Lower Saucon Township
Pension Advisory Committee Meeting
Meeting Minutes September 14, 2016

<u>Roll Call</u>: Present –Cathy Gorman, Joe Scott, PSAB, Thomas Schatzman, Morgan Stanley, Kal Sostarecz, Asst to the Manager, Leslie Huhn, Township Manager, Lou Mahlman, Priscilla deLeon, Council Liaison (via phone). 11:05 AM

Absent: Molly Bender, Mary Curtin, Chris Leidy

1) PSAB Update – Joe Scott

Joe started to review the June or second quarterly report. He wanted to reiterate that they moved away from the monthly reports. They are providing the quarterly reports that are more standardized and provide more information about the program. It is a much broader look at performance over a much longer period of time and risk standards that they are meeting. Page one tells the whole story how the account is balanced and how it is allocated. Top left corner shows year to date. At the end of June they were up 1.38%. We are currently at the end of July up 3.3%. One the right hand side gives the information as to how we are performing under risk management. He wanted to let us know that this is the report standard they are going to provide us from now on. It will come out quarterly. The next report will cover the third quarter and will be out in mid-October. Please let him know if we do not receive it. The second page shows you the allocation tables. The third page goes into a summary report of the fixed account, which we are not in so the first and second page is what is important to us. We operate a balanced account which you are in and the fixed account is all bonds for other clients not wanting to be in the market. There are no other administrative changes with PSAB.

2) Morgan Stanley – Thomas Schantzman

We need to focus on the three-year number on the first page, the 6.42 to 6.78 very close to the policy benchmark. What the MRT does not do historically is match a market that is going straight up. What the MRT has done over the years, if you look at the bottom, you will see the Dow market capture, of 64 – 65% so where the MRT has shined over the years is in a bad market. Where the MRT does struggle, and this is on purpose, is in a straight up market. So you see a little bit of a miss this year. I want to talk about two aspects of that. One is the manager aspect where we had Atlanta Sosnoff and we had Herndon, we have moved on from both of those managers in the middle of June. They were pretty much the cause of some under performance. We do not like to move from managers often. We do like to give them a lot of room to recover but Atlanta we were concerned with them as a business. And Herndon we were concerned about the product. The MRT was in over the years was terrific it was a well performing fund. Then Herndon moved the team that was historically managing that fund was moved to another product. For us that did not work. We gave them an opportunity to rethink that move but they did not want to change. You see the longer term numbers 6.4 – 5.6, very good numbers. Again it is the defensive nature of the portfolio at this point that is not getting it done. Here is what I would say about that, the two best performing areas in the market this year are utilities that are up 22%, markets up 7% and Telecom, which is up 18%. One of the biggest factors we look at in a portfolio like this is the interest risk, interest rate sensitivity because we are fairly certain that the Federal Reserve's next move is not going to lower interest rates but to raise them. A lot of people are not prepared for that. What is happening is people are reaching for yields because they cannot get it in bonds and you cannot get it in cap. But you can get it in a utility company. People want that 3 or 4% dividend but the problem with that is we don't own any utilities, so we did not benefit from that, but they are trading at 2 times book value. Normal is 1.2 times book; 2 times book has never been seen before so we know that something is wrong. We saw this in the 90's with tech stocks and the Google, Facebook, Amazon phenomenon occurring. We are not participating there either. It is a high quality portfolio without interest rate risk. We view this as an investment fund but that is second, first we view it as a benefit paying fund. That is the primary consideration. We want to get to the actuarial assumed rate of return but we have to pay the bills. That means sometimes we might hold three million in cash, a small portion of the plan, but we have three million in bills to pay this quarter. So, we are trying to play that matching game to make sure that everybody in your plan gets the benefit check first and then we seek the best returns we can. In terms of changes in the plan, that is it. One more change will occur later this year. The real estate fund, which has done really well; 10-12% rates of returns, some of the auditors of some of the plans in the MRT did not like the quarterly statement as opposed to the monthly. It created a problem for some of the Boroughs and Townships in the plan. The auditors were red flagging it so it extended the expense of the audit and extending the period of time in which you would receive your benefit statement. Your statements were getting out late. We need to fix that. We have a firm that will take over the core real estate part of the portfolio, very good numbers, around since 1982, that has a daily evaluation. Like a mutual fund. We are going to own the same properties for the most part, but we are own them in a vehicle that gets valued everyday so we don't have late statements, we are not waiting a month for our year end audits, taking two months for the year end to be done. We ran into an operational road bump. That is the only other change that we are thinking about. This is way too soon, but I have to tell you September has not been a great month; the Dow is down ½% and the stock market is down ½%. The MRT is down .2% for this time period. We just don't have that interest rate sensitivity. We don't know what is going to happen next year. Over a seven year period of time is how we like to look at these things. I cannot imagine over the next seven years that rates are not a little bit higher. We are at a 52 year low. One area we are not touching is Europe. A lot of firms made a big engagement in Europe. We are half weighted in Europe. A lot of people are getting in because it looks cheap.

There is no growth and no fiscal stimulus and we are seeing this play out with negative interest rates. So about 20% of the world's bonds, not in the US, but global traded at a negative yield. Meaning you pay them for the bond. I don't know what happens when that unwinds. When this flips it is going to create chaos for those bonds. As investors, we just don't own them. Our bonds which are 30-35% portfolio are US investment grade bonds. Three to five year maturity. Some are a little bit shorter than that. We have been overly cautious. But when we look at the negative bonds; I just don't know anyone smart enough that will understand what is going to happen when they flip positive rate of return. No investors are buying these bonds only speculators who are trading every day. We are under owning Google, Facebook, Netflix and Amazon; we don't own utilities, any exposure to long term bonds. Long term bonds are up 19% and we are not there. The yield for these bonds if we held them to maturity would be close to 0. Long term investors would not be in 30 year bond market, or utility stocks or telecoms. This stuff tends to regress to the mean. Remember when banks traded at two times book value, the result – chaos. Now that is trading at .8; that is normal. This report is dated and you are doing better. If you go into page three. You are not in this. This is where we are holding the three million in cash. That is about it. Emails and phone calls are welcome. I will leave you with this; we are going to enter into the rocky time of the year, with the election months. This election may be more violate up or down. I would not be surprised with a little bit of sell off. It is that time of year and it is at the end of a four year cycle. And we are likely to have a very ugly, contention election cycle. What is very likely is that we will still have divided government and whoever wins, congress will be dead set against that person.

We are not sure how this election will turn. Not much a President can do without Congress and the Stock market likes that. It may be a rocky 4th quarter. Cathy mentioned that at some point we are going to have to look at our assumptions again, after reviewing with the actuary. The valuations will be done next year so that will need to be discussed in December. Joe asked if we will be reporting year; preparing the Act 117 reports for next year. Cathy confirmed.

3) Financial Reports
Cathy distributed the financial reports. The Township has reimbursed the plans of their administration fees to date for the Non Uniform Plan, $10,774.37 and Uniformed Plan $28,284.21.

4) State Aid
Cathy reported that she has good news. The unit value as increased by 11.6% to 4,374.6462 per unit value which comes to $223,106.95 last year we received, $199,962.57. Based on our policy for distribution, the Non Uniform plan will get $91,867.57 which is $8,254.57 more than is required. The Uniformed plan will be getting $131,239.38 which the Township will be paying $158,652.62 on the plan. Speculating next year we will be receiving the same amount of money that will bring us to the next agenda item, we are looking at the Non Uniform plan receiving $8,147.57 more than what is required and we will be paying $159,174.62 to the uniformed plan. This will be a set figure for next year. When we start the calculations for next year's valuation and the 2018 MMO's that will be subject to change. It would appear that the Non Uniform plan will not require contributions this may change when the valuations are done and how far off the mark we are with our valuations and assumptions at this two year cycle. Priscilla asked why we are paying the $158 thousand. Cathy responded that the uniformed plan's 2016 MMO was $289,892.00. Priscilla asked to speak with me at a later date.

5) 2017 MMO
The 2017 MMO was presented as $83,720.00 for the Non Uniform Plan and $290,414.00 for the Uniformed Plan, totaling $374,134.00 of which we will be expecting $223,106.95.

6) R. Jacoby COLA
Mr. Jacoby's COLA is at .2% this year. He will be at 11.8% of the 30% maximum. I will send him a letter notifying him of the change effective November.

The MMO's were moved for approval. Leslie approved the MMO's and Lou seconded. Minutes were approved.

Meeting adjourned at 11:30 AM.