Lower Saucon Township
Pension Advisory Committee Meeting
Meeting Minutes June 8, 2022

Roll Call: Present –John Herb, Morgan Stanley, Joe Scott, PSAB, Molly Bender, Jared Gunshore; Jonathan Mull, Jason Banonis, President of Council; Cathy Gorman, Director of Finance

Meeting opening 11:04

Missing: Brian Courtney

1) PSAB- Joe has nothing pertinent to add.

2) Morgan Stanley –John shared screen. We are still experiencing market volatility. The market standpoint this quarter there was no where to hide; as we look at this for the end of the quarter and where we sit today, we have been going through a period of significant volatility in both the fixed income market and equity market. The themes through the first quarter and to date has been value stocks outperforming growth stocks. The value markets down 7.4% versus large cap growth down 9.4%. Large Cap stocks outperforming Small Cap stocks. The US market down 4.6% through the first quarter versus small cap stock down 7.53%. Domestic stocks outperforming International. International stocks measured by EFA are down 5.91%. Other than cash, there was nowhere to hide. This has been a perfect storm from an investment standpoint. You have negative returns for fixed income, and negative return for equity markets. So in your typical balanced account; there was no where to hide in a broad asset class other than cash. We are in the midst of rising interest rates; we are at 40-year highs for inflation so how aggressive is the Fed going to be in raising interest rates to combat inflation. We are seeing slowing in economic growth, although still above trend at 2 ½ GDP growth, but again the US economy is certainly slowing. Corporate earnings have been very strong over the past several quarters but appears they have peaked as well and are beginning to slow. On the consumer level, retail stocks are being particularly hard hit with slower spending. Before our last meeting we had Russia invading Ukraine, which continues to weigh on markets. Energy and Commodity markets are gray markets since Ukraine has always been called the "bread basket" of Europe. They are a significant exporter of grain. There are 26 countries that receive 50% of their grain from Ukraine and Russia. This is showing effects on the commodity market and continue to weigh on inflation. We began the year with valuations on the US markets at above average, not where they were in the late 1990's. Clearly equity markets were stretched. Equity markets are now close to fairly valued. The PE's are roughly 16 point from earnings; historically it has been 15 times. We are slightly over. Markets are concerned that the US will move into a recession next year; that the Fed will not be able to orchestrate a soft landing for the US economy; that the Fed will be too aggressive in raising interest rates which may push the US economy in a recession next year. If that is the case, we expect the recession to be mild from where we are now in an economic standpoint.

   From a sector standpoint, it has all been about energy. Energy has been a dominant sector last year and continuing this year. For the quarter up 39%; as we sit here today energy is up 61%. Energy and Utility stock, up 4.8%, they have been the only safe haven from a sector standpoint. Hard hit has been the growth-oriented sectors; consumer discretionary stock, technology, communication services and continues to be the case. From an interest rate stand point we start the year with a 10-year Treasury at 1 ½%. We have seen a significant rise in rates. We ended the quarter with a 10-year Treasury at 2.34% as we sit here today it is about 3%. As interest rates rise, bond prices decline in value. We are seeing negative returns for fixed income markets. Bond market is down 5.93%; intermediate bonds down 4.5%, short term treasuries down 2.3%, and cash/money markets/CDs are at a 0% return. We will start to experience positive returns in cash investments as the Fed continues to raise interest rates. Just to reiterate there was nowhere to hide in fixed income.

Treasury Bonds down 5.5%, TIFs, Treasury inflation protection securities, down 3%, municipal bonds down 6 ¼%. Investment grade or corporate bonds down 7.6%; no matter where you go in fixed income there was no where to hide.

The economy globally is slowing. Economic growth over the last two years was unsustainable and the stimulus being eliminated right now, continue to slow. What is driving this is the significant rise in inflation. Inflation is rampant everywhere. The Feds are going to be aggressive in combating inflation so they will be aggressive in increasing interest rates; that is how they combat inflation. They raised rates in March by 25 basis points; raised rates by 50 basis points in May, they should raise rates by 50 basis points in June and expectations are that rates will be 2.5 – 2.75 by the end of the year. These weigh on fixed income and equity markets which is why we have negative returns on a year to date basis. The Fed has also recently announced that they are going to be implementing quantitative tightening. Back in March of 2020, in the midst of the pandemic, the Federal Reserve implemented quantitative easing, which means they were going into the market and buying 80 billion dollars a month of treasuries and 40 billion a month in mortgage backed securities. They were pumping in 120 billion dollars a month in the market, providing liquidity, stimulating growth and keeping interest rates low. They eliminated that at the end of last year and into the first quarter. Now they have announced they will be administering quantitative tightening, where they will be removing money from the system. Starting in June they will be removing 47 billion dollars a month coming out of fixed income markets and in September removing 95 billion dollars a month. Again, the Fed is tightening financial conditions to combat inflation by increasing rates and quantitative tightening. This is a concern from a market standpoint. The market has been a wash in liquidity for the last two years. Feds are removing that liquidity to combat the record high inflation.

Inflation peaked during the 1st quarter at 8.5%, that was a 40-year high. April came in at 8.3%. We feel inflation has peaked. If inflation falls to 5-6%, the Fed is still going to be aggressive in raising interest rates to get inflation under control. The inflation target for the Feds is 2-2 ½%. They may raise that to 3%, we are far away from that amount. This is definitely having an impact. Looking at small business confidence, small business is the engine of growth for the US economy, the percent of businesses thinking it will improve less the percentage of businesses who expect the economy to deteriorate. We are at the lowest level going back to the 1980's. This is recessionary levels we are seeing. Small businesses are saying this is a terrible environment to be operating in regards to inflation, employment, regulations, etc. This is a measure we have not seen in 40 plus years. Consumer confidence has collapsed. We are at the level of the consumer crisis back in 2008-2009. The consumer is telling you inflation is an issue due to the rise in prices. Consumers are changing their behavior due to the rise in prices. So, the Fed needs to get inflation under control. The consumer represents 75% of the economy. The consumer pulling back is definitely is going to have an impact on economic growth. You will see the University of Michigan study showing consumers expectations of personal finances. Will the consumers' expectations from a financial perspective, be better one year from now. Again, we are at recessionary levels. Much worse than 2008-2009. Consumer feels they will be much worse off a year from now.

Rates increasing having an impact on the 30-year mortgage index. Now that we are approaching 5% rates, we are seeing a significant decline in mortgage applications. The housing market has been an engine of growth for the economy over the last several years. With the interest rates now with a 30-year mortgage exceeding 5%, the affordability index has dropped dramatically, it is definitely starting to slow. The housing market is extremely important to the economy if you go into all the auxiliary services associated with buying and selling a house, again we will have an impact.

As of two weeks ago, significant downward volatility in the market, US bond market down 8.5%, we are down about 9%. 10-year treasury has been trading at a range of 2 ¾ to 3%. The bond market is pricing at a worst-case scenario due to the Fed raising interest rate. The peak is at a 3%

range for the 10-year treasury. US market down 12%, we were down as low as 18% in end of April and into May. We saw a rebound in equity prices. This is where we sit today. Growth stocks continue to underperform value. International is slightly ahead of US now on a YTD basis. Lastly, the annual return for the S&P for the past 40 years, the US stock median return has been 13%. However, in any one year, you see a 10% plus correction in the equity markets. We were down 20% for 2022. The moral of the story is if you want above average returns you need to invest in equities to meet pension obligations, you need to put up with equity market volatility. Part of investing is putting up with volatility, Any one year you are going to see a 10% plus correction. Last year we were only down 5%, very low volatility, historically though it is 10% when dealing with equities.

As for the MRT, we had a good year last year up 14.48%. This is a challenging year, for the quarter we are down 4.5%. From an asset allocation stand point, we ended the quarter at 47.9% in domestic equity, 14.34% in international equity, 26.7% in fixed income, 6.9% in core real estate and 4% in cash. Our goal is to provide consistent returns, down side protection, and reduce volatility which we continue to do by investing in core real estate within the portfolio. From a strategy standpoint, we are at 62% in equity, broken down by large cap core. We have overweight value, 14% in large cap value, 12% in growth, we continue to overweight value versus growth; diversified by mid and small cap. 14% in international, and 26.6% in core fixed income. If you focus on the core fixed income, again we are diversified. We are overweight in short term fixed income versus core fixed income and intermediate fixed income, so in a rising rate environment, shorter maturities will not fall as much in a rising rate environment. We have 6.93% in real estate and 4% in cash. At the end of 2021 the Trustees hired an additional real estate manager, Intercontinental with a 5-million dollar allocation, that was implemented on April 1. The overall allocation to core real estate is about 8.27% today. We will be taking that closer to 10%. This has been very beneficial and important going forward if we are going into a lower return environment. In real estate, as a reminder, both managers have been overweight in industrial; the Amazon warehouse, the last mile from a distribution. We are overweight in multifamily real estate. Apartments have been beneficial. After one year there is the ability to increase rents due to inflation. We are under weight in retail and office. With core real estate, with an environment like we are in, it produces dividend income, 6% plus, provides stability of principal, core properties do not fluctuate in value in a quarter by quarter basis. It provides for the growth of the assets over time. The ability to raise rates with inflation, provides a hedge against inflation, and provides diversification. We typically use two managers per asset class. Assets are in active and passive managers. They are low cost and predictable returns. There are no changes other than the additional of the core real estate manager. The only other possible change is to continued increase in passive management for large cap growth.

Lastly, reinforcing MRT has a very comprehensive fiduciary oversight ongoing process. The investment policy continuously reviewed, always a relationship between assets and cash flow, and asset allocation. Investment strategies are reviewed monthly, formally quarterly. Significant manager due diligence, performed on each of the investment options currently utilized. Performance is formally reviewed monthly and quarterly. And lastly, trustee education. We met with the trustees at the end of May; a significant amount of time taken looking at the economy and market, prepare for a challenging year. Joe asked about May's YTD numbers. John said we do not have those valuations yet. Estimates are down 9% YTD.

3) Project 2023 MMO –
Cathy said the forms being used are from 2022 but the formulas are to be used for 2023. Payroll has changed. We are looking at a similar amount to what we had last year. The Uniformed Plan would be a little over $433,000.00 and the Non Uniform would be able $188,000.00 which is pretty close to what we had last year. A slight increase due to payroll increases. I will update our numbers and

provide them to the committee at the next meeting in September for approval. The MMO formulas are based on the last actuarial evaluation.

4) Financial Report
The Non uniform plan the Township put in $98,438.50 and the Police plan; $244,356.04. That is inclusive of reimbursement of administrative fees and monthly MMO payments.

5) New Hires
At the last meeting I reported on several terminations and retirements. We recently hired Tyler Weiss in our Public Works Department which is an additional employee. And we hired Rachelle Markovic as the Receptionist and Erin Jackson and the Financial Clerk. Both started in May before the AG 385 cut off date.

6) Settlement Filings – None Received

7) Minutes approved – If everyone is ok with the minutes they will be posted on the website.

8) Next meeting date: September 14th 11:00 AM

Close meeting 11:37 AM

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