JACKSONVILLE POLICE AND FIRE PENSION FUND

BOARD OF TRUSTEES MEETING

DATE: January 20, 2017

TIME: 9:05 to 10:32 a.m.

PLACE: Jacksonville Police and Fire Pension Fund
One West Adams Street
Suite 100
Jacksonville, Florida 32202

BOARD MEMBERS PRESENT:

Richard Tuten, III, Board Chair
Richard Patsy, Board Secretary
William Scheu, Trustee
Chris Brown, Trustee

STAFF PRESENT:

Timothy Johnson, Executive Director,
Plan Administrator
Debbie Manning, Executive Assistant
Devin Carter, CFO
Robert Sugarman, Board Counsel
Jarmon Welch, Actuary (via telephone)
Pete Strong, GRS (via telephone)
Dan Holmes, Summit Strategies Group
(via telephone)

CITY REPRESENTATIVES PRESENT:

Steve Durden, Office of General Counsel
Anna Brosche, City Council Liaison

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BOARD MEETING

January 20, 2017 9:05 a.m.

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CHAIRMAN TUTEN: Let's call the meeting to order. First thing, the pledge of allegiance.

I pledge allegiance to the flag of the United States of America, and to the Republic for which it stands, one nation, under God, indivisible, with liberty and justice for all.

If I could keep everybody standing for just a second. We have a moment of silence for some deceased members: James Stevenson, firefighter; Henry Lindsey, police officer; Doyle Hall, police officer; David Addison, captain, fire department; and Claude Springs, Jr., retired fire captain.

(Pause)

CHAIRMAN TUTEN: All right. Thank you, everybody. You may be seated.

Public speaking period. We only have one speaker, a Bill Gassett. Oh, boy. Bill, please come up. There he is.

MR. GASSETT: My name is Bill Gassett. My address is a matter of record.

Wednesday was quite an interesting day, and so we felt compelled to prepare Part 6, called

Sherlock Holmes. And what we did in page 1, if you'll look at it real quickly, we did a side-by-side comparison of the returns of what the pension fund has done versus an alternative strategy like the Dow Jones.

And so, for example, 1994, the value of the fund at that time was 427 million. The gain gave about an $84-million profit. The Dow Jones had a higher percent retain. Gave a gain of 151 million. And that far right-hand column shows the differences throughout the course of that last 23 years.

There were some minuses in there, but the grand total difference is 377 million. Now, not being one to allow a chart to exist silently, I ran through the equivalent discounted cash flows and found that that would be equivalent to about a $1.6-billion plus.

So in effect the outstanding unlimited liability would be reduced at $280 million had this been adopted, not the restrictive plan that you have now. And you would have been in excess of 80 percent funded.

The next page shows an update based on what the good Mr. Jerome (sic) produced yesterday.

This 10 percent number is a gross 10, but net 7. You need that number to make sure you get people to age 82 based on the day it was presented through Mr. Jerome last Wednesday.

The problem is, the problem is, that if you took -- did a sum total of that column from the policemen's fire and pension fund, that first yellow, you're only doing about 7 1/2. By coincidence, the Dow Jones return gave me about a 10 1/2 percent net return.

So with your 7 percent still in the works, it will probably stay there, you're going to run out of money in about 13 years. That has not changed, by the way, since the last chart was presented, about a year ago.

Jerome made an extremely -- so as far as that point, should you pay off the $42 million at once or over a period of time, I would suggest at once because your new requirement is not the 7 percent, but the 10 percent. That's the real number you've got to make because you have no money in the future retirees. It's all current retirees.

So with that, every dollar you postpone the next two or three years, your cost of capital on that carry is 10 percent. You made a good point last time. What if the market is just flat next year? Well, that money that year will cost you 20 percent. So you always make the 10, plus the 10 that's coming up next year.

Just other, real quickly. Please consider an alternative strategy. If you're positively guaranteed locked in, this damnation that I mentioned last month will continue.

It also will mean that you, City Councilwoman, you guys will have to be on the hook for an initial $330 million just to keep these folks solvent.

Now, Jerome made a very important comment. It's too bad he got cut off too soon. But on page 1 of what he handed out, he said that he was able to calculate the 1.8 billion based on you've got to make 7 percent.

If you've got to make 10 percent, and you can have your guys check this, that number kicks up to 2.2 billion. That's your true unfunded liability. So please keep that in mind.

Bottom line, please consider sending a letter. It doesn't cost you anything, and it may be the one thing that gets the ball rolling to get this thing solved.

Any questions? Thanks very much for your time.

CHAIRMAN TUTEN: Thank you, Bill.

No more public speakers. We'll move on to the Consent Agenda. If everyone has perused the Consent Agenda, any questions, comments, concerns?

(No responses.)

CHAIRMAN TUTEN: We'll need a motion and a second.

MR. BROWN: I make a motion to accept the Consent Agenda.

MR. PATSY: Second.

CHAIRMAN TUTEN: We have a first and a second. Any questions?

(No responses.)

CHAIRMAN TUTEN: All in favor?

(Responses of "aye.")

CHAIRMAN TUTEN: Any opposed?

(No responses.)

CHAIRMAN TUTEN: All righty, then.

Moving on to Mr. Timothy Johnson.

DIRECTOR JOHNSON: Yes. Good morning, everyone.

If you turn to the tab in your book titled Executive Director's Report, I've got a relatively brief report for this month. The first thing you see are the Dashboards. And I wanted just to remind the members that the Dashboard does two things for me.

It's a cumulative tally of the actions of this Board. So everything that the Board does relative to benefit approvals, retirement approvals, investment actions, are in this budget -- are in this Dashboard.

Additionally, it gives me information relative to the productivity of my staff. In other words, there are things that don't come to this Board for approval that I keep track of as well, like the operating budget and our public records requests, as well as our progress on our records retention project.

As you'll see at the top of the second page, we've added actual pages to those two Dashboards. So previously with regard to the public records requests, I was keeping record of the requests that we received and completed.

Now we've actually included pages in that report. So you can begin to see the volume of the work that's being done. We're doing the same thing now for records retention so that you can see the progress that's being made in that regard too.

In terms of updates, there's only two. The big news is I was directed last month by the Board to schedule a workshop to discuss the October 1, 2016 actuarial report. That workshop occurred just two days ago on Wednesday, and we'll have an update on that through our actuary, Jarmon Welch, in a minute.

He is on the phone along with Pete Strong from GRS to answer any questions we might have relative to the assignment that was given on Wednesday.

Next, a resolution was introduced by the Board to confirm the appointment of Tracey Devine as a member of the FIAC, and that has been submitted to council. I wanted to acknowledge Councilwoman Brosche for taking her time to walk me through the appointment process so that we can hopefully efficiently get Tracey through that process and get her working on behalf of this Board on the FIAC. So thank you for your help.

And then lastly we've added to the daily updates that you-all receive. We send you a daily update of the market value of assets. We added to that a link to *The Morning Pulse*, which is a daily snapshot of news regarding pensions, 401(k)s, personal finance, technology, investment, and several other things.

I've gotten it for years. And in the past I would excerpt articles from it included in my report. So a light went off one day and I said, instead of taking a handful of articles and putting it in my report, why don't I just send this thing to you-all every day. So now you have access to the same information that I receive, and those stories are outstanding.

If you followed recently, you'll see that even Jacksonville has been reported in *The Morning Pulse*. So I hope that that's useful to you, particularly with all the changes that are going on here in Jacksonville with regard to negotiation with the union.

So with that, I'll entertain any questions before we move on to the other reports by counsel and the investment consultant.

CHAIRMAN TUTEN: Just one question for you, Tim.

DIRECTOR JOHNSON: Yes.

CHAIRMAN TUTEN: On the Dashboard on the first page right down there with your Benefits.

DIRECTOR JOHNSON: Yes.

CHAIRMAN TUTEN: Pension Estimates, per prior month, 30, Year-To-Date, 133. What number -- what is that number?

DIRECTOR JOHNSON: So we routinely will get requests from members to estimate what their benefit will be in the future.

CHAIRMAN TUTEN: I gotcha.

DIRECTOR JOHNSON: Right.

MR. BROWN: And the New Medicals? The New Medicals.

DIRECTOR JOHNSON: Right. That's right. Those are new people that are coming in going through the medical process --

MR. BROWN: Okay. Got it.

DIRECTOR JOHNSON: -- to identify any pre-existing condition before they're approved.

I appreciate those questions because I want you to understand what these things are measuring as well as I do.

CHAIRMAN TUTEN: Gotcha. All right.

DIRECTOR JOHNSON: All right. Thank you.

CHAIRMAN TUTEN: So I guess we have Counsel Reports, Steve Durden.

MR. DURDEN: Good morning.

The two reports I'm bringing from the office relate to litigation. At this point the two pieces of litigation -- I'm sure you-all are all aware of. One is the Curtis Lee case on public records.

I don't know if you recall, but one of the judges was someone who may have a bit of a -- or believes might have a conflict, so he recused himself. And then it took a while for the chief judge to issue a new order. And the new judge is going to be -- it was Judge Norton who had the conflict.

I think she may have had -- she may have had litigation with regard to Mr. Lee at some point while working for the General Counsel's Office. I don't remember the exact conflict, but she felt that it was sufficiently strong enough that if Mr. Lee asked for it, and he did, that she should recuse herself. So she did recuse herself.

But that wasn't before a couple of motions had been filed, a motion to dismiss in official capacity -- don't know if you recall -- each, including myself, a number of us were sued and each were sued in your, quote, individual capacity. A motion to dismiss was filed on that.

This was a failure to comply with pleading requirements. It was a motion to dismiss because the PFPF, as in the fund, is not a separate entity. The Board of Trustees is an entity, but there's no entity called the Police and Fire Pension Fund.

And then also there's a motion to strike the demand for jury trial because there's no jury trial in a public records case.

Because of the recusal, we now have a new judge and I think it's Judge Soud. I think that's what -- I think the order just came out -- let's see. I think that's what he told me. You know, it's not in the report, but I believe that's correct. Judge Sound is the -- interestingly enough, Judge Soud was a lawyer for the General Counsel's Office many, many years ago, but I don't -- there's no reason for that to be a conflict. That's not going to be justification for a conflict.

So my guess is at some point before too long, Mr. Payne, Jacob Payne, who is the main litigator, the main litigator in this particular case, will be asking for hearings on the various motions so that we can either clean up the case or get rid of it completely. It's hard to completely get rid of a case on a motion to dismiss, but at this point there is that effort.

Then the other litigation is, as you may know, the John Keane litigation. The Board was officially served -- I think I saw the date of the 5th or the 6th, or something along those lines, of January.

An answer is due on -- is next week, the 26th. And I believe that Ms. French may be asking for an extension. She didn't tell me that. That's not official yet, but that's -- the lead lawyer in that case will be Loree French, again, with Jacob Payne assisting. Rita Mairs will also be working on that case. The two lead lawyers will be Mairs and French. And certainly, if you have questions, please don't hesitate to call them.

Jacob Payne, I believe, is probably working on the first response to the litigation.

CHAIRMAN TUTEN: All righty. Anybody have any questions?

(No responses.)

CHAIRMAN TUTEN: Thank you, Stephen.

MR. SUGARMAN: We've got a verbal report, if you would like.

CHAIRMAN TUTEN: Yes.

MR. SUGARMAN: First, thank you-all for engaging us. It's something we've really looked forward to. It's challenging. A lot of the issues here are novel, and I'm really enjoying the time I'm spending almost every day on issues that are coming up.

(Laughter)

DIRECTOR JOHNSON: I wish that weren't true, but it is.

MR. SUGARMAN: The transition from Bob Klausner's office to ours is running smoothly. He's answering my questions, giving me any documents I need, as I knew he would.

And the transition of the division of responsibilities, which previously all were with Bob Klausner and now are divided between OGC and me, is also going very well. And we're working very well together as I'm learning and talking to all the different staff.

So in some of the things you've head about, for example, the Keane case, we took a look at it. We had a phone conference with Loree French and Rita, gave them some ideas, sent them some cases. And basically we're on standby whenever they -- whenever they need us. Give them some things to think about. But we are working as a team on that.

The opinion on the DROP payouts, whether or not they comply with the Internal Revenue Code and comply with your code, we have completed our work on that. We had our first conference with the OGC yesterday, because they're dealing the a similar issue on behalf of one of their clients, and we should expect to have an opinion, both saying the same thing, within the next week or two. So that's still in the works.

The Keane case I mentioned.

So we're off and running. Things are going very well. I want to thank Tim and Deb for making that transition for us, introducing us to who we call and how we get in on meetings telephonically. You have a really good staff working here. Whatever we need, we get in a matter of minutes. Thanks.

CHAIRMAN TUTEN: All righty. Are we going to get Dan on the phone, Tim?

MS. MANNING: Dan is calling in at 9:30. So maybe give him another minute.

Dan, are you on the line?

CHAIRMAN TUTEN: Well, do you want to skip and fast-forward to something else?

DIRECTOR JOHNSON: We can skip that and we can go to Old Business, I guess.

CHAIRMAN TUTEN: Well, how about -- is Old Business, is that Jarmon?

DIRECTOR JOHNSON: That is Jarmon. Jarmon is on the line.

MS. MANNING: Jarmon and Pete Strong are on the line.

DIRECTOR JOHNSON: Through the Chair, Jarmon, can you hear me? It's Tim.

MR. WELCH: Yes, Tim, I can hear you. Hello, everyone.

DIRECTOR JOHNSON: You know, I should acknowledge Deb as well. She and the staff, they did a great job. Those who were here on Wednesday know how difficult the phone was when Bob was on the line. It was a mess.

So they worked and were able to get this state-of-the-art conference line and we can hear perfectly. So this is great.

Jarmon, everybody can hear you just fine.

The draft letter that you were directed to write on behalf of the Board to be sent to the state justifying a step-down from the 2.5 assumed payroll growth rate down to the rolling ten-year average of 0.067, that was sent to the members of the Board when you sent it to me.

They have had a day or so to review that, and I thought this would be a great opportunity, if you would, to just elaborate on that letter and entertain any questions that the Board members might have to you.

MR. WELCH: Okay. All right.

In the letter I make three arguments for the state to allow the three-year staggering.

The first argument, number one in it, is that it's consistent with past practice to do the three-year staggering because you can see how past practice has been to stagger the 2008 payroll growth assumption of 5.25 percent down to 4 1/2, 3.25, and then to 2.5.

So actuaries like to be level and consistent and regular systematic in their recommendations rather than have a big jolt at one time. And so the consistency is preserved by not going immediately from 3.25 to zero in the 10/1/16 valuation, but to put it in over several years.

So the state called me and we discussed this, and I've sent them some information that was already public on the website.

The second argument and the main argument -- the main argument is that the state's job is to make sure the minimum annual required contribution is paid into the fund. If they don't do that, well, then you get into trouble with it.

So the second argument is that, with staggering, they're still getting amounts above the minimum required contribution. Or to put it another way, I'm saying to them, you look at the total package, and the total package now includes the supplemental contributions, so give us a break with the annual required contribution. Let us set it at the staggered level.

And to me, that's -- that's a powerful argument because you probably -- it puts them in -- it would ease the difficulty for them too in terms of approving it because when they -- when they approve certain liberalizations or lower funding, they're afraid of making policy for the 400-and-something plans all across the state. They don't want to open a can of worms.

But I pointed out to them that you are a unique situation, which they really agreed with that. But that's the fact that you have this supplemental contribution in this plan and probably nobody else does.

So I say you're there to preserve this minimum contribution level and you got it. And so you've got a total package that's good. So approve what we're requesting.

Now, the third argument was that -- which is what they would have basically thought I was going to write about, this argument of trying to show that going forward there will be payroll increases.

And so I referred them to the actuarial report, the key data pages that show that the DROP -- the number of DROPs in the last five years has went down, and there's a number of new hires. There were a couple of hundred people that were hired over the past year.

And then also I mentioned to them that the mayor proposed a 20 percent pay increase over three years, which may or may not come to be.

So I said -- so in your usual argument where you ask that, regardless of anything else, if you're going to have a payroll increase assumption, you expect to see payroll increase. I said, that's probably going to happen too, although it won't happen immediately, but it will happen over a period.

So I left it there. I talked to Doug and I talked to his boss, Keith, on the phone. They called me after I sent them a note that we needed quick action here.

And I said, don't go forward with the thought that you-all had, that between now and the middle of the summer, that a review would be done actuarially and you would then review it internally and then you would come back.

I said, there's a need in Jacksonville to have a prompt answer. And I said, the issue is pretty clear in the letter that I'm -- I'm discussing with the Board to send you, and could you please just get back in a few weeks and tell us if it's okay with you.

I'm encouraged that they will come back and say the staggering is okay. They may not do it in several weeks. It may take a bit longer, because when you deal with the state, if you bring up an issue, for example, like one time I called them and said, let's count DROP pay in the payroll increase assumption because we -- that helps us. It's also real pay. They immediately said no, that in their rules they would not allow it.

But when I suggested this, they didn't immediately say no, and they said, we'll take it under advisement and we'll get back to you. And so I think you're in a good position. They probably will approve the staggering.

DIRECTOR JOHNSON: Thank you, Jarmon.

Through the Chairman, if the response from Tallahassee, the Division of Retirement, is to allow the step-down of the payroll growth rate, then what will we do with that information once they tell us that it's okay and that they're accepting your recommendation?

CHAIRMAN TUTEN: As far as -- you're talking about Jarmon?

DIRECTOR JOHNSON: I'm talking about Jarmon, yes.

Jarmon, did you hear that question?

MR. WELCH: Yes, yes.

Here's the way -- here's the way the department works. Hopefully in a few weeks they will write back and say the staggered suggestion and the actuarial letter of such and such is acceptable to the department.

Then I would write back and I would say that this means the budget is reduced from 203 million -- it's reduced by 25 million to 177 million. And I would copy both the Trustees and the state on that. And then that's it.

I mean, when Joey is doing his budgeting and truing up the amount for the year for fiscal year '18, that's what he would use. And when the state, at the point in time, they were reviewing the reports, they would have that and they would use it.

There's no need -- I mean, I'm requesting the actuary report be adopted as it is. Changes in it are handled by side letters like this, and they go in the state's file and your file so everybody knows where you end up.

DIRECTOR JOHNSON: Thank you, Jarmon.

CHAIRMAN TUTEN: So in other words, once the state -- if the states comes back and says, yeah, you guys, this looks good to us, you can approve it, let's go with it, really, the only thing left for us to do would be to approve the changes to the actuarial report as far as from the original 2016 with the 44 million, and then --

MR. WELCH: The acceptance of the state -- of the letter, the acceptance of the 177 million that --

CHAIRMAN TUTEN: So we have to send it back to the state to get their approval?

MR. WELCH: Yes.

CHAIRMAN TUTEN: Yeah. That's what we would do, correct? I mean, that's all we'd have to do. Once the state approves this, we vote here what we want to do, whether or not we want to pay it all at once or do three at a time and then we're done.

MR. SUGARMAN: Yes. You're approving, in essence, a revised report, would be the report as revised by this letter, or the impact statement or whatever it is, however form Jarmon is going to give it to us, and that would be sent to the state.

MR. BROWN: But it's not revised yet because it hasn't been approved by the state, right?

MR. SUGARMAN: That's right. The steps now are we're awaiting the approval of the phase-in by the state, and then if they approve it, then it goes to you, and Jarmon -- if Jarmon recommends it, which I'm sure he will, and then you approve the actuarial valuation as revised. Then that goes to the state for approval and that goes to the city as its pension bill for next year.

MR. BROWN: Okay.

MR. SCHEU: So procedurally we're approving it -- because I thought what we did was approve it as revised, subject to revision if the state didn't approve it.

MR. BROWN: See, I thought we were going to be approving it subject to the approval of the state, like a conditional approval, if that's even appropriate.

MR. SCHEU: And it would be -- it would revert to the original if the state didn't approve it. That's what I thought.

MR. BROWN: Yeah.

MR. SCHEU: And then we wouldn't need to come back.

MR. BROWN: That's right. Can we do that?

Can we take care of all the voting now and then, subject to what happens at the state level if they approve it, then obviously these changes go into effect. If they don't approve it, then it reverts back to the original report?

DIRECTOR JOHNSON: Well, we're framing the motion, so let's see.

Bob, do you want to comment on that?

MR. BROWN: Bob, do you have any issue with that?

MR. SCHEU: Bob, that would be a question for you.

MR. SUGARMAN: I would rather have you approve the report as presented with the -- but subject to revision due to subsequent events that might arise.

Collective bargaining might be completed. That might loosen up some surtax money. That's one subsequent event. This state approval is another one.

So we'll approve it subject to revision, if necessary -- if needed due to subsequent events.

MR. SCHEU: And we would vote on that at that point?

MR. SUGARMAN: Right. You'd vote on it

today and then you'd vote on the subsequent events, on the revisions caused by the subsequent events.

MR. SCHEU: Sure. Okay.

MR. SUGARMAN: It's only the January 31st deadline that's causing us to have to look at this right now. Normally we'd wait --

MR. BROWN: Right, sure.

MR. SUGARMAN: -- and see how those things play out and talk about this in April or May.

MR. SCHEU: And we should convey to Councilwoman Brosche, as you've heard, that for your committee, that we're hoping that this will come about. We still have to vote on it, but that looks like we will.

MR. BROWN: Right.

MS. BROSCHE: Thank you.

MR. SCHEU: As you can do your plan.

MR. CARTER: Through the Chair, we already communicated to the council auditor's office and the city about the report itself.

So, of course, like Mr. Sugarman stated, it's the fact that we approve it today due to -- based upon our call from the state, they're okay with that.

So we already have that covered so they understand, given the fact that we're in negotiations with the actuary report and whatnot, so there may be some changes, but they are aware of the January 31st deadline.

CHAIRMAN TUTEN: So the first motion we need is to send this to the state as it is, correct? That's what we're doing right now?

DIRECTOR JOHNSON: I would just like to get clarification from Bob whether Bob is saying we have two motions: One, to accept the report; the other to send the letter, or whether we're motioning to approve the report, which includes the letter.

MR. SUGARMAN: The letter is just -- the letter is not a revision to the report. The letter is just something that's happening.

MR. SCHEU: Could I suggest a motion that we approval the report as submitted, subject to revision, based on the response of the state to that letter --

MR. SUGARMAN: Yeah, and other subsequent events.

MR. SCHEU: And other subsequent events.

MR. BROWN: And I'll second that motion.

CHAIRMAN TUTEN: That would include this sending to the state? And that would include accepting the three --

MR. SCHEU: No, I think we're not voting on that yet, because we would come back and have to vote on that.

MR. BROWN: Yes.

CHAIRMAN TUTEN: Okay.

MR. BROWN: Counsel is recommending for us to do it in a two-step process.

CHAIRMAN TUTEN: That's fine. All right.

We have a motion for the first recommendation, this recommendation to accept it.

MR. SCHEU: Yes, subject to possible revision based on the letter and subsequent events.

CHAIRMAN TUTEN: Right.

We've made a motion and a second to send this to the state, as Mr. Sugarman described.

MR. SCHEU: To approve the report, subject to subsequent events.

CHAIRMAN TUTEN: Okay. Any questions?

MR. PATSY: I just want to make sure I'm clear that what we're adopting today is what was presented with no changes Wednesday. Was it

Wednesday? Two days ago.

Is that correct, Jarmon?

MR. WELCH: Yes, that's true.

MR. PATSY: Okay. So subject to revisions based on feedback from the state.

MR. SUGARMAN: Right. If the state says no and no collective bargaining agreement is reached, then this is -- this is the report.

MR. BROWN: Right. Okay.

MR. SUGARMAN: If any of those things happen, then that's reported to you and the actuary will say, this warrants a revision in the report, we'll show you the revision, and then that's what you'll adopt.

CHAIRMAN TUTEN: And then at that point we'll decide whether or not we want to continue with the three payments spread out or decide to say, okay, regardless of all this, we're going to vote for it.

MR. BROWN: Right.

MR. SCHEU: That's right.

CHAIRMAN TUTEN: Okay. We had a question.

Any other further questions or comments?

(No responses.)

CHAIRMAN TUTEN: All in favor?

(Responses of "aye.")

CHAIRMAN TUTEN: Any opposed?

(No responses.)

CHAIRMAN TUTEN: None.

MR. BROWN: And I'd like to make a motion that what we just did with the stated conditions be drafted in a very short letter to the mayor and his staff, explaining what we're doing because there's no representative from the city here. So in order to inform them, I think just a very short letter.

I'm making a motion that we draft that and sent it to the mayor.

MR. SCHEU: I'll second it.

MR. PATSY: I'll second it too.

MR. BROWN: We're piling on that one.

MR. SCHEU: I would like to suggest that Mr. Sugarman participate in the drafting of that letter.

MR. SUGARMAN: Tim and I will work together on it.

MR. BROWN: Good.

MR. SUGARMAN: But first, the letter will begin, in order to meet the January 31st deadline, this is what we've done.

CHAIRMAN TUTEN: Okay.

MR. SCHEU: I'd just like to thank Jarmon for all his work on our behalf --

MR. BROWN: Yes.

MR. SCHEU: -- and particularly his patience and his understanding with respect to this.

MR. WELCH: Thank you.

MR. BROWN: Thank you.

CHAIRMAN TUTEN: All righty. We have a motion and a second to send a letter to the mayor and other city representatives explaining exactly what we're doing here.

Any questions, comments?

(No responses.)

CHAIRMAN TUTEN: All in favor?

(Responses of "aye.")

CHAIRMAN TUTEN: Any opposed?

(No responses.)

CHAIRMAN TUTEN: No. All righty.

DIRECTOR JOHNSON: Very good.

CHAIRMAN TUTEN: Is that it for Old Business, Director?

DIRECTOR JOHNSON: Yes, sir.

CHAIRMAN TUTEN: Do we have Dan on the line yet for the investment?

MR. HOLMES: I am online.
MR. WELCH: Okay. I'll leave now. Thank you-all.
MR. BROWN: Thank you.
DIRECTOR JOHNSON: Thank you, Jarmon.
MR. STRONG: Pete, I'm going to sign off too. This is Pete Strong.
MS. MANNING: Thanks, Pete.
All right. So, Dan, we have you on the line?
MR. HOLMES: I am. Can you hear me okay?
MS. MANNING: Yes, sir.
MR. HOLMES: Fantastic. And I can hear you as well.
DIRECTOR JOHNSON: Hey, Dan, this morning. We wanted to express our condolence at the loss of your father. We know how difficult that can be, particularly after the holidays. And, you know, our hearts and our feelings are with you during this difficult time. So thank you for being here today.
MR. HOLMES: Well, I would like to say thank you for -- Tim, to you, the staff, the members of the FIAC and the Board members. I appreciate your condolences and the warm thoughts that you

expressed, the support you gave me and a little bit of time to kind of get back on my feet.

It was not the holiday season we had planned, but we're blessed to have him as a father for so long, and for my mother and my father to be married for 64 years. So I really appreciate your patience, and I think it reflects on the class of your organization.

DIRECTOR JOHNSON: Thank you, Dan.

CHAIRMAN TUTEN: You're welcome.

MR. HOLMES: So am I free to kind of jump into the agenda?

DIRECTOR JOHNSON: Yes, sir.

MR. HOLMES: Okay. Thank you.

The first topic we have is the Monthly Capital Market and Economic Update.

What's interesting is, is December kind of got wrapped up into everything that was kind of thought of as kind of post-election. Interestingly enough, December was pretty quiet compared to November.

The most important thing that happened during the month of December was basically the fed came through with its anticipated rate hike. And so that was important. They raised the range by 25 basis points for fed funds rate, from 50 to 75 basis points, is that range.

The second thing that it did was the fed signaled three additional rate hikes were anticipated for this year, for 2017. They believe that rates would get up to about 1.4 percent -- or another 1.4 percent.

What's interesting is over the past at least five years, the fed has always been way out in front of the market. The market has had discounted interest rates and growth rates compared to what the fed was projecting, and now it might be the reverse.

The fed may actually -- or be out in front of the market and the market may have to wind up catching up to the fed.

So the bottom line is some generally raising interest rates with a little bit of inflation is not a bad thing, especially for capital market assumptions.

So with that said, the market -- the bond market did not react. Actually, the broad bond market was really up 10 basis points, a positive return, for the month. Most of the damage from rising interest rates came on the anticipation that happened during the month of November.

Jobs were created during the month. There was a little bit of a tic up in unemployment to 4.7 percent, but basically we're seeing strengthening in the job market and the wage market, and that's allowing the fed to raise rates.

The other bit of positive good news for the month, real GDP was revised up to 3.5 percent for the quarter. So that's the strongest quarter during 2016. We don't have a print for the fourth quarter yet, but the hope is, is that the average will come in for the year over 2 percent.

And then, finally, leading indicators continue to show that the economy is in an expansionary mode. The ISM, nonmanufacturing index, reached or tied its record high, which basically just continues to show the market is growing -- or the economy, rather, is growing.

So for equities, that translated into generally positive return. For the month of December, the S&P was up over 2 percent. But, more importantly, for the year domestic equities were up fairly strongly. The large cap stocks measured by the S&P, up over 12 percent.

Small cap stocks measured by the Russell 2000, up 2.8 percent for the month and over 21 percent for the calendar year.

Another bit of good news was the international equity markets rebounded. You'll recall they were down in November after the election on anticipation of a higher dollar and more domestic-oriented trade policies. So they traded off, especially emerging markets. But the bottom line is they rebounded during the month of December.

So we saw EAFE up 3.4 percent, but only really up 1 percent for the year. However, the bigger story in international was emerging markets, they were up about 20 basis points for the month, but up over 11 percent for the year.

And, finally, the other turn around from -- compared to 2015 was oil, and then the kind of offset of that, the MLP index.

And so we saw the MLP index up fairly strongly in the past couple of months. It was up 4.4 percent alone during the month of December. And then, more importantly, for the calendar year up over 18 percent.

So by and large growth assets had a good --

a good quarter and a good year.

On the fixed income side, as I mentioned before, with the anticipation of the rate hike, we saw interest rates move up and bottom prices move down during the month of -- really, the months of October and December.

But the bottom line, it was basically flat for the -- flat for the month, and then modestly positive for the year. The Barclays Aggregate Index was up about 2.6 percent for the year.

We liquidated the bank debt portfolio at the end of the year in order to fund Neuberger Berman, but we got the majority of that run-up in that part of the market. It was up about 9 percent for the year. So we captured that gain before we funded -- we funded Neuberger Berman.

So that kind of did as the backdrop. Let me see if there's any questions.

DIRECTOR JOHNSON: No, Dan. Thank you very much.

MR. HOLMES: Thank you.

Moving on to the Flash Report. The second agenda item is the Flash Report. I'll remind everyone that this is a preliminary Flash Report.

As you no doubt have seen in pre-review we don't have all of the benchmarks yet, and we want to make sure that we've got fully audited statements. So the final numbers will be reflected in next month's quarterly report.

But on a preliminary basis, the news is as follows:

First of all, at the end of the year, the total fund market value was 1,761,000,000 and change from there. That reflects not only the city's contribution, but also a gain for the -- for the quarter of over 1 percent. So not too bad on the year either. So that's the market value.

You can see relative -- asset allocation relative to targets above that. That's on the top, left-hand side of page 1. So the overweight in domestic equity, which helped in the course of the year, remained.

The underweight to fixed income we continue to work on. And then international was a slight underweight as well, but that was also additive to performance on a relative basis for the year.

CHAIRMAN TUTEN: Dan --

MR. HOLMES: Turning to page 2, you can see performance --

MR. BROWN: Hey, Dan?

MR. HOLMES: Yes.

CHAIRMAN TUTEN: Hey, buddy, this is Rich. Do me a favor. When you're discussing the manager returns, skip ahead to net-of-fees returns.

MR. HOLMES: No problem. Do you want me to do the same for the asset class as well?

CHAIRMAN TUTEN: Yeah. That would be great.

MR. HOLMES: Okay. Then I'll direct your attention to page 5 then.

Okay. So this is the start of the net-of-fees section. The total fund composite for the quarter, which also coincides with your fiscal year, was up over 1 percent and above the policy index on a net-of-fees basis.

On the calendar years basis, the total fund composite was up 8 percent and a little behind the policy index.

Where returns came from from the calendar year are as follows:

First of all, the highest performing asset class for the fiscal -- I'm sorry, for the calendar year was MLPs. You can see MLPs in the portfolio up over 17 percent. Your composite was below that by about 4 percent. The reason why is your two managers invested a portion of the MLP market which is -- tends to be more yield oriented, a little less volatile and higher quality.

So the lower quality stuff is the stuff that ran, especially at the beginning of the year, with the rebounded oil. Those are the MLPs that are closer to the pipeline, the closer to exploration. They tend to have a lot more down on the balance sheet, et cetera.

We, at this -- this is reflective of the manager's style as opposed to being viewed as something wrong with their -- with their particular process. We don't have any worries about that. But above everything else, that asset class contributed 17 percent towards the return on a net basis. Again, on a net basis --

MR. PATSY: Hey, Dan --

MR. HOLMES: -- since inception, both managers have outperformed the benchmark.

MR. PATSY: Hey, Dan --

MR. HOLMES: The second biggest contributor was --

MR. BROWN: Dan.

MR. HOLMES: Yes.

MR. PATSY: Hey, Dan, this is Rick. The rationale on the MLP managers for that positioning, that tends to be the higher quality segment of the market. Is that accurate?

MR. HOLMES: Yes.

MR. PATSY: Okay.

CHAIRMAN TUTEN: Thanks, Dan. Continue.

MR. HOLMES: So just to make sure I'm in -- I understand what you're saying, the higher quality -- the higher quality -- or the fact that your portfolio has the higher quality MLPs is the cause for the underperformance.

MR. PATSY: Okay. That's good.

MR. HOLMES: Okay. In the long term, I think that's the place to be, or we think that's the place to be.

MR. PATSY: From a capital preservation perspective, they're less susceptible to --

MR. HOLMES: From a risk-return perspective as well. We think that you get the -- over the market cycle, that part of the MLP market tends to get the majority of the upside with less downside.

MR. PATSY: Got it. Okay. Good.

MR. HOLMES: Okay.

The second part of the portfolio that added during the calendar year was the domestic equity portfolio.

Domestic equity portfolio was up over 10 percent, 10.6 percent. It too underperformed the index a bit during the course of the calendar year. It -- we've talked about some of the managers in the past.

The FIAC and I are still working on the plan of rectifying that. Suffice it to say it's going to be going more towards heavier passive weight. We're working on the implementation of that. And that's due primarily to valuation in the market, which we'll touch on here after the Flash Report.

In the international portfolio, the international portfolio was up -- I'm sorry. Strike that.

The next best performing sector was the real estate portfolio. Real estate was up about 8 percent last year. The managers there outperformed the benchmarch during the course of the year. But please note that that benchmark -- that's on a preliminary basis. The benchmark still needs updating.

And so -- but the bottom line is both managers were north of 8 percent on a gross basis, about 8 percent on a net basis, and keeping with their peers, or at least the ones that I've seen thus far.

The next best performing asset class was international equity. International equity was up over 4 1/2 percent last year, just slightly below the benchmark for the year by about 37 basis points. That was basically on a fee basis.

Silchester continues to do well. The managers all continue to -- actually, all the managers on a gross basis outperformed for the calendar year.

The leading -- the big help there was the exposure to emerging markets. The emerging markets manager was up over 11 percent followed by Silchester. Silchester continues to perform amazingly well, especially in terms of their consistency, and they were up over 6 percent.

Baillie Gifford was positive and outperformed their benchmarch, but on an absolute basis -- on an absolute basis they were up -- they were up 1.4 percent in keeping with other developed markets. And then, finally, the index fund was basically in line with the index.

So those are the areas of return. Fixed income did well. It was just slightly below international. It was -- and actually for the calendar year performed significantly better than our capital market assumptions. And the reason for that is if you'll recall, rates dropped for at least the first half of the year.

In addition to that, you had spread exposure with Thompson Siegel and the bank debt portfolio manager. We took advantage -- or the portfolio was able to experience those benefits, and that's what really drove performance, that spread exposure. And then we basically -- we continue to believe that that is attractive.

And then moving to the two managers, Loomis and Neuberger Berman have more of that, so we think that will be additive to performance.

Let me stop there and see if there's any questions.

MR. PATSY: Dan, when is Loomis going to get funded?

MR. HOLMES: Next week.

MR. PATSY: Okay.

MR. HOLMES: So that's next, I believe, on my review. I was going to review funding of Neuberger Berman and Loomis.

There should be a one-page outline showing -- or recapping the Neuberger funding. So on December 22nd, Neuberger Berman was funded with $159,639,000. They were funded in cash. The source of the funding came from the bond index fund, and then the termination of the Eaton Vance bank loans, and then also a portion of the city's contribution to the pension plan.

That was all preapproved previously by the Board. So it was simply execution during the month. By year end, the portfolio had been fully built. And in addition to that, there were funded, like I said, with about 159,000,000 and they grew a little bit over the course of the month to over 160,000,000.

And so we reflect there basically their allocation across the sectors as it stood at the end of the year.

So, again, remember the purpose here was to get broad fixed income exposure, especially in the spread sectors, and to do that in a cheaper version than going with dedicated managers.

So at the end of the year, the portfolio had

13 percent high yield, 11 percent in TIPS. Other spread sectors included mortgage-backed securities and commercial mortgage-backed securities. US mortgages -- agencies were part of it, but not much, but mortgages were about 28 to 31 percent. In addition to that, they also have a little bit of global exposure as well.

So bottom line is you've got exposure there outside of just US investment-grade credit and government bonds. So that's diversifying.

MR. SCHEU: Hey, Dan, what type of mortgages back those securities, just in general terms?

MR. HOLMES: The -- they'll be typical -- you know, first of all, you have agencies, US agencies, like Ginnie Mae in that type of portfolio. Then you'll have both commercial mortgage-backed securities and then traditional single-family mortgage-backed securities.

MR. SCHEU: Thank you.

MR. HOLMES: And then, Rick, you had asked about the funding of Loomis.

So the funding dollar amounts have already been approved by the Board. We're just seeing through the execution this month. We didn't execute with them last month because Loomis believed that they weren't going to have enough liquidity in the market during the month of December to buy the type of securities they wanted. So we agreed that it was prudent to wait until January to do that.

So the way they're going to be funded is $35 million will be redeemed this week from the -- I'm sorry, next week, from the bond index fund. Thompson Siegel Walmsley will liquidate 74 million from their portfolio. That's a total of $109 million. $1 million will be transferred to cash for liquidity needs, and then a remaining $108 million will be transferred in cash to Loomis. And they've told us that they'll have their portfolio built by the end of the month.

With their portfolio, my expectation is we'll see exposure not just in US investment-grade governments and corporates. It will probably be more governments, less corporates.

Then in addition to that, they'll have high-yield bonds. They'll have some emerging market debt exposure as well. They tend to carry exposure in Canada as well. And so it will be a little bit more diversified and a little bit heavier on credit than Neuberger Berman.

So that's a recap there. Let me stop and see if there's any questions.

CHAIRMAN TUTEN: Nothing so far, Dan.

MR. HOLMES: Okay. Thank you.

And then, finally, there is a -- there should be a handout. It's designed to identify some of the risks and opportunities as we see the market today.

I think there's some -- I will -- I will try your patience for a couple more minutes here, but I think this will serve as a good background for some of our thoughts about asset allocation review and implementation for this calendar year.

And so it's entitled "Macro Topics" on the top, left-hand side. And I'll give you the Reader's Digest version, but please stop me if you have any questions.

So the take-away on page 1 is basically showing returns for 2016 for the major asset classes, or at least the equity asset classes on this page.

So it's designed to show first, as I mentioned, large cap stocks are up over 12 percent. Small cap stocks up over 21 percent.

EAFE, we've noted, was low at 1 percent and emerging markets at over 11 percent. That was the return.

But the way that the indices achieve those returns is significant. So you saw kind of a constant low level of dividends. But the big issue is the change in the price-earnings multiple and earnings per share of growth rate.

And so the take-away here really is, is that domestic equities going in the last year we believe were expensive. We now believe they they're even more expensive.

The run up in price is what drove performance; whereas, if you looked at actual earnings per share, the earnings per share for both large cap stocks and small cap stocks were negative.

And so in our view, those negative earnings per share is baked into our capital market assumptions. And so by multiple measures, we believe that domestic equities markets, both small and large, continue to be expensive, and unless earnings growth picks back up, we will expect lower returns going forward in the future. Doesn't necessarily mean negative returns, but just lower than what we saw in 2016.

For international, we saw not only negative earnings per share of growth rate in developed markets, but also the currency effect hurt. And that also has continued or was a big part of what happened in the last quarter where the dollar appreciated over 5 percent.

Now, that's not the same with emerging markets. Emerging markets were the only area that was relatively attractive across all the points.

Currency was added to performance. They had real earnings and a decent rate at 5.8 percent for the index, and then there was positive change in price, but the multiple expansion was not out of control.

On the bottom of the page, we're taking the forward-looking measures. And the bottom line there, if you look on the right-hand side of that graph on the bottom, the red means warning.

So in other words, domestic equities are overvalued. International equities are undervalued, and there's a real opportunity with emerging markets. They continue to be undervalued, and they have -- they're projected to have positive earnings and currency effects are supposed to be additive as well.

On the page -- the second page, we go through the exact same exercise with bonds. And I won't go through every single chart.

One thing interesting to note is if you look at the top right-hand side, if you just look at the change in the yields, you basically see why bonds did fairly well for the majority of the year. That's because we had a declining interest rate environment, and it wasn't really until post-election that you saw rates come back up.

On the bottom left-hand side, you see the returns for the various parts of the -- or for the various bond indices.

And a couple things to note, TIPS did well last year. High yield was up over 17 percent. Bank debt was up about 10 percent, and emerging market debt was up about 10 percent.

And so in our view, high yield is a little bit rich, but on the right-hand side it shows -- basically we believe that rates are expensive. That's shown in the top of the right-hand side, looking at the government bonds, but we think that spread product remains attractive, emerging market debts and bank loans, and to some extent high yield, not quite as much.

But basically if you roll up, core plus looks -- is an efficient way of getting exposure there, and that looks attractive as well going forward.

On page 3 we do the same thing with real assets. And, really, the take-away here is our second warning signal and our second area of opportunity. And that is MLPs, despite having a good return last year, continue to be reasonably priced.

On the bottom right-hand side of page 3, you see that the Alerian MLP index earnings yield is right in the middle of its historic average at 51 percent. So it's neither expensive nor cheap. It's kind of right where it is over -- on average.

Distributions, or think of it as dividends, continue to forecast to be positive. And so we believe that MLPs can be additive in the portfolio going forward.

Conversely, one area that we're keeping an eye on is the NCREIF Property index cap rate. And if you'll look at the bottom right-hand side, you see it's in the 100th percentile.

So, folks, what we're saying here is, is that you've had good price appreciate and income both in the real estate market as a whole. It has pushed down going in yields and it's pushed it down to an historically low level.

So as the rates on treasury bonds come up, the spread between treasury bonds and real estate basically collapses. It gets narrower.

So what that means is that -- if I'm talking to people who already know the answer, my apologies, but I want to make sure we're all on the same page.

What that means is as rates go up, core fixed income looks less attractive because of its illiquidity. Right now it's still projected to have a little bit of attractiveness versus core bonds, but at some point in time we may need to start pulling back on that. But we need to keep in mind that at different points, core real estate can be illiquid.

And so we continue to monitor that, but as we look forward, there's still -- core real estate still has a little bit of an earnings advantage over bonds. But as rates rise, that advantage decreases. Does that make sense?

MR. BROWN: Yes.

MR. PATSY: Dan, how much do rates have to come up before, you know, you sense that that -- we're in that condition?

MR. HOLMES: Rick, without looking at it closer, I'd say in the ballpark of probably over 2 percent.

MR. PATSY: Okay.

MR. HOLMES: There's still a -- you know, there's still a decent spread there, but the bottom line is, is that -- let me see. I've got to go back and find the cap rate. But the -- oh, here it is.

The cap rate is 5.1 percent. And so, you know, you look at that versus where the ten year is at 2.4 percent.

So I think that you still want to have at least -- in my mind at least a 1 1/2 percent spread.

MR. PATSY: Okay.

MR. HOLMES: Let me ask you to finally kind of turn over to page 5, if you will.

And looking at page 5, the take-away here is, is that we saw the markets react immediately after the election. And we also produced a paper that hopefully you-all saw called Trumponomics where we took the economic platform from the Trump administration as it was professed during the election, tried to translate that into what the effect would be on the markets.

The bottom line here is that we believe that almost all of those have already been baked into the market reaction. There's very little need for us to adjust our capital market assumptions going forward because basically a lot of it has been factored in already by the market reaction to date.

One area that's probably on a lot of people's minds is the impact on emerging markets. So the take-away here is, is that emerging markets came under pressure primarily because of the professed protective trade policies, the renegotiation of trade policies as well -- or trade treaties, and then also the possible strengthening of the dollar.

So as I mentioned, the dollar has already strengthened. It can probably go up from here, but right now we believe that the dollar is overvalued.

But the bottom line is, is that the projected increase for inflation and manufacturing in the US basically has a positive outcome or projects a positive outcome for emerging markets.

So the next few slides basically are designed to illustrate that, but suffice it to say we're just giving you the headlines. When we have periods of increasing growth, US growth and increasing manufacturing and also increasing inflation with the US dollar, that has been additive to emerging markets.

So we have emerging markets in the portfolio. It helped us in 2016, and we continue to think that it will help us in 2017 and beyond.

Let me direct your attention finally to page 8. So not only is there a positive relationship between emerging market equities and US inflation, US economic growth, there's also a positive -- or on top of that, emerging markets continue to be cheap. And so page 8 is just a demonstration of exactly how cheap they are.

And so having that exposure in the portfolio, like we said, continues to be additive.

And the last few pages are designed to show that -- or support the fact that the US dollar has appreciated. And it's basically appreciation that is to a point now where, you know, you wouldn't want to do any type of hedging.

The dollar can continue to appreciate more going forward, but since it's appreciated fairly rapidly and in a fairly strong fashion, we would expect that most of that is baked in and not -- and we're not overly worried about further dollar weight as compared to the -- or its effect on the international exposure in the portfolio.

So going forward, we're going to be working with the FIAC to create an agenda list for the calendar year, review capital market assumptions and make adjustments as necessary.

I'll stop there and see if there's any questions.

MR. PATSY: So, Dan, are you -- by the way, this is very well done --

MR. BROWN: Yes.

MR. PATSY: -- I think this is probably one of the better, you know, analysis of what to expect going forward, both on a macro perspective and on a market perspective. It's sufficiently complicated, but not overly complicated. So that's good.

So are you going to come back with any recommendations that are actionable based on this information?

MR. HOLMES: Yeah. Yes. We just set our capital market assumptions. We actually have been having meetings for the past two weeks looking at -- going through our normal process of how we set capital market assumptions.

We've had to make some adjustments, very broadly. We've had to bring down expected returns a little bit primarily on the fixed income side. We've had to make some adjustments in volatility assumptions.

Not too many changes on the equity side, but what I want to do is once that is set -- and it will be in time for the next meeting, I'm going to take the current target asset allocation, marry it with our economic views as expressed in the capital market assumptions, and then look at where we think adjustments need to be made.

So that will reflect what we think is rich, what we think is cheap, talk about areas where the plan doesn't have any exposure, and we're maybe going into some new areas, might be additive to the portfolio return or reduce risks.

MR. PATSY: Okay.

MR. HOLMES: So the short answer is yes.

So my goal for the year is two-fold: One, to bring you more of this macro economic information, and I appreciate any feedback. If it's too complicated and you just want the headlines, that's fine. I feel compelled to support it with research. So we'll provide you the economic areas, focusing on opportunities and risks with recommendations for adjustments.

And my second resolution is to try to be shorter in my presentations.

CHAIRMAN TUTEN: No, you did a good job, Dan. Anything else you want to hit us with before you go, pal?

MR. HOLMES: No, sir.

CHAIRMAN TUTEN: Rick has a question.

MR. PATSY: I forgot to ask this when we were going through the manager performance.

I assume that when you show up in February with the capital -- with the quarterly update, you're going to have an extensive review of Brown?

MR. HOLMES: Yeah. We've been -- we're trying to develop consensus with the FIAC as to exactly the best way to make transition there. And we haven't come to consensus yet about what's the best way to handle that, but my hope is that will be finished by February meeting.

CHAIRMAN TUTEN: Dan, don't necessarily worry about that. As far as we're concerned or I'm concerned, I just kind of want to get an overview, I think like Rick's getting at, as to why they're doing what they're doing or haven't done what they haven't done or going to do what they're going to do type of a thing.

I mean, we can -- you can still do all that stuff you want to, but we just want the overview and kind of get into why they've kind of underperformed since they've been here.

MR. HOLMES: Understand. I can give you a two-minute overview now if you need to, if you would like it.

MR. BROWN: Yes, sure. Let's do that.

MR. HOLMES: Okay.

So I've met with them extensively. You're not the only client where we have Brown. So you're now to the point -- hold on one second.

Active management in large cap has been difficult. It's been made more difficult during the period of quantitative easing. The reason why that has been made difficult is that quantitative easing had its desired effect. It basically raised all boats in the equity markets and basically raised valuation of the equity markets by forcing more money into the markets.

You make fixed income and cash less attractive, and so investors have to go someplace for a return.

During quantitative easing, by and large, dividend-paying stocks and especially higher dividend-paying stocks and also defensive sectors have greatly outperformed the more sustainable growth-type stocks.

The only time period that we saw that rotate back around was 2015 where quantitative easing ended. Investors looked and said, hey, wait a minute. These high dividend-paying stocks and defensive sectors have really gotten run up in price because of all the money that's moved into them. They looked around and they realized that these growth stocks that Brown and other managers had were cheap, and they piled in during 2015.

Unfortunately that reversed in 2016 again. The market got nervous at the beginning of the year and went back.

So the bottom line is it's been very hard for active managers that tend to emphasize companies that have higher quality balance sheets. They have less debt. They tend to have more sustainable earnings growth. Valuation can vary.

What we saw, that by investors supporting the higher dividend paying, they tend to be less growthy. They have to pay dividends to get investors to invest there. They also tend to have lower quality balance sheets.

So those more momentum-oriented stocks really did well to -- against the more sustainable growth stocks that Brown and other large cap growth managers traffic in.

So large cap active has been under pressure relative to passive. Large cap growth active has been under significant pressure during that time period.

Brown, compared to peers, also has not done quite as well. The reason they have not done quite as well is they run a more concentrated portfolio, fewer names, bigger positions.

In a number of cases, some of names that they've bought have been under price pressure. They simply have not performed well. They would love to talk to you and tell you the stock story; but finally, in the end, the greater degree of concentration will help them recover faster, but that's also been the driving force why they have underperformed worse than other large cap growth managers.

Active large cap growth managers across the board have not done well. The passive index has done extremely well compared to active. But Brown has done worse in that.

And so the question going forward is, should we continue with simply a replacement with another large cap growth manager? Do we just get rid of Brown, or do we go more passive?

And so there's a significant argument to be made for the passive side there. Again, we're trying to work out --

CHAIRMAN TUTEN: Dan --

MR. HOLMES: Now, the challenge there is you've got the Dow and the S&P now kind of coming off all-time highs. The question is, do you put

more into passive while it's still relatively
expensive?
CHAIRMAN TUTEN: Hey, Dan, do you guys see anything in your economic forecast in the future that would actually help Brown as far as performance-wise?
In order words, with the future economic policies of Trump, the emerging markets, blah, blah, blah, anything like that? In other words, reasons for us to hold onto that or --
MR. HOLMES: That's a great question, and that's exactly the way we should be thinking. The challenge there is their implementation.
So, in other words, kind of across that market as a whole, yeah. If you look at the growth -- the growth index PEG ratio and Brown's PEG ratio, it's relatively low. And with the PEG ratio is the price, the earnings, relative to the growth rate.
We saw a low like this in 2015 when growth outpaced value. So in 2015, large cap growth came back and outperformed value by 9 1/2 percent. During that time period, Brown outperformed the index by over 2 percent.
But here's the issue. Because of their

concentration, one, can they still physically do that? Yes. But they're going to have to -- you know, they're going to have to hit from the cycle. They're going to have to hit from the cycle for a decent period, and they're going to, you know, have to get that stock selection correct.

And so the concentrated nature of their portfolio is going to either make them or break them. They're going to have to get them all right, or if they get them wrong -- if they get them wrong in a big way, they're going to dig the hole deeper.

MR. PATSY: Dan, let's back up a step.

You know, you're attributing a lot of their underperformance to the issues of quantitative easing and what it's motivated investors to do.

Quantitative easing, while it may not be at an end, it certainly is much closer than it was 12 months ago.

What is your expectation going forward between the relationship of passive versus active? If passive has been, you know, the driving force, is that going to change going forward?

MR. HOLMES: My expectation is different for different parts of the market.

And so here we're simply talking about large cap domestic equities. My expectation is, as the US equity market, large cap equity market, as those indices ease a little bit, if you go through a period where the market shows concern about either the new administration not being able to get economic policies accomplished, or if earnings come in -- we're starting earnings season now -- if earnings come in fairly disappointing.

And, again, why would they be disappointing? A stronger dollar tends to put pressure on US manufacturing. You know, so there's a variety of reasons in addition to that, but that's one of them.

If earnings come in disappointing, that would cause the equity market the trade off. During that time period, you're going to -- if you accept the returns of the index, you're going to have negative returns, assuming that the markets are trading off.

Active management tends to be more equally weighted than market weighted, and that's usually where active manager adds value, is by protecting on the down side.

Now, the question is, how persistent is that added value? And my view is, is that it's difficult on a net-of-fees basis and especially on the growth side of the ledger to persistently add value above the index.

MR. PATSY: So can I sum your answer as you expect passive to continue to outperform active as long as the markets are going up?

MR. HOLMES: Over trailing, say, rolling five-year periods, I would expect -- you know, if I had to kind of translate it, I would expect it's a look like where passive stays right around median on a net-of-fees basis.

MR. PATSY: Okay. So good active manager ought to add value.

MR. HOLMES: Which doesn't sound -- it sounds kind of average over time, but when you think about it, and if you think about my prior statement, that -- that the persistence is not there as much on the growth side, I think there's your answer.

MR. PATSY: Okay.

MR. BROWN: How long do we give Brown to, quote, hit the cycle, is the question.

MR. HOLMES: I would like to have an answer in February.

MR. BROWN: Okay.

CHAIRMAN TUTEN: Dan, can you give us Brown's returns for a longer time period, going back, say, ten years? In other words --

MR. HOLMES: Yeah --

MR. BROWN: Can you bring those in February?

MR. HOLMES: Let me grab something off my table.

CHAIRMAN TUTEN: I don't need them right now, Dan. Just bring them with you.

MR. BROWN: Yeah, in February. If you could bring that information on Brown, maybe a more comprehensive report on the performance over the last decade to the February meeting.

MR. HOLMES: Yeah. The bottom line is they have underperformed over the trailing one-through-seven-year periods. You have to go out ten years to get above the index. And on a net-of-fees basis, it's almost a push.

But I'll put together a report on Brown and send it to you.

CHAIRMAN TUTEN: All right. Thank you, Dan.

MR. HOLMES: My pleasure.

CHAIRMAN TUTEN: Anything else, anybody?

(No responses.)

CHAIRMAN TUTEN: I think that will do it for today, Dan. We appreciate everything you do, buddy, and good luck with everything.

MR. HOLMES: Thank you. I appreciate your -- you guys' support.

CHAIRMAN TUTEN: Any time, Dan. We look forward to February, my friend.

MR. HOLMES: Ditto. Everyone take care, have a great day.

CHAIRMAN TUTEN: All right, brother.

MR. PATSY: You too. Thanks, Dan.

MR. HOLMES: Thank you.

CHAIRMAN TUTEN: Director, is that it? Oh, we have one more thing.

DIRECTOR JOHNSON: We have one more thing.

If you'll look on your agenda, we had anticipated that Linda Dufresne from KBLD would be here presenting our external audit for 2016.

You know, I asked Devin -- Devin, if you wouldn't mind, just for the record, give the Board a couple of comments about, you know, why we didn't have the report done, what you anticipate, you know, the Board seeing when we do get the report and when the report is going to be here.

MR. CARTER: Okay. We decided -- we agreed to defer the report given the fact that uncertainty in the actuary report because it goes into the financial statement, and they want to review it one more time again.

Then also to the Keane lawsuit, they want to speak with OCG just in case there's any contingencies or not.

We plan to have the report done by the 31st. It will tentatively be submitted to the city pending Board approval on the February 17th meeting.

So we didn't feel comfortable presenting something, given the fact we didn't know what decision was going to be made.

DIRECTOR JOHNSON: Very good. Any questions for Devin?

(No responses.)

MR. BROWN: Thanks, Devin.

DIRECTOR JOHNSON: That's all for New Business, Mr. Chairman.

CHAIRMAN TUTEN: Well, unless someone else has something exciting to add, which I hope they don't, meeting adjourned.

DIRECTOR JOHNSON: Thank you.

(The meeting concluded at 10:32 a.m.)

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CERTIFICATE OF REPORTER

I, Denice C. Taylor, Florida Professional Reporter, Notary Public, State of Florida at Large, the undersigned authority, do hereby certify that I was authorized to and did stenographically report the foregoing proceedings, pages 3 through 72, and that the transcript is a true and correct computer-aided transcription of my stenographic notes taken at the time and place indicated herein.

DATED this 14th day of February, 2017.

____

Denice C. Taylor, FPR
Notary Public in and for the
State of Florida at Large

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