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# TOWN OF PALM BEACH
# MINUTES OF SPECIAL RETIREMENT BOARD MEETING
# September 15, 1998

## I. CALL TO ORDER

A special meeting of the Retirement Board of Trustees was called to order by Chairman Harvey at 1:05 p.m. on Tuesday, September 15, 1998, in the Town Hall Council Chambers. Attending were Chairman Robert Harvey, Vice-Chairman James Wearn, Mayor Paul Ilyinsky, Council Present Lesly Smith, Trustees Robert J. Doney, Karen Lane, Charles Boggs, George Frick, and John DeIorio. Also in attendance were Plan Administrator William Crouse , Personnel Analyst Carla Kneipp, and Finance Director James Demming. Attorney John McCracken arrived after the meeting had begun.

## II DISCUSSION OF PLAN STRUCTURE, MANAGER STRUCTURE, AND MANAGER PERFORMANCE.

Mr. Harvey explained that the issues on the table were the issues of asset mix, the percent the board wanted to set as guidelines, and other issues regarding whether a target could be set without having to necessarily be at that target. He then explained that another issue related to this was asset allocation and how that asset allocation should be implemented in terms of the investment managers, such as the number and type of managers and their styles. Mr. Harvey explained that another issue was whether the board wanted equity managers only, and to have them separated from the bond managers, vis a vis having the managers do both. He then stated that it might be helpful to have Carl Deane from Callan Associates give the board a quick overview of these areas.

Mr. Deane asked if the board wanted to focus on this one issue at a time or discuss it all together. Mr. Wearn explained that all of these questions were somewhat intertwined as the predicate on which they would go forward to invest, and consequently, if they were to have an overview, he would like to have an overview on all the subjects first, and then a detailed discussion on all of the subjects before considering any action on any of the subjects. Mr. Harvey stated that this was very reasonable, and asked if the board was in agreement with this. The board members indicated their agreement.

Mr. Deane stated that this special meeting addressed issues that were probably the most important things the board would do for the pension plan in total. He then reported on the background of these issues and explained that the actuary and the consultant were people who were hired by the board and worked for the board, and had the interests of the plan at heart. He stated that the actuary determined what the needs of the plan were, and Callan's job was to give the board the information that they needed so they could hit the targets that the actuary said they had to have, and so the board could do it in a prudent manner. Mr. Deane explained that the actual investing of the assets was left up to the investment managers' discretion. He explained that there was a letter in the books that were distributed to the board members, and that the last paragraph of the first page of this cover letter was the heart of the asset mix discussion. He reminded the board members that the actuary had determined that the retirement fund was to earn 8%, and if this was earned over a long period of time, the goals would be met and the benefits would be paid. Mr. Deane explained that the 8% was determined based on assumptions made by the actuary, and that these assumptions were necessary in order to project benefits. He stated that some of these assumptions were subject to change, for example, the inflation assumption. Mr. Deane explained that the actuary used a 5% inflation assumption, and over a period of time, this had proven to be a very good assumption, however, back in the late 70's and early 80's, inflation was well up in double digits and after so much of that, a lot of plans increased their inflation assumption, and the actuaries approved it because inflation had come up. Mr. Deane stated that now inflation was down, and that the inflation assumption could be lowered. He stated that the actuary calculates the liabilities, which were a big pool in the future, and discounts it back by 8% per year, until the present value of those future benefits is reached. Mr. Deane explained that the percentage that the actuaries were discounting the benefits back to was very important to the contributions of the fund. He stated that if the assumption was lowered to an inflation of 2% and a real rate of return of 3% for a total of 5%, the liabilities would be discounted in the future back at 5%, and the liability is actually larger. He stated that what the actuaries did with those numbers was very important because it affects the contribution to the plan by both the employees and the Town. Mr. Deane explained that by taking what the actuary had established determined what the plan monitor had to do. He explained that the liabilities had to be matched up to the assets, and if the actuary said that an 8% rate of return was necessary in order to meet the goals, the monitor had to determine how to reach that, which was best described by the asset mix of the plan. Mr. Deane explained that some assumptions had to be made regarding each asset class and what they would earn long term. He stated that five years was generally used, and explained that as an example, Callan used an expected rate of return from the S&P500 of 9.1%, with a standard deviation, the measure of risk, of plus or minus 13.3%, which meant they would expect that most of the time the quarterly returns could vary around that plus or minus 13.3%. He explained that Callan had lowered their expected return for equities over the last two years, and kept the risk at about the same. Mr. Deane stated that in reality, over the last three years, they'd had over 30% per year returns at the S& P500, so the Town had well above what Callan's expectations were. He stated that Callan's expectations were built on history and where they were currently, and how the assets related to each other, as in, were the bonds and stocks relatively fairly valued to each other or not, and Callan made small adjustments. He stated that Callan would expect that those equity rates of return would come back to the norm, meaning the 9.1%, at some point. He explained that during that last month or two, there had been some regression. Mr. Deane explained that Callan developed those same kinds of assumptions for bonds and stocks and put them together to form a total fund. Mr. Deane explained that Exhibit 1 in the book showed the asset mix number, one at 20% in equities and 80% in bonds, asset mix number two at 40/60, which is where the plan was now, and asset mix number three at 60/40, and the highest risk mix at 80/20, 80% stocks and 20% bonds. Mr. Deane explained that the median, or expected return, of those asset mixes was also shown over a five year period of time. He explained that a median return expectation at 40% equity and 60% bond was 7.6% with a risk level of 7.25%, which demonstrated a 50% probability of exceeding a 7.6% rate of return, and a 50% probability of falling below the 7.6% rate of return over a five year period. He explained that as the return expectation rose, so did the risk expectation. Mr. Deane pointed out the range of possibilities by utilizing Exhibit 2. He explained that the worst markets and the best markets possible were figured in for a best-case, worse-case, and average-case scenario. Mr. Deane stated that Callan had been looking at the average, and that with the present asset mix, there was a 75% probability of exceeding or reaching a 5.4% rate of return. He stated that there was the same probability for the same return with asset mix number three, and it was not until the 90% percentile, with the worse markets possible, that there was a lower rate of return. Mr. Deane stated that what the board members had to decide as trustees was the level of risk they were comfortable with. He stated that if the markets came back to where they were supposed to be and where they traditionally had been, then it would be difficult to make that 8% rate of return, because bonds would not provide it, nor would stocks.

Mr. Deane then reported on the element of risk, and referred to Exhibit 3. He stated that this was where the board members would begin to notice the impact of more equities on their plan when it was looked at over a one year period of time. He explained that this referred to the expected range of return in any one given year, and showed a different scenario, but at the 75$^{th}$ percentile, there was not a lot of difference in the rate of return, but below that, at the 95$^{th}$ percentile, there was the possibility of a negative 5% rate of return with that asset mix, but there was an almost negative 4% rate of return with the Town's current asset mix. Mr. Deane stated that the reason he pointed this out was because Callan thought that the more equities there were, the more risk would be taken, but when these were put together with an asset class that was not correlated highly with it, for example, bonds, the mix began to diversify and the risk was lessened in that manner, so it was diversification that was softening the blow, because bonds don't work the same way that stocks do. Mr. Deane explained that a mix of 60/40 appeared to be a more efficient mix and would give a higher probability over rolling five year periods of time of achieving the actuarial assumption. He stated that any time the Town's actuarial assumptions changed, this had to be revisited.

Mr. Harvey asked if the board members would like to consider this issue before addressing the others. Several board members indicated that they would like to deal with this issue first. Mr. Wearn stated that he would prefer to go through the entirety of the presentation and what things the board would need to consider so that he was sure that no one decision was made in a vacuum. Capt. DeIorio asked if there was a possibility of this happening. Mr. Deane explained that the next issue that would be covered was the equity manager structure, which was independent of the asset mix. He explained that the asset mix was, in and of itself, a separate issue.

Mr. Doney stated that in reading the report from Mr. Deane and the report from Mr. Vroom, he had become very concerned regarding the factual truth of the numbers they had reported on. He also asked if the board thought it might be prudent to include the actuary in these discussions. Mr. Harvey explained that the actuary would provide a number that would be the plan's target, but what was being considered today was how to get to that target. He stated that the other issue regarded the managers. Mr. Harvey stated that knowing where the board wished to go as far as asset allocations were concerned might also help fulfill how they wished to structure the managers. Mrs. Smith asked if the board would be sitting here having this discussion if the managers had met their marks, and suggested that the presentation be continued. Mr. Harvey explained that there were two issues, one regarding the asset allocation mix, which was set by the board. He stated that the board could make a choice at this point, explaining that they could stop the presentation at this point and discuss asset allocation and decide how to proceed with the specifics of the managers, or they could hear the whole report at this point, then come back and deal with the individual issues. Mrs. Smith asked Mr. Deane if he had anticipated going through his entire presentation, or if he had anticipated stopping at each point. Mr. Deane stated that the procedure was strictly at the pleasure of the board, but that the discussion of the asset mix was a separate issue that overrode almost everything else he would be discussing. He stated that there was nothing in the rest of the report that really would affect the board's decision one way or another on asset mix. He stated that the asset mix information had been given to the board and he would suggest that the trustees discuss this while the information was fresh.

Mr. Harvey stated that the first proposal was to go through the whole report and then go back to each issue to make a decision, and the other was to stop here to consider asset allocation before going on. Capt. DeIorio moved to stop the presentation at this point to discuss asset allocation before moving on to other segments of the report.. Mr. Frick seconded the motion. Mr. Harvey, Mayor Ilyinsky, Ms. Lane, and Mr. Bogs voted aye. Mrs. Smith, Mr. Doney, and Mr. Wearn voted nay. The motion carried.

Mr. Harvey stated that Mr. Deane had demonstrated various options to the board. He stated that he would like to clarify one issue, regarding the issue of legislation that dealt with maximum amounts of equities. Mr. Crouse explained that effective October 1, 1998, the State had set limits on the amount of equities with regards to the 175 and 185 monies only, and on and after October 1st, it could not exceed 50%. He explained that if the Town did this before October 1st, it would be grand fathered in. Mr. Harvey asked how much the 175 and 185 monies amounted to. Mr. Crouse explained that it was a very small amount, and at the last meeting, the actuary had touched on that with regards to the overall amount of money of approximately $350,000 per year. Mr. Deane explained that the possible problem was that this money was co-mingled with the rest of the fund. Mr. Harvey explained that the dollar amounts made it a non-issue in terms of making a decision, however, the second question was, how did the board account for this money separately, which was not done at this point. Mr. Crouse explained that if the board chose to not be grand fathered in prior to October 1, and chose to separate those monies, this would take some doing, but those monies would definitely have to be separated. Mr. Harvey asked if a theoretical maximum could be established in order to give the board the most flexibility, but control that by the sub-issue of directing the managers to reach certain mixes. He stated that in theory, there could then be more flexibility in the plan.

Ms. Lane asked what the cap was on these monies. Mr. Frick explained that after October 1st, there would be a 50% cap. She then asked what the cap was after October 1. Mr. Crouse explained that the cap had been significantly lower than that, with plans that typically exceeded the State limit. He explained that the State had then given cities the option to make their plans official, and may then go after plans that were exceeding the limit.

Mr. Harvey explained that the first issue the board needed to address was the asset mix, and asked if the board wanted to change this structure. Mr. Wearn explained that he thought it would be appropriate for the board members to be sure they were comfortable with their actuarial assumption of the plan at 8% annually, which included the 5% inflation factor. He stated that he was not sure that the board had received this advice or recommendation from the actuary at the last meeting, but as a predicate for anything that the board did concerning the asset mix alternatives, that needed to be finalized. He stated that his second comment was to question the limitation to only four asset mix alternatives, when really, only two were advanced as reasonable, when there might, in fact, be a third, or a number of variable alternatives, such as a 50/50 split. He posed the question, what would the asset mix alternatives look like if there were a 50/50 split, and what would the asset mix alternatives look like for the split to achieve a theoretical median return of 8%, as opposed to 8.1%. Mr. Wearn stated that it appeared to him clearly from Exhibits 2 and 3, that what was being discussed was volatility and risk factors that would apply throughout the range of the asset mix alternatives, because he understood that the markets, as he had heard expressed, would return to their various medians, but if they were to return to the various medians, they would also go to the extremes over a lengthy period of time, so there would be greater volatility. He stated that this brought him back to the question of what the legislature looked at, the reasons it arrived at a 50% maximum after its deliberations, and commented that Mr. Deane was apparently familiar with those. Mr. Deane explained that he was not familiar with what went on in the legislature itself, but just the results that came out. He explained that the State of Florida Retirement System had a maximum exposure of either 70% or 75%. Mr. Wearn stated that there were obviously some reasons why the legislature adopted a 50% equities asset mix, and he was interested in having the benefit of those reasons. He explained that he was concerned that if the board was going to be looking at alternatives, that they look at all alternatives as opposed to just two or three.

Mr. Harvey stated that this was true, but the board needed to agree upon the percentage of the mix, and needed to hone in on what they wanted in order to move forward. He explained that the actuarial assumptions were basically an indication of what the plan needed to achieve. He stated that whether the real world would allow the plan to achieve that was unknown. Mr. Harvey stated that the board was dealing with only two financial assets, and they were stocks and bonds, and that had been the board's domain. He stated that if financial assets were out of favor, both stocks and bonds would do poorly, and the actuarial target would be missed. He stated that the difference would have to be made up through the contributions from the Town, but in this fairly narrow world, the choices were stocks and bonds because real estate and other items had been eliminated. Mr. Harvey stated that assuming the board was dealing with stocks and bonds, the issue of whatever the actuarial assumption were was based on a fairly pure science. Mr. Deane agreed and stated that the return expectations that were shown in the simulations also use a 5% underlying inflation assumption, so the real key for the actuary and the board was what was the real rate of return expected, which was 3% over inflation, to meet the goals. Mr. Harvey then stated that since 8% was based on an inflation assumption, the board may not agree with this assumption, but maybe Mr. Wearn's point was that the 8% was based on an inflation assumption, and the plan may not agree with this assumption, in other words, inflation could be running at 2 to 3 percent, not at 5%, which is the assumption, so maybe Mr. Wearn's point was, was this a realistic number, and was the actuary going to come back three months from now and say that in reality, they had adjusted their inflation assumptions to be 3% going forward, and really the number would be 5 to 6%. Mr. Deane explained that what the actuary would do would be to come to the board and say that back in the 1980's, they had assumed a 5% inflation, because inflation had moved down for the previous 12 years, and the next 12 years had run along at 2%, so they would recommend to the board that they reduce the inflation assumption in the calculations, which the board would then approve, and if in fact they did reduce the inflation assumption, they would see the liability get larger. He stated that the board would be forced to increase their return assumption. Mr. Deane explained that inflation would have to stay down for a long period of time for the actuary to recommend that it be moved down. He stated that any thing that changes one of the major assumptions by the actuary means the board would have to go back and revisit the assets. He stated that right now, it was fairly commonplace for 8%, and that this was pretty standard in the industry. He further stated that the key to the asset mix options was the risk factor.

Mrs. Smith asked Mr. Deane if he had spoken to the money managers when he was preparing these charts regarding the figures he was using. Mr. Deane replied that he had not, explaining that this was not something that the money managers ordinarily got involved in. He explained that they would try to make some predictions about where the market would go, but this information was normally handled by plan monitors. Mrs. Smith asked Mr. Deane what had been his basis for changing the asset mix from 40% to 60%. Mr. Deane explained that it had been based on the fact that if it was not done this way, the plan would have difficulties making the 8%. Mrs. Smith asked if changing the asset mix would increase the risk. Mr. Deane replied that it would to a degree, and that was what the board had to weigh. He explained that they could not get more reward without some additional risk, but the question was, how much risk was the board willing to accept.

Mr. Doney commented on the actuary's role in the process, and stated that he did not see this as an independent process without the actuary being present, because based upon his understanding of the actuarial report and the unfunded accrued liability that the Town had, there were adjustments that could be made there in the actuarial assumptions, and based upon the whole series of assumptions, there was some interplay that would be helpful with Mr. Deane's role as the monitor and the actuary's role in terms of the actuarial assumptions. He further commented on the second issue of beating an October 1 deadline by trying to adjust the asset mix. He stated that the necessity and urgency of this meeting was to try to make a change in the investment policy so that then they would be repositioning the direction of the investment policy of this board. Mr. Harvey explained that the issue regarding the October 1 deadline issue was something that the board did not have to do, but was merely something the board could consider. He stated that the board could say in theory that the plan could have up to

100% equity and at the same time say that the current policy set it at 40/60, so that in theory, the board would have as much flexibility as possible in going forward. He stated that if the board got locked in at 40%, and the board wished to change it in the future, they would be locked into 50%. Mr. Harvey stated that this was the theoretical issue they were discussing, but the real issue was what asset mix the board wanted. Mr. Doney stated that he did not understand this issue as theoretical, but as a legal limitation, and that he would feel more comfortable if the board's attorney could render an opinion regarding this. Mr. Wearn indicated that he also would like an opinion from legal counsel.

The board members continued to discuss this issue, with several options debated. Peter Van Beuren of Loomis, Sayles and Company and Ed Vroom of Roanoke Asset Management also addressed this issue, and indicated that the asset mix should be adjusted to 65/45 or 60/40. Mr. Deane also indicated agreement to this asset mix. However, because the board members wished to have input from the board's attorney, no decisions were made until Mr. McCracken's arrival.

Upon Mr. McCracken's arrival, he stated that the questions the board were raising were not as simple as they might appear, and he asked if the board members would be willing to continue on with other business until he could arrive at some sort of response. He explained that his questions were whether this board had any authority to make this change now, and secondly, whether the Town of Palm Beach, either before or after October 1, 1998, had the ability to make this type of change by ordinance in any event, regardless of the statute. Mr. Harvey stated that if at a future date the board could make the decision, then this would be a moot issue. He explained that if they could not, then the issue would be whether there was something in the Town ordinance that had ever set asset allocations, or did the Town delegate that responsibility to the board. He asked Mr. McCracken if he would look at these issues.

Mr. Harvey re-addressed the earlier discussions the board members had regarding asset allocation, stating that during these discussions, there had been some sense of what this should be. He stated that the issue the board needed to deal with at this point was, what sort of asset allocation did the board want to set at this time. He stated that right now, there was a 40/60 asset allocation. He asked if the board members wanted to change this or not change this, and if they did want to change this, what did they want to change it to.

Mr. Boggs stated that he would like to see the asset allocation change to 60/40, as recommended by the consultant and by the managers. He stated that in the long run, the increased risk in this was minimal, and that the return was greater than the extra risk. He further stated that, as had been stated by Mr. Deane, the board did not have to change to this immediately, but could make a gradual change to the 60/40 over a period of months or years.

Mrs. Smith stated that she was sure that the pension plan's portfolio had shown a dramatic decrease since the first of the year, and there was the worry about losing the principal. She stated that if there had been an additional 50% in stocks, the plan would have lost more. Mr. Deane explained that the purpose of this exercise was to give the board members an idea of what the markets give over longer periods of time, and for them to set the asset mix based upon their expectations of the market, because nobody could time it. He stated that the last thing in the world that he would want the board to do would be to try to guess which way the market was going and adjust the asset mix accordingly. Mr. Deane stated that what he had shown the board members today was the 8% return expectation from that 60/40 mix, with plans hitting more than that when the markets were up, but that what he was worried about was when the markets were down, and when they were normal. He stated that there would not be extraordinarily up markets all the time, and when that happens, the board would not have a good probability of achieving 8%. He explained that with a higher equity exposure, they would. Mr. Deane stated that they may suffer a little bit more each individual year that the market was down, but they would recapture that because the market was up more than twice as often as the market was down, historically, and for longer periods of time. He further stated that it goes up higher than the markets drop. He explained that everything, statistically, was working in the Town's favor on this, and his only point was that he wanted to reinforce that the board had to set the targets for the total fund, and that meant coming up with a figure that said they had a good chance of making their actuarial assumption. Mr. Deane stated that if, as fiduciaries, they set an asset mix that did not give them the opportunity to do that, then they were failing in their fiduciary duties.

Mr. Wearn stated that he would like to reconsider Exhibit 1. He stated that as he extrapolated, the purpose of the examples was to look at the comparison of the median return versus the risk. He stated that he was really comfortable with the median return percentage exceeding the risk percentage, but in the 2.5 mix and in the 3 mix, the risk exceeded the median return.

Mr. Deane explained that for clarification purposes, the risk number was not a rate of return number, but simply a spread of the returns on a quarterly basis, up or down, so it could be interpreted as a plus or minus 7.25%. He stated that if he had a 10% return this quarter, he would expect anywhere from a 17.25% to 3% return the next quarter, most often in that range. He stated that the fact that an individual was more comfortable with a rate of return that was higher than the risk was fine, but they did not bear a linear relationship. Mr. Boggs stated that there was a linear relationship between the difference between the 7.60% median return and the 8.1%, so for each one tenth of a percent, there was about a 4% difference in equities, so if the mix was 56/44, there would be an 8% median return, which was right on target. Mr. Deane replied that this was correct. Mr. Boggs suggested that 56/44 was a mix that the board might want to think about, but that he preferred 60/40.

Mr. Boggs moved to change the investment policy to set the asset allocation to a 60% equities and 40% bonds, with a time schedule to move from the current allocation to the proposed over a period of 12 months. There was no second.

Capt. DeIorio asked if the12 month period of time suggested by Mr. Boggs was an acceptable period of time. Mr. Boggs indicated that there was no specific reason for suggesting this period of time.

Mr. McCracken raised a point of order regarding the motion, stating that the motion was out of order. He explained that before the 1998 amendments to Chapters 175 and 185, the statute limited the amount which could be invested in common stocks to 30%. Mr. McCracken explained that there was a provision in the statute which allowed that amount to be exceeded if the Town ordinance provided for that. He explained that the Town's ordinance did so provide, in section 43 of chapter 15, that this board may exceed the Chapters175 and 185 limitations on investments in common stock, but may not allow purchases "which cause the value of the stock held by the fund to exceed 50% of the market value of the assets of the fund". Mr. McCracken explained that the exception to the state statute was found in the town's ordinance, which allowed this board to go up to 50%, but the ordinance did not allow this board to go over 50%. He stated that the new statute provided that Chapters 175 and 185 may go up to 50%, and also had the same kind of savings clause in it, which it previously had, to allow for boards to exceed that amount invested in common stocks if the ordinance provided for it. Mr. McCracken explained that the only way that this board could allocate more than 50% to stocks was if the Town of Palm Beach Council amended the ordinance to change the limitation from 50% to some higher amount. He also stated that the statute specifically contemplated that that was the type of issue which a board such as this board would recommend to a council such as a Town Council, so it would be appropriate, if this board thought the limitation should go to 60%, to make such a recommendation to Town Council, and then let the Town Council consider that.

Mr. Harvey stated that Mr. McCracken had covered the fact that, at some point in the future, after October 1, if this board wanted to go to 60/40, and if the Town Council passed that Ordinance, the board would have that option. He explained that worrying about that deadline was no longer an issue because the board had that flexibility at this time, and that was all they had been trying to protect. Mr. Harvey then stated that this flexibility was a maximum of 50%, which had been capped in the past at 40%. He stated that the board could now discuss whether or not they wanted 50/50, which was the max they could do right now, or they could have a second discussion regarding whether they wanted to go higher than that, and if so, then that would mean the board would have to send the proposal to a higher level and let them discuss that.

Mr. Doney asked if this board was to recommend something to the Town Council, then would the Town Council have to have two readings prior to October 1. Mr. McCracken stated that the October 1 deadline was not relevant to this issue. Mr. Harvey explained that the board was not faced with an artificial October 1 deadline, but that at some point in the future, they could recommend to the Town Council to go to 60/40, and if the Council passed an ordinance to that effect, then that would become the ground rules under which the managers would operate. Mr. McCracken explained that those would be the ground rules under which this board would operate. He explained that this board would not have to go to that, but could go to a lesser allocation. Mr. Harvey agreed, and stated that the board could then decide whether or not they wanted to pass those ground rules on to the managers. Mrs. Smith asked if, at this time, this board could decide to go to a 50/50 asset allocation. Mr. McCracken replied yes.

Mr. Harvey stated that there were two or three outcomes, depending on how the board members felt, and explained that one was to do nothing and move on; if there was a feeling that the asset mix should be increased, then to determine what that level should be, and if it was 60/40, it could be passed on to the Town Council; or to change the allocation to 50/50.

Mr. Frick moved to increase the asset allocation to 50/50. Capt. DeIorio seconded the motion. Mr. Harvey explained that this motion and second was to increase the asset allocation to 50/50 in terms of this board, and then the board would have to make a decision as to whether they would pass that on to the managers. There being no further discussion, all voted aye, and the motion carried.

Mr. Harvey reminded the board that if they ever wanted to re-address changing the asset allocation to 60/40, this would have to be put in place through the Town Council. He explained that this was not something that could be changed quickly. Capt. DeIorio asked how this would take place. Mr. Harvey explained that if the board asked the Town Council for authority to go to 60/40, as a maximum for equities, and the Council approved it, the board could stay at 50%, they could go to 55%, or they could go to 60%. He stated that the framework would be put in place at the retirement board level, who would then pass that authority on to the managers. He explained that the 60% maximum would be a theoretical maximum until such time as the board implemented it.

Mr. McCracken addressed another matter regarding structure, and stated that the statute would also give the board the ability, if the Town ordinance was changed, to invest up to 10% in foreign securities. Mr. Harvey asked who defined foreign security, and was it a stock listed on the New York exchange that had ADRs. He stated that he felt this should be addressed at another time. Mrs. Smith stated that the State might offer a definition of foreign securities. Mr. Harvey asked if Mr. McCracken could investigate this and provide the board with a definition of foreign securities. Mr. McCracken replied that he would do this.

Mr. Harvey then stated that the next issue the board needed to consider was how they wanted to divide the 50/50 asset allocation amongst the managers. He explained that currently, there was an index fund, Roanoke, Loomis Sayles, and a laddered bond portfolio at First Union. He further explained that currently, the board had equity managers who were doing bond management, so did the board want to consider having equity managers do equities and have a bond manager doing just bonds, or did they want to explore different combinations, such as having more equity managers. Mr. Harvey asked Mr. Deane to address this area.

Mr. Deane explained that the next section of the information provided to the board members dealt with the equity side of the portfolio. He demonstrated a style map to show the board how they were currently structured in the portfolio, and explained that this did not address how much was in equities, but how those equities were positioned. He explained that the S&P 500 plotted in very large companies, and that the market had favored these companies, and had a slight tilt to the growth side. Mr. Deane stated that what Callan recommended to their clients in terms of positioning their portfolio, if they did not have a specific need in a different area, or a bias toward value or toward growth, was a "market neutral" position, which was basically 80% of the portfolio in mid to large, and 20% of the portfolio in smaller cap. Mr. Deane then compared Loomis Sayles' performance with the figures on the style map, and explained that they had a value tilt to that portfolio, which was what they had been hired to do. Mr. Deane explained that the S&P compared to ANB, which was the index fund, so the Town had a certain amount of money in the index fund. Mr. Deane then demonstrated Roanoke's small cap on the growth side. He explained that what this represented was the positioning of the total portfolio when all managers were put together, the index, Loomis, and Roanoke. Mr. Deane stated that this put the fund in a very definite strong growth bias, not necessarily small cap bias, because the S&P index fund served to act as an offset to the small cap in Roanoke. He explained that this was a long way from the market neutral position. He stated that this was not a statement of good or bad, but in fact, if they looked at what had been in favor for years, the growth tilt had been advantageous to the Town. Mr. Deane explained that it was known that growth would come out of favor sooner or later, value would come in to favor, and there was one manager on the value side, which may not be enough to pull it over to take advantage of it. Mr. Deane explained that the positioning of the managers was a key issue for the board, and there were a lot of alternatives. He stated that the board could add another small cap manager to the value side or they could shift money over to Loomis to try to pull it over to value. Mr. Deane explained that if the board did not have any biases to a market neutral position, there were a number of alternatives available to take advantage of different situations.

Ms. Lane asked where the laddered bond portfolio came into play in this arena. Mr. Deane explained that he was discussing only equity at this point, and they would be discussing the bonds separately.

Mr. Deane explained that the board had a mid cap growth orientation, and explained that with the existing managers, assets could be shifted between the managers to bring the current position back closer to the representation on the value side. He stated that Roanoke had very strong growth characteristics and much smaller capitalization. Mr. Deane stated that Callan's recommendation was that, barring any other action, the board might want to consider shifting some of the monies among the managers to see what would bring the total equity portfolio closer to that market neutral position.

Mr. Deane explained that the overriding factor about the bonds was that the retirement fund had, in essence, three different bond portfolios: the bond portfolio run by Roanoke, which was a core bond portfolio, playing in the marketplace with the Lehman Brothers market index; Loomis' bond portfolio; and a laddered bond portfolio. Mr. Deane stated that evidence would suggest that specialists do better than generalists, which was not true in every case, but somebody focusing strictly on the bonds and somebody focusing strictly on the equities and not having to worry about the asset allocation, seemed to have been a better way to go over the past fifteen years or so. He explained that on the chart, each bar chart represented the range of returns of all of the core bond managers in their universe. He explained that a core bond manager was classified as one that was basically duration, or maturity, neutral. He explained that if the Lehman Brothers Aggregate Index had a duration of 4.9, most of the core managers would be plus or minimum 10 or 20 percent of that, and they did not make huge bets in the duration of the portfolio, which was a very risky thing to do. He stated that this was a very conservative approach to bond management in this universe. Mr. Deane demonstrated Roanok's performance during the time period of the last quarter, last year, last three years, and the last 16 and one half years. He explained that for the last 16 and one quarter years, Roanoke had returned money out of the bond portfolio at the rate of 12.5% per year, which ranked in the 11$^{th}$ percentile, so only eleven percent of the core bond managers had done as well or better than Roanoke had over the last 16 and a quarter years, which was good bond performance and good added value. Mr. Deane stated that what the board members wanted to look at in the added value scenario was for the manager to add value beyond an index fund. He explained that the board had gotten over 100 basis points per year premium, before adjusting for fees, which probably worked out to 60 basis points or so. Mr. Mr. Deane stated that this worked out to 60 basis points premium that had been added per year for that 16 and a quarter years, which was pretty strong. Mr. Deane explained that they had achieved this by having great years some years, poor years other years, and occasionally having good years. He stated that this meant there had been volatility. Mr. Deane then showed an illustration of the risk/reward scenario that Roanoke had incurred over the last 16 and a quarter years. He explained that Roanoke had been relatively consistent, and that they had returned substantially higher rates of return than the median. He stated that their risk posture was a little bit higher relative to the core bond managers.

Mr. Deane then demonstrated Loomis' performance. He stated that in developing this information, he had not had the luxury of them being employed for 16 years, but only for two and one half. He explained that in bond management, Loomis had had good numbers, and strong numbers for the last year. He explained that using the composite used by Loomis for bonds, there was a period where they did not do as well, which could relate to just getting the portfolio positioned, but they started out poorly. He explained that they had gotten better and better. Mr. Deane stated that over a period of ten years, the composite was in the top third of Callan's database, and if the premium was compared to Lehman Brother's Aggregate, it was about 40 basis points, which was adjusted for fees, so it was about a ten or twenty basis point premium over the index over that period of time. He explained that it would be a premium on a net basis as well as a gross basis, assuming the fees for an index fund in bonds would be ten or twelve basis points. Mr. Deane stated that using the composite numbers to determine the level of risk taken by Roanoke indicated that Roanoke was more in line with the other core managers, with a return substantially below what Roanoke's had been, but above the Lehman Brothers Aggregate. He stated that this looked more like a general core portfolio than Roanoke's, which was a little bit out on the volatility scale among these managers.

Mr. Deane then reported on the last issue in the fixed income portfolio, which was the T-bond account. He explained that he was not sure of the origin of this account, but that Mr. Vroom had mentioned a laddered portfolio in his letter. He explained that this portfolio had a function of having ready cash available, income coming in that could be used to help pay benefits, but the performance had had bottom quartile performance for the last five years. He explained that this was not an actively managed portfolio, and it was not trying to beat anything. He stated that it was simply buying different year maturities, and each time one matured, another one was bought back in. Mr. Deane stated that it had been a drag on their total performance of the bond portfolio, and therefore, on the total fund. He explained that if the board had a requirement of 50%, which means that there was less than a 50% probability of the total fund of averaging 8% per year, and there was a portfolio causing drag on the return, the board might want to consider something better to do with those assets. Mr. Deane stated that Callan's suggestion on the fixed income portfolio be that the board consider combining all of the fixed income assets and placing it either with one of the existing managers, hiring a bond specialist, or possibly, putting it with an index fund. He stated that Callan's suggestion was, that given the level of risk in Roanoke's portfolio, the board might want to consider combining those assets, creating a separate bond portfolio, and letting one of the existing managers do that, as opposed to having three separate bond managers in there. Mr. Deane stated that they may get the benefit of a fee reduction by doing something like that.

Mr. Deane then addressed the equity recommendation. He explained that this section dealt with the questions that had been raised regarding Roanoke's performance. He stated that he had read the letter written by Mr. Vroom, and understood that 1996 and 1997 were devastating to their plan. Mr. Deane stated that he had done some analysis beyond that. He stated that he had not wanted to pay much attention to the total fund on this, because this had been an evolving situation. Mr. Deane explained that of the total fund run by Roanoke over the last sixteen and one quarter years, the only thing that really had much bearing were the last quarter, last year, and last three years. He explained that the target that Roanoke was running against was a blend of the S&P 500 and the Lehman Brothers Aggregate, and that they had substantially underperformed this target. Mr. Deane stated that prior to that three year time period really did not have much bearing against the target because the target was different. He stated that this was not surprising because the S&P 500, which was big cap, had been in favor, and Roanoke had been holding mid to small cap and hadn't had a chance, even in growth. Mr. Deane explained that when the equity portfolio was compared against other mid cap portfolios, with mid cap portfolios being the style group that Roanoke was being placed against, a midcap portfolio on Callan's database had an average of about $4 billion in capitalization as a median, with Roanoke having close to $2.5 billion, so among the mid cap managers, they were slightly smaller in size. He explained that over the last three to four years, this no doubt had been a big factor because size had been a real determinant of performance. Mr. Deane explained that the last two years had been devastating on the portfolio, but what the board could see looking out over the last 16 and a quarter years was that they had returned money at about the rate of 17.5% per year, which was not bad, but it was behind the small cap index, and also slightly behind the Russell 2000. Mr. Deane explained that, ranking among other midcap managers for 16 and a quarter years, they ranked in the 77th percentile, which meant that 77% of the midcap managers outperformed them over a cumulative 16 and a quarter year basis. Mr. Deane explained that a year by year look showed that 1997 and 1996 were devastating years, with 1995, 1994, and 1993 being good years, 1992 at bottom quartile, 1991 third quartile, 1990 bottom quartile, 1989 second quartile, 1988 third quartile, 1987 fourth quartile, 1986 third quartile, 1985 fourth quartile, 1984 first quartile, 1983, second quartile, and 1982 first quartile. He stated that what he was trying to point out was the extreme volatility in the returns of this portfolio relative to other portfolios in the midcap area. Mr. Deane stated that if 1996 and 1997 were removed from the equation, the numbers might look a little bit better, but the reality was that they had happened. Mr. Deane then stated that looking at the performance on a rolling three year basis, the performance looked poor for some three year periods and better for others. Mr. Deane stated that if the individual years were looked at, there were five bottom quartile years, five top quartile years, three second quartile years, and three third quartile years, but the cumulative effect of that was at the 77th percentile over the last sixteen and a quarter years. Mr. Deane stated that the board had to make the judgement as to whether they were happy or unhappy with that kind of performance. Mr. Deane then discussed Roanoke's performance for the last five years. He explained that the standard deviation was the variability of quarterly returns, with the higher the standard deviation, the higher the risk, and the lower the standard deviation, the lower the risk. Mr. Deane stated that Roanoke's standard deviation was 19.8 for the five year period demonstrated, the median middle cap fund was 12.2, and the S&P index was 11.7. He explained that there were two kinds of risk, upside and downside, but downside risk indicated that Roanoke's risk factor was 11.0 compared to 1.98 or 2.0 for the median midcap fund. Mr. Deane explained that the residual risk was what was left after factoring out the market, in essence, the risk that was inherent in the strategy of that particular portfolio manager, so the residual risk for Roanoke was very high. Mr. Deane stated that the same relationship occurred over time.

Mr. Deane stated that his job was to present the information to the trustees, who had to make the decision whether they were pleased with the performance of their managers. He explained that he did not believe that his numbers differed from the numbers presented by Mr. Vroom.

Mr. Deane then reported on the action steps outlined in his report. He stated that the most important one was one which had already been addressed, that being the asset allocation, and the second one was to pool the fixed income assets and try to get some economies of scale and placing it with one of the existing managers or hiring a new one, which could be more expensive and time consuming than putting it with an existing manager. Mr. Harvey asked why it would be more expensive to place the fixed income assets with a new manager. Mr. Deane explained that it would be more expensive to liquidate a portfolio and have someone else buy another portfolio, in addition to the cost of doing a manager search. He explained that both managers had done a decent job with the bonds, and if the bonds were combined, with the laddered portfolio eliminated, there would probably be a fee break. Mr. Deane explained that both managers were doing well with the bond portfolio. Mr. Deane explained that the last item was to restructure the equity assets, no matter what was done with the managers, and that Callan recommended that the fund be market neutral.

Mr. Harvey stated that Mr. Deane's second recommendation was in reference to managers who were picked for their expertise in bonds, as opposed to blended portfolios. He stated that the other point was that less was normally paid for bond management than for equity management. Mr. Harvey explained that what the board was now dealing with was two pools of $50 million, and asked if the board wanted to have managers solely dedicated to bond management, or did they want it split among the managers.

Mr. Boggs stated that he would like to see Roanoke take 25% of the total portfolio and management it as bonds, explaining that this would still give them about the same amount of money and would give them a chance to shine, considering their past performance with bonds. He stated that another option was to leave Loomis with 50/50 bonds and equities, so they would have 12.5% in equities and the other 12.5% in bonds. He explained that this would give 25% with Roanoke, 12.5% with Loomis, and 12.5% in a mid cap bond fund to help balance the portfolio.

Mr. Wearn stated that he would like to draw the board's attention to Section III, Tab 1, first page, which described Roanoke Asset Management's total investment professionals, stating that under Portfolio Management for Equity, two professionals were indicated, and under fixed-income, none; and for Research Analysts, Equity one, and fixed-income, none. Mr. Wearn stated that he was concerned with this. Mr. Boggs stated that he had not noticed this, but that they had done a great job with this for sixteen years. Mr. Wearn asked if the board could hear from Mr. Vroom regarding this.

Mr. Vroom explained that there were three professionals in the firm, and that they managed numbers of balanced funds in the firm. He explained that they considered themselves to be equity specialists, but they managed the entirety of numerous portfolios with bonds and stocks.

Mr. Harvey stated that the report indicated that there were three professionals indicated in the report, but in reality, the three were professionals in both arenas. Mr. Vroom replied that this was correct.

Capt. DeIorio asked what an acceptable period of time would be to view bond performance, since Loomis had been with the Town for two and a half years. Mr. Deane explained that a market cycle would be looked at, and this could be anywhere from three to five years, however, the last two and a half years had primarily been falling interest rates and a rising market, so there was no real information available yet.

Mr. Harvey asked what the board members' wishes were regarding management of the bond portfolio. Capt. DeIorio stated that one recommendation had been to combine all fixed assets and either put them in with one of the existing managers or a new core fixed income manager, or an index fund, but they all pointed to eliminating the laddered portfolio. Capt. DeIorio stated that his question was, if Roanoke had such good performance in the bond end, and Loomis had not had enough time yet, would the board be shooting themselves in the foot by pulling from either one of them. Mr. Boggs explained that his suggestion had been to leave Loomis as they presently were, with 25% of the portfolio, with a 40/60 split, but change it to a 50/50 split, which was 12.5% bonds and 12.5% stocks, with the other 12.5% of the laddered portfolio put into a midcap index fund. Mr. Harvey stated that one thing that was in the background was if there was a manager who was managing both equities and bonds, the portfolio should be split so that there was a dedicated manager. Mr. Harvey stated that in Roanoke's case, when those numbers were shown against the midcap, the bond side had been stripped out. He explained that what was really being talked about here was dedicated portfolios, where it would be possible to have a manager doing equity and fixed income, but they would have a fixed income portfolio, and a fixed income bond manager managing that, and an equity portfolio with an equity manager running that. He stated that the bond world and the equity world could then be visualized in separate portfolios. Mr. Deane agreed, and stated that the only other reason for suggesting that the board try one manager was for the economies of scales on the fee, but they may be able to do just that and deal independently with each manager on a fee basis for fixed income and for equity. Mr. Harvey stated that maybe once the board had dealt with the managers and the portfolios, they could maybe reprice the portfolios, including the custody service, because First Union was getting a larger custodial fee, based upon the fact that they were managing a portion of this. He explained that what the board was dealing with at this point was how to break up $50 million in bonds, and that breakup would be in dedicated portfolios. Mr. Harvey explained that when the board discussed equities, and broke up the equities, they would not have to worry about whether they hit their 40% ratio or not, but that would be equity money, and they would have an option to be in equities or to be in cash, but were being employed for their expertise in the equity world.

Mr. Vroom stated that over the course of several meetings, he had explained what he thought the reasons were for Roanoke's under performance over the last two years, and how adjustments had been made to their strategy. He explained that the letter he had sent to the board members showed that their performance for the years ending 1993, 1994, and 1995 was outstanding. He explained that from the beginning of this fund, on a non-discretionary basis, the equities of this portfolio had been compounded at 16.7%, which he felt was an outstanding equity return when everything was taken into consideration. Mr. Vroom stated that as far as bonds were concerned, he felt that Roanoke understood the market, and even looking at the volatility of the market, they had maintained a triple A quality in this portfolio, which was not measured in volatility. He stated that this was a qualitative measurement of this portfolio, which made the members of the board very comfortable over the years. Mr. Vroom stated that he did not know how to respond to the report on the equity side of the portfolio.

Mr. Wearn asked Mr. Vroom would like to comment on the action steps that were outlined. Mr. Vroom stated that he thought that the recommendation in terms of the equity balance was a good one, and whatever impact this might have on Roanoke, it was prudent to have a balance that was more towards more traditional, lower volatile managers. He further stated that he thought the consolidation of the fixed income portfolio made sense, and that he did not think it made sense to have three separate bond portfolios. Mr. Vroom explained that he felt the laddered portfolio had no purpose at this point, and that there should be some intelligence applied to that portfolio to try to earn a rate of return. Mr. Vroom explained that the bond world of today had a thirty year treasury bond earning 5.4% or less, so to achieve better returns than that would not be as easy as it had been in the past. Mrs. Smith asked if Mr. Vroom thought all of the bonds should be in one place. Mr. Vroom stated that a dedicated bond portfolio would add a clarity to everything.

Mr. Van Beueren stated that he agreed that the time frame had been very short for Loomis Sayles to provide a long term record, with three to five years being a good time frame for most firms. He explained that Loomis was a firm that had quite a few assets in the fixed income area, with significant research staff and research analysts dedicated to fixed income, so they came with a lot of expertise in this area. Mr. Van Beuren explained that they had no problem managing very large fixed income accounts. He stated that while the value equity style had been out of favor for the last few years, he thought they were getting close to their benchmark there. Mr. Van Beueren stated that in a dedicated type portfolio, it was certainly a much more clear way of allocating and managing funds.

Mr. Boggs reiterated his suggestion that Roanoke receive 25% of the total portfolio, which would be half of the bonds; with the other half of the bonds splits between a bond index fund and Loomis. Mr. Harvey stated that if they were discussing the bond portion of the portfolio, this would translate to 50% for Roanoke, 25% to a bond index fund, and 25% to Loomis. Mrs. Smith asked what percentage Roanoke presently had. Mr. Harvey stated that it was about $25 million total, with $16 million in bonds. Mr. Frick suggested putting the laddered fund directly into a bond index fund, and letting the managers work with this change for a given period of time, and if the board was not happy with this at a later point, they could make additional changes then.

Mr. Doney asked if implementing the changes that were being discussed would be very difficult. Mr. Deane explained that looking for an index fund would not require as much time or money as looking for an active manager, but from the due diligent standpoint, the board should look at a number of index funds to decide who they would want to place their money with. He explained that this could be very time consuming and costly. Mr. Deane stated that he would ask the board if they were really achieving any economies of scale by continuing to utilize three bond managers, even if it is an index fund. He stated that given the fact that there already were two managers, he was not sure that the board needed to add a third party to that, given the size of their fund. Mr. Boggs asked if Mr. Deane would recommend changing the laddered portfolio to bonds, and splitting it equally between the managers. Mr. Deane stated that the only alternative would be to put it with just one, but if the board could get the fees between the two managers in an appropriate range, then he would recommend it, since they were getting a premium from them both so far. Mr. Boggs asked if they could expect the fee structures to be reduced. Mr. Deane stated that this was something they would have to talk to the managers about, but there would be more money going in.

Mr. Harvey suggested that the board members may want to consider how many managers they wanted on their bond portfolio. Mrs. Smith asked if the fee negotiation was performed by Mr. Deane. Mr. Deane explained that he could be a part of that. Mrs. Smith asked who would conduct the fee negotiation. Mr. Deane explained that the board or a subcommittee would do this, either with or without him. Mr. Harvey explained that first they would have to come to a conclusion regarding how much they would be managing before they could quote a fee. Mrs. Smith stated that if it was split in half, then no one would have to negotiate it for them, because they would take the fee they were being charged now and say that because the managers were being given more money, a reduction would be requested. Mr. Harvey explained that the fee now was forty basis points on a composite, which was made up of equity and fixed, and normally equity was higher than fixed. He stated that in breaking these down to individual portfolios, the board could ask the managers to quote a fee on the fixed portion, and then the board could come to a conclusion on what they were willing to offer each one.

Mr. Doney asked if the board took a certain action today, would it be reasonable to anticipate that the November board meeting would be when implementation of the action steps would be triggered. Mr. Harvey stated that what he would like to do at this point is figure out where the board wanted to be in both sectors, and then figure out the time table. He stated that the fixed income portion was easier, given the fact that there was a treasury portfolio that was fairly liquid and could be distributed, which was easier than dealing with the equity side.

Mr. Boggs stated that it sounded as if they were fairly well agreed that they wanted only two managers for fixed income, and moved that the number of fixed income managers be limited to two. Capt. DeIorio seconded the motion, and all voting aye, the motion carried.

Mr. Frick suggested splitting the laddered portfolio between the two current managers, and set up the separate accounts for bonds and equities for a certain time period. Mr. Boggs stated that if the board did this, there would probably be more than 50% in fixed income. Mr. Harvey explained that the board would deal with the amounts, because they knew what the policy was in terms of 50%, so they would assign the right amount of monies, but what they were trying to determine at this point was how many managers were wanted for bonds. Mr. Frick suggested splitting the money fairly equally between the two. Mr. Harvey asked if this was contingent upon agreement to a fee structure. Mr. Frick indicated agreement, and suggested splitting the laddered t-bond account into bonds for the current active managers to handle, and that there be no more composite accounts. Mr. Wearn suggested that the board be careful to not implement this concept until they had negotiated fees, and that it be understood that this was a concept only, and that it would not be approved in fact until the November meeting or some subsequent date. Mrs. Smith agreed, and stated that the managers would submit a fee structure to the board for consideration at the November meeting. Mr. McCracken reminded the board members that they had an existing contract with the bank, which would have to be reviewed. Mr. Harvey agreed, and suggested that First Union could be asked to resubmit a fee based on being a custodian of four or five different accounts.

Mr. Harvey explained that they wanted two bond portfolios to represent each 25% of the total, so implementation-wise, each bond member would have a dedicated portfolio of $25 million on a bond basis, which would resolve the bond world. Then, to resolve the equity world, the rest of the treasuries would be divided.

Mr. Wearn reiterated that the board was discussing a concept, and he had a great deal of concern about making a conceptual motion. He explained that he thought the board members understood what they were talking about, but he would rather see it unfold with consideration of the equity side at the same time, and that it all needed to be passed to the administrator and to legal counsel for them to try to put it together for the board to consider in November for implementation in the early part of the year. Mr. Harvey agreed, but suggested that a framework be in place.

Mr. Harvey stated that, based on previous discussion, there was now a maximum of 50% in equities, and the board should discuss the number of managers they wanted in equities, and who those managers should be. He stated that presently there was an index fund, Roanoke Asset Management, and Loomis Sayles.

Mr. Deane stated that Callan's recommendation had been to create a market neutral portfolio, which would devote approximately 20% of the assets to the small to mid cap manager, in this case Roanoke, and the remaining 80% split among the S & P 500. He explained that right now Roanoke had 25% of the equity assets, and what he was suggesting was 5% less than this, which would reduce the exposure to no more than 20% in the small to mid cap; and the remaining 80% to be split among the S&P 500 Index Fund and Loomis to try to bring the positioning back to a little bit more to market neutral. Mr. Wearn asked if the board should consider a different allocation, such as reducing Roanoke to 15%, with S&P and Loomis at 85%. Mr. Deane agreed that this was a possibility, and explained that the 20% was the maximum exposure he was recommending for the small cap. Mrs. Smith asked why Mr. Deane felt the fund should be more market neutral. Mr. Deane explained that the two styles were growth and value, and they both get to the same place, but they come in and go out of favor. He explained that there was a very heavy growth tilt right now, so when growth went out of favor, then there was not a lot of value exposure, and the portfolio would not do as well as it could. He explained that this was an attempt to diversify and smooth out the bumps.

Mr. Harvey stated that the board members had to consider how they wanted to be structured stylewise, with the next question being who should implement this. He explained that there was the S&P 500 index and the two present managers, and the question was how many managers did the board want, and what was the role of the S&P 500 Index, and what was the role of the number of managers the board hired, and which managers were to be hired for those roles.

Capt. DeIorio asked if there was an advantage to trying to figure out what area the fund was lacking, and possibly hiring a manger and splitting the money that way to cover all quadrants. Mr. Deane explained that this was a possibility, but the board was working with a limited number of assets, and to go to an additional manager, there would be additional fees and additional managing problems. He stated that he did not think this was necessary, because the board had the small to mid cap representation, which they needed. He explained that he did not think that the board needed to add another manager, but that between balancing the other two, they could shift assets around enough to bring themselves more towards the market neutral area.

Mr. Wearn asked if there was a fund that might better balance with the S&P 500, in terms of an index. Mr. Deane explained that there was a lot of statistical evidence that active managers, once they hit the mid cap and small cap areas, provide added value over the indexes. He explained that these indexes appear to be easy to beat, so Callan would recommend the active management side of it. Mr. Wearn asked what Mr. Dean's recommendation would be if the board was starting out new and had no management style and had $50 million for equity. Mr. Deane stated that he would recommend $10 million in the mid to small cap and $20 million each with a mid to large cap value and a mid to large cap vote, on the active side. He stated that the board was almost there because they had the S&P. He stated that since the S&P was both value and growth, then they would have to play around with how they would weight Loomis and the index fund to make sure that the total portfolio was kept in balance, which was not a major issue.

Mr. Boggs asked how Mr. Deane would feel about putting 60% into the S&P and 20% each into the two managers. Mrs. Smith asked if a percentage was kept in cash, or if everything was committed. Mr. Harvey explained that there was a working cash account separate from this, so essentially, there was cash available. Mr. Doney asked what that amount was. Mr. Deane stated hat he did not think it was more than 4% of the total assets. Mr. Demming stated that it averaged around $80,000.

Mr. Wearn stated that he still had a concern about the performance of Roanoke, and leaving the same amount of funds under that management with the facts and the information that had been laid in front of them over the last several months.

Mr. Boggs stated that Mr. Wearn had a good point if the board wanted to keep the managers they presently had, and maybe they would want to consider giving 25% to Loomis and 15% to Roanoke, instead of 20/20. He stated that as far as he was concerned, the more there was in the S&P 500, the happier he would be. He stated that he liked the 60%, and that breaking out the other 40%

depended partly upon which managers were used. Capt. DeIorio suggested 60% to the S&P with the remaining divided in some manner among the others. Mr. Deane suggested that the board might want to look at this decision in the same light that they did with the asset mix. He explained that one part was more strategic, as in how did they want their portfolio to look, and the other was tactical, as in a market neutral position. He explained that they still had flexibility.

Mr. Wearn stated that Mr. Deane had mentioned a 40/40/20 as bringing the fund closer to market neutral, which meant 20% more to Loomis and 20% less to S&P for a better balance. Mr. Frick moved that based on the percentages of the equity fund, 40% go into the S&P 500, 40% go into the value manager, and 20% into the growth manager, to achieve Mr. Deane's recommendations for a neutral portfolio, and that such motion was in concept only. Mr. Wearn seconded the motion, and all voting aye, the motion carried.

Mr. Harvey then asked the board members who they wanted to manage the 40/40/20 styles. Mr. Frick suggested that since there were so many other changes that the board would be facing, he would recommend that the board stay with their current active managers, and if they wanted to, they could change managers if they decided it was necessary at some future time.

Mr. Wearn asked Mr. Deane for his recommendation. Mr. Deane explained that he thought what the board was discussing made a lot of sense. He stated that there was nothing wrong with the recommendations the board was discussing. He explained that he did not think that the money the board had was enough to add another manager. He stated that he thought the options were to either put Roanoke on some kind of probation, make a change if they wished, or leave things as they were.

Mr. Harvey stated that the issue the board needed to consider at this point was, did they wanted to change managers or stay with Roanoke and put them on some sort of probation. He stated that he felt the board members were comfortable with the index fund and Loomis. Mr. Boggs stated that he was not sure that he wanted to recommend that the board double the amount of equities that Loomis was managing, which is what the 40% would do, based upon their two and a half years of performance. He further stated that he was not sure that he wanted to give Roanoke 20% based upon their past performance. He stated that the best performer had been the S&P 500, and he hated to see that reduced. He stated that right now it was at 23% to 24% of the fund, and by changing to what was being discussed, it would be reduced to 20%, and the managers were being rewarded by being given more to manage when they had not done as well. He commented that this did not compute.

Mr. Wearn stated that he subscribed to the concept that this did not compute, and he would repeat that the board started with a concern, four or five months ago, about the growth manager's performance over the last number of years. He stated that he thought the board needed to bite the bullet and go out into the market place and look and see what was out there, and see who might be interested in managing the reallocation percentage that the board had set forth. Mr. Boggs concurred. Mrs. Smith asked how the board would go about doing this. Mr. Harvey explained that a manager search would be conducted, as they did after Wolf Webb.

Capt. DeIorio stated that he would defer to the experience of those who had been in this for a longer period of time, and that while he understood what Mr. Boggs was saying in that it didn't appear to make sense, there was a lot for the board members to consider and a lot of questions to be answered, and he thought that the board had taken the appropriate steps and had used their counselor for advice. He stated that this was the advice that their professional had come up with, and he thought that the board had answered the questions that they needed to answer today, and they had taken the steps that needed to be taken. Capt. DeIorio referred to what Mr. Frick had stated earlier, which was that the board had accomplished a lot in a short period of time, and if they take an additional step and do something with one of the managers, the fund may end up taking a hit, maybe only for the short term, but he felt that the board had done a lot and he felt they should see what happened after this point. He noted that this was other people's money, and it was a lot of money, but the board had to be prudent in their steps.

Ms. Lane stated that she liked the allocations of the 40/40/20, and she liked everything the board had discussed. She explained that she did not want to go into the middle of a search right now while the funds were being re-allocated and the board was making these major decisions. She stated that the board should do one thing at a time and be conservative in their approach. Ms. Lane stated that she had been through a search before, and she really did not feel it was an appropriate time to be doing it now. She explained that she would like to put Roanoke on notice and to have a probation period with less to work with, and see if Roanoke was able to perform better.

Mr. Doney asked if, with the percentage identifications and policy actions that the board had discussed, enough direction had been given to Callan as the performance monitor, and also to Mr. McCracken, so that all of this could be reduced to writing and brought back to the board at the November meeting, and from there, with all the appropriate fees. He stated that the board had talked about an action plan, and he thought that Mr. Deane's action steps had now evolved into an action plan, in terms of detail, but now did not the board have to further detail that with the professional help of Mr. Deane and Mr. McCracken, and also with Mr. Crouse as Plan Administrator, to reduce this to writing so that then the board had something they could reflect upon at the November meeting. Mr. Harvey stated that he agreed with all of this, but before it could be put to writing, they had to know what percent allocations, how many managers in equity, and which managers. He stated that the board had to finish the last two steps here so they could put it into an action plan. Mr. Harvey explained that they did not have all of the decisions in place, but were trying to grapple with the last set of decisions, just as they did with the bond monies, where they were allocated and figured out what they were going to do. Mr. Harvey explained that with regards to the equity monies, the board seemed to be between an index fund of 60/20/20 versus a 40/40/20, and the question was, should they go to a 40/40/20, which implies that more money was being given to Loomis, and was that what the board wanted to do, and did they want to replace Roanoke now, or did they want to put them on probation and let it ride.

Mr. Frick stated that he agreed with what Ms. Lane had said, and believed that the 40/40/20 had been voted on. Mayor Ilyinsky stated that he, too, agreed with Ms. Lane, in addition to the 40/40/20 allocation. He stated that everything going on with the President would have an enormous effect on the fund, and that they had to be willing to ride this out. Mrs. Smith stated that the board had agreed upon the 40/40/20, but in regards to the amount of money that Roanoke and Loomis were handling now, with the change that was made today, asked if that would increase the money they had. Mr. Boggs stated that it doubled the amount that Loomis had and kept Roanok at about where they were. Mr. Harvey stated that based on a total fund of $100 million, $50 million would be going into bonds and $50 million into stocks. He explained that with a 40/40 allocation meant a $20 million/$20 million/$10 million split, and currently, in equities alone, Roanoke had about $8.5 million, Loomis had about $10 million, and the index fund had about $20 million. He explained that in looking at the proposal, the index fund would be about the same, Roanoke would be about the same, and they had essentially doubled the amount to Loomis, in broad terms. Mr. Deane stated that this would meant $20 million in the index fund, $45 million with Loomis, and $35 million with Roanoke, and it was split out by bonds. Mr. Boggs stated that this was why he had suggested the 60/20/20 split, because it kept Loomis and Roanoke about where they were at now. Mrs. Smith stated that the 40/40/20 had been passed, and it was easier for her to see the figures in the changes that they were making, and then when the board looked at it in February, they could decide after a six month period if they wanted to add or subtract from the manager.

Mr. Deane stated that a question had been raised regarding why he would want to give Loomis or Roanoke or a small cap manager more money because the S&P had been the best performer. He explained that this was precisely why the board would want to give Loomis and Roanoke more money, because the S&P could not continue to be the best performing fund for the next five years. He stated that over periods of time, it was in the middle of the universe, where half beat it and half did not, so if the board put all of their eggs into the S&P 500, they would take a bigger hit when it fell. Mr. Deane explained that value would come back as would small cap, and the board had to be there with their fund. He stated that what happens when it comes back, they would find themselves selling it off as it went up, to get back into position. He explained that this would keep the risk posture of the plan intact by doing that.

Mr. Harvey stated that the allocation percentages had been decided upon, and asked if a motion was needed in terms of the managers who would carry out each of those sectors. Mr. Wearn suggested that a motion was not needed since they would not be changing managers. Mrs. Smith agreed. Mr. Harvey asked if the board wanted to consider putting Roanoke on probation. Mr. Wearn asked if all of this was in concept at this point, for the ultimate purpose of the administrator and legal counsel and staff to come back to the board with firm proposals for action at the November meeting. Mr. Harvey agreed and suggested that this could be formalized in a written form at the November meeting, and also include the fees. He stated that a proposal should go out to each of the managers outlining their potential new allocation, and that they would now have a dedicated bond portfolio and a dedicated equity portfolio, and ask them what their management fee was on each of those sectors, and ask for a proposal based on the general outline. He stated that this could then be put on the agenda in November.

Mr. Doney asked if this was the type of letter that the performance monitor would write to the investment managers. He explained that the board needed someone with professional expertise to implement all of these things. Mr. Deane stated that Callan would be happy to do that in conjunction with the plan administrator and legal counsel. Mr. Doney then moved that Denise Jones of Gabriel, Roeder, & Smith be present at the November meeting to be able to reflect upon what this board would be doing and to give her observations as to the plan assumptions and that payment be authorized for this. Capt. DeIorio seconded the motion. All voting aye, the motion carried.

Mr. Harvey summarized the board's actions thus far: He stated that what would happen was that Mr. Deane would meet with Mr. Crouse to draft letters outlining what the board had proposed in terms of the new allocations of 50% stocks and bonds, the new policy with dedicated portfolios, with an equity and a bond portfolio. He stated that the board would also need to deal with First Union on the custodial aspect at the appropriate time of their contract to say that they had gone to a different mode, and that their mode would be strictly a custodial of assets, and as such, the board would like to have them reflect a new custodial fee as opposed to an investment management fee in a laddered portfolio.

There being no further business, the meeting was adjourned at 5:20 p.m.

Approved: ____________________________________

John DeIorio, Secretary