TOWN OF PALM BEACH

Office of The Town Clerk

REPORT OF THE INVESTMENT ADVISORY COMMITTEE MEETING HELD ON FRIDAY, FEBRUARY 11, 2011

I. CALL TO ORDER AND ROLL CALL

The Investment Advisory Committee was called to order on Friday, February 11, 2011, at 2:10 p.m., in the Town Council Chambers, Palm Beach. On roll call, all members were found to be present, with the exception of Committee Members Heinz L. Gundlach and Benton Bohannon who had been unable to attend the meeting.

II. PLEDGE OF ALLEGIANCE

Chairman Michael F. Andrews led the Pledge of Allegiance.

III. APPROVAL OF AGENDA

The Agenda was approved as printed.

IV. COMMUNICATION FROM CITIZENS

There was none.

V. APPROVAL OF MINUTES

Motion made by Committee Member Bernard R. Panfel, seconded by Committee Member William John Mikus, to approve the Minutes. On call for a vote, the motion carried 3-0, with Committee Members Gundlach and Bohannon absent.

VI. FIDUCIARY LIABILITY POLICY RENEWAL

Karen Temme, Risk Manager, provided a recommendation that the Committee renew with RLI Corp., for a fiduciary liability policy for a current $2 million liability, a $0 deductible, and an annual premium of $5,748.00. Options were available to increase the limits, although it would increase the premiums.

Responding to Chairman Michael Andrews, Ms. Temme indicated that all the Boards and Commissions had similar insurance policies. She noted that the only difference was that the pension boards had a higher limit of liability, in which $10 million was based on the funding levels of the boards.

Responding to Committee Member Mikus, Charlene O'Toole, Wells Fargo, noted that the reason there was no response from the rest of the insurance groups was that each company that writes these types of policies has different requirements or levels of comfort.

Motion made by Committee Member Mikus, seconded by Committee Member Panfel to accept the recommendation for renewal of RLI Corp., a fiduciary liability policy for the Investment Advisory Committee. On call for a vote, the motion carried 3-0, with Committee Members Bohannon and Gundlach absent.

VII. <u>REPORT FROM PFM ASSET MANAGEMENT</u>

David Jang, PFM Asset Management, LLC, provided PFM's Market Update.

Mr. Jang made several of the following comments in response to questions and comments by the Committee:

- Companies are making record profits, but they are not spending any money to hire additional workers.

- We will not see any fundamental changes because small businesses account for 65% of all new job creation. There are no incentives or policies to help small businesses; everything is GM, John Deere, etc.

- Governor Scott is moving money out of education; he is not replacing stimulus dollars that the State of Florida received in the last couple of years. School districts will be forced to lay off workers.

- Small business is defined as 50 employees or smaller. Committee Member Panfel indicated that in Washington any company that earns up to $250 million in sales is considered small business; the Department of Defense considers 75 employees or less as small business.

- Bank of England purchased a net of $350 billion in U.S. Treasuries; China and Japan will continue to be large purchasers of our U.S. Treasuries. Japan is repatriating funds back to China to stimulate their local economy. The stock market in China for the past 12 months has been flat. China is raising interest rates, which is a negative factor, and they are simulating more domestic demands to make their economy less export driven.

Mr. Jang provided PFM's Quarterly Performance Report, which was submitted into the record.

Responding to the Committee's questions, Mr. Jang provided several of the following comments regarding the Quarterly Performance Report:

- The Committee's investment diversification is sound; he met with Dustin Heinz who was using the barbell strategy on their core bond portfolio and keeping money short to take advantage of rising interest rates.

- PFM is buying agency floaters to take advantage of the rising interest rate environment. Their strategies mirror the 1 to 3 and also intermediate 3 to 5 years and are doing the same with a barbell strategy, floaters, and also spreads between agencies and treasuries.

- In the Peer Universe Comparison of the Report, the Committee could see how well their bond managers were doing in their portfolios. Mr. Jang indicated that he had discussed the way the comparison was set up with FMIvT and that they were comfortable with it, which was why they hired the Asset Consulting Group, as a third party, to be part of their whole team.

- The value of the portfolio erodes, as inflation rises. If inflation is gauged just from the CPI index less the volatile core, the core inflation takes out volatile food and energy; just looking at the core is not true inflation. The real inflation is below the target of the fed or the lower band, and the volatile energy and food sector needs to be put in, because that is where all the inflation is going on.

Finance Director Jane Struder noted that Committee Member Bohannon, who was unable to attend the meeting, emailed several questions. Chairman Andrews read the following questions into the record:

1. We have several managers that have lagged their benchmarks for a considerable period, i.e. Brandywine, Sound Shore, and Artio. Why would we not use ETFS, which track these benchmarks instead of an active manager? This is as much a philosophical question as a technical one. For example, replacing Brandywine with "IWP", replacing Sound Shore with "IWS"; and Artio with either "EFA" or "ACWX"? This also addresses Mr. Gundlach's issue with specific holdings because the composition of ETFS is always known. I realize this is part of the larger debate of passive vs. active management, but I think we should have that debate periodically.

2. I could not reconcile the total amounts of funds in the PFM accounts shown in their summary statement with the actual account statement. On page C-1, accounts 68904245 and 68904255 show $38mm and $42mm respectively, while the actual statement and your report show $34mm and $38mm respectively. Is this because accrued interest is included in one set of numbers and not in the other?

3. Is it possible to have the rebalancing transactions report so we can see what changes actually took place?

4. The committee should address the question of having almost a 7% cash position in the trust. Should and how should this be committed?

Assistant Finance Director Cheryl Somers responded to question #2. She noted that the following differences in the two portfolios were: PFM included accrued interest and the money market balances in their numbers. On her same report, she indicated that she did not show accrued interest, and that the money market balances were separate; when the three components were added together, the two tied in.

Ms. Struder noted that the remaining questions pertained to Prime Buchholz, and the OPEB Trust balance on Ms. Somers' Report has about $1.1 million in cash relative to Mr. Bohannon's question #4 asking if there should be that much cash in the Trust or should it be invested with Prime Buchholz.

Dr. Andrews thanked Mr. Jang for his report and service to the Town.

VIII. QUARTERLY PERFORMANCE UPDATE - PRIME BUCHHOLZ

1) Asset Allocation and Performance Comparisons

Sean Higman, Prime Buchholz, provided an update of the quarterly performance, which was submitted for the record.

Responding to the Committee's questions, Mr. Higman provided several of the following comments:

- In tracking money, if your first quarter is low, the period of time for recovery or evaluation should be extended, as it takes longer to recover.

- A cash flow chart will be added to the Quarterly Performance Update, as it was not included in today's update.

Ms. Struder responded that relative to the cash flow, the initial deposit was averaged in, which was $16 million, and $1.5 million was added last year.

Chairman Andrews noted that it would be about $.5 million before breaking even.

Mr. Higman said that looking at the inception number, it was off a little bit less than 1%, since they started the portfolio.

Committee Member Panfel noted that the asset market value (pg. 16 on top), was $17.253 million, which would be down $247,000 from the amount put in.

Chairman Andrews suggested that on the cash flow chart an 8% line be inserted from the time the portfolio started; he noted that he would like to see where the Town broke even and where the theoretical crossover point would be at 8%.

Mr. Higman indicated that he would provide an estimate through January to Ms. Struder by email of the whole portfolio. He stated that the health portfolio is up a little over 1.15% thru January.

Mr. Higman responded to Dr. Andrews that it would be accurate to relate in his presentation to the Town Council that the Town's capital investment has recovered at this time.

In response to Committee Member Bohannon's first question regarding whether it was worth trying to beat the indexes. He noted the following:

- It is worth it to try to beat the indexes in the least efficient areas of the market; in the most efficient areas, it is probably weak, such as the large cap domestic indexes.

- The reason for not being able to beat the index is because of panic selling in order to meet redemptions. For example, the perverse result that gave beyond this active vs. passive change was that small cap stocks outperformed large cap stocks during the crisis, in which the fundamental analysis would say that in an economic crisis, small cap stocks should fare worse; they fared better because they were less liquid and were not available for sale as large cap stocks. A hedge fund manager had to sell to meet liquidations, he was selling what was liquid, so large cap stocks were hurt worse than small cap stocks.

He discussed the differences in the General Employees Retirement Fund, the Firefighters' Retirement Fund, and the Police Officers' Retirement Fund. He noted that the General Employees Fund would have a slightly lower number in Asset Allocation; he said that in the past 25 years an average rate of return was 8.9% , but going forward it is more like 5.3%, which is the idea that going forward is not a repeat of your past.

Committee Member Mikus stated that all the numbers changed when an inflation index is introduced.

Mr. Higman noted that the Town's policy is more diversified; the General Employee's policy is more mainstream and consistent with portfolios and Mr. Jang's analysis. The next question is the return, risk, reward, and tradeoff, and one would have to look backwards and test that premise. In actual performance, in the last 25 years, a simpler balanced portfolio produced 6 out of the last 25 years. He said that Ms. Struder circulates the report to the Town Council and the actual numbers are very similar.

Chairman Andrews noted that the actual numbers that he would question if he were on the Town Council would be the Police Officers' Retirement Fund of 10.9, the Firefighters' Retirement Fund of 10.9, the Town's Fund of 12.2, and the General Employee's Retirement Fund of 12.7.

Mr. Higman indicated that the 3 year number was off 1.6 for 3 years. He said that the actual on 12/31/10, 3 year compound is 1.6 for the Town (page 16 of the handout), the Firefighters' portfolio was down 60 basis points, the Police Officers' portfolio was only down 30 basis points, and for comparison the General Employee's was down 1.4 for that period.

Responding to Mr. Bohannon's third question relative to the rebalancing schedule, Mr. Higman indicated that he would be comfortable in providing a history of rebalancing, but that everybody would need to understand that none of the rebalancing that had ever been recommended is tactical, meaning that Prime Buchholz would resist on the positive or negative side of saying that value was added through rebalancing. He stated that the verbal policy is intended to reduce risk.

Mr. Higman indicated that according to the policy, rebalancing was done if one of the policy ranges were triggered, and whenever there was cash flow. For instance, a little bit of money was collected from Guggenheim this month and it has to be redeployed to Ms. Struder and the Committee. If over a million dollars was collected and put in reserves on the Town's books, it was appropriate to add to the portfolio, which would be an occasion to rebalance. He would not rebalance because the next quarter nothing was happening. It was important to be careful, because at end of the day, there was no intention to try to time the markets.

Chairman Andrews reviewed Mr. Bohannon's list of questions with the Committee, and question number four remained, which was addressed below.

Responding to Mr. Bohannon's question #4, relative to having almost 7% cash position in the Trust, Ms. Struder indicated that $1.1 million were invested in the reserves, and that part of it could be moved to the Trust.

Chairman Andrews indicated that if any Committee Members have a question for any of the portfolio managers, they could contact them directly. Mr. Higman responded that he would facilitate the distribution of the responses of questions through Ms. Struder to ensure receipt by everyone on the Committee.

Dr. Andrews thanked Sean Higman for his presentation and the consistency of his update.

Responding to Chairman Andrews, Mr. Higman noted that a hard copy of the update is sent in addition to electronically, which should be received within seven days prior to the next meeting.

IX. INVESTMENT REPORTS

Assistant Director Somers provided a brief summary of the December's Monthly Investment Report.

Responding to Chairman Andrews, Ms. Struder indicated that the allocation of the Florida League of Cities is high at 44% and that it should go down, as the Town receives their property tax distributions in November and December and in a few more months will receive January and February. If it is not reduced by the spring, it will be rebalanced.

Chairman Andrews expressed concern regarding the Florida League of Cities having 40% in longer term investments.

Ms. Struder pointed out that the OPEB Trust column has $1.17 million in cash and that it would need the Committee's approval to move the money. She noted that Prime Buchholz has $29,000 in the fund plus the $140,000 that is coming from Guggenheim; if $830,000 was taken from reserves, it would allow about $1 million to invest, which would leave $270,000 in the reserves fund.

Motion made by Committee Member Panfel, seconded by Committee Member Mikus, to approve moving up to $830,000 to investments, leaving $230,000 in the cash fund. On call for a vote, the motion carried 3-0, with Committee Members Bohannon and Gundlach absent.

X. NEXT MEETING DATE

Responding to Dr. Andrews, Ms. Struder noted that Dr. Andrews, Mr. Bohannon, and Mr. Gundlach were up for re-appointment. She said that Mr. Gundlach verbally stated that he was resigning from the Committee.

Dr. Andrews indicated that, as they meet four times a year, a member who missed three of the four meetings ruined the function of the Committee.

Ms. Struder indicated that she had taken the issue of quarterly meetings and the number of excused/non-excused absences to the Ordinances, Standards, and Rules Committee (ORS) in order to have number of absences reduced to two absences in any 12 month period. She noted that there would be one open seat on the Committee and if one of the Members knew of someone who would like to apply, please have them contact us.

Finance Director Struder indicated that the meeting date was usually the second Friday of the month. Mr. Higman asked if the meeting could be held on 20th of May, in the afternoon, as he will be here for another meeting in the morning that day. All of the present members were in agreement to the meeting date.

Ms. Struder indicated that the Florida League of Cities would be invited to the meeting.

X. ANY OTHER MATTERS

There were none.

XI. ADJOURNMENT

There being no further business, the February 11, 2011, Investment Advisory Committee Meeting was adjourned at 4:00 p.m.

APPROVED:

Michael Andrews
Chairman