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TOWN OF PALM BEACH
MINUTES OF RETIREMENT BOARD MEETING
August 21, 1998

I. CALL TO ORDER

The meeting of the Retirement Board of Trustees was called to order by Chairman Robert Harvey at 9:10 a.m. on Friday, August 21, 1998 in the Town Hall Council Chambers. Attending were Mr. Harvey, Vice-Chairman James Wearn, Trustees Karen Lane, Charles Boggs, George Frick, John DeIorio, Mayor Paul Ilyinsky, Council President Lesly Smith, and Town Manager Robert J. Doney. Also in attendance were Plan Administrator William C. Crouse, Personnel Analyst Carla S. Kneipp, Finance Director James Demming, and Attorney John McCracken.

II APPROVAL OF AGENDA

Chairman Harvey asked if there were any changes to the agenda. Mr. Crouse asked that item IXa, consideration of retirement for Robert Curro, be added, and that two requests of Capt. DeIorio be added to item IXb, consideration of an increase of the multiplier for public safety officers and consideration in reducing the costs of health insurance to retirees. Mrs. Smith moved approval of the amended agenda. Mr. Doney seconded the motion, and all voting aye, the motion carried.

III APPROVAL OF MINUTES

Mr. Doney asked that the minutes of May 22, 1998 indicate that he was absent. Mr. Frick moved to accept the corrected minutes for the regular meeting of May 22, 1998. Mr. Boggs seconded the motion, and all voting aye the motion carried.

IV QUARTERLY REPORTS

A. Roanoke Asset Management

Ed Vroom of Roanoke Asset Management appeared before the board and reviewed the historical and recent rates of return. He explained that he also wanted to make a few comments on their sector of the market because that was an important aspect. He further stated that his partner, Adele Weisman, would review an important segment of their equity strategy that was being executed in the portfolio.

Mr. Vroom explained that the total portfolio value was $26,095,000, with the common stocks representing slightly below the 40% target, and short term reserves in the fixed income portfolio at a little over 55% of the total. He stated that he had reviewed a historical chart with the board at the last meeting, but he wanted to re-emphasize that Roanoke viewed their rates of return, not as a long term problem, but as a short term problem. He explained that their compounded rates of return through 1995 were at 19%, which represented a 14 year compounded rate of return, and was above all of the benchmarks. He stated that when the last two years were included, which were very difficult and challenging years for Roanoke, the numbers changed, and any return series were significantly less good because of the 1996 and 1997 period. He stated that Roanoke viewed these years as a two year problem. Mr. Vroom explained that the short term rates of return indicated marked improvement, both on an absolute and relative basis. He stated that in May he had discussed the fact that they had experienced a difficult January, and there had been a subsequent recovery in March and April, and that had extended itself into the second quarter. Mr. Vroom stated that Roanoke had been able to produce a positive rate of return in the second quarter, which was primarily a negative quarter for most of the indices and most of the professional managers. He explained that for the first six months of the year, Roanoke had shown a 10.8% rate of return for stocks, and looking at the Russell 2000, they had doubled that. He further explained that looking at some of the Callan indices, they were above their mid cap manager universe and well above their small cap manager universe. He stated that there had clearly been a change in the trend in their performance, in their point of view, and he was happy to report that. Mr. Vroom stated that it was clear that Roanoke's segment of the market had been significantly underperforming for the last two years, but what was not evident from those numbers was the significant undervaluation that existed in the small and mid cap segments of the market. He stated that relative valuation to Roanoke was demonstrated by primarily the price earnings ratio of a particular stock, and that was the primary valuation measure that they looked at. He stated that if the board looked at their segment of the market, the small and mid cap segment, versus the S&P, what they would see would be a price earnings ratio both on a trailing basis, looking backwards, or historical lows on a forward basis. He explained that this meant lows that hadn't been seen in 28 years, in some cases, so they were at fundamental valuation levels that were historically low. Mr. Vroom stated that another way to look at this was the T. Rowe Price New Horizon Fund, which was a very large, well-thought of, well-respected small and mid cap mutual fund who did their own valuation measures, and these indicated that the valuations of the stocks in that fund were at their historic lows as well. He stated that Roanoke's segment of the market grew faster than the large segment of the market, and if their segment was looked at on a price to revenues basis, it was as low as it had ever been. He explained that in addition to this, the revenue and earnings growth of their segment had maintained a roughly two times faster growth rate than the S&P 500. Mr. Vroom stated that putting this all together showed significant undervaluation. He explained that the reason they invested in this segment was to achieve greater rates of return in the long run, and small caps from 1926 to 1997 produced significantly better returns, although they were cyclical.

Mr. Vroom explained that he would like the retirement board to focus on the 1998 and 1999 numbers, because Roanoke's growth expectation for the year 1998 was 28.4%, which was three and one half times the S&P, which was expected to come in at 7.9%. Mr. Vroom stated that more importantly, they were expecting nearly a 30% growth rate for the portfolio for the following year, and the S&P would come in a 8.9%. Mr. Vroom stated that the price earnings ratio indicated that their portfolio would sell at almost the same price earnings ratio as the S&P 500, for a growth rate that was almost two and a half times that. He explained that the only thing that could change about this was that their growth rates were wrong, but if they were anywhere near correct, they should be rewarded at some point by a much higher relative valuation than they were currently getting in the portfolio. He stated that the relative valuation was a mirror to the market's.

Adele Weisman of Roanoke Asset Management appeared before the retirement board and discussed three areas of concentration in the Town's portfolio, the consumer area, the technology area, and the telecommunications area. She explained that the only significant change since the last meeting had been an increase in the consumer area, from the mid 20's from last year to about 27% as of March 31, to more than 32% now. Ms. Weisman stated that on a cyclical basis, this increase reflected the domestic only character of the consumer area, and in fact, in this sector, Pacific rim exposure was a positive. She explained that these companies sourced their goods in the Pacific rim, and with the currency devaluations, goods become cheaper and profit margins increased. She explained that on a secular basis, the change in this sector reflected real positive changes in the economic position to the consumer. She stated that employment was at record levels in this country during this time, with nominal wages going up, and in low inflation, that meant increases in disposable income and very high confidence levels as consumers. Ms. Weisman stated that consumer attitudes and their propensity to spend, on a long term basis, were a function of the consumer's economic position, which had been improving since 1992, and was likely to stay healthy looking forward.

Ms. Weisman then explained that the second focus of this portfolio was in the telecommunications area. She stated that it was about 18% now, and she anticipated Roanoke increasing it a bit, so she wanted to share their perspective on this rather complicated and very high profile area. Ms. Weisman explained that this was a particularly interesting area because, even when she got into this business, telecommunications companies were thought of as utilities, and in the U.S., they were regulated duopolies or monopolies that methodically resisted change. She explained that on a world-wide basis, they were actually government owned companies whose mandate was to not change. Ms. Weisman explained that since the Communications Act of 1934 through the early part of the 1990's, there had been basically no change in the business environment for these companies. She explained that three events had very dramatically changed this landscape. Ms. Weisman explained that the 1996 Telecommunications Act in this country and the 1997 World Trade Organization Agreement to privatize had eliminated barriers to competition, not just on a domestic basis, but on a global basis. She explained that the third event was the Internet and its technologies, both for the consumer and for businesses, and had resulted in a huge increase in data traffic. Ms. Weisman explained that data traffic grew 30% a year globally, and voice traffic grew about 4% per year. Ms. Weisman stated that these three events had resulted in fierce competition among the incumbent service providers, and between the incumbents and the scores of new companies, wireline and wireless, and Internet service providers, all vying to deliver services and win or retain the consumer or business markets. Ms. Weisman explained that there had been important new networks based on new architectures for data and voice, such as companies like Quest, as well as a rash of mergers. Ms. Weisman stated that this convergence, via these mergers, and via these new companies' initiatives, was a reality now. Ms. Weisman explained that the biggest and most important event happened in June, with a $40 billion merger between Telecommunications, Inc. and AT&T. She stated that this married the long distance/Internet service and wireless businesses of AT&T to the cable TV, telecommunications, and fast Internet access businesses of telecommunications. Ms. Weisman explained that from a telecommunications point of view, they were gaining the prowess of AT&T's brand to market their new services, and from telephone's point of view, they were merely gaining access to one third of U.S. homes through this acquisition. Ms. Weisman stated that this was large cap land, but between the mergers and acquisitions area, there were real opportunities in the small and mid cap area for investment appreciation, and those were in companies that included new service providers and in companies that provided very complicated services that these new companies or converging incumbents needed and couldn't provide for themselves. Ms. Weisman stated that there were also opportunities among the manufacturers of equipment for these companies. Ms. Weisman stated that 18% of this portfolio were in holdings in this area, in companies like ECI Communications, ICG Communications, Ascend, International Telecommunications Data Systems, Mobile Data Systems, and Uniphase. She stated that they would expect that the current exposure would benefit from all of the macro events that she had described.

Ms. Weisman then briefly reviewed the fixed income profile, stating that it continued to be a very high quality, intermediate, laddered portfolio, and Roanoke's approach continued to be a conservative one. She stated that they looked at this as a balance to the more aggressive equity portion of the portfolio. Ms. Weisman explained that they had never market timed or attempted to anticipate rate changes in this portfolio, and the results had been a portfolio where current yield and yield to maturity converge at a very tight band, and performance continued to consistently approximate the index.

Mr. Vroom stated that they had been talking about small, mid, and large cap, and explained that when he and Ms. Weisman were talking about small and mid cap, they were talking about companies that had market capitalizations of roughly $1 to $3 billion, so these were not start up companies, but were companies that were generating a couple hundred million dollars of revenues and were fairly well established in business.

Mr. Doney asked whether the board was going to be hearing from Carl Deane from Callan and Associates on a one by one basis regarding the information provided by the investment managers. Mr. Deane explained that he would address the board after the individual quarterly reports had been presented.

B. Loomis, Sayles & Co.

Peter Van Beueren of Loomis, Sayles and Company appeared before the trustees and explained that present with him was David Sowerby, Vice President of the Detroit office, who would be making the presentation.

David Sowerby addressed the retirement board, and explained that he primarily concentrated on the fixed income side of the portfolio with a team of individuals, and Greg Watkins concentrated on the equity side of the portfolio. He explained that traditionally, one, if not both, of them would be present at the pension board meetings. Mr. Sowerby stated that more than anything for the long term fundamentals that drove the value of the portfolios in stocks and bonds continued to be low inflation and low interest rates. He explained that thirty year treasury bonds were at an all time record low below 5.5%, which likely meant good chances of 6.5% or 6.75% long term mortgage rates. Mr. Sowerby stated that 1998 had shaped up to be a relatively good year for the capital market. He explained that what had been seen in 1997, which had been an even better year for returns, were the first glimpses, particularly for some disparity in returns in the marketplace. He explained that this had been a relatively good year for the markets, but it had been a different animal than what most investors had been accustomed to for the last 30 years. He explained that 1998 had been a relatively good market, but it had not been a very deep or broad market, especially on stock returns. Mr. Sowerby stated that the market had clearly been concentrated in mega cap stocks, the very largest stocks, such as Coca Cola, General Electric, and Microsoft, as well as a market that had been very dominated by high P/E type stocks, stocks with high price to earnings ratios. Mr. Sowerby stated that by some measures, it had been the widest variance between growth managers and value managers, which was what they were, looking for undervalued, lower price to earnings companies, and was probably the widest disparity in performance in about twenty or thirty years. He explained that returns had been positive, but there had been about eleven full percentage points that had a little bit of difference between growth and value in this type of environment, and it had clearly been dominated by the largest stocks and the stocks with the highest P/E ratio. Mr. Sowerby stated that as a value manager, there were probably three things they could do when they were confronted with an extended period where higher P/E stocks were doing very well relative to their discipline, which was finding lower P/E type companies. He explained that the first thing they could do was to capitulate and abandon their discipline, which was something they certainly did not intend to do at Loomis Sayles. Mr. Sowerby explained that the second thing that could be done would be to freeze, which was to do nothing in the portfolio, and was not the right approach to take. Mr. Sowerby stated that what Loomis Sayles held steady to was to maintain their discipline, and understand that there would be periods where growth and value had different cycles, but value was a very effective strategy. Mr. Sowerby stated that a subset to this, which they were doing at Loomis Sayles currently, was to focus more on product, which started with the value style of stock selection. He explained that Loomis was building more of an epicenter in Detroit for value investors because they thought it would be more efficient, and more of a concentrated value team. Mr. Sowerby stated that their highlights continued to be good markets, but markets where there had been a wide disparity between high P/E and low P/E, but relatively good rates of return, and bond returns that continued to match and exceed the respective indices and perform well within the Callan universe, and in the first six months of 1998, returns of just under 6% for the total portion of the portfolio, and a balance mix of about 36% in equities and 64% in fixed income. Mr. Sowerby explained that equity returns for the first six months of the year were 8.5%, and fixed income returns were 4.5%. He stated that the S&P 500 had 17.7% rates of return, but there was a disparity between growth and value. He explained that the largest stocks had accounted for as much as 40 to 50% of the returns that had taken place this year. Mr. Sowerby then reported that as a value manager, they wanted to stay true to their discipline so wanted to own value stock. He explained that their belief, over the last three years, showed that value had lagged, but over a twenty year time period, had comparable type returns, even when value, on a 20 year basis, had marginally better rates of return than growth, even considering the last three years, and in particular magnified in the last twelve months. Mr. Sowerby summed up the equity side of the portfolio by stating that as a value investor, Loomis remained true to identifying lower priced to earnings, undervalued, quality companies with valuations roughly 20 to 25% under the S&P 500, which were more affordable type stocks with potential quality nature in the way of earnings growth and higher dividend yield in the portfolio. He explained that average market cap in the portfolio as a large cap value manager remained roughly $27 million.

Mr. Sowerby then reported on the fixed income side of the portfolio, and explained that the bond portion of the portfolio was very important because it was 60% to 65% of the assets, and had been a relatively favorable bond market in 1998, especially with interest rates hitting an all time low, with low inflation being the key behind that. He explained that much like the equity market, some of the challenges in Asia had created uncertainty with corporate earnings, and Loomis Sayles thought some of that turbulence and some of the weaker performance in corporate securities this y ear, A rated or better, had created an even better opportunity to add yield to the portfolio. Mr. Sowerby explained that Loomis Sayles had been able to capitalize with a slightly longer maturity or duration in the portfolio, with duration a key measurement for interest rate sensitivity. He then stated that the yield to maturity remained slightly higher than the Lehman Government corporate benchmark, with Loomis Sayles' yield to maturity in the portfolio at about 6.1% at the end of July 31, 1998.

Mrs. Smith asked what Loomis Sayles' philosophy was on the sales and purchases of the various stocks, explaining that she wondered why they would sell IBM in January at $101 and buy it back in March at $105. Mr. Sowerby explained that the sell decision was the toughest decision to make. He explained that on Wall Street, for every 25 buys, there was maybe one sell. He explained that when Loomis looked to sell a stock, it was because it had not met its price objective, primarily based on its valuation on a P/E basis, and in the case of IBM, it was sold at $101 because they thought it had made its price objective, but then took a second look at the stock and the fact that there had been more dynamics in the industry that had helped better earnings growth, and re-added it to the portfolio. Mr. Sowerby explained that the sell decision, in a broader scope, was just as important as the buy decision, and there was never any guidance from Wall Street on sell decisions.

Mr. Van Beueren explained that these decisions were fundamentally driven and it had been a very volatile period of time, that quarter to quarter had been tied into estimating what the companies would earn, and there had not been a clear view going forward with some of these companies.

C. First National Bank

Sandra Fleming of First National Bank appeared before the retirement board and reported on the performance of the Treasury bond portfolio. She explained that it was a one to ten year laddered bond portfolio that encompassed 30% of the total. Ms. Fleming explained that the performance was right in line all across the board with the Merrill Lynch one to ten year government treasury index, which was what she used to compare it. She stated that it had been at 6.5 six August of 1992. She explained that the maturity schedule of the fixed income portfolio showed a $2.7 million par value across the board, and there was approximately $900,000 in cash that came from a $500,000 maturity and some build up in income that would be reinvested to streamline from 1999 to 2008, and would get all the par values equal and would keep them at approximately 10% of the market value in each particular year. She explained that the last three maturities of the year were the $1.5 million in 1998, which would be kept in money market because that market was earning about 5.4%, which was considerably higher than could be gotten in a Treasury bill due out in February of 1999.

D. Callan Associates

Carl Deane of Callan Associates appeared before the retirement board of trustees to discuss the market overview. He explained that the median return for the last quarter for an active portfolio was almost zero, but there was a range of 5% positive down to more than 5% negative, so there was quite a spread. He explained that the S&P 500 ranked in the 22nd percentile, so it outperformed almost 80% of the active managers.

Mr. Deane then reported on domestic fixed income, and explained that there was a very slight spread of returns around the median, with the median manager having about a 2.1% rate of return, and the index with a 2.3% rate of return, so the index slightly outperformed at the fortieth percentile. He explained that in the quarter, at a median basis, the bonds were the better place to be from the active manager side. He explained that the situation was similar for the year.

Mr. Deane explained that there was one common characteristic for positive returns, and that was growth, and growth was in favor. He explained that the dominant characteristic for negative returns had been small cap, so if a manager was associated with small cap, they would have a hard time of it to make positive returns in the quarter.

Mr. Harvey asked Mr. Deane what was the definition of a small cap manager. Mr. Deane explained that small cap would primarily be under a billion dollars in capitalization, with a median of about $900 million. He explained that mid cap would be from $3 billion to $10 billion, and above that would be large cap. He explained that there was a huge spread in the large cap stocks, and that performance was being dominated by Intel, Microsoft, General Electric, and Coca Cola, and that 10 stocks could account for most of the S&P return in there. Mr. Deane explained that the key here was that what had been going on in the market place for the last three years had been large cap growth stocks, and that the board had a mid to large cap value manager, a mid to small cap growth manager, with the S&P 500 taking advantage of the large cap. He explained that for the last year, growth had been the best characteristic.

Mr. Deane then reported on bonds. He explained that the best performing sector of the bond marketplace had been extended maturities because interest rates had been moving down. Mr. Deane explained that the Town did not have a long bond strategy, but rather, more of a core type strategy. He stated that the returns had been pretty good for core, but not up to the level of the extended maturity.

Mr. Deane explained that at the end of the quarter, there had been about 54% of the assets in fixed income and about 41 to 42% in equities, and 5% in cash, which was essentially on target. He stated that this would bode well for the quarter because bonds weren't bad and stocks were a little bit below the bonds in terms of negative returns.

Mr. Deane then reported on the positioning of this fund as a total fund, with all managers combined, and how they ranked against all of the public plans in the data base. He explained that for the last year, this plan had returned around a 15% rate of return for the year, which was good, but that 90% of the public funds had outperformed this fund. Mr. Deane explained that not all of the public funds had the same asset mix as the Town's, but even in comparing funds as if they had the same asset mix, the Town would have had a lower rank, which meant that the added value for the managers was negative for the year. He explained that even over a five year period, the asset mix had not had any added value.

Mr. Deane then reported on ANB, which was the S&P 500 index. He stated that there was about $25 million in this, and was performing at the index rate of return. He explained that the good news was that the S&P 500 was very much in favor for this time period.

Mr. Deane then presented the analysis on Loomis Sayles. He explained that at the end of the quarter, Loomis had essentially been on target, and were positioned to the guidelines on a fully invested basis. He stated that they had about $28 million in total assets. Mr. Deane explained that the key in looking at the performance of the managers on a total fund basis, combining all equities, cash, and bonds, and looking at the total rate of return for their assets managed, was the target. Mr. Deane explained that the target, in the last quarter, performed in the top third. He stated that it was not surprising that Loomis had underperformed the target, because Loomis was not the S&P 500. He explained that when value came back into favor, long term was when Loomis should come close to the S&P500 return and above, but it was the short term where they would not. He explained that the target was strictly the S&P500, with 40% the S&P and 60% Lehman Brothers aggregate, and this was what they were operating against. He stated that it was not surprising that Loomis would fall below that, and it was what put them down below most of the other public funds in the data base. Mr. Deane explained that one function was the asset mix and the other function was that value had been out of favor.

Mr. Deane then reported on the equity portion of the portfolio. He explained that given the fact that value was out of favor, over the entire time period, compared to other value managers, Loomis had slightly below median performance over the last quarter and year, but going out over three and a quarter years, they were right at the average for other value managers. He explained that for what Loomis was supposed to do, they were doing about average, but the problem was, this had been out of favor, even though this would change. He stated that Loomis was in the 37th percentile in their equity portfolio in three and one quarter years.

Mr. Deane then reported on the bond portfolio, stating that it had been a very strong performance in the last quarter, because they were a little bit longer in average duration than the index. He explained that in a period where interest rates were going down, the longer the duration, the better the performance. He stated that their performance had been almost 12% for the year out of the bond portfolio. Mr. Deane stated that over the last three and a quarter years, they were still slightly above average, and above the index, so they had added some value to the bond portfolio.

Mr. Deane then reported on Roanoke Asset Management. He explained that there was essentially the same positioning as Loomis, with 40% in equities and 60% in fixed income. He explained that they had a fairly good quarter, and finished in the 50th percentile and slightly below the target. He stated that for the last year they had been in the 97th percentile. Mr. Deane stated that it was not surprising that they were below the median, given the fact that small cap had been out of favor, but it was well below their peer group.

Mr. Deane then reported on the equity portfolio analysis, and explained that this was being measured against mid cap portfolios, which were $2 to $4 billion in size up to maybe $10 or $12 billion in size. He explained that they had outperformed their peer group for the quarter, but were slightly under the S&P, but this was still fairly good performance. He stated that looking at the past year showed a different scenario, with Roanoke still down at a 10% rate of return overall for the equity portfolio, which ranked at 96th among other midcap portfolios. He explained that going out over a five year basis, there was a 16% rate of return versus a 23% rate of return for the S&P, and an almost 20% return for the median mid cap portfolio. Mr. Deane explained that compared to other midcap portfolios, Roanoke's total risk ranked in the 6th percentile, so they had higher volatility than most of the midcap portfolios. He then explained that the downside risk ranked in the 4th percentile, so there was a very high downside risk in this portfolio, and that it was a volatile portfolio.

Mr. Deane reported on Roanoke's bond performance, explaining that the bond portfolio had a fairly good quarter, beating the index and being at median for the peer group comparison. He explained that for the year it had been strong, at the 30th percentile with 11% rate of returns. He stated that over five years, they were beating the index and they ranked right in the middle of their universe. He further explained that compared to other core bond portfolios, both of the managers had higher risk, or higher volatility, in their bond portfolio than the typical portfolio.

Mr. Deane then reported on the T-bond account, explaining that it was essentially fully invested. He explained that it had enjoyed very good performance for the last year, although there was nothing active that the manager would do to improve performance, other than to try to get the best trading that they could to buy and sell securities. He explained that over the long haul, this portfolio ranked in the 91st percentile, underperforming the index by about 80 basis points per year, but this was not a reflection of good or bad on the part of the manager, because the manager was doing a laddered portfolio, which was very structured.

Mr. Frick asked how much the last two years had affected Roanoke's equity over the five year period.. Mr. Deane explained that those two years would affect it a lot. He reminded Mr. Frick of the analysis that had been discussed at the last meeting regarding the last ten years, which indicated four years in the bottom quartile, five years in the top quartile, and one year in the middle. He explained that the cumulative performance up to that point in time put them in the 90^{th} percentile.

Mr. Doney asked Mr. Deane what other comments or observations he might have, based upon what he had heard from Roanoke, Loomis, and First Investment Advisors. Mr. Deane stated that he would take no exception to anything that they had commented about, with the exception of the bond portfolios being a little bit more volatile. He explained that the managers were not privy to the data base utilized by Callan so they were coming out of a vacuum and looking at their own strategy and evaluating it. Mr. Deane explained that any other comments he might have would relate to the management structure part of the portfolio.

Mr. Doney asked if the board members thought it would be helpful to hear from the managers regarding any comments they might have on Mr. Deane's presentation.

Mr. Vroom explained that their bond portfolio was $14.3 million with a current yield of 6.3% and a yield to maturity of 6. He explained that almost 82% of this portfolio was in U.S. Treasury Governments, so it was not a risky portfolio. Mr. Vroom stated that in terms of Roanoke's equity performance, he had laid out their year by year rates of return since they had been managing this money, and he emphasized that any time series that included the last two years would put them on very negative ground.

Mr. Sowerby explained that there were many different forms of risk, but two that were important were volatility and inflation. He explained that at Loomis Sayles, they felt that putting the probability in the Town's favor in the long term was to own more corporate bonds in the portfolio than the benchmark. He explained that the reason to own more corporate bonds in the portfolio than treasury securities was to add value, and this might increase volatility, but he thought the bigger risk was inflation.

Mr. Doney asked if it would be of help to this board to have the managers present when Mr. Deane presented his report. He explained that the board may have questions of the managers, and it could helpful to hear their comments and observations independent of Mr. Deane's.

Mr. Harvey stated that since there were at least three board members who would have to leave fairly soon, he thought that perhaps Mr. Deane could summarize his recommendations and provide a background of the work he had performed, but that he thought a special meeting would be needed in order to discuss that sole topic, without the other agenda items, and that the remainder of the agenda items could be completed during the present meeting. Mr. Doney agreed. Mrs. Smith asked Mr. Harvey how soon he would like to have the special meeting. Mr. Harvey stated that he was flexible but perhaps within the next month. Mr. Wearn suggested that the Plan Administrator contact all of the board members after this meeting to try and establish a common date. The board members indicated agreement.

Mr. Harvey then asked Mr. Deane to discuss his action recommendations so that the board members would have time to think about the different options, and that in terms of the managers, they may wish to stay to listen.

Mr. Deane explained that he would discuss the action steps that he had recommended, and they would be in the order of importance. He stated that Callan thought the first thing the board should address was the asset mix of the plan. He explained that, given the actuarial assumptions of an 8% earnings rate and a 5% inflation rate, the 40% equity and 60% fixed income made it difficult to make the 8% earnings assumption over long periods of time. Mr. Deane explained that the more aggressive asset mix posture offered more on the upside, and did not cost the plan much on the downside. He explained that he would go into this in more detail at the special meeting, but this was the basis of his recommendation.

Mr. Deane stated that the second issue was the fixed income portfolios. He explained that one thing that had come clear in analysis was that the specialty management focus as a group tends to provide slightly incremental better returns than balanced managers. He explained that Callan was suggesting that, no matter what amount of money there was in fixed income, the fixed income assets be put into a low volatility core strategy, or possibly even the bond index. Mr. Deane explained that this may allow the board to take advantage of fees, because they were probably paying a higher fee for the bond portion of the management through a balanced manager than they would if a specialty bond manager was hired. Mr. Deane stated that Callan was also recommending that, because of the drain on the performance over certain time periods, the t-bond account be reconsidered as a part of the total pool of assets and placed with an active manager or an index of the Lehman Brothers Aggregate.

Mr. Deane stated that the third item was the restructuring of the equity portfolio, and what Callan was recommending was a neutral structure, which meant evenly divided between value and growth, with mid to large cap at about 80% of the market and small cap about 20%. He explained that Callan encouraged the board to structure the portfolio in that kind of a strategy, and he would have some style mapping graphs to show the board.

Mr. Deane explained that the question of Roanoke's performance was probably the last important decision that the board would make. He stated that the real question was how much should be in that asset category, with the secondary question being who would run that portfolio.

Mr. Deane stated that these items were what he would put before the board in a special meeting, and that they would require quite a bit of time to go through.

Mr. Frick asked if item number two was recommending that the stocks be handled in a similar way as the bonds. Mr. Deane replied that this was an option that the board could consider.

Mr. Wearn stated that the first area of consideration, the asset mix, caused him some concern to consider that question in a vacuum without having a good analysis of the Town's history of the last 10 to

20 years to see if the actuarial assessment had been achieved over that period of time, and if it had, to have it attributed to whatever factors were involved, so that the board could look and see whether the plan had a likelihood of achieving the actuarial assessment by maintaining the current asset mix. Mr. Deane explained that the plan had made its actuarial assumption. He explained that he did not know what had happened in the late 1970's and early 1980's when inflation was running 12 or 13%, but even if that scenario returned again, his suggestion of moving towards the more aggressive asset mix would only get the plan closer to it. Mr. Deane explained that there would be times over 40 or 50 years when a 3% real rate of return would vary just depending on the market conditions. He stated that Callan was looking at the history of the asset returns as an asset class going forward, based on historical and current situations, and this meant that with a 40% equity exposure and 60% in bonds, if the actuarial assumptions come true, an 8% actuarial assumption would be very difficult to make. He explained that if the board went to a 60/40, there would be a higher than 50/50 probability of making the actuarial assumption. He further explained that this was something that they would go into in more detail at the special meeting.

Mr. Harvey asked if, in the assumption made by Mr. Deane regarding the 5% inflation rate, that would be compatible with increasing the equity returns in that environment, and did Mr. Deane think the target rate of return would be hit. Mr. Deane replied yes, and explained that there was an advantage in that the actual inflation rate was lower than the assumed inflation rate, so there had been great returns out of the markets. Mr. Deane explained that if inflation started to creep up and the markets came back and reverted to the mean, as was expected at some period of time, then it would be difficult. Mr. Deane stated that an assumption of approximately 9% was used on the stock market, and the expectation going forward was that it might be even less than that. He stated that if that happened and inflation did move up somewhat, it would be difficult to make that 8% assumption. Mr. Harvey asked if Mr. Deane's recommendation was to increase the equity portion of that. Mr. Deane explained that it could be done in stages, and what he would suggest was that it might be prudent for the board to make that a part of the guidelines, whether or not they utilized it, but to give them the ability to do that if they so chose. He explained that the 175/185 changes that were coming up would grandfather-in any limitation that was outside their ranges, prior to their enactment. He explained that the 175/185 monies were only a portion of the contributions, and that they came from State. He explained that they came from the premiums of the insurance companies within the State, and the state doled them out to the police and fire pension plans in the form of a contribution. He explained that there were some restrictions in the 175/185 monies, one of which had been a 30% maximum limitation to equities. He explained that technically, the Town's plan would be in violation of that right now, for that portion of the monies, but that the State was taking it up to 50%. Mr. Deane explained that there was a statement in their letter that said that any plan that did not conform to that or was outside those limits would be allowed to maintain their existing policy. He explained that the suggestion he was making was that even if the plan did not go to 60%, to allow the opportunity to do so to give themselves flexibility in the future, and not violate the state's requirements regarding 175/185 monies. Mr. Deane explained that the Town's funds were co-mingled with the 175/185. Mr. Frick explained that the 175/185 monies were invested with the other funds, but they were itemized separately. Mr. Deane explained that he was suggesting that there was a window of opportunity that it might be wise to take advantage of at this point.

Mr. Doney suggested that it might be helpful to know, in writing, at the next special meeting, the actual cost that Callan would charge to implement the action steps as well as any other costs. Mr. Deane explained that there would be no additional costs unless the board contracted Callan to do a search, which would be approximately $25,000 if they were looking for one manager, and less if it was an index fund. He explained that for the items they had discussed today, there was no additional fee.

Mr. Wearn asked if the board would need the actuary's input on this first question on the balance of equity versus fixed. Ms. Jones stated that she would defer to Mr. Deane's judgement in terms of whether or not the current portfolio mix was meeting the targets. She explained that Mr. Deane was correct in addressing the real rates of return, which was what they were really focusing on, however, the long term investment return assumption was also important because that operated over the life of the plan. She then commented on the inflation portion, and explained that because the retirees' benefits were not adjusted in accordance with inflation, that inflation portion really only served to act on the cost during active employment, and there were still some 200 retirees out there that had liability, so the investment return assumption operated over all of the members, whereas the inflation portion only operated on the active portions. She explained that the combination was important. Mr. Deane asked Ms. Jones if there was any movement on the part of the actuaries in changing the inflation assumption. Ms. Jones explained that there had been some plans that had lowered the inflation assumption, but what that served to do was to increase the real rate of return, which sets a larger target for the plan to meet. She explained that this would reduce the contributions coming into the plan and require that the investment return be higher.

Mrs. Smith asked Mr. Deane that, as he performed the same type of services for other municipalities, did they struggle with the same dilemma as far as their managers, such as Roanoke running into trouble over the last two years, and if so, what were they doing about it. Mr. Deane explained that it was an ongoing problem. He explained that with a market as weird as this market had been, and focusing on the last three years, he had never seen the S&P do this well relative to the rest of the active managers. Mr. Deane commented that there were a lot of public and private plans that were looking at their own structure. He explained that the key to how to evaluate Roanoke was, in this strategy of management, the universe they were being compared against, not that they were losing ground to the S&P 500. Mr. Deane stated that what they wanted to focus on was the fact that they were losing ground to other mid to small cap managers. He explained that there was no right or wrong, but that they might have turned the corner this last quarter and every one of them might be up, but he would ask the board to revisit what had been sent out before, which demonstrated rolling three years as well as year by year for ten years and cumulative for ten years. He reiterated that this was a decision the board would have to make. Mrs. Smith asked how these figures compared to other small cap managers, and asked how the board would know how Roanoke compared. Mr. Deane explained that the analysis went back for ten years against the peer group. He stated that the key issue was that when Roanoke was first hired, they were the only manager, and their direction had been to give the Town better than market returns, with that market being the S&P 500. He explained that it had only been since Callan came into the picture, and style analysis was looked at, that they had begun to be compared to other people who did the same kind of thing.

Mr. Doney explained that there was no one on the current board had been involved with Roanoke when they were first hired, and his involvement at that time had been as an Administrative Assistant, so there were different perspectives at that time and decisions were made on those. He explained that the long term issues were important to consider, and that board members also change every few years, and that many dimensions had been added to the analysis. Mr. Doney stated that he would like to move slowly on this issue, and he felt that it was important to have Roanoke, Loomis, and the others present at the special meeting. He stated that he felt it would be helpful to have all of the processionals present when the board deliberated on this. Mr. Demming further stated that he wanted Mr. Demming's and Mr. Crouse's perspective on these issues at this meeting.

Mrs. Smith asked that the reports be provided to the board members prior to the meeting, as it was easier to read it ahead of time and have time to digest the information. The other board members agreed.

Mr. Boggs stated that the small to mid cap manager and the value manager were being compared to the S&P 500, and asked if it would not be better to not do that, explaining that it really was not relevant. Mr. Boggs explained that he would rather see how these managers compared with other managers of the same group. He stated that comparing them to the S&P was apples and oranges, and the board should not be asking them to compete with the S&P when there were certainly times when they could not. Mr. Harvey explained that the board had originally set out that the mandate was for the managers to compete with the S&P 500, and the managers had individually selected their styles, because they believed that their styles would outperform the S&P 500. Mr. Harvey further explained that they were also being measured against their own discipline styles, so they were being measured in both manners.

Mr. Harvey explained that the Plan Administrator would contact everyone regarding a special retirement board meeting to address all the concerns that were discussed today. Mr. Wearn stated that he hoped all of the people that Mr. Doney had suggested would be invited to attend the special meeting. Mr. Harvey stated that he had mixed emotions regarding whether they needed to be there or not. Mrs. Smith asked why Mr. Harvey would not want them there. Mr. Harvey explained that it was a public meeting, but he viewed the meeting as an opportunity for the board members to discuss various issues, with recommendations to be made at the following meeting. He stated that everyone was welcome to attend the special meeting, but he personally wanted them back managing the portfolios. Mr. Deane stated that 99% of what would be discussed was a strategic look at the plan, as opposed to a tactical. He explained that there was only one issue on the tactical side right now, and that seemed to be the Roanoke issue. Mr. Deane stated that he would invite the managers if they wanted to be there, but not make it mandatory, because there really wasn't much for them to do because they were just looking at the tactical side of asset management, and the board was looking at the strategic. Mr. Harvey agreed, and stated that the strategic decisions were the board's, not the managers'. He explained that the board had to come to the conclusions and set the agenda, and then the information would be provided to the managers. Mr. Harvey stated that the managers could be invited to attend, but that it would not be mandatory. The board members indicated their approval.

Mr. Crouse stated that he wanted the board to be very aware of the fact that, with regards to the 175/185 monies, if there was a decision to have the equity allocation above 50%, it could only be done prior to October 1. He explained that if this decision was not made and in effect prior to October 1, by State law the Town would be restricted to 50%. Mr. Harvey stated that he would like to have a meeting as soon as practical, within the next couple of weeks, if possible. He explained that he understood one or two members may not be able to attend, but his goal was to get the maximum number of members here to discuss the relevant points. Mr. Doney asked that Mr. McCracken look at what the board could do to strategically place itself in the maximum policy position regarding the 175/185 monies. He then stated that he agreed with Mrs. Smith in that anyone who was providing written materials for the board members to please provide them to Mr. Crouse at least a week in advance so that they could then be distributed to all of the board members. Mr. Crouse stated that if this was going to be done, the material should be provided to him at least two weeks in advance, which was when the packages went out to the board members. He explained that he thought the board members should have their packages two weeks in advance of the meeting. Mr. Doney agreed, and asked that Mr. Crouse provide a written letter to everyone who would be providing written materials to please provide the information to Mr. Crouse at least two weeks in advance of the meeting.

V. APPROVAL OF ACTUARY'S FEE FOR 1999

Denise Jones of Gabriel Roeder and Smith appeared before the board to discuss the proposed fee increase for 1999. She explained that she had provided a letter to the board regarding the proposed fee increase for the Fiscal Year 1999, and because that increase represented an approximately 26% increase in fees, she wanted to discuss the reasons why this increase was being requested. Ms. Jones stated that the information that had just been distributed was a three year history of GRS's time and expense charges for producing the annual actuarial valuation and the routine consulting services they provided to the board over the course of the year. She explained that over the three year period, the time and expense charges had exceeded the retainer fees, and the anomaly in year 1996 had to do with corrections to the data, which had resulted in the report having to be redone. Ms. Jones stated that additional fees should have been charged for that, but were not. She explained that the expenses for doing the actuarial valuation were in the $13,000 range, and that was the reason they were requesting the increase in the fee.

Mr. Wearn stated that he had a question on Ms. Jones May 26, 1998 letter, where it said "in the absence of changes in governmental or financial reporting standards", and asked if Ms. Jones anticipated any of those changes affecting the $13,600 retainer request. Ms. Jones replied that as far as she knew, there were no proposed changes in governmental or financial reporting standards. She explained that the new GASB information was already included in the report, so that should not result in an increase in the fee. She stated that she would like to change that phrase to include "in the absence of changes in plan provisions or governmental or financial reporting standards", because the other problem that they were running into, although not in the last two years, but with some other clients, was when there were changes in plan provisions, they had to do valuations to itemize the cost of the change, because it was required by the state and strongly recommended by the Actuarial Standards Board. She explained that in the past, they had not been increasing their fees because they were usually locked into their retainer fees because they were quoted in advance. Ms. Jones stated that they were requesting from their clients that if there was a change in plan provisions, they be allowed to add in a line item for the additional cost of running the valuation that would be needed to determine the cost of the change.

Mr. Wearn moved approval of the actuary's proposed fee for 1999. Mr. Frick seconded the motion, and all voting aye, the motion carried.

VII DISCUSSION OF DEATH RECORDS CROSS CHECK SERVICE (offered by Gabriel Roeder & Smith)

Mr. Crouse explained that he had been contacted by an individual with Gabriel Roeder and Smith regarding a computerized system that would check whether an organization's retirees were still alive. Mr. Crouse stated that his office did that on an annual basis by sending verification of benefits forms to all of the retirees and beneficiaries of deceased retirees. He explained that this process took several months and required a great deal of follow up. Mr. Crouse explained that a very conservative estimate of the cost of doing this was $300 in paper and time. He stated that the Gabriel Roeder Smith system would cost less money, and that it could be done twice a year for half the price. He explained that doing this twice a year would cost $155.60, and to do it once per year would cost $127.80, because there was an annual $100.00 set up fee.

Mrs. Smith asked if it would save time to send just one notice that explained to retirees that they would not receive their next pension check unless the verification notice was returned. Mr. Crouse replied that it would save time, but it would not be fair to the retirees, and explained that many of them had automatic depositing of checks. Mrs. Smith asked if this service meant that Gabriel Roeder would find the people and would determine whether or not they were alive, or would letters simply be sent out. Ms. Jones explained that the process consisted of a comparison of the retired life data that was received for the actuarial valuation with the Social Security file of people who were listed as deceased. She explained that they would then report back to the staff and indicate those records that matched, and that staff would then check into it to determine that the information was accurate. Mrs. Smith asked if money was ever lost by people cashing checks in instances where the retiree or beneficiary was deceased. Mr. Crouse replied that this had happened on a couple of occasions during the short time that he had been the Plan Administrator. He explained that with the assistance of Mr. Randolph's firm, his staff had been able to track down most of the monies, and in fact, that situation had just occurred, and a legal letter had been sent out to the family of the deceased explaining that monies were owed to the pension plan. Mr. Crouse explained that in this instance, the deceased beneficiary had a joint account with her daughter, and the money was automatically deposited, but the Town had not been notified of the death until four months after the fact. Mr. Crouse explained that by doing checks twice a year, it would allow his staff to find these things a little sooner. He stated that there presently were 279 retirees, including beneficiaries, and he thought that for the cost of the program, it would be beneficial to the system.

Mr. Boggs moved authorization to utilize the death records cross check service, on a semi-annual basis, offered by Gabriel Roeder and Smith. Mr. Wearn seconded the motion, and all voting aye, the motion carried.

VII REPORT ON QUARTERLY EXPENDITURES BY JAMES DEMMING, FINANCE DIRECTOR.

Mr. Demming reported that the estimated cash flow in the checking account had required no additional money, as there appeared to be sufficient money to cover benefits and expenses for the next quarter. He then reported on the expenses that had occurred to date, and asked if there were any questions regarding these.

Mr. Boggs moved to accept the report on quarterly expenditures. Mr. Frick seconded the motion, and all voting aye, the motion carried.

VIII DISCUSSION OF THE AGE DISCRIMINATION IN EMPLOYMENT ACT (ADEA) AND DISABILITY RETIREMENT

Mr. McCracken explained that this was not an emergency matter, and could easily be deferred to the next meeting.

Mr. Frick moved discussion of the Age Discrimination in Employment Act and disability retirement be continued to the next meeting of November 20, 1998. Capt. DeIorio seconded the motion, and all voting aye, the motion carried.

XI ANY OTHER MATTERS

A. Retirement application of Robert Curro, Storekeeper.

Mr. Crouse reported that Mr. Curro had been employed by the Town in the Purchasing Division and was retiring under the age 55 and out. He explained that he met all requirements for retirement and that he had worked for the Town for 17 years and 3 months.

Mr. Boggs moved approval of Mr. Curro’s retirement application. Mr. Frick seconded the motion, and all voting aye, the motion carried.

B. Request of Capt. DeIorio

Capt. DeIorio explained that he had submitted a request for two items for consideration, but he would like to table item one until a later date, but he would like to discuss the second item at this time.

Capt. DeIorio explained that he had been approached a number of times over the years as the Fire-Rescue representative, as he was sure Mr. Frick had been approached as representative for the Police Department, to assist with or do something about the health insurance costs, and to do some kind of health insurance cost containment or subsidy assistance, for retirees. He explained that upon retirement, the pension was eaten up quickly by health insurance costs, which was a concern of all of the members and something that he thought needed to be looked at. Capt. DeIorio stated that he did not have solutions at this time, but he was offering alternatives as far as meeting as a board with just the issue of that to tackle, or maybe setting up workshops or a subcommittee of the board to formulate some strategy, and then bring it back to the board.

Mr. Harvey questioned whether this was an issue for the board to address or whether it was a general employment issue. Capt. DeIorio explained that at this time it was an employment issue because at this time health insurance was administered by the Personnel Department, and was not part of the board. He stated that he thought the board needed to look at doing something to assist in the offset of that cost.

Mr. Frick explained that the Town was the exception to not having some form of medical benefit in the retirement plan, and the retirees spend $400 more or less for themselves and their spouses to be on the medical plan, and in the case of the employees Mr. Boggs represented, that could be 50% of their pension. Mr. Frick explained that this had been brought up before, but they did not know how to make headway on this issue, but they felt the board needed to provide some sort of support to the employees.

Mr. Harvey asked if this was a function of this board, or was it a function of the Town policies on the benefits that were provided to retirees. Mr. Doney explained that it would be helpful to hear from Mr. Crouse regarding this. He explained that the Town Council traditionally set the actual rates and cost sharing at the September Council meeting, not just for the retirees and their dependants but for the employees and their dependants as well. Mr. Doney explained that this was a Town Council policy deliberation issue, but this board could make a request based upon its consideration to the Town Council, but he thought that Mr. Crouse could identify for the board how it was done now.

Mr. Crouse stated that he would like to echo the concerns voiced by Capt. DeIorio and Mr. Frick, explaining that it was definitely a concern that he dealt with. He further stated that the nature of medical costs was that they continued to increase. Mr. Crouse explained that the Town did more than many employers by picking up a fairly large of the premium cost for the retirees, so when the comment was made that medical coverage could cost $400 a month for a retiree and the spouse, that was true, but the actual costs were well over $800, so currently, the Town was assuming a portion of the premiums. He further explained that there were some other alternatives that he was looking into, and he hoped to work with the ICMA-RC Corporation regarding a particular program that was IRS approved, where individuals could set aside monies in a voluntary employee benefit account that were tax deferred, and could be used for purposes of paying premiums or unreimbursed medical expenses as a retiree. He explained that he did not know the time frame on this, but he had already asked the ICMA people to look at that plan and to try to get something going. Mr. Crouse stated that he did not know what else could be done at that moment, but he did not think it should be a matter of this board, but rather it was something that the Town Council should address. He explained that he was currently looking into certain aspects of that problem and hoped to make some progress.

Mr. Harvey stated that he was questioning whether this board was the right place to address this. Mr. Frick explained that as a retirement representative, people approached him with the problem. He stated that he would like to have a workshop where people could suggest some solutions, then these could be recommended to the Personnel Department. He explained that right now the issue was not being addressed. Mr. Harvey explained that this was an employee benefit issue that dealt with insurance, so it should be discussed with the Personnel Department. Mr. Frick explained that one option could be to increase the cost of living adjustment to cover the cost of the medical insurance, and this was something that had to be addressed by the board. Mr. Harvey stated that he needed broader guidance from the Town Manager on how this should be approached. Mr. Doney explained that the ultimate policy decision was the Town Council's, and that the Retirement Board and individual board representatives were all confronted with questions on this issue because the health insurance costs were considerably ever increasing. He stated that what he thought Mr. Crouse could do as Personnel Director and also Plan Administrator, would be to meet with employee groups and give them the benefit of knowing how the Town Council has assisted with the costs. He stated that the Town Council had been very fair with the break down of the costs and how much the retiree paid and how much the Town paid. Mr. Doney stated that Mr. Crouse could provide this information to employee representatives who could then share it with employees so that employees would be aware that, while it was a cost consideration for a retiree, it could be higher in the marketplace to duplicate this benefit.

Mr. Frick asked that the employee representatives be authorized to have a meeting with the Personnel Department to discuss this issue. Mr. Wearn explained that in order for this to happen, it would have to meet the Sunshine guidelines, with meeting minutes and public notice. He stated that he did not see any reason why the various representatives, could not on their own, talk with the Plan Administrator and come back at the next meeting if there were any suggestions as to how this could conceivably be addressed by the Retirement Board, and if there were ways that it could be addressed by the Retirement Board, then the next question would be to place that in front of legal counsel to determine whether the jurisdiction exists under existing code, and if not, then it was a Town Council matter to consider amendment of the code. Capt. DeIorio explained that he had been looking at it from the perspective that yes, it was Personnel Department related issue and a Town Council related issue, but was there something that the board could do as a board out of the retirement system to supplement that, as another option. He explained that if there was, then it was a board decision, and the board needed to meet under the auspices of Sunshine law. He stated that he understood that it was a Town policy issue, but he also wanted something from the board's perspective as far as what could the board do through the fund to help supplement that.

Capt. DeIorio suggested that a subcommittee of the board be set up to meet and discuss the related insurance issues, separate from a policy decision of the Town, to formulate plans and strategies for the board to help offset or supplement health insurance costs for retirees, and report back to the board on the results. Mr. Boggs explained that the budget had already been set for the upcoming year, and suggested that, with this in mind, perhaps this issue could be further discussed at the next regular board meeting. He suggested that then additional information could be provided regarding whether or not other plans provide additional coverage for insurance. Mr. Harvey agreed that it could be discussed at the next meeting, and reminded the board members that this was not a stand-alone issue. He explained that this was more of a Human Resources policy on what sort of benefits they wanted to give employees and retirees.

X. ADJOURNMENT

There being no further business, Mayor Ilyinsky moved to adjourn. Mr. Wearn seconded the motion, and all voting aye, the meeting adjourned at 11:45 a.m.

Approved: ___________________________________

John DeIorio, Secretary