MINUTES
PENSION TRUST COMMISSION
2ND FLOOR CONFERENCE ROOM
NEW CITY HALL
APRIL 24, 2014 – 9:00 A.M.

Paul Ellwanger, Vice Chair, called the meeting to order at 9:00 a.m. in the New City Hall 2nd Floor Conference Room. Notice of meeting and agenda was posted on the City Hall notice board as required by law.

ROLL CALL

PRESENT: Teri Bayones; Paul Ellwanger; Jerry Ihler (entered late); Andy Hill; Bill Kindt; Steve Livingston.

ABSENT: None

ALSO PRESENT: Tanya Riley, Human Resources; Denise Ezell, City Clerk's Office; Tim Wilson, City Attorney's Office.

Ezell stated due to health reasons Joe Mercado has resigned from the Trust.

II. Introduction of Visitors

Ellwanger stated we don't have any visitors but we do have our friends from Morgan Stanley.

III. Approval of Minutes from October 24, 2013

Motion by Livingston, **Second** by Ellwanger, to approve the minutes as written for October 24, 2013. **Aye**: Ellwanger; Livingston; Bayones. **Abstain**: Hill; Kindt. **Nay**: None. **Motion Passed**.

IV. New Business

A. Receive quarterly financial report from Morgan Stanley and take action if necessary.

Armstrong asked could we wait until Ihler gets here to give our report.

Ellwanger stated sure. Let's just move to the Consent Agenda.

V. Consent Agenda

FOR THE BENEFIT OF THE AUDIENCE, ALL MATTERS LISTED UNDER THE CONSENT AGENDA ARE CONSIDERED TO BE ROUTINE BY THE PENSION COMMISSION AND WILL BE ENACTED BY ONE MOTION. THERE WILL BE NO SEPARATE DISCUSSION OF THESE ITEMS. IF DISCUSSION IS DESIRED, THAT ITEM WILL BE REMOVED FROM THE CONSENT AGENDA PRIOR TO ROLL CALL AND WILL BE CONSIDERED SEPARATELY.

A. Consider the application for normal retirement from Thomas Perry.
B. Consider Memo of Information regarding the death of retiree Robert Jamison.
C. Consider application for early retirement from Anita Parham.
D. Consider Memo of Information regarding the death of retiree Henry Wells.
E. Consider application for normal retirement from Carl Dentler.
F. Consider application for normal retirement from Pratap Ganti.
G. Consider Memo of Information regarding the death of retiree John Payne.
H. Consider application for normal retirement for Karen Clymer.
I. Consider Memo of Information regarding the death of Barbara Lankford spouse deceased retiree Edwin Lankford.
J. Consider Memo of Information regarding the death of retiree Jimmy Lyons
K. Consider Memo of Information regarding the death of retiree H.D. Woodall.
L. Consider application for normal retirement from Alicia Mitchell.
M. Consider application for normal retirement for Robert Sockbeson.
N. Consider application for early retirement for Bruce W. Alger.
O. Consider Memo of Information regarding the death of retiree Charles Chaffins.

Kindt stated I would like to pull F, L and N.

Bayones stated I would like to pull H, I, and K.

Motion by Kindt, **Second** by Hill, to approve items A, B, C, D, E, G, J, M, O of the consent agenda. **Aye**: Ihler; Hill; Kindt; Livingston; Bayones; Ellwanger. **Nay**: None**. Motion Passed**.

Ihler stated the first item that was pulled was Item F.

Kindt stated I didn’t see the sheet that shows the option selected.

Riley stated it must have been left out of the packet. He did enroll in the insurance.

Motion by Kindt, **Second** by Ellwanger, to approve Item F of the consent agenda. **Aye**: Hill; Kindt; Livingston; Bayones; Ellwanger; Ihler. **Nay**: None**. Motion Passed**.

Ihler stated second item is H.

Bayones stated I show that Clymer was 65 and the commentary shows 66.

Ihler asked does that affect the calculation.

Riley stated no.

Motion by Bayones, **Second** by Ellwanger, to approve Item H of the consent agenda with stated correction. **Aye**: Kindt; Livingston; Bayones; Ellwanger; Ihler; Hill. **Nay**: None**. Motion Passed**.

Ihler stated item I.

Bayones stated the date of death on the commentary is for Barbara. His actual date of death is October 12, 2010.

Motion by Bayones, **Second** by Ellwanger, to approve Item I of the consent agenda with stated corrections. **Aye**: Livingston; Bayones; Ellwanger; Ihler; Hill; Kindt. **Nay**: None**. Motion Passed**.

Ihler stated next item is K.

Bayones stated the background states "her" and should be "his".

Motion by Bayones, **Second** by Ellwanger, to approve Item K of the consent agenda with stated corrections. **Aye**: Bayones; Ellwanger; Ihler; Hill; Kindt; Livingston. **Nay**: None**. Motion Passed**.

Ihler stated next is item L.

Kindt stated I show she filed for normal retirement and it should be early retirement.

Bayones stated I show the same thing.

Kindt stated I hope she wasn't mislead when she signed up.

Bayones stated the selection sheet shows she signed up for normal retirement.

Kindt stated she is not 62 and she doesn't have 25 years.

Bayones stated my concern was she checked normal retirement.

Wilson asked how was it calculated.

Bayones stated she may be getting more than what she is entitled to.

Ezell stated Riley has gone to check the paperwork.

Bayones asked what is the process if we calculated the paperwork under normal retirement and it was wrong.

Wilson stated we would call the retiree and recalculate it.

Ihler stated while we are waiting on Riley to return let's move to the item N.

Kindt stated the commentary stated normal and should be early and the age should be 61.

Motion by Kindt, **Second** by Bayones, to approve Item N of the consent agenda with stated corrections. **Aye**: Ellwanger; Ihler; Hill; Kindt; Livingston; Bayones. **Nay**: None. **Motion Passed**.

Ihler stated we will come back to item L once Riley has reentered the meeting. In the meantime we will move back to New Business.

A. Receive quarterly financial report from Morgan Stanley and take action if necessary.

Armstrong stated we will be looking at our bond portfolio today. Starting with the Performance Report turn to page 2. In the top right hand corner where it says "Since Inception" look down to the fourth line where it says "Net Portfolio Appreciation". Since we started in 2007 the account has made $14,000,000 at a rate of return of 5.25% per year. Rate of return for the last 5 years is 8.5%, past 3 years 5.6%, and the last 12 months 8%. In the most recent years we are getting close to 6.5 or 6.75%. In 2007 it was down due to the market falling 50%. On page 4 look at the "Annual Performance". This is the year by year history. In 2007 we were up 73, 2008 down 9, and 2009 up 13. We had a good year in 2013 we were up 12.9. Look at the column called "Net Contributions & Withdrawals". We started putting money into the account in 2007. Since that time you see money has come out each year. For most years it was $500,000. The total since inception is $5.8 million and the account has grown from $39 million to $47 million. It is still growing even though we have taken out roughly $6 million. This is a confirmation that things are headed in the right direction. The balance is growing. The next page shows a listing of all that is in the account. On the next page look at the t-bills under "Fixed Income". We have $10 million in T-Bills that are 1 year or less. Look to the right and you see the current year is zero. So right now out of $47 million $10 million is T-Bills earn zero. On page 8 you see you have $1.5 million in cash that is also earning zero. About a quarter of the portfolio is earning zero. Believe it or not zero is better than -8. The next page is the mortgage backed bonds. On page 8 you see "Total Mortgaged Backed Bonds" is down to $5.9 million and the yield is 3.97%. What we have done is as the mortgaged backed bonds have matured we have not bought more. We have put it into short term cash making nothing. I'll get to this in a moment but that is the purpose of our meeting today.

Armstrong stated go to page 2 of the "Asset Scan" and look at the pie chart. You see 6% in cash, 48% in US stocks, and 6.6% in foreign. That is about 55% and our target is 50%. We are right where we want to be in stocks. Remember we increased our allocations last year. Looking to the lower left you see we are diversified among all those different sections. Looking at the style box we are very close to our target. We shoot for 25/25/25 across the top, 5/6/5 in the middle and 3/3/3 at the bottom. We are very close.

Armstrong stated okay let's move to the next set of charts. The first chart is interest rates. It goes back for the past 12 months. In the lower left hand corner at the bottom it is about 165 to 170. A year ago 10 year treasuries were paying 1.7% then they sky rocketed. In the upper right hand corner you see where we are now at about 270. Interest rates went up 1%. That doesn't sound like much but 1 divided by 1.6 is a pretty high percentage. When interest rates go up bond prices go down and when interest rates go down bond prices go up. Looking at the next page you will see interest rates did just the opposite. If we inverted these 2 pages and put them together you would see they track almost exactly the same. We started the year with 10 year treasury bonds at 137 and they went down and up and right now are at 127 which is a difference of 10. Ten divided by 137 is 8%. So last year treasury bonds fell 8% in value. We don't have 10 year treasuries we have Fannie Mae and Freddie Mack. We have those because they pay more. Last year when interest rates were down we thought it would go up so we bought short term treasuries to make zero to avoid the -8. That is why a quarter of your portfolio is making zero. Even making zero with a quarter we made almost 13%.

Kindt stated you make zero sound pretty good.

Armstrong stated we would like to make a little more and that is why we want to talk to you about some alternatives. The last chart is the stock market. A year ago we were at 14,600 and ended the year at 16,400. We are up about 12%. Half of 12 would add 6% return to the portfolio. Had we had 50% making -8 we would have dropped to 2. Last October we increased from 35% stock to 50% because rates were so low. At that point stocks were no riskier than bonds and it has worked. We went to the numbers because you get more volatility along the way but with our investment policy we are looking for 50 year returns so we smooth it out by going high with stocks.

Armstrong stated now look at the Vanguard 500 Index. These are Morning Start Reports. The first page is the S&P 500 that tracks the market. Fifty percent of your money is in investments like that. Actually the mutual fund we have beat the S&P 500. That is another reason why we made more than 2%. I put this in front to show you what we don't want to add more too. You are at half and we don't need to add more. I used this as a point comparison. You might want to tear it off. Now flip over to the Dreyfus/Standish Global. The first thing you notice is the line is a lot steadier. Look in the middle at the right hand corner. Instead of investing in stocks it invest in government bonds from all over the world. Look at the upper left hand corner where it says "Total Return". For the past year it is up 1.49, for the past 3 years 4.94, for the past 5 years 7.23 and for the past 10 years 5.9. That is better than zero. Look under the chart where we have a year by year return and where it says "Total Return %". To the left you see 3/14. In March of 2014 the fund is up 2.2% for the year. In 2013 when bond prices fell 8 to 9% this fund was flat. If you look all the way back to 2003 it has never lost money. We can't say it won't but they have done a really good job of managing this. Our office doesn't have the ability to know whether we ought to own a Denmark or Canada bond but these guys do. Looking at the next one again you see a pretty stable line. They have made 3, 5, and 12% over the past five. They did lose money in 2008. A little more volatile but still way less than the stock market. In 2013 they actually made 2.8% which is better than zero or the -8 or -9. They are investing in government bonds from all over the world. If you compare those 2 charts side by side you see a lot less volatility than the Vanguard but more credit risk. Credit risk means the bonds they own might go broke but have less interest rate risk. You reduce credit risk with diversification. For example if you own 1 bond and it goes broke you have lost 100% of your money. If you own a 1000 you have lost 1/1000th. They own 476 total fixed incomes. Fixed income means bonds. Dreyfus owns 197. Look at the Prudential Short-Term on page 4. This line is pretty straight or flat. Returns are making 1 to 3 to 5% depending upon the timeframe. Look what they are invested in. These are US corporate bonds or bonds issued by companies. You can see these are all alike.

Armstrong stated we are talking about how we can build your portfolio of stocks by using 10 to 20 mutual funds investing in stocks. The bonds we have always kept in government agencies because we would make enough money on them. We can't do that any longer. The government is trying to make zero and we are trying to avoid a lose. We would like to change the investment policy. As the mortgage bonds mature we would move the money over here to reduce interest rate risk and take on some credit risk. We would reduce the credit risk with diversification and blend them through a bunch of these different funds. Eventually interest rates are going to go up and when they do we can make money in treasuries again.

Ihler asked what is duration.

Armstrong stated duration is a number we use to measure interest rate risk. You see over here interest rates went up 1% and bond prices fell 8% and that number is call "duration". If interest rates go up 2%...2 x 8 is 16%. So a $1000 bond is now trading at 840. They still mature at the full face value and we are reducing interest rate risk.

Warren stated we are giving up government bonds because you have to go out so far to make what we could. Ten year treasuries are paying 2.6 duration of 8 or 8.5. If we come into here and swap credit risk, diversify it, and get a shorter duration. Then when interest rates go up the value will hold better and we can go back to government bond.

Armstrong stated the last thing I want to point out is Exchange Traded Funds. Find the one that says Gugenheim. These act a little different but are basically are the same in terms of performance. Look at page 5 where it says "ProShares Short 20+ Year Treasury". Look at the black line on the chart. It looks awful and we think you should have some of them. When interest rates go down bond prices go up and when interest rates to up bond prices go down. We are concerned with interest rates going up. This fund inverts the process. When interest rates go up the value goes up. You do that by buying low and selling high but you reverse the timing/sequence. That is called selling short. Your investment policy does not allow us to sell short and it shouldn't. The reason it should prohibit it is because normally when you sell short you loss is unlimited. What we are doing is buying something that sells short. We are buying long but they are short selling so our risk is the same as any other investment. We can only lose what we put into it. What this does is if your durations are 2.5…3…3.5…4 and we put 10 to 15% of your bond money into a -18 your interest rate duration shortens pretty close to zero. The drawback is it doesn't pay any interest. So we give up a little interest but make money on the other bond funds. If interest rates go up the value of this goes up when we sell. Up until last year interest rates were going down. Look at the chart and in 2010 it lost 13%, 2011 it lost 29% and in 2002 it lost 6%. Interest rates were going down and the value went down. Last year interest rates went up 8% and the value went up to 12.98. When your bond money comes in instead of buying more mortgage back bonds we would like to spread it out among all these different funds to increase credit risk. We will reduce it with diversification and almost eliminate interest rate risk. We would try to make at least 2 or 3% as opposed to zero or -7 or 8%. This requires a change in the investment policy. Looking at the investment policy everything will stay the same except for on page 6 and 7. In November of 2007 we change the allocation from 35% stock to 65% stocks. We didn't have a signed copy of these changes so we are making those at this time. Today we would like to increase the range and the reason is in case interest rates go higher we can go back to 35% but if it goes down to zero where there is clearly no reason to own bonds then we will be able to increase allocation of stocks. So we are asking you to increase the range on either side of our target to 20%. This will allow us in stocks, cash and bonds to go as low as 30/70. Secondly on page 7 under the first Roman numeral I “Permissible Investments” at this time it stated “must” and we would like to change that to “may”. Under number II we took out the part about always being in the top third of their category. That forced us to sometime sell to often. We still try to keep them in the top third. Those are the changes we recommend. Are there any questions.

Ellwanger asked this is your recommendation.

Armstrong stated yes.

Ellwanger asked what were we at.

Armstrong stated the cash and bonds were 65 and stocks were 35 we want to go to 50/50. The range was 10% either side and we want to increase it to 20% either side. This gives us a little more discretion in the asset allocation.

Ellwanger asked so it was 40/60.

Armstrong stated yes and we want to increase that to 30/70.

Ellwanger asked what is an “Exchange Traded Fund”.

Armstrong stated they can be bought and sold all day long at whatever price during the course of the day. Mutual funds only price at the end of the day.

Ellwanger asked is our current policy only in government bonds.

Armstrong stated yes.

Ellwanger asked and you want us to go to either government or other types of bonds.

Armstrong stated bond funds, government or other type of bonds in mutual funds.

Warren stated the main reason for this is the inefficiencies of the market. Only larger participants can participate as there are changes in the inventory. When the government made things better they took away the ability for large companies to inventory bonds. They felt they were profit trading. There use to be more people dealing in bonds and now there are fewer.

Ellwanger stated you talked about risk. We are going from no risk to risk. Talk about that a little bit. How much risk?

Armstrong stated bonds have 2 types of risk. Interest rate and credit risk. With credit risk you might go broke. What are the odds of a US treasury, Fannie Mae, Freddie Mac, or government agency going broke. These are essentially zero credit risk. If you hold on to the bond it will mature at full face value. With credit risk if you hold on to the bond it might not mature at full face value. It is up to the ability of the payee to pay it back. You reduce credit risk with diversification by buying thousands of them but you can't completely eliminate it. With interest rate risk if interest rates go up bond prices fall. We know it will mature at full face value and along the way collect some interest. If we sell the bond we are subject to interest rate risks. We are trying to avoid the downturn that has happened along the way so we recommend reducing the interest rate risk by shorting the duration. The only way to do that and make interest is to take on credit risk and try to reduce that risk with diversification. It is a judgment call as to which is better. At this time we believe interest risk is greater than credit risk. We will have to watch these more carefully but we believe they will make more money and more stability along the way. The portfolio won't bounce up and down as much. If the whole world goes to pot and the only one left standing is the US then you would have been better off with treasuries.

Warren stated with interest rates falling one of the first steps was to change the allocation because this is a long term account. We have gone from 35% stocks to 55% which will greatly help the long term performance. Now we are talking about bonds. We don't want to trade risk unless it is obvious we need to mitigate it. It is in the interest of the plan and the pool of money to remove the worse total return position for bonds to where we can do a better job.

Ihler asked should we change our targets even more.

Armstrong stated there is something to be said for that. Dean said in 2007, 2008 and 2009 that most pension plans were at 65% stocks and 35% bonds. When the market went through its big downturn they got killed. Our plan was the opposite. If you remember Dean thought our plan did really well. The last time he was here he said most plans are 35% bonds and have done better the last couple of years. They are just now catching up to where we are. When you look at the arithmetic and history there is no question that putting the plan at 100% stocks for 50 years is where we would make the most money. The only reason we have bonds is when the stock market falls. So when you see your value drop and it doesn't go down a lot you will leave it alone so it will come back up. Most people have a difficult time doing that. The only reason is to reduce volatility.

Ihler stated by changing the range from 30 to 70 it gives you more flexibility.

Warren stated the number 1 goal is a tradeoff between risk and return. It is different with individuals than it is with a board/plan. If we have a 20% drop we need ammunition so we can increase our weight. We need the flexibility. We are here every quarter so if you change the range you will still see us every quarter. This is due to the current circumstances. We are going to do what is best for the plan. Our federal reserve has made the safest places to put money the place to earn the very least. The reason is because in 2008 when everybody got scared they put everything somewhere safe. The federal reserve is trying to force people to take risk with their CD money. We are restricted by policy by the words "must be" and we need to remove that for the betterment of the Trust or we will have to go to more risk in stocks.

Ihler asked what is the pleasure of the board.

Motion by Ellwanger, **Second** by Kindt, to accept the recommended changes to the Investment Policy on page 6 and 7 as presented by Morgan Stanley. **Aye**: Ihler; Hill; Kind; Livingston; Bayones; Ellwanger. **Nay**: None. **Motion Passed**.

Ihler stated let's move back to Item L of the consent agenda.

Riley stated Mitchell was calculated at normal retirement and it should have been early. I will contact Ms. Mitchell and financial services to make the necessary corrections. Once the corrections are made it will be place on the next agenda for approval.

Ihler stated thank you. So we will need no action on this item.

B. Accept Asset and Liability Forecast of Chuck Dean, and take action if necessary.

Ihler stated Dean presented the actuarial report at the last meeting. As a result of some of the changes we made almost 3 years ago our numbers were around 62.5 or 62%. This was a surprise because we had anticipated it would continue to go down and would take 20 years before we started to swing back up. We are not where we need to be but we are seeing a swing up from Career Averaging. The report showed it was doing much better than we had anticipated. For those who were not here you should have received a copy of the report. We didn't have a quorum at this meeting so we were unable to accept the report.

Motion by Hill, **Second** by Kindt, to accept the actuarial report. **Aye**: Hill; Kind; Livingston; Bayones; Ellwanger; Ihler. **Nay**: None. **Motion Passed**.

C. Consider accepting the annual audit report of the City of Lawton Employee Retirement System for the year ending June 30, 2013.

Ihler stated the report was a very favorable one. There were no deficiencies and it was a clean audit. It was suggested as a result of change in the IRS regulations that an actuary be done every year in order to meet the reporting requirements. This was also recommended by Dean. Are we in agreement for an actuary every year for a short term?

Livingston asked what is the cost of an actuarial report.

Ihler stated around $7000 a year.

Livingston asked isn't it part of the Trust's requirement that we have an actuary every 2 years.

Ihler stated yes.

Livingston asked will we need to change that.

Ihler stated I would say no but I'll need to go back and read what it says.

Motion by Livingston, **Second** by Hill, to accept the audit report and to approve the recommendation of the having a yearly actuarial report. **Aye**: Kindt; Livingston; Bayones; Ellwanger; Ihler; Hill. **Nay**: None. **Motion Passed**.

D. Receive Quarterly Employees Refunds Made From Retirement System and Receive Quarterly Statement of Receipts and Disbursement and take action if necessary.

Ihler stated total assets for the 3rd quarter is $51 million. Revenues received were $1.58 million for the quarter for a total of $7 million year to date. Expenditures were $1.1 million for the quarter and almost $3.6 million year to date. We had a net increase of $433,000 for the quarter and almost $2.5 million for year to date. We started the year with $47.5 million and we now have $51 million. Payout to employees leaving the city was $96,351.

Motion by Hill, **Second** by Kindt, to accept the financial report. **Aye**: Livingston; Bayones; Ellwanger; Ihler; Hill; Kindt. **Nay**: None. **Motion Passed**.

VI. Comments

Hill stated first I would like to say thanks to those who look through this paperwork so thoroughly. Also I would like to look a little deeper into the annual actuary. I'm not convinced it is needed for $7000 annually.

Ihler stated I can't recall the exact details but it was a reporting requirement that finance was required to do. The auditor recommended the only way this requirement could be met was to have an actuary done every year. It would be worth re-visiting the issue.

Livingston stated your finance people should understand what auditing requirements we are trying to meet.

Ihler stated Mitchell will be at the next meeting but it might be nice if the auditor were here also since they made the recommendation.

VII. Audience Participation

VIII. Adjournment

There being no further business the meeting adjourned at 10:30 a.m.

Motion by Ellwanger, **Second** by Kindt, to adjourn. **Aye**: Bayones; Ellwanger; Ihler; Hill; Kindt; Livingston. **Nay**: None. **Motion Passed**.