

PENSION ADVISORY BOARD/HEALTH & WELFARE BOARD OF TRUSTEES  
NOVEMBER 12, 2014  
QUARTERLY MEETING

The Pension Advisory Board/Health & Welfare Board of Trustees, met for their Quarterly Meeting on Wednesday, November 12, 2014, in the Township Building. The meeting was called to order at 5:30 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: Supervisor Greg Waks, Board of Supervisors Liaison; David Kraynik, Township Manager and Vice Chairperson; Nick Hiriak, Finance Director; Sara Evans, Director of Human Resources; Chief Tom Nolan, Secretary; Eric Medrow, Chairman; Sudha Suryadevara, Non-Uniformed Representative; Thomas Minger, Jr., Citizen Representative.

MEETING MINUTES:

It was moved by Chief Nolan, seconded by Mr. Kraynik, all voting "Aye" to approve the July 9, 2014 Meeting Minutes as submitted. None opposed. Motion approved 4-0.

PRESENTATION BY D. F. DENT RE: UPPER MERION TOWNSHIP POLICE PENSION PLAN AND FUND

Mr. Dan Dent, Chairman, D. F. Dent, presented an overview of the portfolio. He noted the many holdings in the Fixed Income category and explained this is due to the purchase of CD's that can be obtained for 40-60 basis points than can be obtain in treasuries with the same credit risk. These are all guaranteed by the U.S. Treasury and FSLIC.

Performance for this year has been somewhat soft. While the performance is still positive it is lacking in some of the benchmarks. One of the reasons is that 2013 was an extremely strong year and late in that year going into this year strong 2013 performance was borrowing some of this year's performance.

Mr. Dent reviewed the change in market value over the course of the last 12 months, the same calculations for the past three years, and the last five years. As of October 31, 2013, the portfolio started at 43.3 million. There were expenses (primarily the distribution withdrawals) of \$1.6 million.

Mr. Medrow asked for Mr. Dent's views about the Treasury Department setting aside the Quantitative Easing (QE) programs yet indicating they might be back on QE at some point, and how this is affecting the portfolio. Mr. Dent responded the Federal Reserve indicated last month the QE would finish running its course of buying bonds every month. With the strengthening in the economy and the tax revenues coming in, the fiscal picture is improving dramatically and for this reason pressure on interest rates is not expected because there will be a continued reduction beyond the QE3 in the borrowing by the federal government. There will still be a running deficit but the deficit is less than half of what it was two years ago. This means less pressure on the markets and should result in lower interest rates going forward.

Mr. Medrow asked what Mr. Dent thought the prospects were for QE4 in the spring of 2015. Mr. Dent responded he has heard many opinions.

Mr. Dent commented the focus of Federal Reserve Chair Janet Yellen is on employment and the unemployment rate is down to about 5.9%. Mr. Medrow noted the unemployment figures do not take into consideration the historically low participation rate for those who are not seeking work because they cannot find work and have dropped out.

Mr. Dent said there is another issue that is not in the press as much and that is the impact of automation and computer technology and there are many other areas where jobs have been eliminated.

Mr. Dent indicated he spoke with James Kennedy, President, Thomas J. Anderson, recently and he said their more recent actuarial analysis of this plan was almost 2 years ago. They will do another analysis the beginning of next year, but as January 1, 2013 based on the market value of the plan it is 87% funded. They have another method of calculation which is very specific actuarial methodology and based on that it is 97% (on the smooth). Last year the total return on the entire portfolio was 19.3%. This year the total return as of October 31 is about 3.5% combining the two it is close to 22%.

Mr. Medrow asked for clarification about the reference to 87% funded. Mr. Dent responded the assets (present value) in that portfolio as of January 1, 2013 were 87% of the present value of the future liabilities.

Mr. Medrow commented 87% is very high and noted it is in the first tier of pension plans throughout the entire state.

Mr. Minger noted there have been two or three recent police retirements. He asked how that is going to affect liabilities in terms of how that is taken into consideration. Mr. Dent responded Mr. Kennedy would have to answer that question since he knows the profile of the population and the retirees.

Mr. Kraynik indicated his understanding is that as of January 1, 2015 we would be at 100% asset smoothing and he does not believe we would be at that level if those retirements were negatively affecting the plan.

In response to a question, Mr. Medrow indicated the retirements are calculated on page 6 of the D. F. Dent Pension Plan, the second column reflecting additions/withdrawals expenses. Mr. Medrow asked if three retirements a year is unusual. Chief Nolan responded three is not unusual, but for next year and the following year there is only one each year based on the DROP program.

Mr. Dent said he would certainly think that Mr. Kennedy's calculation as of January 1, 2013 factored in retirements coming up this year and next and then discounted back to future benefit payments, but Anderson's updated actuarial analysis will be available probably by late spring 2015.

Mr. Kraynik pointed out Anderson has to get it to the state by March 31<sup>st</sup> and it should be available sometime in March. He suggested bringing in Mr. Kennedy again after the report is issued for an explanation and discussion with the Pension Advisory Board.

Chief Nolan noted all the officers retiring in the next couple of years are already technically in the plan because of the DROP program. Once they enter DROP they are considered retired and are already in that calculation.

Mr. Medrow commented several years ago there was a 60/40 split between equities and fixed return and the Pension Board informed Mr. Dent if equities are moving up in value; retain those even if it violates the 60% rule. There has been concern about the load on the fixed income side of the portfolio and we need as much push from the equities as possible.

Mr. Minger asked Mr. Dent if risk is taken in duration or credit to get the return of fixed income. Mr. Dent responded the credit risk is reduced to the lowest level. The overall credit rating at the end of the report has been notched up because we have gone from corporates into these CD's which are basically AAA rated.

Mr. Medrow commented the bond portfolio is very much in a short position so that we are looking at 100% return on our dollar because those securities are going to mature and we are going to take our 100 cents on the dollar.

Mr. Dent noted Mr. Kennedy at Anderson has commented the Upper Merion Police Pension Plan is at the top tier within the state in terms of the funding.

Referring to page 8, Mr. Dent pointed out a very long term 20-year review of the capital flows starting at \$14.4 million in 1994 to the current \$44.4 million.

Mr. Medrow asked if the year 1994 reflected on the chart indicates the beginning of Mr. Dent's tenure with the Upper Merion plan. Mr. Dent responded he started a few years before with about \$9 million.

Referring to page 9, Mr. Dent pointed out the best returns for this calendar year and the best returns within the portfolio.

Mr. Medrow noted Fastenal Company as one of the five lowest. Mr. Dent commented Fastenal had a flat year performance wise. The company a year ago recognized they needed to make some changes to their sales organization and they are beginning to get traction from that and starting to see accelerating monthly sales.

Mr. Medrow asked if Mr. Dent still feels comfortable with Fastenal. Mr. Dent responded in the affirmative. He said it would be a mistake to sell before we see the performance traction they get with the sales. It will probably be trimmed back going forward.

Mr. Dent noted 3D Systems Corporation was the best performing stock last year and the worst performing stock this year. In spite of this fact half of the position was sold at higher prices which is reflected in purchases and sales. Mr. Medrow asked for the name of their major competitor. Mr. Dent responded Stratasys.

Mr. Medrow asked if Stratasys might have been a better pick. Mr. Dent responded for the time period until the beginning of this year 3D had a better return. 3D has done poorly this year and Stratasys has not done that well this year either. Within the last two weeks Stratasys has been purchased and is in the portfolio as of October 31<sup>st</sup>. Mr. Dent indicated about six weeks ago he and Mr. Morrill went out to Minneapolis and talked with the founder of Stratasys as well as the CFO and current CEO. They came back very impressed with Stratasys and their conclusion was that additive manufacturing, which is basically the other term that describes 3D printing, is going to be a very disruptive technology for a long period of time and we want to have representation in that industry.

Referring to page 10, Mr. Dent said some of 3D Systems was bought back representing .5% overall in the portfolio which is \$196,000. On page 11 the sale of 3D Systems early this year is reflected at \$95. It was bought back in May 2014 at \$50. The volatility is the reason it was trimmed back late last year.

Mr. Medrow asked for more information on Clean Harbor, Inc. Mr. Dent responded this is one that was eliminated and it was largely due to their failure to

meet earnings expectations. The recycling operation was very troublesome for them and it held back their earnings. Management's ability to execute has been disappointing.

Referring to the purchases and sales on page 14, Mr. Dent noted there are major changes which includes the deletion of Clean Harbor.

Mr. Morrill stated since March of this year three names have been added to the portfolio; IMAX Corp., Signet Jewelers Ltd., and Costar Group, Inc. There were six deletions from the portfolio.

Mr. Morrill discussed the business model for IMAX. He said they have a better quality video and sound and theater owners believe it is driving people back to the movies. IMAX will show a single movie across the country for two weeks. Currently they are showing *Interstellar*. Because it is a short release, it is a better experience and is driving people back to the movies.

Mr. Dent discussed Signet Jewelers which is the number one player in mall-based jewelry stores. Mr. Morrill said they have their own private label brands as well that drive profitability and it has been the best performer this year in the portfolio.

Mr. Morrill said Costar Group is a software company that has developed a commercial real estate data base that is second to none. No one else has it. It provides one depository for commercial real estate brokers. This has been a good performer in the portfolio.

With regard to the deletions, Mr. Morrill discussed Concur Technologies which is a company that does software for travel management. For a large corporation wanting to control their corporate travel expenses it is whole software system that limits what hotels an employee can stay in and will help them pick the flights based on what the company has prearranged.

A question was asked if Concur Technologies was deleted. Mr. Morrill said it was acquired. It was a deletion that was acquired by SAP in September.

Mr. Dent commented in the last year whenever a purchase is made they have to sell an equal or greater amount of equities. They cannot make a purchase and increase the equity percentage on that transaction. Whenever they do anything now it is an even swap or they are raising cash. They are not going to be a net buyer of equities because of the high percentage.

Referring to page 15, Mr. Morrill discussed the sector weightings. He said D. F. Dent is a bottom investor so they are looking for great companies that are led by great management teams. They are not so much worried about what sector they are in, when they first start our research. They are aware of their

overweight in Technology and Industrials and their underweight in Telecommunication Services, Utilities and Consumer Staples.

Mr. Medrow said the only one he would question would be the energy side since he sees a tremendous boom in energy coming up next year. Mr. Morrill responded energy has had a low return and has been hard hit this year, but he agreed with regard to the longer term possibilities. Mr. Medrow commented he does not necessarily mean buying the energy itself (i.e., natural gas, oil), but other services such as transportation, infrastructure and that type of thing. Mr. Morrill agreed.

Mr. Medrow raised the issue of an export law that is in place which was enacted in the early 1970's prohibiting the export of oil. Mr. Dent responded about three months ago Pioneer Natural Resources had the first exports of U.S. crude oil in the last 40 years because of some exemptions with the properties that were not subject to that law. Mr. Dent noted by 2020 the United States will become a net exporter of energy.

Referring to page 16, Mr. Morrill discussed diversity in terms of market cap. He noted the international piece of the portfolio are companies domiciled outside the United States and it represents 8.43% of the portfolio. Mr. Morrill also pointed out D. F. Dent has always been very underweight in mega caps and are more of a smaller large cap and mid-cap investor.

Mr. Dent offered some comments on the international. The payments to beneficiaries going forward are in U.S. dollars and they want to be very careful about any non U.S. investments. D. F. Dent does not want to have assets in such things as euros and pesos to meet dollar obligations for police retirees and they are very careful in this respect. International companies that are selected are ones they meet with and know and are companies that have unusually attractive prospects going forward. A very targeted approach is utilized, not just trying to buy South America or Brazil. Mr. Dent noted IMAX referred to earlier is an international company headquartered in Toronto. Its growth going forward is going to be largely in China. Pricemart is basically Caribbean and Latin America.

Mr. Medrow commented he hears comments from citizens that there should be a larger international portfolio. Chief Nolan stated he does not completely hold that view and is comfortable [with the portfolio.]

A member of the group commented there is a lot more international exposure than people realize.

Mr. Morrill stated in addition to the four companies at the bottom of page 16, the portfolio is made up of U.S. Companies that have 40% of the total revenues outside the United States. He pointed out the CEO's of the companies

they invest in know exactly where to put their capital to generate the most growth and that is what they are doing.

Mr. Dent stated the MSCI benchmarks are used for international and they break down the components, Europe, Middle East, Africa, Asia, emerging markets. The equities in the portfolio for the past year, the past three years, the past five years and the past five years have exceeded the performance of each one of those benchmarks for each one of those periods. Mr. Medrow asked if D. F. Dent has done a study on this. Mr. Dent responded in the affirmative. Mr. Medrow asked for a report on this to keep on file for any inquiries.

Mr. Dent indicated foreign investments represent 8.4% of the equities and D. F. Dent follows the marching orders of the investment committees they work for. If there is a strong inclination by this board to either not have foreign investments or increase them it can be done.

Referring to Fixed Income on page 17, Mr. Dent stated the benchmark which is Barclays Government Credit Index has an average maturity of 7.5 years. He explained the short maturity of 2.6 years.

Mr. Dent discussed the Bond Maturity Schedule on Page 19. He said the important thing to note are the years 2015, 2016, 2017 and 2018. Without being concerned about what is going on in the markets there are very high quality maturities coming in to meet obligations in those years going out the next five years. It is laddered out intentionally to meet the obligations.

Mr. Medrow commented D. F. Dent has done an excellent job with the Fixed Income portfolio.

Mr. Dent explained the bar chart on page 20 and the risk of extended maturities and the reason why it is worth getting some current income to try and stay reasonably short.

### NEW BUSINESS

Mr. Medrow announced that Sgt. Andy Fidler is the new police representative on the Pension Advisory Board. Chief Nolan indicated Sgt. Fidler is a former bargaining unit representative and provided additional details about Sgt. Fidler's background.

Mrs. Evans noted the Pension Advisory Board reorganization meeting will be held on Wednesday, January 14, 2015 at 5:30 p.m.

### OLD BUSINESS

None.

ADJOURNMENT

With no further business to come before the Board, it was moved by Mr. Kraynik, seconded by Chief Nolan, all voting "Aye" to adjourn the meeting  
At 6:45 p.m.

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David G. Kraynik  
Township Manager and Vice Chairman

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Minutes Approved:  
Minutes Entered: