MINUTES OF THE INVESTMENT ADVISORY COMMITTEE
FRIDAY, MARCH 14, 2007
EMERGENCY OPERATIONS CENTER
CENTRAL FIRE STATION, 3RD FLOOR

I. CALL TO ORDER AND ROLL CALL

The Investment Advisory Committee Meeting was called to order on March 14, 2007 at 2:00 p.m.

On roll call, the following committee members were present:

Investment Advisory Committee
Stephen L. Brown
William J. Mikus
Bernard R. Panfel

The following committee members were absent
Chair Michael F. Andrews
Vice Chair Edward L. Hennessy, Jr.

Others in Attendance
John Randolph, Town Attorney
Jon Prime, Prime Buchholz & Assciates
Sean Higman, Prime Buchholz & Associates

Town Staff
Jane Struder, Finance Director
Cheryl Somers, Assistant Finance Director
Betty Cotton, Recording Secretary

II. PLEDGE OF ALLEGIANCE

In the absence of the Chair and Vice Chair, Mr. Brown led the pledge of allegiance.

III. APPROVAL OF AGENDA

The committee approved the agenda.

IV. COMMUNICATIONS FROM CITIZENS (3 MINUTE LIMIT PLEASE)

No citizens attended.

V. APROVAL OF MINUTES FROM THE FEBRUARY 9, 2007 MEETING

Mr. Brown asked for comments on the minutes.

Mr. Mikus said on page 17, the minutes stated, "Mr. Mikus asked if they would do the Russell 1000…" That should read, " Mr. Mikus asked if they would use the Russell 1000…" That correction will be made.

The committee approved the minutes with that change.

VI. INDEMNIFICATION UPDATE

Mr. Brown stated they have a tentative meeting on Monday, March 19th at 5:00 p.m. with Mr. Randolph, Bill Guttman, and their new attorney Bill Capko.

Mr. Randolph said he has zoning commission all day so they are trying to determine how long the meeting is going to last to see if they can meet before or after that meeting.

Mr. Brown said if Mr. Randolph can do this at a different time, they are open to that. He asked Mr. Randolph if he has any comments?

Mr. Randolph said he does not have anything. He was here to give any updates. He said Mr. Brown is heavily involved in this matter and has all that information.

Mr. Brown said they would like very much to find a way to meet the concerns that have been expressed by Mr. Randolph while at the same time maintaining the philosophy that there is a presumption that the Town will support up front anyone who serves on these boards and commissions who is sued. Part of the worry is if there is an extraordinary situation where the Town would prefer not to be embarrassed by that situation. He is looking at ways to address that. They also are looking at Mr. Randolph's expressed concern that if there was an undertaking by individuals to repay the advances of the Town by "bonding". He is looking into that but that didn't turn out to be so easy. They are still pursuing various alternatives. He said if Mr. Randolph has some simple way to do that, it certainly would be interesting.

Mr. Randolph said a letter of credit would be fine.

Mr. Brown said that was looked into.

Ms. Struder said it could be pursued with the committee member's own financial institution but not necessarily through the Town.

Mr. Brown said the other thing that came up was whether this committee would be a pioneer in this regard. He said they would be close but there are a couple of other Towns that have done something in this regard, not as broadly as this, but targeted to an investment board. He does know about one other Town very near Palm Beach that is thinking of doing an ordinance in this same area. He has not seen that ordinance yet. He thinks there is a fair amount of activity. They are aiming at having an ordinance presented to the Town at the April 10th Town meeting. He thinks that anyone on a committee, or anyone else who wants to make their feelings known one way or the other, can communicate with the Town Council and the Mayor by telephone, in writing or any other way. He stated that Mr. Elwell asked what time would be good and the morning of the 10th would be best for them. The Civic Association has hired Bill Capko who is a local lawyer to represent in this issue. Bill Guttman had a great deal to do with developing the proposed ordinance and he is a very good lawyer but he is not a Florida lawyer. He became increasingly uncomfortable about being the representative without having a Florida licensed lawyer involved. So the decision was made to hire somebody that is licensed to do business in Florida.

VII. UPDATE ON TOWN COUNCIL APPROVAL OF INVESTMENT POLICY

Mr. Brown and Ms. Struder attended the meeting and the Town Council approved the policy as suggested. He stated Jon Prime did the presentation and a very good job of answering their very interesting questions. The questions revolved around how good the 8% assumption was. It is clearly not going to be a year to year thing but they were trying to find a combination of risk reward which would keep the volatility within some kind of balance. He thinks, in following up on that, there was a belief of some people on the council that if the 8% was missed in a year, two years, that this would affect the Town's contributions. He doesn't think it is as simple as that.

Ms. Struder said she does not think there is a direct correlation by year but it seems to over time.

Mr. Brown said he thinks the actuary smooths the returns over time. He has not looked into it in detail but based on his knowledge about how these things work, it can usually be quite a while and hopefully by then the investments will be earning the 8%.

Mr. Higman said it is smoothed and there are some new notice rules relative to pension protection act that apply. As far as compelling that adjustments be made to a contribution, that does not happen. It smooths for at least three if not four years.

Mr. Panfel asked whether the Town would be required by the GASB 45 to reflect the liability?

Mr. Higman asked whether the Town funds or not?

Mr. Higman said no, that just says what has to be disclosed. The law comes from Florida State law and/or Federal law.

Ms. Struder said the Town has to reflect the liability but does not have to fund it especially for the OPEB Trust. For pensions, it is different.

Mr. Higman said just as it is in the corporate side, FASB dictates the disclosure and ERISA and DOL drive the funding.

Mr. Brown stated in attending the Town Council to hear one item, he ended up hearing several items. Ms. Struder was involved in the presentation of the financials and the audit report which was extremely favorable with the Town of Palm Beach. Ms. Struder likes to hide how well the Town is doing under a bushel basket. He knows it is pretty hard to hide how well the Town is doing. The people in the Finance area should be very proud of that.

Ms. Struder said thank you.

VIII. SELECTION OF MONEY MANAGERS

Mr. Brown asked Jon Prime and Sean Higman to report on the selection of money managers.

Mr. Higman said he passed out a single sheet, their roadmap for the book, that should have been in the book.

Ms. Struder said she emailed this out to the committee members also.

Mr. Higman said they have looked at each one of their recommendations and their asset allocation agreed to at the prior meeting is reflected in the investment policy statement. Their implementation schedule is a little different as a result of the fact that they are constrained by their 25% international under Florida Statutes 215.47. Since they are depositing cash essentially, their cost equals their market value. Over time, they will be able to get to their strategic asset allocation as cost and market value depart and they have more room to get to their 22% in internationals.

In the first two columns, they recast the investment policy statement with half of the 22.5% that was going to domestic equity going to the index and remaining going to a growth manager and a value manager. 22% was to go to non US, half each to two complimentary managers, 20% in total to hedge and absolute return, 20% to go to the fixed income portfolio, half of which was going to a core bond and half to convertibles, and then real assets 15%. They will talk about the individual names. Based on the information given, they actually have it a little more than $16,000,000 but they will adjust it accordingly.

In their analysis, they looked at their other places where they would have non U.S. securities, which are particularly the two hedge funds, and looked at the content of non U.S. within their asset allocation. In the third block to the right, the non U.S. Exposure in Forester Partners was about 39%, by plan 3.9%. By fund, Archstone had 36% which equates to 3.6%, so they have to take essentially 5% out to get there. They have to underfund the international in order to comply with their regulation. They are going to do that simply by shifting that money up to the index. They will underfund international by 5%, instead of 22.5%, they will have 17.5%, and they will put all of that money with the index. As they rebalance, they will look for opportunities to move money into the international overall.

Mr. Brown said on these absolute return hedge funds, the 39% and the 36%, he does not know what they are today, but they vary all over the place from time to time, so is it the day they fund that matters?

Mr. Higman said they vary some but because they are fund to funds and the amount of money that moves in and out of those does not move by big swings. They will look at it probably a couple of times a year to make sure that they are in compliance. They have intentionally built a little space in there to be compliant.

Mr. Prime said and it is based on cost so as soon as they get some relief from the growth and market value, they should be able to make that adjustment and try to work back towards the 5% difference in moving it for the long only managers so they will end up with a little more than 25% but they need to maintain the 25% at cost.

Mr. Mikus said so the regulation only discusses the 25% when purchased and then it can grow to anything desired?

Mr. Higman said the regulation states specifically in cost without defining cost. This is actually the more conservative approach. There are some who would say that it is not necessary to look through the hedge fund as long as the hedge fund is domiciled in the U.S., the hedge fund underlying in non U.S. does not have to be considered. They take a more conservative approach and say that they look through and ask them to report that. So they think they are being on the conservative side.

He asked if the committee has any questions? They did this broadly speaking so then they can just talk about the individual managers.

DOMESTIC EQUITY

Mr. Higman said he will discuss the first block, the domestic equity managers. There is a quick summary on page 1 of the passive options available to Prime and their minimums. They are recommending the Vanguard Total Stock Market Index because of its size. They are going to use the admiral classes and they will be 9 basis points. It will be based on the MSCI broad index and it pretty much stands on its own. They could have gone to the Spartan in Fidelity but it is on the Wilshire 5000. All that does is pick up additional capitalization stocks. They would rather use the MSCI broad and use active management for the smaller cap funds.

Mr. Brown said he does not really know the MSCI broad index.

Mr. Higman said MSCI has developed their own set of indexes that, like Russell and S&P, reflect the broadest market here. He is not sure how many names are in the MSCI.

Mr. Brown asked is it broader or narrower than the Wilshire 5000?

Mr. Higman said it is narrower than the Wilshire, broader than the S&P 500. They track fairly close in the year to year comparison. The primary difference between the Wilshire and the MSCI is that much smaller component, the smaller cap names included. So for the last three years, the Wilshire has modestly outperformed on a compound basis but that has to do with the relative out performance of small and mid cap stocks.

He said the next mandate was for an all cap mid/large value. They are recommending the Southeastern Fund which is profiled on page 3. It is Longleaf Partners. This is their commingled fund. Managers over time will do both mid and large cap stocks. He will introduce the all cap growth as well. On page 4, Friess Associates is a fairly famous name, and they would be recommending the Brandywine Fund and like the Southeastern Fund, it is an all cap growth fund meaning that it will move from large to mid and mid to large depending on where it sees opportunities.

Mr. Brown asked if Southeastern is small caps?

Mr. Higman said they have a small cap fund. They try to avoid small cap as a general rule. They do not believe that the risk reward tradeoff is appropriate in small cap.

Mr. Brown said the committee does not have their own lawyer but he asked Ms. Struder if she has observed in the other similar investment groups here in Town? He personally invests in Longleaf Partners Fund and has for many years. He asked if he can vote on this?

Mr. Prime said he would not think so.

Mr. Mikus said that is a good question but he said Mr. Brown has no control over that. There would be no benefit to him no matter which way Prime went. For a shareholder in Longleaf, there could be an argument that there would be some benefit but not in the market.

Mr. Brown said but they do not have shareholders.

Mr. Mikus said they do.

Mr. Panfel said he thought Chair Andrews might have a problem in regard to his voting but he does not think Mr. Brown has that problem.

Mr. Brown said he thought that at least they have to disclose if they have investments so that it is in the minutes that they have disclosed that they have investments in these funds. He does have investments in Longleaf as well as their two other funds, international and small cap. They are a great institution.

Mr. Prime said the concept they are using in the domestic equity is to use an all cap and to the extent that the manager sees opportunistically by cap size, they will move towards either increasing or decreasing the capitalization in the portfolio.

Mr. Brown said this is not his understanding. He knows Longleaf has a small cap fund.

Mr. Higman said yes but they will not go to small. They might go to mid cap.

Mr. Brown said so it is not an all cap fund. It is a large or mid cap fund. The question he has is the reason that they do not go into the second one is for institutional investors because of their minimum being so high.

Mr. Prime said yes, they cannot get in because of the minimums in the fund.

Mr. Brown asked if they are pretty rigid on that?

Mr. Prime said yes they are particularly when there is a large minimum.

Mr. Brown said and it states next to it that they are closed.

Mr. Higman said Prime will be able to get in.

Mr. Brown asked them to tell the committee more about Friess.

Mr. Higman said Friess was founded by Foster Friess, and it is a premier fund that over the long term was somewhat more volatile than perhaps they would have been interested in. They had a history of going to a fair amount of cash over time. They have limited those moves to more risk adverse. They are not taking those big swings. They hold about 100 to 150 names at any given time. Right now, at the end of December 31, 2006, they were about half solid mid cap but they are moving up over time. Notice the year to year performance versus the Russell 3000 Growth Index. They have beaten the index every calendar year since inception.

Mr. Brown said and they tend toward the mid cap.

Mr. Prime said it will vary but they normally will have a pretty good amount of mid cap in their portfolio, mid to mid large.

Mr. Higman said neither of them will go completely into one versus the other, no higher weights.

Mr. Brown asked if they can't get into Brandywine until December?

Mr. Higman said right.

Mr. Brown said before leaving that page, acknowledge that the committee did comment on that as high turnover. Is that a thing of the past? He sees + or – 200% down at the bottom of the page?

Mr. Prime said it depends on what is happening in the market but generally speaking the turnover has been higher than normal than the average fund. Some of that is because of their success in terms of capturing gains from the portfolio. It is a portfolio that has a higher turnover.

Mr. Brown said they have a great track record.

Mr. Mikus said in this case it is not as relevant.

Mr. Higman said it is not as relevant because the Town is not a taxable investor so it really does not make too much difference.

Mr. Mikus said one of the first things he looks at is turnover expenses.

Mr. Prime said what is causing the turnover is success as opposed to failure. Some of it has to do with, particularly in the mid cap portfolios, with the way they move in and out of position sizes by doing multiple trades to get in and out because of the market impact, so some of that can be related to position sizes also.

Mr. Higman said and to the extent they have been going through periods where they have mid cap stocks and the size of their fund, they don't want large positions in those mid cap stocks. It generates a lot of turnover.

He said the next few pages beginning on page 6 show the group of managers to see what their return and their characteristics look like. Page 6 shows how they compare with the Russell 3000 and where their weighted average capitalization would be. It is more solidly in the mid cap. One of the hallmarks of their portfolio is that if there is going to be any overweight, it would be in that mid cap space.

On page 7, they look to make sure they haven't created a portfolio which has an absence of weight to particular industry. For instance, there have been portfolios particularly with active management predominantly which might have no energy in it. Those portfolios were really hurt the last couple of years. Here, with the exception today of the consumer discretionary, it has a bit of an overweight that would be typical of active managers at this point in the cycle. The next several pages represent returns for the different periods.

Page 12 introduces essentially a chart that is mapping risk reward versus the other market oriented portfolios. This is a seven year time frame so they have collected both a variable market and what, in the crosshairs in the middle, is the median return and the median standard deviation for all the accounts in this universe. What they want to see from their managers is a combination which, in the northwest quadrant, the upper left hand box, means that they have return that is greater than median with a risk that is less than median. They are always striving to find managers in that northwest quadrant. Occasionally, they may identify a manager who spends some time in the northeast quadrant so long as that risk reward tradeoff is sufficient. But they would much rather find a manager who consistently is in that northwest quadrant. The team here shows to consistently be north on return higher than the median market core manager and do it at a slightly less standard deviation. The little plus sign is where the index was during this seven year period. From this team, this combination and these weights, will give a domestic equity portfolio which participates in up markets and has some down side protection.

Mr. Brown said they talked last time about whether they needed to have visits from the managers. He thought the conclusion was if the managers are going to be interviewed, it would probably be from hedge funds or maybe real asset managers but not the more straight forward domestic and international managers.

Mr. Prime asked if the committee wants to approve these today by segment, domestic equity, international, etc., or do the entire process at the end?

Mr. Brown said there may be a timing issue at the end but they can certainly decide to agree on the specific managers for domestic equities. He asked if the committee is willing to support those choices for domestic equities?

The committee agreed they are supportive so far.

INTERNATIONAL EQUITY

Mr. Prime said they will move on to the international equity. This is long only equity and they are proposing two firms. Julius Baer is outlined on page 2 and Dodge & Cox on page 6. A couple of considerations in terms of selecting these two firms are these are generally what they would consider core firms. Julius Baer has sort of a growth tilt and Dodge & Cox has kind of a value tilt although they are both core. The other thing is since they do not have enough money really to look at emerging markets as a dedicated allocation within the international segment, they were looking for firms that add opportunistically that would include emerging markets as part of their overall decision process.

Page 2 shows Julius Baer International II Fund, $100,000,000 minimum. Current assets 2.9 million and the fee is 1.05%, 2% redemption fee if in it for less than 90 days. They have an I fund which they have profiled in terms of the performance which is closed now. These are essentially the same fund but the II fund is restricted to companies greater than $2,500,000 in market cap. The reason for that is, it is an asset size issue. The reason they closed I and opened II and set that threshold is so they can take more money by not going into small cap stocks. When they look at performance, they have profiled the I fund performance also. On the right hand of the page under portfolio characteristics, they add a little over 20% in emerging markets. That will vary from time to time based on their views of the emerging markets.

On page 6, Dodge & Cox International Fund is a one vehicle fund. The vehicle information is seen at the bottom. Again, moving to the right hand side in terms of the country allocation, the emerging markets are at almost 16% exposure in the Dodge & Cox portfolio and it is going to bring a value bias to complement the growth bias in terms of the Julius Baer up fund.

On page 7, Julius Baer International Equity Fund I, which is closed, and the International Equity II Fund, which has been in existence for a short period of time, but essentially with the one caveat of a cap size of $2,500,000, they are similar vehicles.

Page 7, third from the bottom, shows the Dodge & Cox International Fund performance on a rolling time period.

Page 8 shows the year by year performance for both of the funds. As mentioned in their rationale, they think these are two top quality international funds that will provide mid cap and large cap plus developing funds which they think is an important element as part of the overall portfolio structure.

Mr. Brown asked if all these returns shown here are net of fees?

Mr. Prime replied yes they are. Look at the fee structure of these two international funds. Julius Baer is a little more expensive but actually relatively modest given internationals. Fees generally in international funds are higher but these relative to the universe of international funds have performed pretty well.

Mr. Brown asked if the committee would support investing in these two funds?

The committee voted unanimously to approve these funds.

DOMESTIC FIXED INCOME

Mr. Higman said Tab V has the domestic fixed income. They are 50% of the assets in a core fixed income portfolio, and 50% of those assets of that allocation in convertible bonds. They are recommending Western Core Bond portfolio listed on the bottom left.

Mr. Mikus said it has to be the first because they do not pay the 12b-1 fees.

Mr. Higman said it is the first one. The 12b-1 fee can be paid and rebated. What ends up happening is they will probably access this through the hybrid fund which is a subsidized fund. They would recommend a tuition recapture broker who would become the broker of name and return about 90% of the 12b-1. They are not prevented from entering into the ones that have that.

Mr. Brown asked if it has a 49 basis point fee?

Mr. Higman said correct.

Mr. Prime said on this schedule, the basis point fees are in the far right column.

Mr. Higman said the obvious question in the big alternative is PIMCO Total Return. The primary reason for not considering PIMCO is because total return is a core plus manager therefore it will have some high yield and will have some non U.S. In coordinating the non U.S. issue, it further complicates the process. In their asset allocation here, they are using fixed income primarily for two reasons, to comply with Florida law and solely to hedge the deflation risk. They are not looking for total return out of this portfolio. They are looking for the best core manager and they believe Western delivers the best core performance and core process to the portfolio. He is sure most of the committee members are familiar with Western Asset. They are the second largest bond manager. Depending on the day, they may be the largest with a very strong performance. They have just gotten all the bond assets from Citi in an exchange.

On page 21 is Income Research Convertible. This is an instance where Prime has a waiver to their minimum. Their minimum ordinarily would be $10,000,000. Prime has talked with them and they are going to give a waiver on that.

Mr. Brown asked if the fee will be the same percentage?

Mr. Higman said it will be the 45.

Mr. Prime said the thing about Income Research is that they manage investment grade convertibles and they are unique in the whole industry in that they are a bond manager who manages convertibles. Typically, convertibles are managed by equity portfolios not bond portfolios. The advantage here is they are concerned very much with bond like risks. It is a strong performer. They use it also in two of the other Palm Beach pension accounts. Here they are only looking at one solution because it is the only convertible manager that they are aware of that it is strictly a bond manager that manages convertible bond portfolios. The advantage is that they are going to get a hybrid so they are looking for equity market participation but on a regulatory basis it is seen as a bond portfolio.

Mr. Higman said the other thing about it is because of that bond mentality, they are only in the high quality category. They are not looking at the high yield convertible in the market at all.

Mr. Brown asked if both of these have good track records?

Mr. Prime said yes. Income Research has managed convertible bonds for Prime as a firm since the very beginning. They have approximately a twenty year experience with them mostly in their insurance portfolios because again under insurance regulations, they are seen as bonds not as stocks. Prime positions them within the portfolio to get equity participation out of what is seen on a regulatory basis as a bond portfolio.

The committee approved the fixed income managers.

REAL ASSET PORTFOLIO

Mr. Prime said the real asset portfolio is a combination of Guggenheim Plus and the Western Commodity Plus Fund. The reason they like the Guggenheim and Western combination is because Guggenheim's fee is very attractive. It is a 1% all in and they have agreed to grandfather the OPEB Trust or combine it under the umbrella of the Town of Palm Beach with Fire and Police. The good news is that they pick up the same, about 30 to 35 basis points, and also they are able to get in under the minimum. The Guggenheim portfolio is a 70% private equity and 30% public equity REIT component. As opposed to looking at some of the other products in this cap, the State Street Real Asset, is they think it is important particularly to pick up the private real estate component. This way they get exposure to private real estate which is 70% of the Guggenheim and 30% of public REITS and then as part of the Western Commodity, they get exposure to TIPS and to natural resources and commodities. The weighting they used is one third in commodities or 5% and two thirds in the real estate portfolio and that is not a scientific approach. They think they need at least 5% in the overall structure, a level of significance of not less than 5%. That drives the commodity exposure and then 15% real asset allocation ends up with 10% in the real estate portfolio. Again, they have a long history with Guggenheim and are going to benefit from the other exposures that they have to Guggenheim under the Town of Palm Beach umbrella.

Mr. Brown said he does not understand how Western works. They seem to be invested in bonds.

Mr. Higman said they are buying and swapping futures to get the commodities and managing the collateral as a short term bond portfolio. They are getting some return from being short in the bond portfolio and the bond portion has a duration of under a year in a high quality. That is just with the collateral portion of the portfolio. Then they are getting the commodity index by swapping futures.

Mr. Mikus said the major difference between the PIMCO commodity and the Western Asset is that PIMCO has a much higher proportion of high duration TIPS product.

Mr. Higman said as opposed to using a short term bond portfolio, they are using TIPS.

Mr. Mikus said they are really looking at an inflationary environment. They would outperform not only on the TIPS portion but also on the commodity portion versus the Western Asset in more pure commodity.

Mr. Higman said it is more pure commodity but remember their being on the short end of the curve rides with rates. It is a little less real protection out of the PIMCO product but it is still fairly good protection.

Mr. Brown said it is interesting that they are really managing a commodity portfolio but the management fees are very low. Are they related to bonds?

Mr. Mikus said correct.

Mr. Brown said that is the best of all worlds.

Mr. Prime said another point he would make about Guggenheim is it is an advantage, but a point of note is, it is like a hedge fund. It has a six quarter lock up so you cannot do anything with it for six quarters but after the six quarter lock up, you have good liquidity, quarterly liquidity with 45 days notice. The other advantage here is they are enabling access to a good piece of the private real estate market without the illiquidity normally associated with private real estate.

Mr. Brown said he has a couple of questions about Guggenheim. Under the private market under portfolio statistics, under private markets 71%, it starts out by describing open-end funds, he is a little confused as to how the private market is defined as open-end funds.

Mr. Higman said they use a combination of open-end funds like Prudential and others as well as direct investments in buildings, etc.

Mr. Brown said so these really are mutual funds in separate accounts.

Mr. Higman said yes.

Mr. Brown said in terms of investing directly, it is not clear how much of that 71% is direct.

Mr. Prime said he does not have that information with him today, but they will be happy to provide that. They are not going to be able to get into Guggenheim until June 30 because they require a 30 day notification so they cannot go March 31.

Mr. Brown said he was wondering about the fees. They have fees of 90 basis points in the wording under Investment Objectives.

Mr. Prime said they are getting 1 to 1.5 excluding the carried interest. Those include the underlying fees so they are targeting 1 to 1.1% and all in. This includes all third party fees plus their fee. Prime thinks that is a very competitive fee and they do get 20% up above the target benchmark which is 70% of the NCREIF and 30% of the NAREIT.

Mr. Higman said that sentence Mr. Brown is reading that says "Management fees for new investors will be increased to 90 basis points". It should say "for accounts less than $5,000,000". That is what they are getting waived. Their portion of the all in fees is 60 basis points.

Mr. Brown said he thought their fee is 1 to 1.1%.

Mr. Higman said 1 to 1.1% includes the 60 basis points fee which was their standard fee. About six months ago, they instituted another fee arrangement for accounts below $5,000,000. They were getting waivers on the $5,000,000 and putting $2,000,000 accounts in there and they put up a bit of a road block. They created a new share class that is 90 basis points. For those clients, the effective all in rate would be 1.3 to 1.4.

Mr. Brown asked if Prime managed to get in under the wire?

Mr. Higman said correct because of the other relationships.

Mr. Prime said their performance is on page 11.

Mr. Brown said their performance is very good because real estate has been very good.

Mr. Prime said both public and private real estate have done very well. They do not think that the private side is as overvalued as the public side. The interesting component here is to pick up that private real estate exposure on a reasonable fee basis and without the liquidity after the 6/40 lock up. Normally in private real estate you are going to be looking at 10 to 12 year lock ups.

Mr. Brown asked if the fee basis that they have negotiated will apply to future monies going into the fund?

Mr. Prime said it applies to anything that would come from your account.

Mr. Brown asked if the committee is supportive of these two?

The committee approved Guggenheim Plus and Western Commodity Plus Fund for the real asset portfolio.

HEDGE/ABSOLUTE RETURN

Mr. Higman said they have recommended allocating 10% in absolute return strategies and 10% in hedge strategies. Forester Partners would be their recommendation for the long/short hedge program, the fund to funds. Forester is being considered by both the Police and Fire. This fund is run by Trent Carmichael and because of his network to Tiger Management has gained access to very, very strong underlying managers. He holds about thirty names at a given time and when Prime is evaluating the fund to funds managers, it is critical to them to know the majority of the underlying managers. The names listed there are among the best in the marketplace. The majority of these names are closed to new investors meaning that Forester has capacity but Prime would not otherwise be able to get into those funds. Again, one of the strong characteristics and one of the compelling reasons for fund to funds is to get the broad diversification but also because fund to funds have access to the best managers.

One of the reasons for the deferral of a decision, at least with the Police pension, was that this comes in two varieties. They have a fee schedule with a three year lock up which has no profit allocation or the standard lock up of two years with a 3% profit allocation. The Police wanted their legal counsel to come back because there was some concern about the liquidity under Florida law. He has not heard back from them. Prime's understanding is that the liquidity is portfolio liquidity not an individual liquidity issue. They have already subjected themselves to an 18 month because they have invested in Guggenheim and one year lock ups in their other hedge fund strategies but they wanted to defer the decision until they hear from their legal counsel.

Mr. Brown asked if he knows when this will happen maybe this committee could use their lawyer's opinion or hire their own lawyer to do the same thing?

Mr. Higman said their legal counsel will respond at the next meeting in May. He can call to see if an opinion has been reached.

Mr. Brown said assuming that there is no legal obstacle here, the committee does not recognize the underlying funds listed on Forester.

Mr. Mikus said The Children's Investment Fund is a Global Activist Fund and he wonders how their performance characteristics are going to look since they are activists.

Mr. Prime said they are top notch. They have been outstanding. The underlying funds are all very high quality. Most of Prime's decisions about fund to funds are done on a look through basis looking at the underlying managers.

Mr. Mikus said he would like to hear the discussion on the three year lock up.

Mr. Brown said if the Town invests in this, at the minimum, they will have a two year lock up. If they take the two year lock up, they are going to have to pay 3% per year profits in addition to the underlying managers' cap that is probably 20%. So if they earn 10 to 15% a year, that's about 30 to 35 basis points a year extra. For the difference between two and three, he would do a three year lock up.

Mr. Higman said they advocated to Police that they should not be measuring this in less than a three year increment.

Mr. Brown asked is there some way of riding on the shoulders of the lawyer for the Police Department in finding out if there is any legal prohibition that says you can't have anything that is not liquid for more than two years?

Mr. Higman said he will verify that. He does not think the lawyer is going to find anything because it is not in 175 or 185. The only place it might be would be in the general investment and he does not know of anything there in the Florida board. He is sure the board makes investments that are longer than three years.

Mr. Prime said State Board investing in private equity and real estate markets are ten to twelve year lock ups. Technically, they are not lock ups but there is an enormous penalty for trying to get out sooner. He has never seen anything in the regulations.

Mr. Brown said if they can have a high quality list of funds and only get 1% overall to no profit allocations, his instinct is that is a pretty good deal on fund to funds.

Mr. Higman said both boards are going to pursue Forester Partners.

Mr. Prime said Archstone Market Neutral Strategies, Ltd. is a high quality fund run by Alfred Shuman and Joe Pignatelli. Archstone runs high bred as well as market neutral. They started the market neutrals by breaking out those managers that used to be in there for hybrid which is long/short market neutral portfolios. Again, in the underlying funds some of the names might be familiar. Again, these are all top quality most of which are closed. Farallon just opened recently and will take some new money in from time to time but generally is closed. It is a lock up provision, redemptions only annually with ninety days notice.

Mr. Higman said they would like to do this one before the fall so they are not backing themselves into a defacto, a longer period of lock up.

Mr. Brown asked if the lock up is a calendar year?

Mr. Higman said the lock up is a year from when invested. So if the monies are invested after the 90 day notice period in the fall, then the funds are effectively locked up for another year.

Mr. Prime said if invested today, the lock up is effective until 12/31/2008.

Mr. Brown said the good thing about this is the absolute return.

Mr. Prime said this is basically multi strategy arbitrage with some market neutral long/short involved in it. It has the strategies typically to get an equity like return over the longer term with volatility lower than the U.S. bond market.

Mr. Brown asked if the returns that are shown are net?

Mr. Prime said they are net of everything.

Mr. Higman said although Police and Fire do not use the market neutral fund, they do use arbitrage.

Mr. Brown asked Mr. Mikus how he feels about this?

Mr. Mikus said all the choices have been outstanding.

Mr. Brown asked the committee if they feel there is anything to be gained by asking any of the managers to come in?

Mr. Mikus said they are all well known, high quality managers.

Mr. Brown asked if the other Town funds interview the mangers?

Mr. Prime said they do in some cases particularly in some of the hedge and absolute return strategies. With some members, where they are not a homogenous sophisticated group, and they do not understand the strategies to begin with, there might be some benefit to some individuals by having the managers come in, but generally speaking, no, as long as the committee understands it.

The committee agreed not to have the managers come in.

The committee supported all the recommendations.

Mr. Prime said the only possible hitch would be in the legal reviews. When Police and Fire were Public Safety, they went through legal reviews. Forester has not been through legal review. Archstone has been through a legal review. The legal reviews vary depending on the firm's counsel that is represented. There have seen some differences in the way Police and Fire counsel approach the legal review. The manager sends the management agreement. In some cases, they have had, not by one of the Town funds, an attempt to significantly rewrite which has caused some concern. They are optimistic that these will be relatively uneventful.

Mr. Mikus asked what issues do they typically argue about?

Mr. Higman said in the past this had to do with warranting that they would abide by any restrictions in their investment policies. In Prime's investment policy statement, they simply said that if using pooled funds, they will examine it up front and advise if there is going to be any exceptions. This particular one started out with the position that she could not recommend the fund unless they would warrant that they would be a fiduciary to the plan. Again, some from just a technicality cannot do that. For instance, a mutual fund that is open to the public can't say that they are going to act as a fiduciary for this single plan. Those are the issues.

Mr. Prime said this is to alert the committee that it is possible they could end up with an issue. If an issue does arise, Prime will work with counsel.

Ms. Struder said it will be sent to Mr. Randolph to handle or delegate.

Mr. Brown thanked Prime Buchholz for their presentation.

IX. REVIEW OF INVESTMENT POLICY FOR SURPLUS FUNDS

Mr. Brown said included in the packet is the Town of Palm Beach Investment Policy dated March 11, 2003. He suggested doing a page by page review.

Ms. Struder said the last time it was reviewed was 2003.

Mr. Mikus said it should be done annually.

Mr. Brown agreed.

Mr. Brown said until this time, all the money has been in the SBA short term.

Ms. Struder said a few years prior to that, they did have a laddered portfolio with First Union.

Mr. Brown said they had tried some other things that did not work too well. When this committee was formed, the SBA fund was earning about 1%. The Town Council had expressed an interest in finding ways to improve the return. The scope was basically to pool the funds and consolidate all the various reserve funds which is how this got close to $100,000,000. They felt that they should not take significant risks in terms of quality and should not take significant interest rate risks but they were willing to go out a little bit on the curve. Having done that, so far it would have turned out better if they had not done anything. They report every month how they have done compared to if all the money had been kept in the SBA, and are behind by about $391,000 cumulative over a four or five year period.

Ms. Struder said this improved in February by $120,000.

Mr. Brown said so they are behind about $271,000. That is not a big amount.

Ms. Struder had a comment under Safekeeping. Where it states "all qualified depositories and broker/dealers who desire to provide investment services must supply the following as appropriate": She asked Mr. Higman if any of this has changed since 2003 or if they are supposed to ask for other things from broker/dealers. She knows they do not deal with any but if they are going to make any modifications to this policy, is there other information that should be obtained.

Mr. Higman said he would guess they would ask for any SEC violations.

Mr. Mikus said that might come under the proof of state registration. It might be the ADV form.

Mr. Higman said that is where you would pick up any official SEC investigations or otherwise pending. Any broker/dealer of any size that you do that with, you will find violations or pending cases if you inquire or somehow express an opinion about.

Ms. Struder said the last time they talked about benchmarks, they were wondering whether the SBA is an appropriate benchmark. That is something they have always used.

Mr. Brown said it is certainly less embarrassing.

Ms. Struder asked Mr. Higman if there are other benchmarks that are used for short term type investments?

Mr. Higman said certainly there are and they use them. So when the reports are received from both Florida League of Cities and SBA, they have their own benchmarks that are more generic. He said what strikes him in reading this is that there has not been enough time to review restrictions that might be generated by Florida law. There is a bit of a conflict in the statement that "you could have securities as long as five years and you are allowed to match them to your cash flows". He would guess that the cash flows do not require the liquidity that is gained from SBA and/or Florida League of Cities. The SBA, the bulk of the funds, average is 49 day weighted average life. Right now with the inverted yield curve, there is not much reason to take the risk. The fundamental question of this investment policy at first is, are there opportunities to more match investment assets to investment liabilities?

Mr. Mikus said exactly.

Mr. Higman said the reason he said that is, just in brief conversations with Ms. Struder, is how long are you away from your last cash flow analysis for each one of these pools? When would you redefine and what level of competency is needed or what is the requirement that you might have to access the funds?

Mr. Brown said he thinks that is the starting point. His recollection is that they tried to get some idea piece by piece of different sectors of these maturities, when the funds might be needed. It was not that easy. There were a lot of places where they may need the funds or they may not.

Ms. Struder said a lot of that was with the beach bond money at the time and a lot of that has been expended.

Mr. Brown said it is worth looking at again at this point. What are the cash needs? A portion of these look like they are going to be around for a long time, maybe the committee would take a different view once the yield curve is more positively sloped.

Mr. Higman said or are there opportunities under Florida law to use asset classes which the committee is comfortable with which more appropriately match? For instance, you have a funded depreciation account or some portion of that account is spending for permanent purpose. You are only spending essentially your new additions to the fund then there are opportunities to think about longer time horizons of asset classes. They do not advise it in Florida. The best comparable to them is they have a few large health organizations who have these funded depreciation accounts, and other cash reserves, which typically they have been reticent to invest more long term. Given that many of these organizations are the biggest thing on their balance sheet, there have been opportunities to do that.

Mr. Brown said he thinks that is worth looking at and certainly is a starting point. The committee needs to know more about how things stand today on these surplus reserve funds. The other thing he would like to mention, and get Mr. Higman's input on, is that what they have chosen to do with a portion of the funds that were in the SBA was to put them in the Florida League. They actually chose two elements of the Florida League. One was short to intermediate, 1 to 3 year, and the other one was an intermediate fixed income fund, 3 to 5 year, all very high quality but using to a great extent mortgage backed securities and other asset backed securities. Given today's environment, even in a favorable interest rate market, are they going to lose ground to treasuries because of worries about mortgages even if they are AAA?

Mr. Higman said with AAA, there is not much reason to worry about the spreads and the widening. Usually in this environment the worry is about whether it has the unintended complexity to it and it is not likely that the long term rates are going to drop precipitously here. It is probably more likely the other way which doesn't hurt the mortgage bonds, it lengthens those securities substantially. Given the quality, it is probably not a large risk.

Mr. Mikus said that is a good point if interest rates stay at these levels. If liquidity dries up, there is going to be less refinancing. So the length of average maturities is going to move up. The duration is going to move out.

Mr. Higman said they will trade out because they are constrained by their own perspectus as those become longer duration. They will either have to adjust and allow them to shorten up or change the construction of the portfolio.

Mr. Panfel asked is that where the realized losses come into play?

Mr. Brown said yes. When they trade them, they take losses. But the idea is the value of the additional returns of the new investments more than offsets the loss. The other thing he worries about is there's never really a maturity for their investments. They did invest in a very small way in six month treasuries. Even though treasuries have lower rates theoretically than these funds, funds should be better than treasuries. The nice thing about investing on your own is that the investments actually do mature. No matter what happens to the interest rates in the interim, if invested at 5%, they will earn 5%. Whereas, with funds, there is uncertainty about what will be earned.

Mr. Higman said it goes back to his comment about matching the liability to the asset. With a relatively longer duration liability, while there is comfort in that laddered portfolio, you should lose if it is significantly a long enough time in an upward sloping curve. But with an inverted yield curve for a short period of time, the laddered portfolio wins every time.

Mr. Mikus said a laddered portfolio concept is more complex than people realize. The duration changes every day. The liability is going to be changing, the ladder changes, the entity becomes a portfolio manager and may not have the skills or the information to do that.

Mr. Higman said it is harder to be measured.

Mr. Brown said the other thing that they took into consideration is that as smart as the Finance people are, they are not really equipped to handle anything beyond investing in the treasury market. The committee could not expect the staff to act in that capacity.

Mr. Higman said having managed large corporate pools both ways, his clearest learning experience was to continue a pool with a layer of funds that are always going to be there. A pool manages their variability with a laddered portfolio to the extent you can rely on the forecast that is reasonable to get the least active manager fees.

Ms. Struder said and they could hire somebody to manage a laddered portfolio, right?

Mr. Higman said typically a laddered portfolio is laddered against some specific cash flow requirement not in general. People who get laddered portfolios are those who go to the brokers because that is what the brokers do. It is almost impossible for their clients to measure success.

Mr. Panfel asked if they usually get a ninety day notice?

Ms. Struder said it depends on the fund. The capital project fund can be variable depending on what is going on like drainage projects. Large expenditures go for the beach project. There is the equipment replacement fund but that is just buying a fire truck every now and then. That is the largest expenditure that will ever occur through that fund. The Town knows a year ahead of time whether they are going to buy anything from that fund.

Mr. Brown said one thing he noticed is that the number has been around a $100,000,000 a long time. Given the hurricane season, some of these were funded for emergency purposes. He does not remember much of a dip in the total so they have to be careful. They could get gains someday if they went beyond five years to a ten year component or something like that.

Mr. Higman said many colleges today care about their immediate needs and do short term. In their three year, they use absolute return and fund to funds because the returns are extremely stable with a significant boost to their return. So they get 7.5 or 8% return on maybe a 4 or 5% standard deviation.

Mr. Brown said the basic question is should they continue to report on a monthly basis how they would have done if they had stayed over the last four years with the SBA? He said they have done this because they are hoping to get into a mutual or positive territory.

Ms. Struder said she thinks to change right now would look a little odd but if the committee changed the whole strategy, at that time, it might make sense to change the benchmark to something else.

Mr. Brown said all they need to say is this no longer makes sense. He said they have been positive in the early stages for awhile then they went negative and stayed there. He asked Mr. Higman if his basic idea is to get a better cash flow going and then think about a broader investment philosophy than they have had so far? He asked how to find the managers?

Mr. Higman said they can help the committee think through the process a little bit. But they will start with the process of what is the underlying purpose of the cash and is the committee comfortable in stepping off of where they are?

Ms. Struder said she has one other question in the policy. Under Authorized Financial Institutions and Dealers, it talks about they need to purchase through "primary securities dealers" rather than secondary? If the investment philosophy is changed, they might have to change that.

Mr. Higman said that could be changed but the whole document would change fundamentally if going very far out.

Mr. Brown thanked Mr. Higman for sharing his expertise.

X. MONTHLY INVESTMENT REPORT - JANUARY

Ms. Somers reported the January investment report shows around $115,000,000 in investments and investment interest income is $1,675,000 for this fiscal year. The Treasury that was purchased will show up on the February report. She said the results in the Florida League were much better in February.

Mr. Brown said Ms. Struder is on the Florida League of Cities Investment Advisory Committee. He asked if she has found that to be worthwhile?

Ms. Struder said it has been very interesting. The last meeting did not go into these investment reports as much as they normally do. They met to pick a high yield investment for their insurance pool so they had to interview money managers for high yield investments.

Mr. Brown asked if generally she thinks they do a good job?

Ms. Struder replied yes.

Mr. Brown stated that was his impression. They are trying to invest in AAA securities. They are doing a pretty good job relative to their benchmarks.

Ms. Struder said they also attended another seminar put on by Mr. Ben Fenkelstein. He has a book called "The Politics of Public Fund Investing". She asked if the committee is interested in obtaining copies to peruse in their spare time? She would be happy to purchase these for the committee if they are interested.

The committee agreed they would like a copy.

XI. INVESTMENT ADVISORY COMMITTEE PRESENTATION TO TOWN COUNCIL

Ms. Struder said this presentation has been deferred from April to December 11, 2007. By that time, they should be well invested in the OPEB assets and maybe will have made a change in the other investments.

XII. INVESTMENT ADVISORY COMMITTEE APPOINTMENTS

Ms. Struder reported they only have three applications, Dr. Andrews, Mr. Brown, and Mr. Hennessy. Each of the applicants need to attend the Town Council meeting on April 9^{th} to give a background update. She said not all applicants show up but Mr. Mikus and Mr. Panfel did for the last appointments. They request that applicants attend especially if there is a new applicant.

XIII. NEXT MEETING DATE

Mr. Brown suggested Ms. Struder discuss this with the Chairman.

Ms. Struder said if the committee does not meet until mid or late April, two members will be gone until November.

Mr. Brown stated they had a telephonic meeting last year.

Ms. Struder said the Town Council does not allow telephonic attendance anymore.

Mr. Brown suggested they could have a meeting about cash flow and discuss whether they will change the policy. What they really need to know is out of $115,000,000, is there $15,000,000 or $20,000,000 that they feel will be there essentially for the next ten years? He stated if he were Ms. Struder, he would be concerned about that and he is sure she will be. The last thing any CFO wants to do is to be embarrassed by cash shortage. They could have the Florida League come in to go over the cash situation and think about the investment policy.

The consensus was to have the Florida League of Cities and Atlanta Capital give presentations at the next meeting.

XIV. ANY OTHER MATTERS

There were no other matters for discussion.

XV. ADJOURNMENT

The committee unanimously agreed to adjourn.