

PENSION ADVISORY BOARD/HEALTH & WELFARE BOARD OF TRUSTEES
NOVEMBER 13, 2013
QUARTERLY MEETING

The Pension Advisory Board/Health & Welfare Board of Trustees, met for their Quarterly Meeting on Wednesday, November 13, 2013, 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 Secretary; Nick Hiriak, Finance Director; Sara Evans, Director of Human Resources; Chief Tom Nolan, Vice Chairperson; Eric Medrow, Chairman; Vincent Mallon, Sgt. Andy Andreyko, Police Representative; Michael Morrill, DF Dent; Daniel F. Dent, DF Dent. Sudha Suryadevara was absent.

MEETING MINUTES:

It was moved by Mr. Kraynik, seconded by Chief Tom Nolan, all voting "Aye" to approve the July 10, 2013 Meeting Minutes as submitted. None opposed. Motion unanimously approved.

PRESENTATION BY DANIEL F. DENT RE: POLICE PENSION PLAN AND FUND

Mr. Dent introduced Mike Morrill who has been with DF Dent for a number of years and works with him on the Police Pension Plan. While Mr. Dent is still the investment manager with investment management responsibilities they prefer having two people involved with major accounts. He indicated there may also be times when he will ask Linda McCleary who is the Vice President of the firm to join the meeting since her specialty is fixed income and she has worked on this component of the portfolio.

Mr. Dent provided an overview of the portfolio. Highlights as follows:

- fixed income portfolio totals about 29% of the total plan assets
- equities significantly outperformed the S&P 500 Benchmark with the equities in the portfolio of 24.5% versus a little less than 20% for the S&P.
- fixed income component in what has been a very difficult fixed income bond market showed a positive return versus the negative return for the benchmark (Barclays Government/Credit Index).

- annual rate of return on the total portfolio for the last three years was 12.38%. Equities again outperformed the S&P and fixed income also outperformed.
- On September 30, 2012 the total value of the portfolio was \$38 million and as of September 30, 2013 the total value of the portfolio was \$42 million plus.
- Leading as one of the best investments within the portfolio has been Visa, Inc. It has been a very strong investment for the last 12 months in the calendar year.
- The second major contributor is 3D Systems Corp.
- The worst contributor is Red Hat, Inc. (open source software)
- Potash Corp. of Saskatchewan is a candidate to be sold at the end of the year.
- Idexx has been one of the favorite companies in the portfolio; however, it has been sold since the valuation has gotten too high with a growth rate approaching 20%. If that company's stock were to sell off considerably adjusting to a lower growth rate it would be a serious candidate to repurchase.
- Trimble Navigation Ltd. has been trimmed back
- Portfolio is overweighted in industrials and information technology, slightly overweighted in financials.

With regard to overweighting in the above categories, Mr. Medrow asked if this means there is an underweighting in health care, energy and consumer. Mr. Morrill commented it is important to have a diverse portfolio across multiple sectors, but they have been able to find very interesting niche growth companies in the industrial and informational technology areas over the past couple of years so there has been an overweight.

Mr. Dent asked Mr. Morrill to go through the market capitalization distribution and comment on purchases and sales. Mr. Morrill discussed the equity part of the portfolio by capital and its delineation by large cap, mid cap and small cap.

Mr. Medrow asked for an explanation for the break point for large capitalization stock as opposed to mid-cap, and the same for the mid and small cap. Mr. Morrill responded their industry does not have a standard market cap range for what denotes mid, large, small cap. They use \$2-10 billion for mid cap so any stock that is above \$10 billion in market cap falls into large cap for them. The smallest name in the large cap arena is Varisk Analytics at \$10.48 billion in market cap. While his firm uses \$2-10 billion for mid cap others can use different market cap ranges. Mr. Morrill pointed out their industry does not have a standard, but they use \$2-10 billion for mid cap. Anything below \$2 billion would be considered small cap. WageWorks, Inc. is the only name in the portfolio considered small cap. The large cap portfolio is a little over 57% of the equities. Mr. Morrill indicated the combination of large cap stocks there includes what they

believe are good long term growth equities and some very good dividend paying stocks. Mid cap is almost 41% of the portfolio and most of those are going to be very good growth companies that they believe will have a long term runway for earnings growth.

Mr. Medrow asked about Fastenal. Mr. Morrill responded Fastenal is the largest holding within DF Dent and one of the best companies in terms of corporate management, the ability to analyze their business, and reconfigure where they are going over the next five years. It is currently about \$3 billion in sales annually and over the next 5-10 years it will be a \$10 billion sales company. It is a large cap company that can actually triple its revenues. Given the position size it will continue to be held.

Mr. Medrow asked if D.F. Dent is close to their 5% on that one. Mr. Dent responded in the affirmative and said 4% of cost. He indicated quite a few companies from mid-cap with the strong markets of the last year graduated from mid-cap into large cap. Mr. Dent said he does not believe we can keep "moving the goal post up" because the markets moved up. He does not want to move mid cap from \$10 to 13 billion. The same thing has happened to some extent with some of the small cap companies. They have moved up from the last five years from small cap to mid-cap.

Mr. Merrill discussed the purchases and sales since March of this year through October 31, 2013. The total amount of purchases in that time frame is \$2.7 million dollars and sales were \$3.2 million. Equities have increased to 68% of the portfolio because of the strong market.

Mr. Medrow noted a few years ago an amendment was made to Upper Merion's investment policy statement which allowed D. F. Dent to continue to hold stocks above the 60% limitation on stocks that were moving up so that the bond portion of the portfolio could be thinned in down. Mr. Medrow asked if that is why we are at 68% in equities. Mr. Morrill responded in the affirmative. Mr. Dent commented in the last half year just looking at the equities there has been a net liquidator of \$500,000 of equities within the plan to keep the portfolio in balance.

Mr. Medrow asked if D. F. Dent applied a sell program as discussed at a previous meeting. Mr. Morrill responded by discussing some of the new purchases in the portfolio. The very first company he mentioned is WageWorks which is a software company that applies software services for employee tax benefit programs. Another new name in the portfolio is Verisk Analytics which is a company that does risk analytics on insurance. It is not a fast grower, but it is very stable. Moody's Corp is the credit rating agency and that was purchased just recently in September and Panera Bread was purchased just a couple weeks ago. On the sales, there are a couple of names that have exited completely: Idexx Laboratories, Inc, Apache Corp. and Resmed, Inc.

Mr. Medrow noticed the sale of 3D Systems Corp. Mr. Merrill commented 3D Systems was trimmed because valuation was excessive. It was the best performer last year and is the second best performer this year. They did not want to get rid of it completely because they believe it has a good runway for growth. It is expensive so if it is sold they would never buy it back again so it is being kept in the portfolio. Mr. Dent noted the position size was reduced and the entire original investment has been recovered.

Mr. Medrow asked under what circumstances a sell program of stock is put into place. Mr. Merrill responded it is as much art as it is science. They look at the valuations versus what they think long term growth rates are going to be and in many cases it is still Price-Earnings ratio (P/E). In some cases it might be Enterprise Value. They are looking for what the P/E ratio is right now based on what they think the earnings can grow and what the historic P/E ratio has been as well. Mr. Dent stated if they feel they have lost the high level confidence that they have in the companies they invest in for any number of reasons, they would most likely sell that stock.

Mr. Medrow asked for a basic review of where we stand with Quantitative Easing, the concept of tapering down the investments over the years and how all that relates. Mr. Dent responded the portfolio is structured to protect against some of these issues such as rising interest rates and rising inflation. With regard to Quantitative Easing and tapering, the Federal Reserve in order to stimulate the economy and reduce unemployment has been ejecting a lot of cash into the economy. There have been a series of what are known as Quantitative Easing strategies. Most recently the Federal Reserve is buying \$80 billion of mortgages every month. When the Federal Reserve buys \$80 billion of mortgages the cash is paid into the banks. This builds up bank reserves and banks end up with a lot of cash available to lend out to help businesses grow and general employment.

Mr. Medrow expressed concern since the dollars printed at the Treasury Department have not been generated by true growth in the economy.

Mr. Dent pointed out the markets are very sensitive to what the future prospects are for quantitative easing. Shifts in that policy have affected the bond market. He noted at the time of the last meeting the interest rate on the 10-year Treasury was 1.7% and it did extraordinarily well last February/March. If all of a sudden the Federal Reserve would not be buying \$80 billion in mortgages a month, this would cause a lot of chaos. So instead of doing that the concept is the Federal Reserve would taper that program and reduce the \$80 billion to possibly \$75 billion or \$70 billion. There was a lot of discussion about that and in the middle of this year there was fear that tapering was going to come in and the Federal Reserve was going to work towards ending Quantitative Easing and ending the program that is injecting all the cash into the economy and causing

low interest rates. So interest rates by September went from 1.7% up to 3%. This hurt the long term bond owner. Mr. Dent pointed out in the performance results for the fixed income the benchmark has done very poorly this year. By being defensive D. F. Dent has provided positive returns in fixed income versus the benchmark and most bond market instruments have negative returns. D.F. Dent will continue the defensive policy.

Mr. Dent believes interest rates will stay low for an indefinite period, especially with Janet Yellen coming in as the new Federal Reserve Chairman. Her strategy will be to maintain a low interest rate until the economy shows more strength and employment shows more improvement.

Mr. Medrow expressed concern that an inflationary push is inevitable sometime in the future and he would hope that D. F. Dent would continue to maintain their defensive posture.

Mr. Dent discussed some of the statistics on the fixed income portfolio versus the benchmark and pointed out there are short maturities to protect against rising interest rates. He indicated another way of measuring volatility and risk within a bond portfolio is duration, and he explained the practice of modified duration instead of the stated maturities of each bond.

In discussing the maturity schedule, Mr. Dent noted the practice of laddering so that the whole portfolio does not mature in 2013 and 2014.

Mr. Dent stated as a firm, D. F. Dent has spent the last ten years building up their talented research capabilities and he noted several key people associated with his firm.

Sgt. Andreyko suggested inviting Anderson to one of the upcoming meetings to get a refresher on the "nuts and bolts" side. Ms. Evans indicated she has spoken to Doug Worley about attending one of the meetings next year in addition to having an ICMA retirement representative on the agenda for next year.

Mr. Kraynik asked how often in the past this Board has seen a representative from Anderson. Mr. Medrow and Sgt. Andreyko both responded, "once." Mr. Kraynik indicated a representative from Anderson will be invited to make a presentation at the next regular meeting after the January Reorganization meeting. Later in the discussion Mr. Kraynik indicated in addition to Anderson, he would want to have D. F. Dent and Barber (actuarial firm).

Ms. Evans proposed that the Pension Advisory Board Reorganization meeting be held on Wednesday, January 8, 2013 at 5:30 p.m. Everyone agreed.

Ms. Evans reported that the pension FAQ has been posted on the township website. It is a document in progress and as additional questions or information deemed beneficial to employees are received the website will be updated. Ms. Evans also noted the ICMA video which is available on the township website that provides a visual and auditory Q&A for retirement.

Since there was no old business to discuss, a resident in attendance asked for an opportunity to speak.

From the Public:

Mr. Phil Fogli, a resident and owner of an investment advisory business in the township, discussed his longtime involvement with clients who are part of the township's pension plan. He indicated he was provided with a copy of the January 1, 2013 Act 205 report which reflects the January 1, 2013 valuation for the police pension plan. In his view, the January 1, 2013 valuation is not giving an accurate rendition of the financial status of this plan and explained his reasons.

Mr. Fogli questioned the investment policy for the police pension plan and a discussion followed after which it was determined that the investment policy would be reviewed as to the lack of exposure to international investing. He also questioned the asset smoothing practice and Social Security offset and discussed the non-uniformed plan.

ADJOURNMENT

With no further business to come before the Board, it was moved by Chief Nolan, seconded by Vince Mallon, all voting "Aye" to adjourn the meeting at 6:06 p.m.

David G. Kraynik
Township Manager and Secretary

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Minutes Approved:
Minutes Entered: