South Central Connecticut Regional Water Authority
Pension & Benefit Committee

October 8, 2020
Meeting Transcription

The special meeting of the South Central Connecticut Regional Water Authority ("RWA") Pension & Benefit Committee took place on Thursday, October 8, 2020, via remote access. Chair Sack presided.

Present: Committee – Messrs. Sack and Messrs. Borowy, Cermola, Curseaden, and DiSalvo
Management – Mss. Kowalski, Reckdenwald and Mr. Bingaman
Morgan Stanley – Messrs. Kelliher, McLaughlin, and Kantapin
Staff – Mrs. Slubowski

The Chair called the meeting to order at 11:11 a.m.

Suzanne:

Thanks very much. Okay, thanks very much for being here everybody, including the RWA members for coming to an extra special meeting, and the folks at Morgan Stanley for taking some time out to have this important conversation.

Suzanne:

The objectives of this meeting are as follows. One is to reflect on the performance that we've had since we've been managed by Morgan Stanley in terms of comparing it to our target of seven percent, and the issue being that if over time we are unable to, based on the way that we've allocated our portfolio, based on our policy statement et cetera, are unable to achieve a seven percent return, what is it that we need to be thinking about? Either altering, either in the way we're managing the portfolio, the cost of managing the portfolio, or the seven percent target.

Suzanne:

So that we are not constantly under the bench mark in terms of trying to get to a point where we can be fully funded without having to do additional contributions on a regular basis. So, that's the overall objective, and what I'd like to talk about is just if we can review where we stand on performance and just confirm and bring everybody back up to speed about what the performance has been against the target. Why the target has been what the target is, and how it looks.

Suzanne:

What you forecast for the future, and then talk through the various options of managing toward either how do we either modify our policy statement to get to seven percent? How do we modify the costs of managing the portfolio, or should we even be considering modifying our target? So, I will turn it over to you, Steve, to bring the group back up to speed about why our target is seven, how we've been performing to that, and some of your observations related to that.

Stephen:

Okay, that sounds good. Thank you, Suzanne.

Suzanne:

Yep.

Stephen:

Why don't we go to the next page, which is the table of contents. Which is more or less in the order that you just suggested, but I might be slightly out of order, but I'll verbally bring us around if we are. So, item number one, just like we usually do, or almost always do at our meetings is, we're going to look at the IPS, the [inaudible 00:14:16] policy statement, but we'll spend an extra minute or two on that today to get everybody's head around it, right? So this is the one that was put in place at this point several years ago.

Stephen:

This is the document that you provide to us that really dictates our behavior inside the portfolio between meetings. And actually, I shouldn't say between meetings. Between meetings and all the time, really. We are then going to update you and Suzanne touched upon this, and this is super important I think. Looking at our expected asset class returns going forward, we have a few sources of that. We always look at Morgan Stanley. MFS just updated their numbers recently, so we're going to show you that, too. But they're not all that different from one another.

Stephen:

My main concern looking forward, equity markets are very difficult to predict. Bond markets a bit easier, and since you do have a fixed income bond allocation for those 10 year and less, and really five year and less liabilities, we know that interest rates are extremely low right now. So, if there's a potentially known short fall on the target going forward, it would likely, I believe, come from bonds.

Stephen:

We can talk about equities and some things that can be done there, and I was planning on talking about that at our regular meeting a bit next week also. We will look at the trailing five years, during which time now, you actually have exceeded the seven percent target.

Stephen:

We'll talk about that and the likelihood of that going forward, and then we did a bunch of stress testing to the existing investment policy. We did rolling five, seven, and 10 year returns, and Alan's going to talk to that a little bit, and we also ran the most recent numbers from the actuaries, and we'll take a look at that, because ultimately, that section number five, to us really dictates the stock bond mix, right? We say what liabilities are going to occur in the short term? Meaning five years or less to us.

Stephen:

In the intermediate term, out to 10 years, and longer than 10 years. So we'll look at that also, and Alan and I will run you through that section, and then we'll bring a cost update also. So, any questions on that? That's the intent. It's relatively simple material. That sounds like a lot. Relatively being a key word I guess, to that comment. Any questions, comments, something different?

Suzanne:

No, I would just try to be sensitive to time and it is, I think everything you talked about, we must cover in this meeting. But to the extent that being concise and moving swiftly is not cutting it short, that would be great.

Stephen:

Okay. I think it will be surprisingly brief. It's not a huge debt today, believe it or not. It's a lot of subjects, but they all blend together. So I'll try to move quickly.

Suzanne:

Okay.

Stephen:

Let's look at the executive summary then, which is the next page. And if I'm looking up, I apologize. I have a bigger screen in front of me. The smaller screen as you all know can be harder to read assuming you have a similar set up. So, let's look at the primary objectives, which is right here towards the lower part of the page. So, obviously, this is as published by you and received by us. We cooperated on drafting it, but ultimately, this is published by you and given to us as our bible if you will. The milestone goal of being fully funded for pension plans by fiscal year end 2023 is your stated target.

Stephen:

Excluding ongoing plan service costs and subject to obviously prevailing market conditions. That's your primary goal, along with to achieve the actual rate of return number, too. In no set order, right? So that's super important, right? That is why what you're telling us, and what you're telling anybody who's an interested party, really what your objectives are in this investment policy. Your asset allocation, which again is heavily dictated to you and us really by the liability structure that the actuaries produce.

Stephen:

We have ranges of equities, fixed income and alternatives with the preferred target you see on the right there. 55 percent equity, 30 percent fixed income, and 15 percent in something alternative or balance, which I often call swing, right? Meaning something that may swing between a stock and a bond, something that doesn't behave like a stock and bond, perhaps real estate, perhaps a hedge fund, et cetera. So that is the stated objective. Now we're going to look at what's likely to happen looking forward, and what has happened looking backwards.

Stephen:

So maybe we jump into the next page would be great. I'm sorry, Jennifer is controlling this. I'm not. So let's now look at some of these numbers we looked at a year ago, but we're going to re-look at them now. So, Morgan Stanley has in green at the top expected asset class returns looking forward. And what Morgan Stanley is saying, we've run the asset class on the left, then your investment policy statement target that you just saw in the center, and then our expected long term rate of return, one from the right, and we blend that all together in the far right.

Stephen:

And basically what we're saying at the top half of the page is based on the current outlook looking forward from Morgan Stanley, so single source so far, but it's all based on these forecasts aren't that varied firm to firm. They can be varied but they're all using, basically, reversion to the mean type statistics, right? Whether it's the mean or valuation, whether it's the mean of what's outperforming and underperforming, et cetera. And based on that, we are looking forward now saying the expected rate of return is 6.06 percent.

Stephen:

When we looked at this a year ago, that's the bottom half of the page. So it has reduced, and frankly has reduced less significant than they may have thought it would have reduced based on what's going on in fixed income. But it was 6.24 percent when we looked at these same numbers a year ago. So there has been a slight degradation there in our forward look, and frankly, it's been in equities, and it's been in fixed income. In both cases, they're both down by 20 basis point in the fixed and 10 in equities.

Stephen:

I personally question whether the fixed income number can even get to the three and a half percent number knowing where rates are now, right? I suspect we will see that number fall again a year from now unless we have a miraculously big change in COVID, and the economy recovers so quickly that we see inflation and rates start to go up again.

Stephen:

That's a big if, but to get three and a half percent from fixed income right now in anything other than preferred stocks, and or in high yield or junk bonds is very difficult to do. You're not going to get it from high quality investment grade at this snapshot moment in time. Let's jump to the next page. How about looking back. Whoops, there we go. Maybe we can blow that one up a little now. That's great.

Suzanne:

Thank you.

Stephen:

Can everyone see it all right? I guess I should ask that?

Suzanne:

Yeah. We can now.

Stephen:

If anyone can't, please speak up because it's important. So, looking backwards, so that was looking forward. So, it's subjective obviously. Looking backward is not subjective. Looking backwards right now, if you look backwards, and you're going 10 years, you can see the returns by asset class. The backward looking 10 year number of your IPS mix is currently 666. And on year ago at the bottom half of the page, it was 715. So, there has indeed been an actual degradation.

Stephen:

And these are the 10 year numbers, and as we'll talk about in a minute, it's very easy to move a three year number. It's reasonably easy to move a five year number, it gets harder to move a 10 year number with any one year, right? And it gets extremely hard to move a 20 year number if I'm making sense. So, the more time periods we have, the more anchored that number is. And I'll talk about that more when we get to the actual results. So, looking backwards, you're looking at returns of if you had invested right in the indexes and in this IPS looking backwards, it would now be 666.

Stephen:

Looking forward, we think it's somewhere more between six and six and a quarter. And looking at the same numbers a year ago, it was 715. Obviously, one year can still make a pretty big difference, especially when that one year looking backwards is 2020, right? We want to be careful that we don't overreact to a highly unusually historic year like 2020 as we walk through here also. So, so far, so good. So, we're looking between six and 715 on this mix looking forward and backwards. So, not far off where we're at, but not exactly at that seven number either, other than one example. Jumping to page eight, please.

Suzanne:

And Stephen, I think it's important to say. These are historical numbers based on the asset allocation mix, not necessarily are historical numbers of performing.

Stephen:

So far, that is 100 percent true.

Suzanne:

Okay.

Stephen:

We're going to get your actual numbers [crosstalk 00:23:14]

Suzanne:

Yep.

Stephen:

But yes, so far. So, we looked at another source, and I picked this. We use MFS quite a bit. They're an excellent money manager. Very large, you probably know them. They've had wonderful results over 100 years. They are the original mutual fund. It was invented by MFS, they've been around forever. So, since they published it, we thought we'd take a look at what they were saying right now. And from an equity perspective, their long term forward returns, they do it a little differently.

Stephen:

We have this underneath the surface, too, but they're publishing it by geography, right? So they're saying looking forward 10 years, emerging market equities are likely to earn over nine percent a year. Developed markets seven, global equities, that would include the US, 4.3, so they're a little lower than we are, and US equities, they're down at two and a half. So very low. But you start to glean something

out of this to say, well, we could accept Morgan Stanley's numbers, or and I think we needed to do a combination of the two, we also could realize not all equities are created equal.

Stephen:

And that's the purpose of this slide, right? That it's been a growth equity market. It's been a domestic equity market. Perhaps some more dynamic movement in the portfolio going forward can and will add some value when we look at, do we tilt a bit more towards value? Do we tilt a bit away from large cap? Do we tilt a bit more towards international? I'm not concluding on this today, I'm just [crosstalk 00:24:41] not at all concluding.

Stephen:

It's too short of a meeting to make a conclusion on that, but behind the scenes, we will make these tilts and have made these tilts, and we've talked about dividend yielding stocks in the past, which are still lagging a bit, but you are seeing some life in the short term from that space versus the large cap growth domestic space. So, probably a lot of words here, but understand that there are things that we can do together and that you can rely on us to do underneath the service to potentially, with patience, I can't stress that enough, with patience, but over the coming time frame, enhance those expected rates of return over just what the domestic equity market is doing.

Stephen:

And just the large cap domestic equity market, which we often overlook at, which is the S&P. So, if we jump to the next page, there are other things going on, too. And this is just to help us glean. We're presented with this challenge that Morgan says the rate of return is going to be 606, not 715 like it's been. What else can be done? So, inside the portfolio, we've also had a period of time that is highly unusual in that US markets have, historically, US and global markets have alternated back and forth as to who's outperforming, but it's long before the day we met really back to the end of the financial crisis.

Stephen:

Domestic markets have been outperforming. You see that in the light blue is domestic markets outperforming. And as you can see, it goes through cycles. And we fully expect that like the growth value cycle, like the large cap versus small cap cycle, that the US foreign cycle will also reverse. There's no reason to think it wouldn't. Securities are a lot cheaper globally, and that there are things we can do to likely over time, again with patience, I can't say that enough time, because it won't be quarter to quarter as we meet.

Stephen:

It'll be over year and three years, and five years, that we could enhance the performance in all likelihood by going to where if you will, the puck is going, not where it's necessarily been. We see the same phenomenon on the next slide, right? And these are things I'd like to do in the portfolio with your consent over time, and I figured this was more of a topic for next week's meeting, but-

Suzanne:

Steve.

Stephen:

Yes?

Suzanne:

Can I interrupt you just for one second? I'm sorry, you're on a roll. But, can we go back one slide, Jennifer? Yeah. So, in this particular slide, I'm curious about this 10 year, what's interesting is when you look at this just from a technical point of view, an amateur technical point of view, it looks like that the US over time is getting larger expanses of outperformance. If you looked at this through, remember when we took a look at the significant market interruptions and how the two performed afterwards?

Stephen:

Yep.

Suzanne:

Going back to both the crash in the '20s and so on? That would also be an interesting slide. Not for today, obviously, but for if we talk more about this.

Stephen:

Good point.

Suzanne:

Our really protracted interactions like the 2008 and this potential for COVID signaling something that says US is even more arguingly a better place to be. Anyway, just a thought.

Stephen:

I agree 100 percent. The longer the data the better. It is interesting that correlations, coefficients which we used to compare these markets, they've been condensing over history, too. So, markets today are more closely linked globally than they were five years ago, 10 years ago, or 30 and 50 years ago. So there is a little bit more commonality at the correlation of the markets, but it's still obviously from this slide and the other slide, there were distinct differences at the same time.

Stephen:

You tend to do well over time, all that being said, and again, patience is key with these type of tweaks. It's, and I'm not recommending a tweak today, I'm just trying to point out that here's the expected rate of return, but what's underneath that, that could deviate from it? In a positive manner.

Stephen:

You tend to do well over time, and history proves this, going where there's better value, not buying a market that's 21 times earnings, but buying into one as on this slide that might be 14 times earnings. Especially in a global world, so takes time. I don't disagree with you, I actually agree with you, and maybe Alan can make a note of that. We'll look at this longer term when we meet I think it's next Thursday.

Tony:

Hey Joe.

Joe:

I'm back.

Tony:

Good.

Stephen:

Hey. Joe, how are you?

Joe:

Good.

Stephen:

So, let's jump ahead again. I don't remember the next slide off the top of my head. I always get it right here. So, this same phenomenon has been happening to an exceedingly unusual degree. Unlike the international, Suzanne, to your point, but between growth and value. We are approaching a three standard deviation event. We're well over two, in the outperformance of growth names. And it's really about five names, versus value.

Stephen:

So there's also an argument where these fabulous companies like the Amazon, Facebook, Apples of the world are going to do well clearly, but there's an argument that their stocks may do less well than the companies, because the stocks have run so far ahead of the rest of the market. And we are positioned for this already to some degree. We've taken a strategy within your portfolios of currently of having about for every two parts that we have in a market cap weighted index, we have one part in an equal weighted.

Stephen:

And we're seeing that pay off in very recent times. It's too short of a window to call it a payoff yet, but it is beginning to move in that direction. So the point with these slides was okay, here's the forecasted rate of returns, but then there's a lot of deviations and dispersion underneath the covers. A lot. If one were to tilt towards value, if one were to tilt towards international, if one were to tilt a little bit away from large cap and more towards mid cap and smaller cap, if one were to tilt internationally, you may while you're buying lower priced securities, that is a recipe for likely outperformance over the coming five years, right?

Stephen:

With risk, right? With the risk of underperforming the market, not necessarily underperforming your seven, right? The goal here is, we need to worry about the markets obviously, but we really primarily need as a group, need to worry about seven. Which will bring me to the next slide. So, we do believe

there are things that we can do under the covers if you will that can help enhance. Obviously, you're not going to go, I don't think, from a target of seven to a target of six.

Stephen:

That would be easy for us. I don't mean easy, but it would obviously if you were to bring that target down, it's easier to achieve. That's just a flat fact. But that would be a very big move for your financials, so I'm not suggesting that. Let's look backwards now, because the last time we spoke, 2020 has been quite the year, right? We've had an extreme down and extreme up, and now we're back to, let's call it we're back to neutral relatively speaking. What has happened over the last five years, because these are key numbers, right?

Stephen:

I guess I will read you across the middle here, I know we have a time constraint, but I think this is important. Because this is what's actually happened now. Through a week ago. Five years ago, the various pools of money, I'll just use the number that's about dead center left, 39,408,660 in the various funds. In the various pools, right? Including matrix trust. You've had net deposits, so this isn't showing deposits separately from withdrawals, but of 10,000,757 during that time frame.

Stephen:

The transfer column equals zero, because that's us moving money intra-account. Where you see the negative numbers, it's what paid out in pension payroll from orange out of the [Viva 00:32:39] in those three bottom numbers. The 5.5 million, the 350,000, the 3,000,770, right? Those are actual payments out to your beneficiaries. The purpose of this whole plan, right? But those net to zero. That's just moving money, funding the Morgan Stanley accounts, or funding the Matrix accounts, and then ultimately funding a payroll to someone or a lump sum to someone.

Stephen:

The net invested is 50,000,165. At the end of September, there's 70,587,505 in there to the penny. So there's a dollar gain over five years of 20,000,421. What's interesting enough, and this wasn't through the last time it shows you, in 2020 in particular with that's going on, and five year numbers can be moved by short term movements, right? When they're extreme. Your net return for the last full five years is 7.68 percent now. So, this says a little bit different than what I started with right?

Stephen:

I was looking forward, and we were looking at index returns alone a minute ago, but if the actuaries would do the reports today for the last five years, you have been and are reaching your actuarial goals. Now, if we go into a steep drop tomorrow, and the markets drop 30 or 50 percent again, then most certainly, this number moves. And this is my point earlier, when you have a one year return, the second year has a big impact on your long term returns, right? When you have a three year return, the fourth year has a reasonably big impact.

Stephen:

When you have a five year return, the sixth year numbers will have an impact, but it's declining. When we get out to 10 years hopefully, and you have a bad year or an exceptionally good year, it's much hard

to move that 10 year number. Does that make sense to folks that we've been dealing with a highly volatile year and relatively short term numbers here, relatively.

Stephen:

They're getting to be intermediate term numbers, so they're a little harder to move than they were. But, so the message here is the goal is seven, and your actually net of all costs have earned 7.68 percent at this point in time. So, it is this moment in time, and obviously, on March 31st when we were talking, that's not true, and even by June 30th, it wasn't true. But now, with a little patience, by September it is once again true. So [crosstalk 00:34:59]

Suzanne:

And Steve, does this include the fact that we contributed additional assets and you had money to, and you provided performance on those assets, right?

Stephen:

This is system generated daily compounded time weighted rates of return. So, we take every day, and say we made .2 percent on Monday, we lost .1 on Tuesday, we made .3 on Wednesday, we lost .2 on Thursday. Those are compounded every day. This is industry standard calculations of time weighted returns.

Suzanne:

Right, but if we had not put in additional contributions right, in which you had access to assets to invest that would contribute to those investments, we would not be at the same rate of return that we are, correct?

Stephen:

Correct, but it would be likely similar. Our systems also calculate dollar weighted returns. So, dollar weighted returns are not typically the industry standard, but we have them. And in advance of this call, we calculated them actually. And the difference with dollar rate of return, so we're not counting that 10 million as a gain, you understand that right?

Suzanne:

Right. Yes, I do.

Stephen:

Right, so that's not counted. But dollar weighted returns, come in, I think Alan I might need you here, but I think they were instead of 7.68, I believe they were 7.64.

Suzanne:

Okay.

Alan:

Yeah, you're right, Steve. They came in at 7.64. And to just expand a little bit, if excluding those 10 million dollar deposits would not affect the time weighting of returns. The time weighting of returns essentially eliminates the effect of the deposit, so even if the 10 million had not been deposited, the net dollar gain loss would be less, but the percentage gain loss would still be 7.68 net.

Suzanne:

Okay.

Alan:

So that's just what the time weighting does.

Suzanne:

Okay. Thank you.

Stephen:

Does that make sense? That was an important question, and it's something we have not discussed in the past. What our industry as a de facto standard uses time weighting, but dollar weighting can be produced.

Suzanne:

It can be. The questions is, are you able to do things with the portfolio that you wouldn't ordinarily be able to do because you have more money, et cetera. But, we don't need to stay on it, because it's likely not going to be a big difference. So-

Stephen:

It would be a bigger difference if you had 40 million and added 60.

Suzanne:

Right. Rochelle, where's the 60 million? All right. Go ahead.

Stephen:

[crosstalk 00:37:49] got 10 over five years. When you got 10 over five years on 40, it still doesn't change the 768 even if you added 60, right? Because those are time series. But that's when you would look at dollar weighted returns, because there was a substantially unusually large change in the dollars due to a deposit or withdrawal.

Suzanne:

Sure.

Stephen:

That's when you typically look at dollar weighted returns.

Suzanne:

Okay.

Stephen:

But they're so marginally close. It's four basis points. It's moved that much up and down since we've been on this call even at that level. So, let's now look at, so that's what you've done. You have met your goal-

Suzanne:

And we have met our liabilities as well, which is important for everyone to know.

Stephen:

Right. Where we're a little cautious looking forward is part of this call, we share this caution with Suzanne. I share not because I can predict equity markets, but because fixed income rates have fallen so far, right? That's my primary concern is fixed income going forward. Equities will be equities.

Stephen:

So, with that being said, Alan then went and ran some very interesting on the next page, sorry. I'm forgetting I have to switch the page. Maybe I let Alan do this too, but he took your benchmark, right? And that is the orange colored line across the center. And he took the seven percent return which is the green line running horizontally, and then he took if your portfolio is just in these benchmarks, and we did rolling five year returns, what is the success and failure of that? This is all looking backwards, but I think you'll find it interesting. So, Alan, why don't you take this?

Alan:

Yeah, so this is a study that I ran going back as far as our index data for the strategic benchmark went. So, what it is, is essentially every bar in the chart here is a five year return. The index data went back to December of 1991, so the first five years return that we had was the five years ending December 31st, 1996, and we ran that all the way through August 31st, 2020. So the end of August. So, in the box there in the middle, you'll see total periods, or 285 total five year periods in the study.

Alan:

The percent of five year periods that produce a return of greater than seven percent was 51.23 percent, and the percent of five year periods that produced a return of less than seven percent was 48.77 percent. So, just about 50-50. Slightly more periods produced a return of greater than seven percent, and then just under there, the average five year return over all of these 285 periods was 7.42 percent. So, that exceeded the seven percent actuarial target. The best five year return was 16.37 percent and the worst five year return was negative 1.37 percent. So, that's backward looking.

Suzanne:

So, Alan, I'm sorry to interrupt you. So, this is a 25 year look. So, do you know what the number is over the 25 years?

Alan:

That's a good question. I didn't actually run the 25 year. We ran rolling five, seven, and 10 years, but I didn't actually run the 25 year. But I can quickly-

Suzanne:

I don't know if you need to. I guess my question really is on the draw down periods, right. Your 2002 to 2006, and your 2009 to 2013, '14, where that's the sock it to you, is the downside and then having to make it up. So I'm just wondering if over time, our portfolio has had the stamina to make up the losses. So that we continue to do a seven percent return.

Stephen:

You want to run that Alan?

Alan:

Right.

Stephen:

I'll take the next few slides. Are you running it as we speak? I'm just asking. Or is that too much-

Alan:

Yes. Yeah, no, I can do that right now.

Stephen:

Okay, while he's doing that then, I'll let him calculate that because that's what he's good at, I'll take the seven and 10 year numbers to see. So, we jump to this seven year number, and it's interesting just visually how much smoother this is, right?

Suzanne:

Yeah.

Stephen:

And that's why we're at five years now, that's what I was talking about. So, these are all rolling seven year periods, and again, it doesn't go back to the same start date, because you've got to have seven years of index data to do this, right? But this is stress testing. And here what's interesting, over seven years, you see less time periods in the box, similar.

Stephen:

261 periods a whole less. Only 40 percent of the time did it outperform seven because it spent a lot of time running closer to six, as you can see. And really just visually you can tell that that's closer to six if not below, and when you start rolling seven year periods, you're obviously condensing those down periods like the financial crisis '07, '08.

Stephen:

The average return over seven years, rolling seven year periods was 7.15 percent. So it came down a little bit. But the worst return over seven years was still positive, and the best can you imagine, the seven return at the best level was almost 16 percent a year. We would all be dancing in the conference room in New Haven at 16 percent a year net I think. And then finally, on the next slide, when we look at rolling 10 year, this is just a stress test. We were really looking here saying, how volatile can these returns be?

Suzanne:

Right.

Stephen:

How often does it miss? If we're looking at a five year period, we just saw in one year, less than one year, right? Nine months in one year, we saw that our five year return fell below seven and our five year return is now above seven. There's a full point swing there. I'd have to go back and look at the numbers from our last meeting, but I want to say it's been a full point swing. We were down in the sixes.

Stephen:

You go to 10 years, what's interesting and, Suzanne, this starts to get to your question a bit. Less volatile, different time frame again, because the index data only goes back so far. It's about a 50-50. There are still 225 rolling 10 year periods. Remember, we're looking at January one year, til January 10 years later. February of one year til February 10 years later.

Stephen:

So, this is all rolling and so on March one year, til March 10 years later. That's what all these are doing. Your average 10 year return was 672. So, a little bit below the seven. And it does argue to say maybe longer term, the number is more in the sixes, and it's not even in the sevens. Because you had a period of time here, again financial crisis, your numbers are down. They're at two, and three, and four, even on rolling [crosstalk 00:44:47]

Suzanne:

Yeah, that's what kills the portfolio. Just kills it.

Stephen:

Mm-hmm (affirmative). It's that gap right there. I wish I could point to it, but you see it. '08, '09, '10, every one of those bars is looking back seven years.

Suzanne:

Mm-hmm (affirmative).

Stephen:

Right? But then you see more recently, we fell to six. The markers were very flat in '14, '15, and '16, and that didn't cause huge degradation, but it did degradate, right? But then during the upswing of the financial recovery, you were nicely above seven for much of that time. Alan just [crosstalk 00:45:24] a number.

David:

Suzanne, can I ask a question? And this is clearly a layman's question, but we've only had the seven percent goal the last few years. It had been gradually brought down to that over time.

Suzanne:

Mm-hmm (affirmative).

David:

Does that matter to any of this in the figuring, or is it not important to what we're looking at here?

Suzanne:

Well, it does. What I think, and Steve, I don't mean to put words in your mouth, I think what Steve's trying to show is that the stability of the portfolio over time. And the reason why I asked for the 20 year is because, I'm sorry. I'm not being very articulate, but when a portfolio loses 50 percent, it needs to gain 100 percent, right? You know this, David, to get back where it needs to go.

David:

Mm-hmm (affirmative). Yeah.

Suzanne:

So, it is those draw downs that sucks the life out of a portfolio and diminishes performance over time. And while you have markets that go above your benchmark, unless they are just gigantic over the benchmark for a period of time, it's very difficult to make up draw downs like that big gap that Steve was talking about when you look at over time performance. So, the fact that we had a target of eight percent, I think what this is telling us is just that was unrealistic based on these historic [crosstalk 00:46:48]

David:

Right.

Suzanne:

But no, the fact that-

Stephen:

And it made it even harder, and it's-

Suzanne:

Yeah.

Stephen:

Right, and yeah.

David:

Okay.

Stephen:

[crosstalk 00:46:57] policy statement may have been somewhat different. I don't think I saw your prior one if you had one, but what this is all saying to us so far, and I'm comfortable with rolling 10 year periods is pretty extensive, right? 225 samples. We just looked at 700 and some odd samples. They're coming. We'll see what the whole period is, but they're coming in closer to 670 to low sevens. We didn't arrive at the seven randomly. I guess we're revisiting it, but it wasn't a random arrival.

Stephen:

Problem is, I'm going to keep saying this. I've said it three times. You're going to be sick of hearing it. You're going to have nightmares about this comment as I do. The problem looking forward is not equity markets. We don't know what they're going to do. It's hard to know. We know it's going to be harder because they're starting at high valuations, but they're not starting at high valuations around the world, and every asset class isn't starting at a high valuation. It's not like the whole market's expensive. Its growth seems expensive.

Stephen:

Value doesn't seem expensive. Mid cap doesn't seem expensive. Small cap doesn't seem expensive, and developed markets don't seem expensive. Emerging markets don't seem expensive. I don't know what I left out there, but there's a lot of things that don't appear expensive. There's one thing that appears very expensive, and is lifting all ships at the moment, meaning it's the largest market cap growth names in the US. So, I guess my point with that is, hard to predict stocks, but you can manage around it to some degree.

Stephen:

Bonds are harder. We got a 10 year treasury, I haven't looked today, but let's look. The 10 year treasury. So we give money to the US Treasury for 10 years, and we're getting .77 percent right this second. That's a fact, right? So it's the bond side that when we assume that bonds can make four percent a year like I think we did in the beginning, and now Morgan's saying three and a half, and I'm sitting here saying, how do I get three and a half?

Suzanne:

Right.

Stephen:

That piece of the portfolio is challenged looking forward, and that's where we can't predict stocks that well, nobody can, but we can predict bonds reasonably well. And then that's the challenge piece, so all those things I'm talking about that we can do with equities, I think we can do and get a reasonable return.

Stephen:

The bond side, I think we have to also be creative in it and creative's a dangerous word in investments. You can't get too creative, or you can have blow ups, right? So, creative might mean a little more

alternatives, maybe some more preferreds as we've already done. Maybe some more corporates as we've already done. But, you don't want to go too far out on a limb.

Suzanne:

I have two questions for you. One is, on the equity side, I know your concern is more on the fixed income side, but on the equity side, just to address questions that are asked offline. So, and tell me if what I'm saying is not true. That our performance in our portfolio is mimicking the performance of these charts that you're showing us. So why go through all this very fancy process of doing what we do, rather than buying the benchmark and just going with the ride if that's what we're doing anyway?

Stephen:

Yep, it's a good question. I didn't mean for these charts to make. This is what we have for data.

Suzanne:

Right.

Stephen:

We're using just the benchmarks for data. But in reality, and we are a reasonable portion, I'd have to calculate it, but a reasonable portion of your portfolio is actually mimicking this. That's true. But then another reasonable portion of your portfolio is not mimicking this. That other portion is trying to do one of a few things. Number one, to your point with the drawn downs, it's try to control the draw downs, right? Something like First Eagle Global.

Stephen:

It is a global manager, domestic and foreign, not in any of these benchmarks, that is a deep value manager that has lowest in deviation, low volatility, and has historically very low draw downs relative to markets. So, we're trying to control the draw downs with some active management, and then in certain cases, not in that case, in certain cases, we're also trying to enhance the return right? So, you could us MFS and their mass investors growth fund that you own. That's trying to get a return greater than the S&P by buying the more aggressive growth components of it. So, we're not exactly mimicking this.

Stephen:

We're actually trying to, again, over time, everything is over time. We're trying to control risk. Things like we talked about just now, like having a little more dividend orientation. Having a little more global. Having a value orientation, which is one in the same. Those things should control our draw downs in most cases, which makes it easier to come back. So, we can stress test that, but this is factual data that we can show you of the actual benchmarks. But it's hard to do that with the different managers that we have, if that makes sense.

Suzanne:

It does.

Stephen:

[crosstalk 00:51:58] We're not necessarily trying to enhance return with active management, but we are trying to control risk.

Suzanne:

But, do you feel like you are?

Stephen:

Yeah, we are. Well, we definitely are. It's in a year like this, it was unusual. So not every draw down is the same, right? If we were at 99 in the .com bust, we absolutely would have controlled risk in heroic spades way. In '08 and '09, we would have controlled risk. This one, everything basically went down in this 60 day period almost the same. So, it was harder to control risk in this draw down, but yes, I absolutely. If you look at the statistics, standard deviation, alpha, beta of the portfolio, we definitely are.

Suzanne:

And then my second question is, this is a really crazy question. It's not really a crazy question, but I don't think anybody would think I'm sane for suggesting it. There are municipalities out there like, I'm on the board of education here in [Killingworth 00:52:55], so we just issues 10 million dollars in bonds and are getting paid three percent. Excuse me. We're not getting paid three percent, we're paying three percent. And does it make any sense for the authority to think about lending money to high, very secure municipal entities? In terms of trying to provide some fixed income that-

Stephen:

Well, we indeed can do that, right? Because in the bond portfolio, we could buy those municipal bonds. But since this portfolio is tax exempt, we would probably buy a taxable bond instead of a tax exempt bond, right? Because-

Suzanne:

Yeah, I'm not talking about buying the bonds. I'm talking about actually lending the money. It just may be too crazy for everybody to think about it that way, but I mean I'd rather get paid by RSD 17 three percent on a 10 year, 10 million dollar bond.

Stephen:

That's a reasonably high return, actually. I'm surprised. How recently was it issued?

Suzanne:

It was really recent, but the people paid a premium also, so but we're paying an interest rate. So whatever we're-

Stephen:

We're paying three, but it sold at a higher price. Yeah.

Suzanne:

Correct.

Stephen:

The investment [crosstalk 00:54:20]

Suzanne:

But we're paying three, so that's what we know at our end of the world. Where that money went, and where it goes, and how it gets whatever. So-

Stephen:

I think that's-

Jennifer:

Suzanne, are you talking about lending money out of the fund?

Suzanne:

Yeah.

Jennifer:

And I think Stephen, you had looked at this. I thought that was not allowed in the type of fund-

Suzanne:

It's quite possible. It's quite possible it's not allowed.

Stephen:

I don't know if I looked into that exact question. I honestly don't know the answer. I think it would be a legal counsel question, frankly. It's not inherently, I don't object to the concept inherently. I don't know what's allowable. Honestly, that needs legal counsel probably on our end and your end. It's just a direct purchase of a security, which we do some of incorporates and in treasuries and in governments. We haven't done it in municipals for the tax reasons.

Stephen:

We do own, in some tax exempt accounts, we do own taxable municipals right? Which are often hospitals or highways or whatever it may be. They're a private public partnership typically. There's no reason to think it can't be done mechanically, or makes no sense mechanically. I'm over my head giving you the legal answer. Oh, Suzanne, you're muted.

Suzanne:

Yeah, sorry. It's a little far fetched. So, we can move on.

Stephen:

I worry about my liability-

Alan:

If I could-

Stephen:

[inaudible 00:55:49] but I might start to worry about my liability.

Suzanne:

No, I agree. It's funky, but when fixed income is at less than one percent.

Stephen:

Well, that's government, right? So we're buying beyond that, but we've got to have some liquid governments to pay next week's pay checks.

Suzanne:

Right.

Stephen:

And that's where as you can tell, that's where I'm worried going forward is what we can get in that space.

Suzanne:

Okay.

Stephen:

Sorry.

Suzanne:

Was somebody else trying to make a point or-

Alan:

Yeah, sorry. If I could just interject for one second. I do have a longer term annualized return figure for this data. So, if we're looking back for the entire length of this data which is just over 28 years, we have an annualized return figure for the strategic benchmark of 8.32 percent.

Suzanne:

Okay, great. Thank you.

Alan:

You're welcome.

Suzanne:

It seems counterintuitive, but that's good. Okay.

Stephen:

Well, because that's the whole period compounded.

Suzanne:

Right.

Stephen:

It's compounding our minds [crosstalk 00:57:02]

Suzanne:

Oh, it's not the average?

Stephen:

It still compounds, I believe, Alan, right?

Alan:

Correct. It's compounded. It's not the simple average.

Suzanne:

Okay. So it's not comparing to this average 10 year that you have on here?

Alan:

Well, these rolling returns are also compounded. Compounded annual returns.

Suzanne:

So, what I was looking for was the number that would replace the average 10 year return on this slide, and it would say average 20 year return. So, if that's that number, then that's good. And if it's not, don't worry about it on this call. I'm just curious about it. You can send it to me afterwards.

Stephen:

But Alan, is it the number that would replace that 20 year return? Or it's 28 years?

Alan:

No, sorry. It's not. It's just a single 28 year return for the entire period. Which, we have 28 years of data, so we would only have one single-

Stephen:

One period.

Alan:

Data point for that period, for 28 years.

Suzanne:

It's okay guys. We should move on.

Stephen:

Okay. Let's move. So let's now move to the next page then. Which, to me, this is really where the rubber meets the road, right? This is what you must do, right? You must meet the pension obligations to your work force, right? So Alan produced this too, so I'm going to rely on him a bit here, and I'm going to turn it over to him, but I'm going to give you the broad brush here. Down the left side are years looking into the future, right? And then we divide that into zero to four years, five to nine, 10 to 14, and so on.

Stephen:

Out to 30 plus, because want to look at the liabilities as they occur. And we have gross benefit payments as a first column, which is the third column in. It's 130 million dollars over the long term life. We have the present value of those benefit payments, right? This is all from the actuaries. 49 million, and if you just look at the next four years for example, the gross benefit payments are 18.7 million. Those are really dollars that must be paid out, and the present value of those theoretically is 15.3 million.

Stephen:

We're a little leery of present value at seven percent in the four year period. Alan will talk about that. We have the pension contribution using the arc, right? We can only assume the arc, so we're using the arc here. We have net benefit payments, and we have the present value of the net benefit payments, and then we have what we calculated, which is a hybrid liability driven, and we used a hybrid for 10 years. And I'll let Alan talk to that. What we do here is we take anything beyond 10 years, so starting in year 10.

Stephen:

If you look at the far right, we use global equities, so domestic and foreign. So we're saying as you saw a minute ago, once you get to rolling 10 year periods, there's never been a rolling 10 year period where we've had a loss in a portfolio like this, or even in equities. So we're comfortable with equities out longer, but as we get shorter, nine years and below, we got to more conservative fixed income for the first four years, and we go to hybrid or what we call plus fixed income, which is more aggressive fixed income.

Stephen:

So that might be preferreds. That's a place where you can get four to five percent even today in alternative balance. The real low rates are those first four years of tranches. So at the bottom, I'm going to let Alan go through this, but at the bottom, we show you what this, and this is only the salary at play.

Stephen:

We're going to look at the union plan next, but we show you what your asset allocations should look like based on this traunching of liabilities. Does that make sense to folks? A lot of numbers on this page, but with that, I'm going to turn you back to Alan, so he can add it all up for you, and conclude it in your current IPS target is in the bottom right hand.

Suzanne:

And can I just ask a question. So, on the totals of the liability cash flow analysis, you're saying that our gross benefit over time payment is 130 million. When you present value that, we would need 50 million dollars today in order to meet that target per se.

Stephen:

Right, if you make seven percent a year.

Suzanne:

If you make seven percent a year, and your pension contribution would need to be 27 million dollars, or you're going to get a 27 million dollar pension contribution, and so the net benefit payments would be the 103. So, essentially and what do we have under management right now?

Stephen:

In the salary alone, give me one second, because remember this is the salary alone.

Suzanne:

Right.

Stephen:

Today, well at the end of last month, you had 37 million.

Suzanne:

Okay.

Stephen:

[crosstalk 01:01:51] six.

Suzanne:

And you said the 37 compared to the 49, that tells you what percentage of fundage you are?

Stephen:

At a very simplistic level, yes. [crosstalk 01:01:59]

Suzanne:

Okay. That's okay.

Stephen:

Right.

Suzanne:

All right.

Stephen:

The actuary [crosstalk 01:02:03]

Rochelle:

Yeah, there was other factors.

Suzanne:

Okay.

Stephen:

Yeah. Definitely other factors in this, the actuary question, but at a simplistic level, sure.

Suzanne:

Okay. All right. Alan?

Stephen:

Alan, do you want to go ahead? Because what we want to do is-

Alan:

Yeah.

Stephen:

We're asking the question here again, is the investment policy statement appropriate given these liability and asset streams and cash flow streams. Which is germane to this conversation on the rate of return.

Alan:

So, based on the analysis here that we've done with the cash flows, at the bottom we have four scenarios that all generated a slightly different asset allocation mix. So, the two main groupings we looked at was the present value of the net benefit payments, and then we ran a more conservative hybrid LDI version of the net benefit payments. So, the hybrid LDI takes the present value for all these benefit payments, 10 years or later. And it takes simply the net benefit payment for the first 10 years.

Alan:

So, it essentially, it's more conservative in that it assumes that we're not going to make the actual rate of return on those cash amounts for the first 10 years, and it assumes that he equity portions for 10 years and greater does generate the seven percent return. So, at the bottom, the first two scenarios there are the hybrid LDI scenarios, and we looked at them both versus the net liabilities and versus the current assets.

Alan:

So, versus the net liabilities, we get a asset allocation of 40 percent cash and fixed, 40 percent equity, and 14 percent in alternative or balanced. [crosstalk 01:04:12] versus the current assets [crosstalk

01:04:13] we got slightly higher cash and fixed at 43 percent, lower equity at 42 percent, and 15 percent in alternative or balanced.

Alan:

And then looking at just the present value of the net benefit payments, we get an asset allocation of 36 percent. With the net liabilities as the denominator, we get a cash and fixed asset allocation of 36 percent, equity of 55, and alternative balance of nine. And using the current assets as a denominator, we get a cash and fixed of 32 percent, equity of 60 percent, and alternative balance of eight. So, the IPS target a 30, 55, and 15 more or less falls in between the ranges of all four of those scenarios.

Suzanne:

It looks like it's low on cash, well, maybe medium on equity, and probably high on alternative, no? Am I reading this wrong?

Stephen:

No. It's a high end on alternatives. It's high-ish on equity, depending what you're looking at, and you're right, the cash portion is on the low end. The cash and the fixed is on the low end. Which was a conscious decision that the committee made several years ago to say we're trying to get to a funded status, let's be a little more aggressive on equities.

Stephen:

That has worked so far, but we know we went, I want to say I would have to go back to those meeting minutes from years ago, but I want to say that we went about five percent over on equity consciously and purposely, and it hasn't changed a lot. Part of that thinking was, remember, all of this assumes only the arc.

Suzanne:

Right.

Stephen:

So the [crosstalk 01:06:07]

Suzanne:

Right but-

Stephen:

So if you're funded more than the arc, it would help.

Suzanne:

Right. So, I think what I want to try to do, Steve, and maybe you can help me, is not to get the whole group. I love all this data, but to help them understand the implication. So, the first piece of your presentation says the implications to us are with fixed income and especially short term fixed income. Government money being so low.

Suzanne:

That is a risk for our portfolio. Second piece is our liability and choosing to do a little bit more aggressive IPS for return. Potentially is a risk, because cash may not be where it needs to be for the liability. So, I just want them to understand. I want us to understand this is where we are, but these are the risks we're taking being in this place, and so we can manage that going forward. So, if I've articulated them improperly, then you can correct me, but-

Stephen:

No, but I would just add one thing to it. If you're funding over the arc, that's less concerning in the short run. Period. How's that?

Suzanne:

Right. Well, and also there are things you can do to help the portfolio, of which overfunding is one of them, right? You can mitigate those risks by doing this, this, or this, right?

Stephen:

Right. And the risk is [crosstalk 01:07:34]

Suzanne:

And the overfunding is one of those.

Stephen:

The risk of going more heavily to fixed, as this might dictate or slightly dictates in this plan, is it's going to be harder to get to seven.

Suzanne:

Yeah, right.

Stephen:

It's a balancing act.

Suzanne:

Okay. All right, let's keep moving.

Stephen:

Union plan is next. I'll just let Alan go right to the bottom, because the numbers, again that is a lot of data. The bottom box is probably what matters the most.

Suzanne:

And it's okay. Just summarize as we said before, Alan. With our IPS target the way it is, using the calculation that you made, what are your observations?

Alan:

Yeah, so the union plan here actually came out very similar to the salary plan. So, the observations are essentially the same as the salary plan. The cash and fixed come in on the low end of the range. The equity come in middle to high end of the range, and then the alternatives come in at the higher end of the range. So, very similar outcome to the salaried plan.

Suzanne:

Great.

Stephen:

I'm going to add one more observation. With the alternatives coming out of the higher end, meaning you're at the higher end of the range [crosstalk 01:08:51] on the fixed side, I think that compliments each other. Because one place that one can go to outer in these low interest rates is a step up not all the way to equities, but to something in between which would be the alternative space.

Suzanne:

Okay.

Stephen:

[crosstalk 01:09:09] tactical portfolio move, but it makes some sense to us that you could sacrifice some fixed for some alternative. If you're trying to get [crosstalk 01:09:19]. And then we have the Viva. Comes up next. And the Viva is a little less different on the equities side, right? You're actually arguably on the lower end. [crosstalk 01:09:35] the fixed.

Stephen:

Probably about what you should be in the alternative balanced, probably on the higher end. So, a little bit different, but you do have the same investment policy for all three pools of money, and we think that's fine and acceptable. Our net conclusion frankly, and this is your investment policy, but our conclusion and our observation is that the investment policy statement target still seems reasonable if not perhaps on the high end in equities, versus the liabilities.

Stephen:

But not unreasonable, and that's the same observation we made several years ago stating that it is the desire of the committee, the board, to try to reach for this seven percent at that time. And that has indeed worked as of this moment in time. But you are taking slightly more risk than the liabilities stream in certain cases at least would dictate.

Stephen:

But less than other cases. So, we're not outside of it in any of the cases, if that makes sense. So, it wasn't our objective or goal, or perception today here that we were going to try to influence you to change your IP [crosstalk 01:10:50] It was our perception-

Suzanne:

Steve-

Stephen:

Our goal, our desire to perhaps influence the rate of return assumptions.

Suzanne:

I'm sorry to interrupt. I have to step away for a family emergency here. I'll be right back, but just keep going on, okay?

Stephen:

No problem. So, I think at that point, we were close to the end of this part of the discussion with the conclusion of, I'll give you a summary is, the investment policy statement appears to be in line with the liabilities, if not the aggressive end of the line, which is where it's been all along. You're making north of seven percent a year on the last five years. We have concerns looking forward that that's going to be harder to make going forward. And I guess I'll stop there. Those are our main observations with lots of data to back it up.

Rochelle:

We just had I think one of the key upcoming decisions, not necessarily for today, but prior to the next valuation, is whether we want to make a small modification to our rate of return assumption. You might recall the board, if I recall, set some years ago. We were doing 25 basis points reductions over time. So, it could be a gradual reduction perhaps to 6.75 percent, and then see what the market does and every year look at the long term returns. So that's just something that we need to consider.

Stephen:

We obviously are in favor of that, not that we have a vote. But obviously, you've heard what we think going forward more on the fixed side. You see what Morgan Stanley and MFS at least think on the equities side. We think we can navigate the equity side with more tools. There are less tools at our disposal when global interest rates are zero on the fixed side.

Tony:

Rochelle, other than the rate or return adjustment, are there any other issues that we should face?

Rochelle:

I think not in this context. Just to recap, so right now due to COVID and our revised budget, we are currently only making the actuarial return. But the plan would be going forward, after 2021, to again make contributions in excess of the arc.

Tony:

Thank you. Suzanne, while you were away, we just identified that one of the things that we could talk about at the next meeting is whether we adjusted the rate of return. Are there other things that you want to move on with?

Suzanne:

Well, one of the other things I wanted to talk about briefly was the cost of managing the portfolio, and just I wanted to know the total cost of the portfolio, and how much that represents in a percentage of the return.

Stephen:

Mm-hmm (affirmative). And I think we have that on the subsequent slides. It should be in this deck. I don't know. Okay.

Rochelle:

Jennifer, if you go a couple more slides.

Stephen:

I think you all know what's included in the cost, but that's in these first few slides. If you want to jump right to it, go to page [crosstalk 01:14:05]

Rochelle:

Another one, another slide?

Stephen:

Do we want to jump to this one, Rochelle? Or do you want to-

Rochelle:

I probably think maybe this one just briefly, but I think what Suzanne is looking for is in the next few slides.

Stephen:

Okay, so what this one says, because they're having questions in the past on a few fronts, so I wanted to clear them on this slide. Sorry, that slide. Maybe we can blow that one up a little bit?

Jennifer:

I'm trying to. It's going to my next slide.

Suzanne:

And this is the advisory cost, but that's not the total cost of managing the portfolio, or is it?

Stephen:

No, it's not. Right.

Suzanne:

Okay.

Stephen:

It theoretically could be, but it's not because we're using third parties.

Suzanne:

Right.

Stephen:

So this gives you, the billing is calculated monthly now. This gives you your asset value each month. It gives you the annualized blended advisory costs based on the total assets because it's on a declining schedule as we know. It gives you what we're calling the published monthly advisory cost, which is if you just calculated what it would be, and it gives you the actual.

Stephen:

There's a slight difference between the actual and published because we rebate fees on our own money fund, right? Because we don't make money on our own money fund, so we give those back. We net them out. So, the published cost at 38 basis points is 191,000. The actual cost is 185,000 so it's 37 and some odd basis points if you do it.

Stephen:

The total is quite not that different. We did do the rebate in March of this year. I know I've had this question before. That was a rebate for when we, it took us a while legally to adjust the fee schedules and include the Viva. That came back to you in March, the $4,900. So that's actually the $5,000 difference. The real difference at the very bottom between the published and the actual is not even a thousand dollar difference actually. So, that's .38 percent basically, at the current asset level. That declines as the fund grows.

Suzanne:

Right.

Stephen:

Are we up to it? Is it the next page?

Jennifer:

You have a conversion list. Maybe go to the-

Stephen:

Let's go to the current one.

Jennifer:

In the current one.

Stephen:

Yeah. I've reversed the order of this at one point. All right. This one is very hard to read, but we don't need to read every line item. So this is the mixture. We've got every line item that you own. The internal

expense, if there is one, of that line item. So, for instance, the money market does not have one. The individual bond holdings, first couple items do not have one.

Stephen:

And then we multiply that out by the assets in that. So this is a moving target, but we multiply it by the assets inside that vehicle. They range from zero for the money market and the bonds to very low. The Vanguard index is three basis points for example. Your most expensive active fund is the [Janus Enterprise 01:16:58] fund in the domestic space. It's 75 basis points. Point is, they run the gambit, right? From nothing to three basis points for an index, to I'll even give you to Goldman Sachs, equal weighted index is nine basis points.

Stephen:

Vanguard's value ETF is four. Columbia, which is an active value manager is 69. So they run the gambit. They average in at the moment at 41. The very bottom line. So your total plan costs, the underlying operating investment expenses are 41, and their advisory are 38. I did do, I'll just mention it, we didn't put it in here, we're trying to benchmark this for you. I hope to have more next Friday in the regular meeting to benchmark it, because it's a great question. 401K plans are very easy to benchmark.

Stephen:

There's tons of data, pension plans of data is tougher to come by. I did go out and we looked at some very large mega plans to see where they came in. It's interesting just to look. If you look at a 177 large plans. This is State of Connecticut, Hartford, et cetera. Three of them where in Connecticut, and these are from their annual reports.

Stephen:

Their internal expenses, not counting advisory came in, and in Connecticut it was 53, and nationally on 20 billion dollar plans, it was 42. So, your numbers are up there in line with your internal expenses are up there in line. We shouldn't be comparing to these mega large plans, but you would fully expect those mega large plans to be cheaper, not the same or more expensive.

Stephen:

That being said, there's so many variables. Those mega large plans have private equity, they have private real estate. They have more hedge funds, and those do run the cost up. So, depending on the asset types that one owns, when you own even private real estate, it may have a very high hedge fund like fee, but it makes a lot of money perhaps.

Suzanne:

Okay. All right, so we have about almost 80 basis points associated with the cost

Stephen:

[inaudible 01:19:04]

Suzanne:

If you were able to cut it in half, you would gain perhaps a half of a percent of performance on your portfolio. Okay.

Stephen:

Yeah. Right, you'd gain 38, 39 basis points. Right. [crosstalk 01:19:16] It is coming down, because the current fee. So, on the new dollar is above 70 million. The advisory part of it's 20 basis points. Just for example. So, that rapidly comes down as that grows from here, and at 85 million it goes at 10. So, that 38, unless we have another god forbid we have another big financial crisis in the short run, that number's [inaudible 01:19:38] and it should start to trend down quite quickly.

Stephen:

We should see to 35 and 30 to your point. The investment expenses, we have managed them down hard and harsh. Even in the last quarter, we get out of the equal weighted index RSP, which I think is at 25 basis points now. We went into Goldman Sachs at nine. We've constantly been driving down that 41. If I go back a few years ago, with your push Suzanne, frankly to your credit, that 41 was let me go back a little bit. It was 58 back in 2016. Might not sound like a lot, but that's big, right?

Stephen:

That's 17 basis points right there, plus call it another five on the advisory fee as we look forward. We've got 20 some odd basis points right there. We will continue to drive down the internal expenses, but I'm a fan of that so for instance, we didn't drive it down in the most recent quarter even though we drove things like Goldman Sachs to a lower price, because we actually hired more active bond management for obvious reasons, right?

Stephen:

And that actually caused the savings we had from Goldman Sachs was offset by some more active bond management. So, that's a good decision I believe. Could we have saved 10 basis points more? Possibly, but then we picked up some American and some Loomis Sayles in the bond space who have done a great job bringing some value to the net return. So it's-

Suzanne:

Okay. All right, so this is what I wanted to see, so I appreciate that. What else do we have on the docket? I think we're running out of time, guys.

Stephen:

That's all we had, sorry. I thought this would be faster than it was, but thank you.

Suzanne:

That's okay. So, nice job on presenting all the data. I think what I'm sensing, and correct me if I'm wrong, or what my observations from this call are that we're hanging in there, seven percent return at our benchmark. We're getting there basically because we are taking a tad bit more of equity in our portfolio. A little bit more risk to achieve that.

Suzanne:

Understood and known, and that there's some issues in the future that are potential more risks to the portfolio, which is largely fixed income and certainly the uncertainty of the equity markets and what's going to happen with COVID and all that other stuff. And so, for right now, what it sounds like to me, and with costs to the portfolio, while we can continue to manage it down, it's not going to change the overall trajectory of life. It's not going to be the difference between fully funded and not fully funded.

Suzanne:

It would just incrementally help along the way. It sounds like to me that we should actually continue to do what we're doing, and continue to find tactical ways to enhance equity portfolios, tactical ways to enhance fixed income where we can, seeking out opportunities. And then thirdly, to continue to tactically wedge away at the cost of the portfolio. To continue to eke out better opportunities for the fund to compound its growth.

Rochelle:

Suzanne, I would just add, I think right before we do the next valuation, we probably should revisit the rate of return that we're going to drive that actuary to use and consider a gradual decline perhaps 6.75 percent.

Suzanne:

Because you want to make that change, or you want to see the data?

Rochelle:

Based on the current projections which our auditors look at, and which our actuary also looks at, seven percent would be high, so I think if the expected long term returns are still in the very low six percent, or even possibly below that, then it would be prudent to make just a very gradual reduction.

Suzanne:

That's a big step, Rochelle. Are we ready to do that, Steve?

Tony:

We need to think about it, or at least discuss it.

Stephen:

I think as Rochelle said, the actuaries will look at your assumptions, and they'll look at the assumptions it's based on, and not just the past performance. Because the past performance, they would say, oh fine. You're out-earning it at the moment, but I think it's a reasonable thing to do. Yes, I do. You don't have to do it. It really affects your financials, right? So, it's an internal decision as to your financials more as it is I'm telling you, is it achievable?

Stephen:

It's possible. Are the forecasts currently backing that? No. Is the bond market currently backing that? No. Is history currently backing it? Yes. I think a reasonable person would say it's reasonable that returns are going to come down, and I stick to my fixed income. Again, the risk of fixed income, I don't want to

overstate it. The risk of fixed income is not a loss. The risk of fixed income is, fixed income is making it harder to make seven.

Suzanne:

Right.

Stephen:

So, I didn't want anyone to think that I'm afraid of losing money there.

Suzanne:

It's a drag on the portfolio.

Stephen:

Right, yeah. And we have to have it, because we got to pay the bills, right? So, it's-

Suzanne:

Right.

Speaker 12:

I thought I heard the door. [inaudible 01:25:23]

Stephen:

I think Rochelle's request is reasonable, but I again don't have a say in this.

Suzanne:

No, I appreciate your advice. All right. So, we're going to talk about that at the next meeting Rochelle, is what you said?

Rochelle:

We don't need to decide at the next meeting. We would need to decide prior to the actuary doing their evaluation for [crosstalk 01:25:46]

Suzanne:

So [crosstalk 01:25:48] so before the RWA would make that decision, Rochelle, I just want to make sure when we do talk about it that we understand the implications if any associated with it. And not only for the funding of the pension, but observations from credit agencies and other things. Okay?

Rochelle:

Okay.

Stephen:

I think you'll find, I'll comment because I started to, but you may find that double edged sword, too. Credit agencies don't want to see an overly aggressive assumption on hand.

Rochelle:

Right.

Stephen:

On the other hand, they don't want to see less funding. It's a trade off.

Suzanne:

Yep.

Stephen:

I think that if a credit agency may say 25 basis points seems reasonable, they're taking a [crosstalk 01:26:28]

Rochelle:

Prudent approach.

Stephen:

Exactly.

Rochelle:

Yeah. Mm-hmm (affirmative). Okay.

Suzanne:

All right. Any questions, comments, or concerns from anybody? Kevin? Joe? Tony?

Tony:

No.

Suzanne:

David?

Stephen:

I apologize as everyone's afternoons are now going to be numeric mentally.

Suzanne:

Yeah, no. That's okay. They invited themselves to this meeting, Steve. It was going to be you and me. They wanted to come, so that's good.

Tony:

We were told to be here. Come on now.

Suzanne:

No. It wasn't from me.

Stephen:

Tony, come on. You're sitting on the beach there. I see the wind blowing in the background. It looks fantastic place to have a meeting.

Tony:

I move that we adjourn as the pension and benefit committee and resume as the authority?

Joe:

Second. [crosstalk 01:27:10]

Suzanne:

Second.

Tony:

It's yours, Suzanne. All in favor, aye.

Group:

Aye. [crosstalk 01:27:18]