South Central Connecticut Regional Water Authority
Pension & Benefit Committee

January 21, 2021
Meeting Transcription

[START AT 12:31 P.M.]

Suzanne:

Thanks, we have three items to cover today. The first is approval of the minutes. We have two meetings that we're approving minutes for, so I'll entertain a motion for approval of minutes of both meetings.

Kevin':

I move that motion to approve both minutes.

Suzanne:

Thank you Kevin. Second?

Joe:

Second.

Suzanne:

Thank you, Joe. All those in favor aye.

Everyone:

Aye.

Suzanne:

Thanks very much fellers. Item number two is to hear from our team from Morgan Stanley, Steven Keller and Joe McLachlan and if Steve and Joe are on the line and ready to get started, we're looking forward to an update on how we're doing on our programs.

Steve:

Thank you, Suzanne. We are on the line, you have cell. This is Steve here and Joe McLaughlin is with me and Alan [inaudible 00:04:52] is also with us today. So happy new year everyone. Safe and doing well.

David:

You too.

Steve:

So far so good on this end. So we wanted to give you an update if we can flip to the next page. I think Jennifer, you're driving the slide presentation I believe.

Jennifer:

I am. You just tell me where to go.

Steve:

Okay, will do. And many of you may also have this on your own iPads. I believe though we're in the conference room, which maybe we will be pretty soon, right? My comments are relatively brief today, as long as you want them to be, but I don't have anything unusual to report, frankly, how much the quarter went up we'll do a little market commentary, relatively brief, executive summary, also relatively to the asset allocations to makeup of the various assets pools of money and we'll look at the investment results. And then if we want to, if we choose to ignore the individual holding on to the degree that you wish to, or that just-

Suzanne:

Steve. I'm just going to interrupt you for a second. Can I ask everyone to just put their phones or audio on mute while Steve is presenting so we can hear him without distraction. Thank you. Go ahead, Steve.

Steve:

And does anybody have anything to add or subtract from that agenda? No? Fine. So let's proceed then. If we can go one more.

Steve:

So we look at this slide every time, because it's just a broad view of the S and P 500 and where it currently stands what's happened and where the valuations are today and in the middle box, as you recall, it gives us a little bit of data to help guide us. So if you look in the far upper right here by year end, we were looking at a market that's about 22 times this calendar year's earnings, because it was forward-looking on December 31st. Historically that's a relatively dear a rich market, not the most rich we've seen. If you look in the box in the middle of, we were 27 times earnings back in 2000 at the peak of the Dotcom bubble if you will. Then we were around 15 and 19, and now we're up at 22. So the market has run up A, it's done that for several reasons but one of the primary reasons is that interest rates are so low and you can see in that bottom right corner of that middle box on this date, the 10 year treasury was at 0.9%.

Steve:

Today it's closer to 1.1% and that's after the treasury, believe it or not, the low in the last year was about 40 basis points, 39 basis points. So we got to a point where if you gave the government your money for 10 years, they would give you a 0.4% back. That was towards the bottom last March, April timeframe. We're back to about 1.1% now, which doesn't sound like a big move because it's small numbers but if you're thinking about it, interest rates have more than double and they're close to tripling, at 1.2% they'll have tripled from their bottom. So still dealing with very low numbers, but an interesting multiple from the bottom.

Steve:

So as long as rates stay low, and we have a lot of stimulus coming in, in the form of government and fed stimulus. Fed stimulus with the low interest rates, government stimulus with the various COVID pieces

of legislation that had been moving through and with the new administration, you see a very large proposed piece of legislation there. So the market is being somewhat fueled by these things at the moment, despite the fact that their earnings are not great in all areas of the market. So they're depressed obviously in certain areas, if you're in energy, if you're in travel, transportation, entertainment, hotels, you name it, we could go on the list is large. If you're in technology, biotech, pharma, it's the opposite and the extreme.

Steve:

So there's other things, medical devices for instance, a lot of procedures being delayed because of hospital capacity. So you've got things in the middle too some happening, but delayed. That being said, so earnings are a little bit depressed. This 22 numbers still assumes earnings as somewhat depressed this year, this current calendar year. We expect earnings to more or less hockey stick up towards the second half and really fourth quarter of the calendar year and that 22 takes that into account. So that being said historically, when one has purchased equities or owned equities at a multiple up in the twenties, your forward looking returns can be more challenging.

Steve:

But we had a really nice spike up at the end of the year. We really had a post vaccine spike since we last spoke. If you jump to the slide after this please, we're still using this slide too, because there still is a lesser, but still an unusual degree of dispersion, more so in the equity markets now. I've dropped the fixed income slide because that no longer exists. If you look at last calendar year, the SNP earned 18.4%, you can see that in the far left. That's after being down about 28% on March 20th. The average stock in the S & P, and this has come up a lot since the vaccine news, the average stock made almost 13%, the 1283 number. So that's again, I'll remind you if you had $500 and you put a dollar in each of the 500 stock, that's that second number.

Steve:

So the average stock came a long way up since we last spoke, that divergence between the market cap weight and the average stock has closed a lot. The divergence that still exists to a very large degree, and it has reversed so much as the reverse, since we last spoke. It's the difference between value and growth and this is using the Russell. Value finished the year, so if you're a really fully a dividend oriented investor, it's likely you finished last year closer to 3%. And if you're a more of a technology biotech type investor, it's more likely you finished the year closer to 38% and I'm talking equities only. That vast divergence is still historic, even though it has closed the gap enormously since we last spoke and really since the very first vaccine news, when the market really broadened out at that point, smaller cap started doing a little bit of the large caps.

Steve:

The average stock started doing better than just the largest stocks. It's very interesting what happened at that point and value started to do better than growth for the first time in a while. So it kind of interesting. Internationally on the right side of the page, I can almost drop that now the divergence is all but gone there. The one thing you see as the number of that 1065 number, that's the market MSCI, all cap world XUS so what that is is that's non US securities, including both developed and emerging markets and then it divided up for you develop markets or the EVA, that was up 782 and emerging markets were up 18%. This is fantastic right because this is all after being those dark red ones. That's

what each of these categories were down at the low last March, so quite the year. I'm actually referred to last year as four years in one. If you're thinking about it, what really happened to [inaudible 00:12:09]...

Steve:

We had the first few months, January and February, it was really till about February 19th, when unemployment was low, unemployment was high, markets were cruising, earnings were fantastic, everything was booming and then we heard of COVID and the second phase really happened from February 19th to March 23rd the market went straight down. The third phase, literally you can pinpoint it to March 23rd we got government stimulus, both from the fed and fiscally and that marked the bottom.

Steve:

And then we had a long, but bumpy run up until November, which I'll call the fourth year in one and that's when the vaccine news hit and then we really were off to the races for a second time, if you will in our recovery. And that leg up, I can't say it enough times it really broadened out what was happening within the market. It became much less narrowly focused. It became focused not just on the stay at home names, but it became focused on a broader market, energy names participated, transportation names participated. You'll see this on the next page of this really interesting statistic, at least to me last year is the bullet point at the bottom of this page.

Steve:

The 53% of last year's return, so 53% of the return of that 18% of the S and P was up last year, came from just Amazon, Apple and Microsoft. The most narrow market I believe we've ever seen in history. What's interesting if you took the S and P 500 and took out the top 30 names, the remainder actually fell three basis points last year. So really interesting. A hundred percent of the return came from 30 names and 53% of the return came from three names. That's a narrow market and that's even with the broadening that we saw starting in November with the vaccine news. I found that kind of fascinating. You've seen this before, top 10 holding still at year end and the S and P made up about 27/28% of it. There's a new addition here, if anyone wants to guess which one it is, I'll give you the answer obviously, but Tesla was added to the S and P and on its arrival, it was already one of the top 10 holdings in the S and P.

Steve:

That had a unique input factor to the S & P. If you look at just below the red box on the right, the price earnings of the top 10 holdings, the S & P because of the addition of Tesla really is now 124. I don't believe it's ever been that higher in history, if you take out Tesla, it's closer to 40, but Tesla sells an extraordinarily high evaluation based on forward earnings. So what's interesting the rest just gives you the 391 holdings currently equal a bottom 10 holdings. Again it's broadening out, it's peaked and you'll see that on the next slide. So I hope you find that one as interesting as I do.

Suzanne:

Look at JP Morgan. Good for them.

Steve:

Oh yeah, JP Morgan is right in there. Actually, what's interesting about that, Suzanne, really, if counting Tesla as a kind of a technology company, at least a forward looking company, only three of the top 10 holdings are not some type of tech and it's Berkshire, Hathaway, Johnson and Johnson and JP Morgan, to your point.

Suzanne:

Yeah. Johnson & Johnson makes sense, right? With the vaccine, all that stuff, but a JP Morgan, a bank that's great, good for them.

Steve:

JP Morgan has been so well run, their balance sheet is pristine. So if you jump to the next page, has this level of concentration ever happened in history? The answer is no. Not at least to the point of the top five holdings. So the dark blue line here and you've seen this before, but I want to show it again because of how dramatically it changed at year end. The largest five companies hit a record as a percentage of the S & P, so those top five companies became 22% of the market and you see in the upper right, you see that dark blue line coming down rather quickly? That's literally from the date of the vaccine news until now, until year end.

Steve:

When you broaden out the top 25 companies have hit this level before but to make my point that that also has broadened out, meaning the top 25 companies are becoming less of a piece of the total market, this is healthy. It's really not healthy long-term for three or five or even 10 companies to make up so much of the return and certainly it's not healthy to see what we just saw a minute ago, that when all of the return came from 30 names, very unusually narrow market.

Steve:

So that's a little bit about what's going on in the market, what's going on and I'll say this again, but I think it's interesting to think of last year as really, that could have been four years. I know we're all a little tired from COVID obviously, but think about it we really lived through four kind of extremely different time periods within one 12 month period. So how did that all gel together for your various portfolios? Let's take a look at that, starting on the next slide. I pause for a minute, does anyone have any questions? Oh, I'm sorry. I think the investment policy statement first. Any questions, comments there?

Suzanne:

I just, to summarize Steve, I think what you're trying to say is that it was an interesting year an uncharacteristic year and also a year that maybe everybody thinks was very robust, but in fact, a few big players pushed it and so it wasn't as robust as it appears.

Steve:

I would agree with that. I would add just to the average company, yes. It was a dynamic year to say the least.

Steve:

So your investment policy statement, this is a little hard to read, but I'll just remind us of the main goals here, which is nice to look at, in the investment policy statement as written right now, the milestone is being fully funded for the plan year, fiscal year 2023. I know that may have moved, but it does say subject to prevailing market conditions and the other primary objective here is to achieve the long-term rate of return that meets the actual rate of return. And the asset allocation, the investment policy statement that preferred there is a ranges. I would just remind you what this is, and we'll see this in a minute, 55% equity, 30% fixed and 15% alternative or balanced. How does that lay out? And Jennifer's got the next slide up already. At year end, the salary and union plans had an upper center.

Steve:

You can see almost $67 million in them, allocated per the pie chart. I always like to refer to the upper right hand box, 59% in equity. Obviously equities had a great quarter. We did rebalance them in January, but we did not rebalance them in December. So we allowed our sense of that from the time of the vaccine news and the run-up in the market we chose not to rebalance until January and we have since rebalanced to target and we did that. Alan could tell everybody, I'm going to say a few weeks ago at this point.

Alan:

It was right around the end of January Steve.

Steve:

So where this got a little bit off, that was from both organic growth and some withdrawals being made and that is not rebalanced. If we jump ahead one more slide. I just want to point out two things on this slide, hopefully you can read this. I did eliminate the one with the smaller type that usually comes after this, I put it in the appendix because I know we're doing this remotely. Thank you, that's great.

Steve:

Potential cash needs. So we had reserved quite a bit of money back in the March, April timeframe when it became likely that the entities were no longer going to be able to make funding or decided not to make funding in the current, that was a calendar year at that point but I guess it's the fiscal year in reality. I don't recall off the top of my head, what we did reserve, Alan, you could probably tell us that if you have that off in your head or in front of you, but at this point in time, on December 31st, we have $445 000 remaining of that reserve. That should come close to but perhaps not quite get us to the end of the current fiscal year and we're okay with that.

Steve:

It would be helpful, if not now in our April meeting to talk about cashflow going forward into the next fiscs. So I'm comfortable with the remainder of current fiscal year from a cash need and the portfolio is highly liquid. It's just that we hate to disturb the underlying asset allocation unexpectedly on a given date. Again, we don't need it today, but I think I'm suggesting at the next meeting that we can talk about funding unless you choose to do it today and is the portfolio going to be the source of pension payroll needs and distributions starting in the next fiscal year? And if so, I think the discussions should include building this cash need backup again, because indeed it says potential here in yellow, but it's turned out to be actual and we do anticipate that all of that 445 will be used between now and the end of the fiscal year and may be even a little bit more than that.

Rochelle:

Steve, maybe if it's okay, I just add a little bit of additional information. So the thought about April at that point, we should be [Elised 00:21:47] through the budget review for fiscal 2022 with the authority board. So we'll have a good understanding if our contributions are going to be above the actuarial requirement. So that will be important for your planning and I also just want to add regarding current cash needs, we did just have a lump sum withdraw from the salary plan because that is part of the plan but even with that, the 445 should be pretty close to what we need.

Steve:

Anybody else there, questions, comments, concerns on that front? It's important to note that we're not worried now, but we will be worried by May, June timeframe, worried is a strong word, but it'd be time to do something or not. Either on cash coming in or reallocate.

Suzanne:

Right. And one of the things I would ask for Rochelle is that we have some sort of schedule that gives us a projection of what you think is going to happen for the next year and the pace at which it goes out so that we can kind of look at that and decide how much cash makes a lot of sense. All right?

Rochelle:

That's fine.

Steve:

All right great and then at the bottom of this page, I can't quite see it on my screen. Okay that's great. Just to show you where the over weights and under weights were at year end versus the investment benchmark were the Russell 3000, the domestic equities, just a little bit under 3% overweight there, again due to organic growth and the underweight is almost entirely in global bond. If you equalize those out and we have rebalanced since this timeframe, that's where the over weights and under weights were at that time. We jumped to the VEBA on the next slide. VEBA looks relatively similar, VEBA has less alternatives if you recall and VEBA, we also rebalanced after the calendar year began. VEBA was running just over 60% in equity at year end with the other weightings very similar. VEBA does not on the next page, have a cash reserve like the pensions do.

Steve:

So there's nothing in yellow there because we did not reserve here but you would note at the bottom versus the benchmark, the investment benchmark, those equities grew so much in the fourth quarter that we actually got almost 4% overweight inequity here and again, the counterweight to that is basically the three percentage points, not in global bond, as well as a few smaller percentage points. That again has been rebalanced when we hit the new calendar year. So that's all completed. We went back to target frankly, realizing some of those gains and re-dispersing them amongst the other asset classes, those equity gains I should say.

Steve:

What did the fourth quarter look like? It was big as on the next slide. You may have already seen it. So in the upper center. So on September 30th, there was 70,794,898 in the various pools, that includes the

monies in the VEBA and that included the monies that matrix trust, who is the trustee and paying agent. During the fourth quarter of the calendar year 699,130 was net withdrawn. They were transfers, those transfers were to fund matrix from Morgan Stanley as you can see. So those moved from upper on the page to down below to fund payroll. They net zero to the Corpus of the different pools of money though. So your net invested, simple math is 70,905,768 kind of top center. You ended the year at 76,000,227. So there was a dollar gain in the fourth quarter alone of 6,131,263. I don't know if it's the best quarter we ever have. I didn't look back but I strongly suspect that it was. It was 8.80% net and 8.90% gross.

Steve:

The real state of return is the actuarial return. So obviously for the quarter, that's 175, when you divide the 7% by four. It did a lot to make up for earlier in the year and that's kind of how the market worked. This is almost that fourth year and one that I talked about. If you jump ahead, one slide, you'll see the calendar year. I won't read you all the numbers again, other than know you started the calendar year at the 69 almost 70 million in the left center. There were about close to $950,000 in net withdrawals last year, again, that's that money we reserve to make payroll while contributions were not coming in from the organization. Your net invested after withdrawals is 68,939, same ending value of the 76 million. So for the calendar year, all the return was made in the fourth quarter.

Steve:

It's how volatile the markets were last year, 7.287,010,063 net. So obviously for the calendar year, excuse me, very nicely ahead of the actuary return. We give you on the next page, the fiscal year, obviously the fiscal year is not over and I won't read you all the numbers, but so far in the fiscal year, so this is from June 01 till December 31. So that seven month period, the returns, 10,585,016.13 net. For that timeframe taking it monthly, the actuaries expect 408, so this quite a bit of cushion at the moment and in the current fiscal year, again, it's still early. I know we all know things can change very quickly, just look at the last 90 days, but at the moment, not jinxing ourselves at all but we are running vastly ahead of the actuary return for the current fiscal year, as we just did in the current calendar year.

Steve:

Let's give her some perspective now and go out to three and five years and we're close to having a six year number from when this was first invested with us. I think we may have that the next time we meet Ellen, is that correct or it's either April or June, but we'll have a six year number soon. Could you jump ahead one more please?

Steve:

So here's three years and I won't read you all the numbers. Three years ago, it's interesting to note there was 59 million in the various funds, 2.2 million net has actually come in, so now there's net contributions, looking back three years. It ended with that same 76.2 million number, 14.8 million been made in the last three years, it comes to 760 net. So again, the last three years is looking good versus the seven target and I'm going to jump to five years on the next page.

Steve:

This also is to show you how volatile these five-year numbers can be because again, if you make 10% in a quarter just to keep the math simple, that adds 2% a year to a five-year number. So we've seen this

five-year number drop below in the last 12 months and now we're seeing this five-year number climb substantially. So five years ago, the various monies, various accounts had a total of 41.7 million in them in the upper left, middle left, I guess I'll call it. The various aspects of the organization have net deposited 9.2 million during that time that's net withdrawals.

Steve:

That is simple math, 50,969,000 invested again, it's worth 76,227,000 at the end of the period. There's a 25,250,000 and a quarter million dollar gain over the last five years from your investments, which is 9.09% a year. I think that's the highest number we've seen on here in quite a while. Again, because we hockey sticked up so much after the vaccine news, of course that's after, I don't know what you call it, it's not a hockey stick down, but I guess if you flip the hockey stick, it is right? Severe down last year, extreme up, net-net's a very solid return of net-net impact of the five-year return. If we look at the five-year return at the end of March, which we did, it was getting soft. It climbed during the year and the five-year return, by the time you hit.

Steve:

... during the year and the five year return, by the time you hit the end of the calendar year is actually over 9%. And that's great, right? I don't want to say it's not great. It's great. I worry about is it achievable again in the next five years? I'm thrilled that I can sit here and say, "We tried to make 7% a year and we made nine now," just like I was not so thrilled when we sat here in April and said, "We tried to make 7% a year," I don't remember it off the top of my head, but I want to say call it six for the sake of argument. It evens out over time as we can see.

Steve:

And the more time we have, the less subject the long-term number is to short term moves, if that makes any sense to folks. Like I said, you could make 10% a quarter. If you're looking at a 10 year return, that is a 1% change to the ten year return, but is a 2% change to the five year return, and a 3.3% change to the three-year return. Am I making sense? Am I going to deep?

Tony:

[inaudible 00:31:03].

Steve:

Oops. Tony, you were a little broken up there.

Tony:

Yeah. I know.

Steve:

Okay.

Tony:

I'm having a hard time today. Are you just getting us ready for a 5% increase next year instead of a nine?

Steve:

Let's jump to the next slide. Thank you for that lead in.

Tony:

Any time.

Steve:

That was perfect timing. We have looked at these a few times. A couple of factors are making us look at these again now. A, you're going to be coming up to a new fiscal year not too far down the road. B, so there's a few factors going on yet. The market's at 22 times earnings, historically when you buy into a market or you invest in a market that's 22 times earnings, your forward looking return is positive but muted. Interest rates we know are low and historically this one's more factual, when interest rates are this low, your return on bonds looking forward is factually going to be lower. So there's some simple things going on. These are the same numbers I've shown you before, but I want to show them to you again.

Steve:

Look at... I know the backwards number is nine. Morgan's official numbers, the same numbers we've seen before looking forward, using the exact allocation that you have today. So the IPS target allocation, 30 fixed, 55 equities, 50 in alternative hedge and swing. That is the exact number we've been invested to, I believe for all of the last five years or most of it. Our expected returns for each of those asset classes is three and a half, seven and a half, and 590. And when you blend that together to your current asset allocation, and this isn't the first time you've seen this number and I look like I'm making it up, right? Because we just made more again. But the forward-looking practical speaking, scientifically derived estimates are closer to six. They're 606.

Steve:

A year earlier, and we'll have this again in May, a year earlier... So we haven't updated this in the last, I want to say nine months at this point, Morgan does this once a year. The year earlier, we've seen this number too, that forecast was six and a quarter. So another factor is, I'm just going to give you this. It's not changing now, but each year, you know that we look at the actuary reports. And each year, on average, your population is aging. You have more people staying and aging than you do younger, newer employees coming in. If that makes sense. And by definition-

David:

That's a closed plan.

Steve:

Right. Right. So it's aging. So by definition, what's going to happen over time is that... Think about it, I'm being extreme, if everyone in this plan gets to the point where their life expectancy is 10 years or less, the actuary reports come in to say, "Guys, your equity exposure really goes down." When everyone's older and receiving benefits, it can't be this heavily in equities. Not that this is heavy, but again, it's dictated by the age of the underlying beneficiaries.

Steve:

So the point simply is be it today or in the future, I thought it was a good time where we just did 9% a year for 10 years looking forward. And we were trying to do seven. And again, it moved a lot last year in different directions, but we think forward looking that these numbers make some sense. I actually think the fixed income number might be high, and it wouldn't shock me if that 3.5% comes down when this comes out again in May.

Steve:

So I'll leave you with that. Any questions, comments, concerns there? I was going to stop there today, unless you wanted me to go into more detail on the individual holdings?

Suzanne:

Any questions from anyone? Okay. So is there anything else we need from Steve and his team? And Steve, do you want to be a part of the conversation? We're going to talk a little bit about rate of return. So I presume you'd like to stay for that part of the conversation, right?

Steve:

Love to stay if you'll have me.

Suzanne:

Yeah, yeah. Most definitely. Okay. So one of the things, so we're moving on to item number three, which is to discuss the rate of return. And what Steve is basically, I think, and correct me if I'm wrong, Steve, is basically cautioning us to continue at 7% as our expectation, given that we've had this run-on for the last five plus years, and even though we made it in the last five years, to consider reducing that.

Suzanne:

And Rochelle reached out to me and asked me the same thing, could we consider taking it from 7% to 6.75%? So I wanted to open it up to the board. I feel like we don't need to do that today, but I do think Rochelle feels like we should do that today. And so I want to make sure we get a chance to talk about it and put a next step in place if we don't make a decision today. Any thoughts or comments, or questions about what we're talking about?

Tony:

Can you remind me what the impact is by lowering it?

Suzanne:

Okay. So that's a good question. So what Tony's asking I think is that if we take it down to 6.75%, what are the benefits of that and what are the potential impacts of that? So go ahead, Rochelle.

Tony:

Yes.

Rochelle:

So I do-

Suzanne:

So... Go ahead, Rochelle.

Rochelle:

I do have, so from a contribution perspective, which is really the upcoming decision, the immediate decision to give the actuary the assumption for the one, one valuations, the impact on the contributions are relatively small. The two pension plans together would be approximately 275,000, that's based on last year's report, but it's a good projection for what the impact would be when they finalize the current report that they'd be working on. The VEBA plan from a contribution perspective is only about 23,000, is their estimate.

Rochelle:

So that's the contribution. The other decision, we don't absolutely need to make it today, but I think it would be good if we could, would be what we're going to use when we close the fiscal year. So there is an impact on the liabilities, and there's a lot of moving parts. So for the pension plan, if we go from 7% to 6.75%, all else being equal, it would be about a $2.2 million increase in the liability, and a little under 500,000 for the VEBA plan. So again, contribution pretty minimal, a little more input impact on the liability. I will add, from the liability and the 531 perspective that our auditors are supportive of reducing the return for financial reporting.

David:

Suzanne, you're on mute.

Suzanne:

Thanks, [inaudible 00:38:11]. But not opposed if we keep it there, right, Rochelle?

Rochelle:

I think, I would say at this point, however, one of the things, and this is part of my thinking on this, we don't see Morgan Stanley's update until May, usually. It is a disclosure item and I think, should it go down further, like even into the fives, I think that there could be more concern on the auditor's part to keep it at 7%, if that goes down further.

Suzanne:

If what goes down further, Rochelle?

Rochelle:

They projected a long-term return because, I mean, we disclosed that in our financials, what the projected return is. So even now, we were comparing just a little over 6% using 7%. if that drops further, that could raise concern, not just from the auditors, but potentially for the rating agencies. [crosstalk 00:39:16] I will mention that we could potentially leave the contribution assumption at 7% and still leave open what we're going to use for 531 reporting. And the auditors would be okay with that.

Suzanne:

Also, that the Morgan Stanley projection is based on our current asset allocation, correct?

Steve:

Correct.

Rochelle:

Correct.

Suzanne:

Okay. And Steve, when you're creating the projection, and we have a range, what do you use? Do you use the most aggressive portion of the range or the most conservative portion of the range for your projected outlook?

Steve:

Neither. I use the preferred, I use the target allocation.

Suzanne:

Okay. So somewhere in the middle.

Steve:

Yeah. It's the actual target that we generally stay pretty close to. The ranges are really there to help us in cases like we had last March, you needed more cash. Or like we had in December, the market did so well.

Suzanne:

Right.

Steve:

But it's based on the preferred, which is the mid point, I'll call it. It depends on the asset class. For instance, the preferred is 55% equity. The max is 60, but then the mid 45. So there it's toward the max. It varies-

Suzanne:

Okay.

Steve:

... but it's the target.

Suzanne:

Okay. So two other tools we have is the target and the asset allocation overall, as well as reducing the performance, correct?

Steve:

Reducing our increasing, correct. But I'll remind you, I think this is the most important aspect that I think we bring to the table with the actuaries is that, the asset allocation isn't derived from a investment only perspective, it's derived from a liability perspective.

Suzanne:

Correct.

Steve:

The asset allocation, we're looking at every life in the plan, there are stated liability. And then saying, "Where should that asset be invested in based on that time horizon?"

Suzanne:

Correct.

Steve:

Right.

Suzanne:

Right. And we do-

Steve:

[inaudible 00:41:25] allocation, but would be, we're keeping it in those ranges of 10 years or more is all equity. One to five years is all fixed. And there's some subjectivity between, I think we use year seven to 10 is somewhat subjective.

Suzanne:

Right. All of which assets are liquid and available. However, your equity assets pose the greatest risk at having to sell them when you don't want to. Right, because they're low?

Steve:

Yes. Agreed.

Suzanne:

Correct?

Steve:

Okay. All right.

Rochelle:

And I will just say, and we definitely have the projection and the actuary reports, we definitely, as more people retire, our each year for the next several years, those benefit payments are increasing.

Suzanne:

Right. So-

Steve:

So that's a slow roll...

Suzanne:

Go ahead.

Steve:

That's a slow roll because of that on equities, the demand for more fixed will increase as that... And that hasn't happened in any dramatic way yet, but it's a slow moving waterfall if you will.

Suzanne:

Right. So we don't want to put ourselves in a position where auditors are uncomfortable or credit agencies are uncomfortable. We also don't want to put ourselves in a position where we have to increase our contributions and our overall liability, if we can. So maybe one of the things that we might want to do is just because we haven't talked about all those moving parts and seen data to support them.

Suzanne:

Maybe what we should do, and David, I don't know if you would be amenable to this is, maybe you, me, Rochelle, Steve and Larry should have a conversation offline and come back and recommend to the RWA what to do. Either in a special meeting or at the next meeting, if that's okay with everybody. I don't know, timing wise, if that works for everybody.

Rochelle:

Could I just, so I think if we wait to give the actuary the assumption a month from now, that would be problematic as far as getting information for the budget assumptions. So I think we would need to do a special meeting if that's okay with everyone.

Suzanne:

That's up to David.

David:

I'm fine with that. I do have some questions about this. I don't want to say "Let's do that," yet because I want to continue discussions, although I'm fine with that. Because some of this is going to get down into the weeds and difficult in this large group of, I think there's 17 of us on here, but five of us board members.

David:

It just seems to me as a layman, looking at this, that with fixed income return being so low, that maybe we are more heavy than we need to be. But what you're saying, Steve, is that we need to be at least

heavier than what may appear to be the right way to go in this environment because we have the need for that cash, potentially sooner because of the retirements of people.

Steve:

Right. The fixed income. I think David, I think what you said I agree with, I'm going to repeat what I heard. The fixed income is there because the actuaries tell us the liabilities that are coming in the relative near term, and when I say that, I mean, roughly between now and seven years from now, are X dollars. And those X dollars equal the 30% allocation that we have to fixed income. And let me go deeper than that. And maybe I am getting in the weeds here with 17 of us, but not all fixed income is created equal either. So when we reserved that million plus dollars back in March or April, that went in super short, safe, fixed income, because we knew that was being paid out immediately, virtually.

Steve:

But when we get to fixed income beyond five years, that's where we might own some lower rated fixed income, some fixed income that begins to take on some volatility, some mortgage back, some non US fixed income. So fixed income has a scale of risk and return, but this 3.5% forecast is recognizing that scale, if I just made sense.

Suzanne:

Yeah.

Steve:

I'll say it differently. If we sat here and agreed, let's take fixed income down to 20%, I would have a concern that we're on the fund's ability on a given moment in time, to have the liquid funding available that we want to have to make sure that we're making payroll. So it's matching those assets and liabilities is what's happening there.

Suzanne:

Right. But it's not so much the access to it because we have access to it. It's a matter of the value of the assets when we have access to it. Correct?

Steve:

Correct.

Suzanne:

Yeah. So it's not like we wouldn't meet our liability. It just means that we might, if the market is down, we might end up selling X on, if you will. When it's low and we don't want to-

Steve:

Right. [inaudible 00:46:14] for whatever [inaudible 00:46:15]

Suzanne:

Right. Right. Right.

Steve:

We'd be seeling equities.

Suzanne:

Correct.

Steve:

Yeah. The theory is that we want five years, and I'll use that because we have we were pretty strict about the five years, five years of cash flows out, net cash flows out in fixed income.

Suzanne:

And there's no alternative for equity based portions of that, that act similarly to fixed income? Utilities, other kinds of...

Steve:

Not pure equity, no.

Suzanne:

Yeah.

Steve:

There's hedged equity, which we own a little of. So hedged equity acts, that's kind of like that seven, eight, nine year money that we tend to do. But this is yeah, there's some squishy area, I'll call it, in between. But zero to five years, no. Starting at year six, sure. We feel super comfortable year seven, eight, nine. The whole theory is, it's not a theory, the whole fact is that we're fully equity anything 10 years or beyond. So your fund is any 10 year or longer, liabilities are 100% equity.

Suzanne:

Right. But that means a big slug is in fixed income because we have meaningful liability within that timeframe.

Steve:

You do. And you have net meaningful liability, net of contribution.

Suzanne:

Right.

Steve:

It's really [inaudible 00:47:32] of arc is what it is.

Suzanne:

Yeah. And so then the other question becomes, Steve, is that if. We always say to individuals, you should keep six months of emergency, of your cost of living on hand for emergencies, right? And so we're saying five years for liabilities, fixed income. The question becomes then how we manage our fixed income assets. Right? So right now they're fully loaded into outside managers. But if there are assets that are performing at such a low rate and are really to place hold for the way station out the door, maybe we should manage them differently too.

Steve:

We did do that. They're not all with outside managers, now I remember. We did buy a bond ladder as part of the fixed income. So I'm just looking at one of the accounts right now, 10% of the total is in individual securities. Sorry, more than that. 15%. So half of the fixed income is not in outside managers, and half is.

Suzanne:

Okay.

Steve:

So that's changed actually, but that was true.

Suzanne:

Yep. The main thing that you could do to get a higher rate of return is to change the asset allocation, right? And to say, "Okay, I really don't want to recommend that you take more risk in the zero to five-year bucket," because you're at an individual, you might say, "Keep six months reserve," but you don't say, "And then put everything else in stocks and then have a balanced portfolio."

Suzanne:

So here, we're saying, "Five years, we know the payments that need to be made." We could re look at the space between six and 10 years, years six, seven, eight and nine, really. Where six and seven, we have relatively conservative, eight and nine, we have getting close to equities. We can use things like hedge equity. We have a merger arbitrage fund in there. We have a convertible arbitrage fund in there. So these are the things that are getting returns that are likely to be, and have been higher than fixed, but lower than equity, but volatility that has higher than fixed and lower than the equity.

Suzanne:

And those are the things that we do own. As a matter of fact, today in the fund, I'm just looking, we have about 5% of the assets. So this, don't show up in equity, they're 55%, but 5% of the assets are in things like merger arbitrage, hedged equity, convertible arbitrage, real estate, commercial real estate, and a hedge fund that hasn't done well, but it's actually come back a lot recently.

Suzanne:

But the point is, if I look at the long-term return of those assets, there are 660, 419, for the more bond oriented one, 871. So you blend those together and you're looking at a six to seven, not above a 7% rate of return though. But that's better than look at our outlook for bonds is. I think that my one fear is when we wait for the current, the new numbers to come out, I think the risk is higher that the forecast is going

to go down than up. So you look at the page that I last set up, our forecast for fixed income is 3.5%. I invested in fixed income. It's not easy to get 3.5% right now.

Rochelle:

And that is actually one of the concerns that I had about when we get this update, which is a couple months away, what is that going to look like?

Steve:

I think the odds are, it looks either the same or worse, and that's a risk.

David:

We change our asset allocation to look at beyond year five, because it just seems to me, we've got to be very careful about the right amount in fixed income when the rates are so low on that right now. And that is the [inaudible 00:51:15] portion. And I wonder if there's a way to tweak that, so that, and it isn't so much the quarter million dollars and $110 million budget, that's not that much that we would let that be the driver.

David:

But I think it's the fact that we want to make sure our liability is stated correctly, but we also want to make sure that the portfolio is targeting the right amount. And we've been getting seven, 8%. We've been getting more than that.

Steve:

[inaudible 00:51:37] really. Raising kind of nine.

David:

Yeah. The 9% over the five years. So I look at this and say, "Well, gee, now we're going to be forecasting even lower when our actual reality returns have been out there."

Steve:

I wish all day long that I could seel that nine going forward. Because I could charge a lot for that, right?

David:

Yeah.

Rochelle:

One of the other things I just want to add to the conversation, because I looked at, because we look at this at different points in time, we look at sort of at the end of the calendar year, but we also look at it on 531. So I went back, we have six years of information. The calculation is slightly different, but on average, over the last six years for the pension plans, we were under a five. So that was reported in our audited financials.

Steve:

And part of that, I'll just add to that, is because that reporting is based on May. And if you recall, this May was not far after this March and the values were down a lot.

Rochelle:

Right. Yeah, and the values, just to share with everyone, the values in the pension plan returns for the last six year on the low end, they were -1.22. On the high end, they peaked at just under 11.5%. But within the, for the six years, they were less than five. So that's another consideration from the financial reporting perspective.

Steve:

Yep. No question.

David:

Steve, how long would it take you to do a review of the asset allocation with the need for the cash upfront? Like we were talking about, maybe recast the year six, seven, eight, nine, look at those.

Steve:

Yeah. I think that's the flexible timeframe period, David. Those six, seven, eight, nine years. How much risk you're willing to take in those years? How long would it take us? We can be ready to meet in, I'm going to say two weeks. I'm putting words in Alan's mouth now because he'll do the number crunching and I'll review it, but somewhere in the two week timeframe.

Steve:

Know it will be based on the last actuary report, not the next, right? But that's relatively stable. It moves at a snail's pace forward. And we'll show you what we did before and what we do, if you took more risk. Note one more thing on it is that, I'm going to give you these three forward looking returns again, the forward looking estimate on fixed is three and a half and on equities it's seven and a half, in alternatives, it's five and a half.

Steve:

So if you put a 100% of this, I'm never going to suggest this, but if you put 100% of it into equities, that's the only way you get to seven and a half. It's frankly, hard to get to seven even, like if we move 10 percentage points over, that would make the 6.06 go up to, I'm rounding numbers here, but 6.5. So it's still not going to get the forward-looking. And you would have to move virtually all of the fixed income to equity to get to that number. You'd then be adding, yeah, then you'd be just over seven in a forecast perspective.

Suzanne:

Are you saying that Morgan Stanley's seven year forecast for equities is 7%?

Steve:

Yeah. Seven and a half. Because we're starting at a multiple of 22 times earnings. Remember? So in history, when you've started at a multiple of 22 times earnings, the return's actually been lower than seven and a half. In history. So it's based on reversion to the mean and the facts, but it's still a forecast.

Forecasts are extremely... At this point, and we're in a moment in time here, six years ago, roughly, we said this mix should make 77 plus.

Steve:

Remember we left... You went a little more equity than the actuaries, those of you that were here, went a little heavier equity than the actuary report dictated and that's worked out as of right now.

Suzanne:

Yeah. But what was there 100% equity forecast back then? 7%?

Steve:

No, it was higher. I'd have to go back and look.

Suzanne:

Yeah.

Steve:

It's come down recently.

Suzanne:

Yeah. So listen, I'm not opposed to doing what we should be doing. What I just want to do is make sure before we increase our liability, that we have just broken our backs to figure out any other way that we can do this as responsibly as we possibly can. Because I just feel like if there could be other ways that we could enhance performance and do the right thing in terms of reporting the information appropriately as well.

Steve:

And I agree with that, as your advisor, I agree with that. Anything we do will increase volatility and risk a bit. There's no question. If we're trying to increase the return, we're going to increase volatility. That's okay, it's just putting that out there with a footnote. But yeah, so recently, for instance, we bought a hedged equity fund. So it has approximately, again, don't quote me on this. I'm not looking at the statistic, but it has approximately half the volatility of equities, actually a little bit less, looking backwards.

Steve:

And it has a return that is, let me give you the actual number, probably same thing, about... Give me one second. A little better than half the return of the market. So it's things like that that are in that seven, eight, nine year bucket, if you will.

Suzanne:

And that's net of performance and performance fees?

Steve:

That particular vehicle. Again, we're looking at a good... That particular vehicle of a five years has made 965 a year. Looking backwards, the volatility on that particular vehicle, beta wise is 0.38. So it's about 60% less volatile than the S&P, with a return that's less than the S&P, but...

Steve:

I'm trying to look at different pages at the same time here, but that's what, we could do a deep dive on some of those things. That fits in that alternative swing, balanced, other category. And we have not over-weighted that category as of right now, which has been a good thing to do.

Suzanne:

Yeah. Okay. Anyway, I will defer to David and Rochelle about what to do next, really. I think we should talk about this more and, if we can, let's do that.

Kevin:

Suzanne, this is-

David:

One... Sorry.

Kevin:

Yeah, I'm sorry, David.

David:

Kevin, please. I was going to ask you. No, Kevin, please.

Kevin:

Yeah, no, I don't have anything substantive to say right now. I just, I'm hearing Rochelle's concerned about the timeline and I'm hearing that we need more information. I'm just wondering if we can get the information quicker than two weeks out, and that might be helpful. I'm all for a special meeting if necessary after you have a kind of a consult with the consultants in between. Thanks.

David:

Well, I was going to suggest that as one possibility, that maybe Susanne work as quickly as she can with Steve and with Rochelle to get the information that would help, and then call us together for a quick meeting to decide.

Steve:

Can I ask Alan, because Alan has to crunch those numbers with me or his team? Alan I don't want to put words in your mouth, but I think today is the 21st. When could we be ready to meet with those numbers? I'm looking at the week of the first, second, third. So when I said ready, I meant we could present them, but I don't want to... Is that not fair?

Alan:

Yeah. That week we should be fine, Steve. We have all the data from the actuary reports, it's just a matter of putting it into a presentable format.

Steve:

So that's only the week after next. So when I said two weeks, I didn't mean send it to you then talk about, I think we could present data to you the week of the first, which is the week after next.

Alan:

Yeah. Yeah. That should be fine, Steve.

Suzanne:

So we can set a date and if you guys can do it sooner, then let's do it sooner.

Steve:

We probably can't do it next week. That would be, I don't want to rush it. Maybe late next week-

Steve:

... maybe late next week.

Suzanne:

If we could, that'll be ideal.

Steve:

I'd say if we do it next week Friday, I don't want... That'd be the-

David:

So if you can try to have things together for you, and Suzanne and Rochelle, maybe I'll sit in on it as well, but for you guys to work this out with the information. And in the following week, we would get together as a group to make the change, if need be, and if things are going to stay status quo at your recommendation, we'll also reaffirm that. Rochelle, would that timetable work for you?

Rochelle:

I'll make sure it works. I really appreciate all the input and the discussion, really appreciate it.

Steve:

Alan, can you commit to a meeting next Friday, the 29th?

Alan:

Next Friday the 29th? I am actually going to be on vacation that day, Steve, but I can have the data prepared. I won't be able to attend.

Steve:

Maybe we do it the afternoon before that, Thursday-

Tony:

You guys don't give up your vacations? What's going on here?

Steve:

Well, I do Tony, but not everybody. Maybe Thursday afternoon, next week then? Are you gone then?

Alan:

I believe that should be fine, Steve, yeah. I'll be-

Steve:

We're just worried about getting the time to get it done.

Alan:

I think we'll be okay by next Thursday.

Steve:

All right. Suzanne, and Rochelle and I can talk with Alan in the meantime and we can do something next week, but at the second half of the week, I guess is what I mean.

Suzanne:

Yeah, I appreciate your stretching to make that happen. Thank you.

Steve:

I just want to do it right.

Suzanne:

Yep. Okay, very good. So Rochelle, do you need to talk about this at any more length?

Rochelle:

Yeah.

Suzanne:

Okay.

Rochelle:

Yes. Thank you very much.

Suzanne:

All right. So unless there's any other items, you mentioned something about contributions but I didn't see that on the agenda.

Rochelle:

The valuation will determine the contribution.

Suzanne:

Right. So we don't need to talk anymore about any of that stuff?

Rochelle:

Not right now.

Suzanne:

Correct. Okay, very good. So David, then we're complete and we can conclude the pension committee.

David:

Okay, then I'll make a motion for your committee that the pension committee adjourn and we reconvene as the authority.

Suzanne:

And I'll second that motion.

Steve:

Thank you everybody.

Suzanne:

Thanks Steve. Thanks Joe.

Steve:

Thank you.

Alan:

Thank you.

David:

Thanks guys.

Steve:

All right.

David:

And Suzanne, you got a unanimous vote on that, I'm sure?

Suzanne:

Oh, all those in favor?

Everyone:

Aye.

David:

Okay.

Suzanne:

Thank you. There you go, David, it's all yours.

[ADJOURN AT 1:31 P.M.]