuries that might be available could be discussed. He certainly hopes that nothing happens to the SBA funds that is dramatic because that is where the majority of the Town money is. That is where the majority of a lot of money is from a lot of municipalities. It is an issue with the Town of Palm Beach but it could be a huge issue with other municipalities across the State of Florida.

XI. DISCUSSION OF DECEMBER TOWN COUNCIL MEETING PRESENTATION

Chair Andrews said he will be doing the presentation to the Town Council. One of the things he assumes in looking at the history of this committee is that he is going to be asked questions directly on why the League is running behind the SBA. He would like some information or thoughts from the committee on how to specifically address that in light of the fact that there may be some changes.

Mr. Brown said first of all it could be said that the committee started diversifying at a point where rates began going up and that hurt the intermediate and short term bond area. He thinks the point that should be made is that over the long term, the SBA type investments produced the lowest rates of return. So it made sense to have some portion of the portfolio in the intermediate term. It has not paid off yet but the committee thinks it will over time and certainly it can be said that it has been paying off recently.

Chair Andrews agreed and said another part is that the committee was formed to explore alternatives to the SBA. He thinks that is one of the things the committee did and the Florida League of Cities was the best alternative that was out there and may prove to continually be an excellent alternative to the SBA going forward. He, as an individual member of the committee, thinks they have done a good job not in an adversarial market but a market that was not particularly friendly to the investments to the extended maturity duration investments that the Town has.

Vice Chair Hennessy asked what was the committee's response last year to the Town Council?

Chair Andrews said they did not do one last year.

Mrs. Struder said this is the first year for this committee.

Mr. Brown said the thing to be careful about with this kind of presentation is that people understand that while the Town would have been better off doing nothing so far, that is leaving all the money in SBA, that the Town **is not** losing money. He thinks there is a great misunderstanding among non financial types that when the statement is made "we are behind" that they think that translates to "we are losing money". The Town is not losing money. They are just making slightly less because of the market situation that they found themselves in and they expect that to reverse.

Chair Andrews said he agrees. It is an opportunity cost. He stated he is not intending to give a long report. He thinks he is going to be fairly short, hopefully fairly succinct and will have information that he will develop with Mrs. Struder on how to address particular questions that may come up

Vice Chair Hennessy said the shorter the better.

Mr. Brown said the OPEB assets will have to addressed a little bit.

Chair Andrews said yes. He is pretty happy to say that they have done what was expected in the one quarter. He would like to talk about that for the whole time.

Vice Chair Hennessy suggested that he end with that.

Mrs. Struder said the meeting is December 11th if anyone else wants to attend.

Vice Chair Hennessy asked what time she thinks they will go on?

Mrs. Struder said they are at the beginning of the agenda.

Chair Andrews asked if it is time certain?

Mrs. Struder said not all the time.

Chair Andrews said the last meetings he has attended, they have had them fairly soon in the schedule.

XII. NEXT MEETING DATE

Mrs. Struder asked if the committee would like to have the next meeting in December.

Chair Andrews said yes they would like to have one in December if possible.

Mr. Brown asked would it make sense to find out what dates the SBA is available and then email to the committee?

Chair Andrews said that would be good.

Mrs. Struder said she will try to do it before the holidays.

XIII. ANY OTHER MATTERS

There were no other matters for discussion.

XIV. ADJOURNMENT

MOTION BY VICE CHAIR HENNESSY TO ADJOURN THE MEETING.
MOTION SECONDED BY MR. BROWN.
MOTION CARRIED UNANIMOUSLY.