

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

The Pension Advisory Board/Health & Welfare Board of Trustees, met for their Quarterly Meeting on Wednesday, March 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: Greg Waks, Supervisor Liaison/Trustee; Eric Medrow, Chairperson; David G. Kraynik, Vice Chairperson; Chief Tom Nolan, Secretary. Others present were: Sudha Suryadevara, Non-Uniformed Representative; Sara Evans, HR Director; Nick Hiriak, Finance Director; Michael Morrill, DF Dent & Company; Dan Dent, DF Dent & Company, Investment Manager. Sgt. Andrew Andreyko was absent.

MEETING MINUTES:

It was moved by Mr. Kraynik, seconded by Chief Nolan, all voting "Aye" to approve the January 8, 2014 Reorganization Meeting Minutes as submitted. None opposed. Motion approved 4-0.

PRESENTATION BY DANIEL F. DENT, DF DENT & COMPANY, INC. RE:
POLICE PENSION PLAN AND FUND

Dan Dent, Investment Manager, DF Dent & Company, provided an update on the firm's management and ownership. He stated over the last 15 years they have built the firm in a manner so that it would continue indefinitely into the future as an independent 100% management owned firm. Mr. Dent announced that his son, Matthew F. Dent, has been unanimously elected President of the firm as of January 1, 2014. Dan noted the firm will still operate the same way and this does not mean he will be any less involved.

Mr. Medrow asked if Matt is licensed as an advisory and has all the credentials necessary to preside over the firm. Mr. Dent responded in the affirmative.

Mr. Medrow asked if their ADV form has been updated. Mr. Dent responded in the affirmative.

Mr. Dent presented the performance report for the Upper Merion Township Police Pension Plan dated March 12, 2013.

Mr. Medrow asked if fixed income the bonds are still being treated as short term investments. Mr. Dent responded in the affirmative.

Mr. Dent discussed the unattractive nature of call features as well as how they can be used advantageously.

Referring to the performance on page 4, Mr. Dent reported last year the total return net of allocated fees was 18.76% for the total account. The equity return was 28.57% and was slightly under the S&P 500 benchmark of 32.39%. He explained the reason was we have been “bumping up” against the high end of the equity percentage ceiling. The Fund liquidated over \$1 million in equities to keep the equity percentage in line with the investment policy. This accounts for the 28.57% return being below the S&P 500 benchmark. Mr. Dent pointed out the equities for the three year and five year periods are in both cases on an annual basis ahead of the benchmark.

Mr. Medrow noted the investment policy indicates the Fund can be 60% in equities, the rest is fixed income, but because of the tenuous nature of the fixed income market and low interest rates, about a year and a half ago, D.F. Dent was allowed to continue to hold those equities that were in a positive position and go beyond the 60%.

Returning to the performance on page 4, Mr. Dent indicated last year was a very strong year in fixed income because of the short maturities. The Barclay's Government Credit Index benchmark had a negative total return last year (-2.36) because interest rates rose during the year. There was almost a 2% total return in fixed income. For the three and five year period the fixed income has exceeded the benchmark on an annual basis.

Mr. Dent discussed the capital flows in the account on page 5. Three years ago the portfolio's total value was \$35.6 million and after paying out benefits the portfolio's total value is \$44.5 million. The amount of distributions on a monthly basis remain pretty constant which last year amounted to \$1.7 million.

Mr. Medrow asked Chief Nolan if there are an inordinate number of anticipated retirements in the coming year in the Police Department. Chief Nolan responded there will be three retirements this year and then two and three in subsequent years.

Mr. Dent reviewed the capital flows over the past 20 years which started out in 1994 with a total of \$14.4 million in the portfolio and currently stands at \$44 million. Cumulative withdrawals from that figure over the years totaled \$19.8 million which exceeded the initial value by about \$5 million. It was noted that the software used for the chart on page 6 only goes back 20 years. D.F. Dent has been managing the Plan since September 29, 1990 which was approximately \$8-9 million at the time.

Mr. Michael N. Morrill discussed the Contribution to Return since the last meeting which lists in this time frame the five stocks that contributed most to return of the portfolio and the five stocks that hurt the most.

Mr. Dent mentioned 3D Systems performed well and has gone up about 6 times over the last three years. It is also a very volatile stock because of all the interest in it. 3D Systems was trimmed back aggressively last year because it was such a winner and so volatile and it was sold at successively higher prices. This was a triple performer within the portfolio from the original cost.

Mr. Morrill discussed some of the lowest return stocks including Fastenal which was a very large holding for a very long time but because of construction delays in the country has come down. LKQ Corporation has a short report written against it. Mr. Morrill said many hedge funds will write short reports to drive stocks down and a lot of the information that came out in the short report was information that everyone knows. He indicated these are names D.F. Dent feels very strongly about in the long term.

Mr. Morrill reviewed the additions and deletions from the portfolio from the end of the third quarter last year up to the present. Specific comments were made about Intuitive Surgical Inc. It was noted that this stock ran into some issues over utilization within hospitals and the number of units being sold has declined. This decline provided an opportunity for entry for the stock in the portfolio.

Waste Connections Inc. is another addition Mr. Morrill noted. He indicated they have a great management team and are in secondary markets where there really is no other competition or they are in markets where the waste removal is treated like a utility and it is a guaranteed rate. This company does both recyclables and solid waste removal.

With regard to Panera Bread Company, Mr. Morrill indicated this company was having trouble with lunch crowds waiting too long and that hit the stock when their sales started going down. This provided an opportunity to enter the stock after it was hit.

Mr. Medrow asked if D. F. Dent has a sell program. Mr. Morrill responded they have a sell program that is based on what they think is a target price based on their earnings model.

Mr. Morrill discussed Discover Financial Services. He said it is a two-fold business which is famous for its "closed loop" credit card not unlike American Express. It is a small portion of what they do. They actually are the number one credit card lending company in the country and their credit growth rates are about 4 or 5% versus the average in the country which is around 1%. Mr. Dent noted this company has a most attractive financial matrix within banking, the lowest

level of credit losses, the highest growth rate in their loans, and the highest capital ratios. Since they do not have all the payroll costs associated with brick and mortar banks, they can lend competitively without all the overhead.

Mr. Morrill stated the three deletions from the portfolio are Potash, National American University, and Intel.

Mr. Medrow asked why Intel was sold. Mr. Dent responded this was liquidated because they missed out on mobile devices and are very heavily weighted with microprocessors especially desk tops. There were better places to place these funds in the portfolio where there was better growth potential.

Mr. Morrill discussed the sector allocation of the portfolio and indicated they are bottom up growth oriented investors looking for great companies to put into the portfolio. They are not as concerned what sector they are in. Information Technology has increased in the last five years as a percentage of the portfolio and currently overweight. Also overweight in the portfolio are Industrials and Financials. Consumer Discretionary, Health Care, Energy, Cash, Materials and consumer Staples are under weight and there is no exposure in Telecommunication Services and Utilities. With regard to Telecommunication Services, Mr. Morrill noted a year and a half ago; American Tower converted to REIT status and is now in financials. This is one of the reasons for the overweighting in financials.

Mr. Morrill reviewed the equity portfolio broken down by market cap, the largest being Johnson & Johnson and the smallest being Wage Works, Inc. Mr. Morrill pointed out because of the market appreciation and how well some of the stocks have done, Wage Works, typically a Small Cap name, is now a Mid Cap. There are currently no Small Cap names in the portfolio currently because of the appreciation of the Small Caps which have graduated to Mid Cap.

Mr. Medrow asked if Small Cap investments are being considered at the present time. Mr. Morrill responded because of the conservative nature of the portfolio they do not want to be too heavily weighted in Small Caps that are a little more volatile and aggressive, but if they find something appropriate they would put it in there.

Mr. Medrow asked about Clean Harbors, Inc. Mr. Dent responded a smaller part of their business is formerly a Safety Clean Company they purchased that recycles spent oil after oil changes performed at various garages. They also go into hazardous waste type operations and do periodic cleaning of big storage oil tanks that have to be emptied and cleaned from time to time. Clean Harbors does a lot of emergency type cleanups, for example, the cleanup after Super Storm Sandy. While it is not the type of company D.F. Dent normally invests in, they generate a very substantial cash flow.

After a discussion as to why Apple is not in the portfolio, Mr. Morrill stated Qualcomm, Inc. is their way to participate in Cellular Communications which is one of the top performers with very strong and stable management.

Mr. Dent discussed the Fixed Income portfolio composition. He noted the average maturity is only 3 years versus 7.5 years on the Barclays Government Credit Index. The actual yield is the same even though the maturity is a lot smaller. Treasuries are much overvalued and there is almost no return from Treasuries. The benchmark has a heavy weighting so the portfolio has the heavier weighting in high grade Corporates. That is how the shorter maturity is maintained while getting the same return as the benchmark with less risk. This is the reason why the performance of the Fixed Income in the portfolio versus the benchmark is so much better last year because the Corporates performed well.

Mr. Dent discussed the recent purchases and sales which are basically maturities and calls. With the outlook for interest rates staying lower for a longer period of time, American Tower was the one item purchased where they were willing to go out much further than the rest of the portfolio to 2020. American Tower had an attractive yield to maturity.

Phil Fogli, King of Prussia, referring to page 4, asked for a definition of allocated fees. Mr. Dent responded those are fees that are allocated between fixed income and equities. They have a fee that is applied to the entire portfolio. Mr. Fogli asked if this is the advisory fee. Mr. Dent responded in the affirmative. He said there are two major components equities and fixed income and the performance you see there is net of fees. For example with 28% of the fee representing the fixed income, 28 % of the quarterly fee is allocated to Fixed Income to give you the net return.

Mr. Fogli asked if the net of fees includes any other fees the plan is experiencing from their custodian or from their actuary. Dent responded he would not really know or have any control over that.

Mr. Fogli asked if Mr. Dent is made aware of the actuarial status of this plan and the actuarial assumptions that are being used and if that impacts how the money is managed. Mr. Dent responded in the affirmative. He indicated there is a fairly significant lag for the annual report on the actuarial. Mr. Dent recalled that a representative from Anderson & Associates came to one of the Pension Advisory Board meetings and indicated the Upper Merion Township Police Pension Plan is the only plan that is as well funded in the Commonwealth of Pennsylvania and they have not seen anything that is equally sound.

Mr. Medrow stated he has heard the number that 90% of our liabilities are covered; however, he has never seen the figures. He said he would like to see the actuary go through these numbers for the Pension Advisory Board at some point.

A discussion followed during which Mr. Dent explained how many plans are affected by lower interest rates which are resulting in an increase in the present value of the unfunded liabilities because they have discounted at a much lower rate. Mr. Dent indicated he would like to attend one of Anderson's meetings to hear what they have to say.

Mrs. Evans indicated May 14th has already been established as the date for Anderson & Associates to brief the Pension Advisory Board. (Subsequent to this meeting D.F. Dent has confirmed their attendance at the May 14th meeting).

Mr. Fogli asked if D.F. Dent was involved in the drafting of the investment policy and if he sees a lack of international exposure across much of their client base. Mr. Dent responded that he was involved in the drafting of the investment policy although the final version was approved by the Pension Advisory Board.

Mr. Medrow indicated the Investment Policy Statement should be drafted by the Pension Advisory Board with input from the investment manager. Mr. Kraynik stated the Pension Advisory Committee should draft the investment policy with a recommendation to the Board of Supervisors for final consideration.

A dialog occurred between Mr. Fogli, who identified himself as an investment adviser to many municipal pension plans, and Mr. Dent with regard to the lack of international exposure in Upper Merion's Police Pension Plan. Mr. Dent outlined the benefits to the Plan by not going in that direction. He noted the portfolio and U.S. equities for the last 5 years have outperformed international, especially emerging markets. Mr. Dent indicated most of their client base is domestic, U.S. equities, but some of the retirement plans do want and they provide for them an international component with a percentage allocation.

Chief Nolan commented the Upper Merion Township Police Pension Plan has had a very good track record and performed well. Even though it has been awhile since the investment policy was drafted that alone should not necessarily mean it should be changed.

Mr. Fogli called attention to page 5 of D.F. Dent's March 12 report indicating a December 31, 2012 Market Value of \$38,983,000, but the last actuarial report dated January 1, 2013 lists the Market Value of the asset on that date of \$40,468,000. He said in comparing the D. F. Dent report and the actuarial report there is a difference of about \$1.5 million. Mr. Kraynik indicated that actuarial will be at the next regular meeting of the Pension Advisory Board and that is a question that needs to be answered.

Pension Advisory Board Action:

It was moved by Chief Nolan, seconded by Mr. Kraynik, all voting "Aye" to accept the D.F. Dent March 12, 2014 report of the Upper Merion Township Police Pension Plan. None opposed. Motion approved 4-0.

ADDITIONAL BUSINESS

Mr. Medrow stated the Pension Advisory Board Joint Meeting with the Board of Supervisors will be held on Thursday, April 10, 2014 at 7 p.m. Mr. Kraynik indicated the next regular meeting of the Pension Advisory Board will be on May 14th when Anderson & Associates will make their presentation. Mrs. Evans noted the ICMA Retirement Corporation will discuss the Non-Uniformed Pension Plan on July 9th.

ADJOURNMENT

It was moved by Mr. Kraynik, seconded by Chief Nolan, all voting "Aye" to adjourn the meeting at 6:32 p.m.

David G. Kraynik
Township Manager and Vice Chairman

rap
Minutes Approved:
Minutes Entered: