PENSION ADVISORY BOARD/HEALTH & WELFARE BOARD OF TRUSTEES
NOVEMBER 3, 2010
QUARTERLY MEETING

The Pension Advisory Board/Health & Welfare Board of Trustees, met for their Quarterly Meeting on Wednesday, November 3, 2010, in the Township Building. The meeting was called to order at 7:00 p.m., followed by a pledge to the flag.

ROLL CALL:

The following members of the Pension Advisory Board/Health & Welfare Board of Trustees were present: Ronald G. Wagenmann, Township Manager & Trustee; Fred Santoro, Staff Liaison; Ron M. Fonock, Chief of Police/Trustee; Andy Andreyko, Police Representative; Eric Medrow, Chairman; Vince Mallon, Civilian Member; and Robert S. McKernan, Non-Uniformed Representative. Supervisor Erika Spott, Trustee and Liaison, was absent.

MEETING MINUTES:

It was moved by Mr. Wagenmann, seconded by Chief Fonock, all voting "Aye" to approve the May 5, 2010 Quarterly Meeting Minutes as submitted. None opposed. Motion unanimously passed.

PRESENTATION BY LINDA MCCLEARY AND MICHAEL MORRILL, DF DENT AND COMPANY, INC.

Ms. Linda McCleary, DF Dent and Company, Inc., stated that her specific responsibility in addition to portfolio management is management of fixed income investments. She indicated that most of the fixed income investments are in balanced account environments such as Upper Merion Township.

Ms. McCleary summarized the latest results of the Upper Merion Township Police Pension Plan portfolio including the fixed income portion. She noted that the fixed income portion of the portfolio has benefited in the last three years primarily from a shift that was made into corporate credits. During the crisis in 2008 yields on corporate bonds became very attractive relative to treasuries which continue to go down. The shift that was made in the portfolio into the corporate sector has proved to be very beneficial. Ms. McCleary noted that a slightly shorter duration has been made which is a measure of the sensitivity of the portfolio to changes in interest rates. With the decline in interest rates what has helped the portfolio keep up with the market is the continued improvement in the relative performance of the corporate credits in the portfolio.

Mr. Medrow asked about the average duration in the corporates and the average duration in the treasuries. Ms. McCleary called attention to the profile of the fixed income portion of the portfolio. She noted that as of October 31, 2010 compared to October 2009 in terms of the average maturity of the portfolio it is shortened by just under a year to 5.8 and compared to the Barclays government credit index it is now about two years short of that index in terms of average maturity. The modified duration of the portfolio is also short of the index. It has gone from 4.6 years to 4.2 years. The yield to maturity is also down as interest rates have come down, but because of the yield on the corporates, it is higher than the index at 4% versus 2.1%. Ms. McCleary explained that part of that is helped by the new position that was taken in an Inter-American Development Bank bond that is denominated in reales.

Mr. Medrow asked if the “modified duration” takes into consideration callable securities. Ms. McCleary responded in the affirmative.

Mr. Medrow asked how they become modified. Ms. McCleary responded that they are adjusted for calls and over the last couple of years as we have become less constrictive on the fixed income market variable rate bonds have been incorporated into the portfolio. She indicated that they started initially buying step up bonds which are issued daily by the U.S. government agencies that have fairly attractive current coupons. The terms of these bonds are such that at prescribed times the coupon goes up and the consequence of that is that they can be called at those times before the coupons escalate. Ms. McCleary pointed out that they have also adjusted for that so when they look at duration they look at the worst consequence. She explained that the question is then asked what is the duration to the lowest yield that we can experience and that is how they adjust it.

Mr. Medrow asked if they feel comfortable in the current interest rate environment about having such a long duration. Ms. McCleary responded they are comfortable being slightly short of the index and she believes that in twelve months it will be shorter still. She indicated what gives them some comfort is that they have a variable rate component that will help and they also have some callable bonds that will in all likelihood be called. This would probably create more cash flow for the portfolio and keep it shorter still. In addition to step up bonds they buy variable rate bonds which are very short; currently they have a 9% position.

Ms. McCleary indicated that there is a cushion in the portfolio; there is only one treasury in the portfolio and the core of the portfolio is the corporate position. The average duration of the corporate position is approximately four and a half years.

Mr. Medrow asked about their philosophy on callable securities. Ms. McCleary responded that they like them in this industry as defense because they will be looking at them on a yield to call basis. The callable ones they are buying have a step up feature so if they are not called then they are going to get an escalation.

Mr. Medrow commented so “instead of looking at yield to maturity you look at yield to call.” Ms. McCleary responded that they yield to worst and in most cases that is yield to call.

Mr. Medrow commented if they are not called that is a bonus. Ms. McCleary agreed.

Mr. Medrow indicated that he noticed that they have reallocated the asset allocation for anything under a year to a fixed income position calling it cash. Ms. McCleary responded in the affirmative.

Mr. Medrow asked why that was done. Ms. McCleary responded that part of this was due to the upgrading of their accounting system in this last year and in doing so those bonds that came under a year in their fixed income analysis had to be classified as fixed income as opposed to cash reserves. She explained that they had to go through a transition period. Ms. McCleary pointed out that in the portfolio all the bonds that are held currently are considered fixed income even if their maturity is less than a year.

Mr. Medrow noted a very heavy weighting towards the corporates. He asked if the difference in the yields to the corporate and treasuries which Ms. McCleary alluded is now quite steep. Ms. McCleary responded that they still think it is relatively attractive as a place to get additional yield but they are back to spread levels that were experienced in the summer of 2007 so that the crisis premium has been squeezed out of the market. She stated that they think that corporates offer good value compared to treasuries as one place to get some extra yield. She said they have never really had a large presence or used mortgage securities for portfolios. Ms. McCleary stated that the corporate balance sheets are in very fine shape unlike consumer and government balance sheets so it seems from a credit point of view that it is still a valid place to be.

Mr. Medrow asked if it is true that most of the large corporations have taken advantage of this recessionary period by cutting their expenses and cleaning up their balance sheets. Ms. McCleary said that is true and many of them have been able to refinance at very attractive rates.

Mr. Medrow asked if the corporate is now is looking at his positions and saying it is probably better to go out in the market to borrow than it is to buy back equity and buy back stock in the company. Ms. McCleary responded that some do repurchases and enhance their dividends on the equity side and some of their companies have been able to make some very attractive acquisitions in this environment that they could not have done three years ago and many have issued debt rather than stock.

Mr. Medrow asked what the Treasury Department is doing with QE2 and how that will affect the money markets going forward. Ms. McCleary said on balance they think it is already in the market.

Mr. Medrow asked for an explanation of QE2. Ms. McCleary responded that Quantitative Easing 2 is the Treasury Department's second attempt to raise inflation expectations by basically printing money to buy $600 billion of treasury securities in order to lower rates. The thinking is to force people to take risk to invest into the stock market. The stock market is up over 10% since the announcement that they were going to initiate a program. Ms. McCleary does not believe that the bond market made any major adjustments so they believe a lot of this has been discounted. Ms. McCleary said that we are in unchartered waters in terms of this kind of a policy in this country so she does not really know what the consequences are going to be. They are obviously fearful that at some point down the road there is going to be an inflationary consequence to all of this. Even though it is painful right now to stay short that would probably be the trend in the portfolio. While we have had the greatest bond market bull market in history, returns from here are going to be based on what the yields are that we are getting today. When you start with a 10 year treasury at 2.4% you can be fairly well assured that your returns are not going to replicate the 8 and 9% returns that have been experienced over the last 20 years. It is painful to be defensive. Ms. McCleary said they are accepting even lower yields than 2.4% on some of our newer investments where they have stayed short, but they think it is appropriate. She said there is nothing to suggest that we are going to experience terrible inflation in the next six months but with all this liquidity and hopefully with continued gradual improvement in the economy one might expect in a couple of years that we will start to feel the consequences. At that time they are going to try to make sure that we are in a more defensive position.

Mr. Medrow said one of the things that we as a group here are concerned about is that we have an investment policy that allows us to go 55% on equities and the balance would be in fixed income, but we are not bumping up against that. Mr. Medrow asked Ms. McCleary how she felt about that and if there is leeway if we have investment options that need to go into the fixed income portfolio considering where interest rates are today. Ms. McCleary responded that they would certainly honor our policy and they are investing in more defensive things and accepting lower yields. If given full discretion in terms of looking over the next year or two they would expect that the returns from equities will be better than bonds and returns from bonds might be a little better than cash, but not much better.

Mr. Medrow asked if the returns from bonds could be negative. Ms. McCleary responded absolutely, but maybe not over the next six to 12 months.

Mr. Medrow followed up by saying then what we are considering a very prudent, careful use of our capital in the fixed income portfolio could turn against us. Ms. McCleary responded that it could, but they hope to be postured in a defensive enough mode that money is not lost. They will continue building up these positions in the variable rate. Ms. McCleary said if you look at a 10 year treasury bond at 2.4%, rates just have to go up half of one percent and it will go up. She said we were at 4% in April so we have to gradually rethink and move in that direction. The absolute returns relative to stocks are not going to be terribly compelling.

Mr. Wagenmann asked if the township should consider even just temporarily allowing a cushion in the amount that is allowed in equities. He referred to the discussion at the last meeting about bumping up on the 55%. Ms. McCleary responded that she believes DF Dent would welcome that discussion.

Mr. Medrow commented that the other defensive position discussed at the last meeting was the laddering of securities that Chief Fonock mentioned. He asked Ms. McCleary's view about laddering and if that is being done with any of the securities in the portfolio. Ms. McCleary responded that it has not been done in a deliberate fashion, but it is certainly something that could be done. She said they tend to do that more in tax exempt portfolios.

Mr. Medrow asked if laddering the maturities would be a viable consideration and if DF Dent could live with that kind of philosophy. Ms. McCleary responded, "we could certainly do that." She said the key is to manage the average maturity and the duration and it could be done in a laddered structure if that is something that would be desirable.

Mr. Medrow asked if Ms. McCleary could begin thinking about laddering and how this could be implemented without "handcuffing" their position.

Mr. Wagenmann commented that he would like to hear what their opinion is comparing the two options that have been discussed as to which one offers a better opportunity on the earnings of funds. He asked whether the idea of allowing a float on the percentage of equities based on an increase of their value or looking at the laddering on a step basis would provide the best ability. Ms. McCleary responded that it is her sense from Dan Dent that the township would appreciate having that latitude not to have to sell things and just go in when bumping up against the 55%. Mr. Medrow commented that should be done anyway.

Mr. Wagenmann commented that they are handcuffed by doing that because they are being forced to sell things that they may feel should continue to be held because they still see growth potential. Mr. Wagenmann provided the example of Fastenal and how well it has done over the years. If continued growth is anticipated why should we force them to sell something that is good for the fund.

Mr. Michael Morrill stated that their firm has had to trim Fastenal for clients when it became such a large position, but they would have been better off never having to do this. He said when it gets over 10% of someone's portfolio that is a little too much. Mr. Wagenmann said he was referring to a situation when the firm is forced to sell because you are right at 55% of the overall investment pool and because Fastenal goes up even though it is still less than 10% of the overall fund, the firm is forced to sell it. He would rather see them take it to 10% of the fund before it is sold in order to maximize the return.

Mr. Medrow commented that we should not rebalance just for rebalancing sake, but we want to rebalance for a logical reason.

Chief Fonock referred to the last sentence on the October 2010 Commentary which basically says that they perceive the stage has been set for equity out performance versus fixed-income in the not-too-distant future.

Mr. Medrow asked if Ms. McCleary agreed that once when we begin to see the unemployment rate come down and realize inflationary pressures that will kill the bond market. Ms. McCleary agreed.

Mr. Medrow said another strategy that the firm may want to employ which has already been done with Rio Tinto is going into some of the international bond issues that are supported with a strong currency like the Australian, New Zealand and Norway currencies. He said those economies will not be as strongly affected by inflationary pressures. Ms. McCleary stated that the firm did buy a reale (Brazil) denominated bond this spring that has worked out very well. They are trying very hard to keep their currency from depreciating and imposing taxes.

Mr. Medrow commented that Brazil has a wonderful inflation protected economy because they are energy independent.

Chief Fonock said since we are talking about expanding our ceiling on the equities he asked if it is true that right now corporations are holding more cash than they have ever held because of the uncertainty and rather than investing it they may increase their dividends. Mr. Morrill said whether or not they use that cash to raise their dividends is going to be a company by company decision, but he agreed that corporations are sitting on a record amount of cash.

Mr. Medrow commented about the tax bill and the uncertainty generated by the congressional outcome or inaction. He said if we go to higher taxes again on dividends that would not affect us as much since we are in a tax favored environment, but it is going to affect corporate policy of those corporations who do want to declare dividends.

Mr. Morrill stated that corporations faced with the uncertainty with regard to taxes and health care are going to sit on cash until they get some certainty. He said many companies have cash overseas and to repatriate that they get hit with taxes. If there is a relief on a repatriation tax that would also allow them to bring more cash back. If they can see a light at the end of the tunnel they may start to hire more people and spending money for construction and businesses.

Ms. McCleary stated that one of companies in the portfolio [Cisco] has already announced their intention to pay a dividend, but they are waiting until the tax bill is resolved. She said they have no debt, billions of dollars in cash, but are just waiting to see what happens.

Mr. Medrow asked that the DF Dent representatives go back and take a look at international bonds, laddered bonds, and those kinds of things that might be incorporated into our investment policy with a view toward a better approach to the fixed income market.

Mr. Medrow asked if Ms. McCleary was familiar with Thornburg Capital. He said they are one of the few mutual funds that use a laddered bond approach and asked if DF Dent could take a look at what they do. Ms. McCleary asked for clarification if it is just to be on the ladder with the idea of trying to match some payment, try to match their cash disbursements or try to match their duration of liabilities or would it strictly be a ladder.

Mr. Medrow stated that it would be to diversify our maturities so that we are not exposed to the need to make a distress sale of a fixed income security. He asked DF Dent to be thinking about that and looking at what is going on in the marketplace and if there is a reasonable approach that they might suggest to get back to us.

Mr. Wagenmann stated that we want to give DF Dent guidance on the leeway on the equities standpoint of growth and he does not want to wait for the next meeting to make a decision on both [options].Mr. Wagenmann said they have to look at the payments out of the fund and keep that in mind that the township has to meet the pension payments. Mr. Wagenmann pointed out if we are going to do the laddering we do not want to get to a point where we are doing a distress sale because we do not have the cash to meet our payments.

Mr. Medrow asked Ms. McCleary to discuss some of the highlights of the portfolio before Mr. Morrill discusses what is being done on the equity side and why equities look better than fixed income these days.

Ms. McCleary stated that she likes as a diversification move and a yield enhancer the position in the Inter-American Development Bank; they are relatively short term bonds with maturity in 2012 and rated Triple-A. An unidentified member of the group asked if we are getting a currency plan on that as well. Ms. McCleary responded in the affirmative.

Chief Fonock asked if this is the first step into foreign bonds. One member of the group believed Rio Tinto was a Brazilian bond, another thought it was domestic and a third said it was based in Australia.

Mr. Medrow commented that the strong economies to be looking at would be those that have good mineral and mining such as Canada, New Zealand, and Australia. He said Australia is providing much of the raw materials for all of Southeast Asia which is a tremendous market.

Ms. McCleary stated that the Australian dollar hit parity either today or yesterday with the U.S. dollar and the Canadian dollar is just about there. She said Australia also raised interest rates yesterday so that is something that they have looked at and will continue to evaluate.

Mr. Medrow asked if there is anything else Ms. McCleary would like to highlight in the portfolio. Ms. McCleary commented on Iron Mountain bonds and she said that Iron Mountain is not an investment grade credit. It is below investment grade and the township's guidelines have allowed DF Dent to use below investment grade up to a low Triple-B up to 10%. Ms. McCleary pointed out that when they buy below investment grade bonds almost without exception it has been in names where they are doing research on those companies on the equities side. She said that Iron Mountain is a company that has had a very high growth rate, has debt on its balance sheet and is probably more leveraged than any company we own. Ms. McCleary pointed out that many of the companies in the portfolio do not have any debt but because Iron Mountain has been investing in its business, its business has been growing nicely, but if they chose to stop increasing their physical storage space, the company would generate huge amounts of cash flow. Because they have 50% debt on their balance sheet they were rated below investment grade. Yet their business model is the reason they had this debt because they were growing so well. Recently their growth has slowed down with the recession and they have been able to refinance and pay down their debt to a point where they probably have the lowest debt ratios now that they have had in years. Ms. McCleary said that they think it is a very safe and attractive deal and if Iron Mountain continues on this way she predicts that it could be an investment grade bond.

Ms. McCleary said she is satisfied with our bonds. She noted that this is the most challenging environment on the fixed income side that she has ever seen, but she believes we are positioned in sound holdings that are giving good current income. Ms. Cleary said that they will take a look at a laddered structure and believes it is appropriate to be defensive at this time.

Vince Mallon commented that to a certain extent the step ups and the variables are defensive positions.

Mr. Michael Morrill stated that his number one role is portfolio management and helps with research and equities.

Mr. Morrill reviewed the three charts illustrating the five year, ten year and one year change of market value and overall performance has done well in a very difficult market. In his review of the breakdown in assets, Mr. Morrill noted that as of October 31 there was a bump up closer to the previously discussed 55% ceiling. He said that stocks were up 19%, bonds were up 10% and they have gone as far as they could on the equity side to get performance. He believes the defensive options previously outlined would be a prudent idea and expressed optimism about the equity market's long return.

Mr. Medrow commented that when Mr. Morrill said "prudent" idea that is a key word because it has been his view that when you begin to take percentages, it moves the equity portfolio up in percentage and lowers the percentage of fixed income and most people think you are not being prudent. Mr. Medrow wanted to make sure that he understood that Mr. Morrill was emphasizing that it would be prudent. Mr. Morrill responded "absolutely." He said it is not as if we are saying we are going to 100% equity, but some natural growth will be allowed to continue in the portfolio. Mr. Morrill stated that we are going to need that kind of equity growth to make up for what the bonds are not going to be able to give us over the next five to ten years.

Mr. Morrill discussed the sector breakdown of the equities in the portfolio. He noted that there is overweighting in the health care area, slight overweighting in information technology and underweighting on all the rest of the sectors. Mr. Morrill discussed Stericycle, a company that collects medical waste from hospitals and doctors offices. While DF Dent considers it a health care company, the S&P places it in the industrials. He explained that there is over 2% weighting so it bumps up the overweighting of the industrials unnaturally. For this reason DF Dent has been underweight with financials and consumer on purpose over the last five years. On the financials we are barely underweight, but we really own no banks and we have only owned only one small bank in the past six years based out of Los Angeles called East West Bank.

Mr. Medrow said banks are almost impossible to evaluate because you have to dig into their portfolio and find out what their actual risks are in each loan that they make. Mr. Morrill commented that as we learned in the past two years it is hard for the markets since you have no idea what their securities are actually worth. He said the low risk financials are T. Rowe Price, one of the premier investment managers and a couple of insurance companies, Markel and WR Berkley. The portfolio is underweight in the consumer area since the economy, the unemployment rate; the dependence on credit has strapped the consumer and placed them in jeopardy.

Mr. Medrow stated that it is his understanding that the consumer has been paying down debt considerably over the past couple of years. He asked if we may be at a point in time to begin to look at the consumer sector since they will begin to buy again after putting off their purchases for so long. Mr. Morrill agreed that the consumer has paid down their debt; however, after what has happened in the last two years they might be a little nervous to ramp up the debt again and may want to hold onto their savings. He expressed doubt that these are the most attractive stocks to be in. Ms. McCleary commented that the reduction in unemployment would be very important.

Mr. Medrow agreed that it would be a driving factor because those coming off the unemployment rolls are going to spend money when they come back into the marketplace. Ms. McCleary said that is something that we all hope for, but it seems as if it is going to be a slow process.

Mr. Wagenmann commented that he meets with mall executives on a regular basis to obtain information in preparing the budget since the township has business privilege mercantile taxes that are based on gross business. In his recent discussions with the mall executives, sales are up 3% and while not great when compared to others that is pretty good.

Mr. Morrill commented on low national auto sales.

Mr. Medrow stated that people are holding on to their cars for as long as possible and he asked about the auto resupply industry. Mr. Morrill said that the biggest mistake made in portfolios across the board over the past two years was getting out of CarMax. It is a great company with a great management team and we did not sell at the top, but got out in the low 20's. It went down to $8 and we did not buy again and now it is back up into the mid 20's. They cut back on their store expansion but they are slowly ramping up and the business is quite good.

Mr. Medrow said it is his feeling that once the new Congress tackles the tax bill the next item on their agenda will be energy. He asked Mr. Morrill's views on energy these days. Mr. Morrill said that they are slightly underweight in energy. He stated that DF Dent is a bottoms up investor, looking for high quality companies, run by great management teams who are going to show good growth over the long term. Mr. Morrill indicated that longer term the trend in the price of energy is going to be higher and that we own some good energy stocks in the portfolio to take advantage of that.

Mr. Morrill discussed some of the cash rich technology companies and some of their innovative solutions of such companies as Ansys that does software simulation in industrial applications.

Mr. Medrow asked what American Power does. Mr. Morrill responded that American Power designs the cell towers. The sites have a small amount of land with a metal tower and the antennas are rented out for different carriers. He noted that they are a global operation.

Mr. Medrow asked about their investment philosophy and if they are looking at management, cash flow, lack of debt, return of equity, return of assets or all of the above. Mr. Morrill responded, "all of the above." He said that first and foremost they are growth managers looking for companies that can show they can sustainably grow their earnings over a long period of time and "have the wind at their back." Mr. Morrill stated that they do have an intense focus on management and spend a lot of time trying to get to know the management of the companies they own.

Mr. Medrow asked about capitalization large versus mid versus small cap. Mr. Morrill said they are multi-cap growth investors so they really do not care about the market cap. He indicated that they do care on the smaller side and tend not to go below 300 million. Mr. Morrill pointed out that a lot of times when you get the smaller cap you depend on the liquidity in the stock and they want to be able to get in and out of the stock fairly easy. Mr. Morrill explained the pros and cons of the various cap companies. He said that the majority of the portfolios are mid cap and the reason he believes is that because small caps are good and have great growth, but a lot of times are run by entrepreneurs and sometimes as they grow and get into that mid cap space and entrepreneurs have a hard time letting go and letting a professional manager manage a larger organization. The mid caps; however, usually have a proven management team that can handle the size of that business and can still be a nice growth business. The large caps give us greater exposure to the international markets.

Mr. Medrow asked if they use any specific research facilities or research tools. Mr. Morrill responded that they certainly look at all the financial metrics, the growth, the return on equity, return on invested capital. He explained that they are not putting companies into a data base with certain criteria and having it produce 40 names that they want to own. DF Dent does use some third party research firms. Some are technical people and some are macro people. Mr. Morrill reiterated that they are bottom up investors, but they do have to pay attention to the macro and understand what is going on in the broader environment. Ms. McCleary commented that since 2000 DF Dent has added a score of younger individuals to do a lot of different things and have made a huge contribution in terms of research.

Mr. Medrow asked what they do differently. Ms. McCleary said they have helped reduce the number of mistakes and do a much more thorough job in terms of scrutinizing everything before we get into a stock. Mr. Morrill stated that DF Dent spent a lot of time this spring going out to revisit a lot of the companies, check in with everybody and "kick the tires."

Mr. Medrow asked what is the DF Dent philosophy for 2011 and how will it be different than it was in 2010. Mr. Morrill said volatility in the market is going to be even greater than in 2010.

Mr. Medrow said that sometimes volatility "is your friend." Mr. Morrill said volatility is your friend if you pick it on the downside and buy that day. He said that they are not great market timers and do not profess to be and do not try to be. Mr. Morrill believes we are going to see a lot of cash on the balance sheet and a lot of flexibility with that cash. He said that one of the things that he did not mention was they do like companies with zero to low debt and have generated a lot of free cash flow because that gives them a lot of flexibility to finance their own growth. They are not dependent on the markets to grow the business. Mr. Morrill stated that they are going to own companies that have a lot of cash, lot of freedom and flexibility to do what they think is right whether that be buy back stock, issue dividends or make acquisitions at some attractive prices. They believe the earnings are going to be decent and the valuations right now are not too stretched for most of the companies. Some have come back pretty sharply.

Mr. Medrow said I guess a lot of companies are sitting on a lot of cash these days.

Mr. Santoro asked if Mr. Morrill believes that the U.S. markets will lead or follow the European markets. Mr. Morrill responded he did not know the answer to that. He said that he does know that in six of the last seven years emerging markets were the leading market of all the different markets. Mr. Morrill believes that emerging markets have stronger growth, he also believes they are more risky. He has been reading that some other institutions are saying that U.S. equities look pretty attractive right now so on an evaluation basis U.S. equities can do well over the next two to three years. He does not know if they will lead every year, but he feels pretty good about U.S. equities.

Chief Fonock asked for clarification about Visa credit card companies. Mr. Morrill responded that they do not issue credit cards but that they own the network in which you swipe your card. A brief discussion ensued regarding the transaction process, the rewards program, the growth of credit across the world.

Sgt. Andy Andreyko commented about the [pension] allocation ten years from now when there will be at least 20 more retirements and this should be taken into consideration when tailoring the parameters for the anticipated bump up of retirees.

Mr. Wagenmann commented growth can only occur as a result of appreciation of current equities so that they are not forced to sell equities that are doing well. He said that the 55% could float up to a maximum of 70% as long as that increase is due to the growth of the current holdings with the restriction that you cannot allow one equity to get beyond 10% of the overall fund.

Mr. Medrow asked about DF Dent’s client base. Mr. Morrill responded that they are 50% individuals and 50% institutions.

Mr. Medrow asked if any of those institutions are municipalities. Mr. Morrill’s response was inaudible.

Mr. Medrow commented that there is no way that we can compare what DF Dent is doing for XYZ municipality as compared to what they might be doing for Upper Merion Township. Mr. Morrill could not think of anything.

Ms. McCleary commented that a fairly efficient way to create a ladder would be to know what those distributions might look like.

Mr. Wagenmann commented that we could probably do it fairly accurately for the next five years since there is a DROP program that allows an officer to declare and their person will be calculated. Payments will start to go into a trust fund for that five-year period.

Mr. Medrow asked if Anderson could provide that information. Mr. Wagenmann responded that we can provide that number and be fairly realistic. He explained that it is the last 36 months of W2 compensation and that could be used for the calculation. Mr. Wagenmann suggested looking at the last five officers that have retired and that would provide some idea from a percentage standpoint of the final salary where they are because officers have the ability to up that pension based on their off duty work.

Chief Fonock said although there are approximately 30 officers retired now and through attrition some pass away, because of the DROP program there will be officers who retire early and will be taking pensions longer. In addition to to early retirements, the off duty work and COLA will result in higher pensions. Pensions that were in the 30's years ago are now going to be in the 60's so it is a significant hit times 30 pensioners.

Mr. Wagenmann said once a more accurate number has been generated the laddering would be done on the fixed assets side to match those numbers over the longer term. The laddering should be in the fixed income so that equities are not disturbed in regard to the pension obligations. Ms. McCleary commented if we could do that that would give more comfort to the equities.

Mr. Medrow commented you would have approximately the cash flow needed as each year of retirement goes by. Mr. Wagenmann said we will share the detail sheets behind the actuarial reports that show the number they are projecting; the steps that got us there and then that would be shared with DF Dent to assist with the laddering.

Mr. Medrow asked if the police retirement benefit is paid out of cash flow or provided with an annuity. Mr. Wagenmann responded that the township used to provide annuities, but now the police have been paid out of cash flow.

Mr. Medrow asked if the investment performance accrues to the trust fund not to the officer. Mr. Wagenmann responded in the affirmative.

Mr. Wagenmann commented that in the Minimum Municipal Obligation (MMO) the officers are making 100% of the contributions they have to make and this is the first time since he has been with the township that the general fund was used to make a payment for the annual police pension plan.

Ms. McCleary asked what is the assumed rate of return. Mr. Wagenmann responded in the last actuarial study he recalls it was 7% and that is why the MMO shot up so quickly.

Mr. Medrow commented that is a pretty high assumed rate of return. Mr. Wagenmann said that the way the law was written for the actuarial studies it does not really matter since they have to float such things as salary increases. There are some limitations. There is a maximum spread that you can have and it is narrow. Their average has been over 8% and the actuarial study because of the downturn in the equities was dropped to 7%.

Mr. Wagenmann offered a motion to modify the policy to the extent that the percentage of equities based on the value of holdings could float up to a maximum of 70% with the overall prescription that no one holding can ever be more than 10% of the plan. Motion was seconded by Chief Fonock. Motion passes unanimously.

Chief Fonock asked if the 10% restriction on the holding reasonable. Mr. Morrill responded in the affirmative.

Chief Fonock commented that there was a discussion at the previous meeting about starting these meetings earlier at 5:00 pm or 5:30 pm. (Additional comments on the time change were made later in the meeting).

ACT 44 DISCLOSURE STATEMENTS

Mr. Fred Santoro, Human Resources Director, provided the group with a copy of the blank form that went out to the township's defined contractors. He explained that a defined contractor in this regard is any firm who gets paid any money from the pension fund for services rendered. Mr. Santoro identified the four defined contractors: DF Dent, PNC as custodian, Tom Anderson, pension consultant, and ICMA (handles the DROP accounts). Completed forms will be posted on the township website and filed in the safe along with the other pension documents.

Chief Fonock commented on the fees charged by these contractors. He said that DF Dent's fees were reasonable, Tom Anderson's are more fixed, but he would like more information on PNC and as a matter of due diligence it would be beneficial to see their fees as compared to the industry standards.

Mr. Santoro stated that the fee structure is in our agreement with them [PNC] and he would provide Chief Fonock with a copy. Mr. .Wagenmann stated that for the next meeting everyone would receive a copy.

Mr. Medrow commented that in 2011 the Pension Advisory Board could review the vendors and their fee structures and compare with industry standards.

Mr. Medrow asked if it should be a goal for 2011 to look at each of the vendors and charges and invite those vendors to one of the Pension Advisory meetings.

Mr. Santoro brought up the point that there is one other component to Act 44 legislation regarding changing vendors. When changing vendors, an RFP is required and the legislation provides the RFP. It must go out to all qualified individuals and the most qualified bidder must be selected and then this must be disclosed to all bidders providing them with their disclosure statements and their bids and then the winning bid must be posted on the township website.

Chief Fonock suggested having PNC in for a courtesy visit. Mr. Medrow said this would not be changing vendors. Mr. Wagenmann said he first wants to review the numbers, make sure everyone understands the numbers, and then bring PNC in.

Chief Fonock said this Act 44 provides us with an excellent opportunity while reviewing their forms to “look under the rug” and understand who they are. He stated if anyone ever asked this board if we went through the Act 44 disclosure and talked to the people who filled it out we would be able to provide a positive response.

Mr. Medrow asked if Mr. Santoro could provide a schedule at the reorganization meeting for the courtesy visits of the aforementioned four defined contractors so that it is part of our meetings for the course of the next year.

Chief Fonock reminded the group that DF Dent comes up twice out of the four meetings and it would be difficult to do both on the one night. Mr. Wagenmann said unless the agreement is made to meet earlier.

After a brief polling of the group and discussion about changing the meeting time, Mr. Wagenmann asked Mr. Santoro to prewrite on the agenda that the Pension Advisory Board will meet on a quarterly basis and if possible list the specific dates and that the meeting will start at 5:30 pm. Mr. Wagenmann stated that this will have to be advertised.

NEW BUSINESS

None.

ADJOURNMENT

With no further business to come before the Board, the meeting was adjourned at 9:10 p.m.

Alfred E. Santoro, III
Board Liaison

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Minutes Approved:
Minutes Entered:

The entire proceedings of the business transacted by the Pension Advisory Board/Health and Welfare Board Meeting were fully recorded on audio tape, and all documents submitted in connection thereto are on file and available for public inspection. This is not a verbatim account of the minutes, as the tape is the official record and is available for that purpose.