

PENSION ADVISORY BOARD/HEALTH & WELFARE BOARD OF TRUSTEES
APRIL 11, 2018
QUARTERLY MEETING

The Pension Advisory Board/Health & Welfare Board of Trustees, met for their Quarterly Meeting on Thursday, April 11, 2018, 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, Trustee and Board Liaison; David Kraynik, Vice Chairman; Roseann McGrath, Vice Chairperson; Police Chief Tom Nolan; Sgt. Andy Fidler, Police Representative; Bill Daywalt, Non-Uniformed Representative; Nick Hiriak, Finance Director; Sibyl Bryant, HR Director; Daniel F. Dent, Chairman, DF Dent and Company; Mike Morrill, Vice President and COO, DF Dent and Company.

MEETING MINUTES:

It was moved by Mr. Waks, seconded by Ms. McGrath, all voting "Aye" to approve the January 10, 2018 Reorganization Meeting Minutes as submitted. Motion unanimously approved.

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

Mr. Daniel Dent, Chairman, D. F. Dent, discussed the performance of the Upper Merion Township Police Pension Plan as of March 31, 2018. Highlights as follows:

Policy Guidelines (as of 03/31/18) – page 3

Mr. Dent stated we are at the bottom level in Fixed Income as a defensive position with the bond market; combining Fixed Income and Cash Reserves. It was noted 4.5% of the current portfolio is in very short-term Treasuries which is a development within the last few months and is viewed together [with Fixed Income] as non-equities which totals 34.5% on a combined basis.

Performance as of 03/31/18 (net of fees) – page 4

Mr. Dent called attention to the return for the Year to Date for the S&P 500 and Barclays Government Credit Index. Both numbers are negative year-to-date. It was noted this is the first quarter in four years when they have both been negative. Mr. Dent said he was pleased to report that despite the negativity of

the S&P, the Equities had a positive return Year to Date of 4.27%; the Fixed Income was slightly positive. The Fixed Income for the Latest 1 Year was 1.21%, however, Mr. Dent noted the Fixed Income Latest 3 Year, 5 Year and 20 Year period was exceeded by benchmark in all those periods. He pointed out Fixed Income has become a larger portion of the portfolio than it was in the past. For the last year the equity portfolio has had a very strong performance against the benchmark (about 10% better than the S&P as well as a higher return for the last three years (all net of fees).

Portfolio Overview – page 5

Mr. Dent noted the beginning value of the portfolio was \$8.5 million going back to 1990 and is currently at \$51.8 million.

Equity Overview – page 6

The largest single sector is Information Technology and is the main reason for the portfolio performance in the last year. Technology, especially some of the large capitalization technology companies led the market and the 29% is actually an overweighting relative to the benchmark. Industrials are the second largest weighting. Mr. Dent noted Industrials are a “catch all” and because of that tends to be a high percentage within the portfolio. For the last four to five years, Visa has been the largest holding and the remaining stocks in the Top 10 Holdings do not change much from time to time. Large holdings become large holdings not by pouring in a lot of capital, but by superior long term performance.

Change in Market Value – page 7

On March 31, 2017 the Market Value was \$46.1 million and is currently \$51.8 million. Referring to the expense column for Additions/Withdrawals, Mr. Dent pointed out for the last year expenses amounted to \$1.7 million which is primarily distributions to beneficiaries. The three-year total is 4.9% (just about three times what it was in last year and the five-year total of \$8.9 million is about five times what it was in the last year. Mr. Dent pointed out the withdrawals from the portfolio over a period of time have been consistent and while there has been a steady withdrawal the amount of increase in the portfolio has been greater than withdrawals. It was noted the equity in the portfolio in the last five years has grown from \$41 million to \$51 million.

Capital Flows – page 8

Mr. Dent stated the cumulative withdrawal from 1994 to 2018 (a period of 24 years) amounts to \$26.9 million.

Contribution to Return – YTD 2018 – page 9

Mr. Morrill noted the five names that have helped the portfolio the most in equities are Red Hat, Inc., Bio-Techne Corporation, Amazon.com, Inc., Visa Inc., and Intuitive Surgical, Inc. The five names that hurt the portfolio the most are WageWorks, Inc., QUALCOMM Incorporated, Healthcare Services, Group, Inc., Celgene Corporation, and Johnson & Johnson. Three names: Red Hat, Visa and Intuitive Surgical were top performers for all of 2017 and are continuing their strong run. Red Hat and Visa are considered tech names and Bio-Techne and Intuitive Surgical are health care names and are the two strongest sectors in the quarter and also for last year. Amazon goes into consumer discretionary and while it is technology based it is really selling to consumers.

The biggest disappointment in the last quarter and last year was WageWorks; however, it has started to bounce back from what amounted to a minor issue with their accounting firm.

Equity Sector Weights vs. S&P 500 Index – page 10

Mr. Morrill noted Financials, Industrials and Info Tech are overweight with Health Care fairly close. He pointed out DF Dent & Company is a bottom up investor and does not have under and overweight concerns. Their goal is to find really good companies. He referred to Mr. Dent's previous comments that technology and health care have driven performance and financials have done well too. It was noted there is no weighting in the portfolio in Consumer Staples and Telecomm Services and Utilities since they are not growth areas. Mr. Morrill said it is very hard to find good long term growth companies.

Purchases and Sales YTD 2018 – page 11

Mr. Morrill noted Brooks Automation, Inc. is one new name in the portfolio. He said Brooks Automation is a company specializing in handling and storing sensitive materials such as tissue samples in controlled environments. It was noted Ventas Inc. (REIT) has been sold because the outlook for higher interest rates is not a good environment for REIT. This was a source of funds to move money into Fixed Income from the equity side. WageWorks has been trimmed. Intuitive Surgical was up 72% last year and it made sense to trim back. Red Hat was up 72%, Roper Technologies was up 42% and Visa was up 47%. Valuations became very expensive and these were also trimmed to move more money into Fixed Income.

Investing Themes in the Portfolio – page 12

Mr. Morrill stated the investing themes have stayed constant over the last four to five years and are expected to stay in the portfolio for a number of years to come.

Market Capitalization as of 03/31/2018 – page 13

Mr. Morrill pointed out since the last meeting with DF Dent there are some names that have moved up from mid-cap to the bottom of the large cap such as Fastenal, Trans Digm, IDEXX, and Verisk Analytics thereby reducing the mid-cap weighting and increasing the large cap weighting.

Net Purchase & Sales: Bond/Stocks (9/30/17 to 3/31/18) – page 14

Mr. Dent stated beginning in 2009 there have been nine years of straight up markets. With that in mind, he has made moves to balance the portfolio since the last meeting. DF Dent has purchased \$2.5 million in bonds and has sold \$2.2 million in stocks. This amounts to a 5.34% reallocation from Equities into Fixed Income. Bonds have gone from 32.53% on 9/30/17 to 34.53% on 3/31/18. It was noted bonds have only gone up 2% as a percentage of the portfolio since the market has been very strong during this period. The Equities have been going up even though 5% was taken out of equities and the net amount in equities has only declined by 2%. Mr. Dent would like to see Equities lower than what they are now which is due to the 8% target rate of return. Going back three to five years, the portfolio has considerably exceeded that percentage placing the pension plan ahead of the trend line. Mr. Dent pointed out these cycles within the market do not go up forever and he wants to protect the profits of the last three to five years. For this reason he is willing to give up some of the Equity returns to de-risk the portfolio and provide some downside protection. He said while 5% from Equities has gone into bonds it resulted in stocks going down only 2% from 67.47% to 65.47%. Mr. Dent indicated he would like to continue this strategy with a goal of working more towards 60% in stocks. He said while some might think that is a low percentage in stocks, the portfolio is at a reasonably high point in the market in terms of returns. This is why Equities have been shifted at a measured disciplined pace into Fixed Income.

Fixed Income Profile – page 15

Mr. Dent provided an overview of the Fixed Income portion of the portfolio. It was noted in increasing the bond holdings within the portfolio DF Dent has been buying "step ups" and floating rate issues. A step up has in the bond indenture an agreement that the interest rate will periodically increase and provides some protection against rising interest rates. Step ups and floaters have been used since those tend to have longer stated maturities, yet still offer a higher return than the short end of the market. In addition these bonds provide protection against erosion of the principal on the assumption that interest rates are going to increase. It was noted the average credit quality has gone from A- to AA-, a slight improvement. The reason is DF Dent has been using short-term Treasuries which are not rated because they are full faith and credit of the U.S. Treasury and are categorized as AAA. With regard to the Sector Allocation, Mr. Dent pointed out Treasuries six months ago were at 9% and have been

increased to 18%. Government Agencies are up slightly and Corporates have been cut back with money going largely into Treasuries. The portfolio to Fixed Income percentage is now 34%.

Bond Maturity Schedule – page 16

Mr. Dent reviewed the bond maturity schedule. It was noted the step ups with longer maturities are defensive due to the coupon structure within the bond.

Outlook – page 17

Mr. Dent stated the overall equity market is trading in a range reaching record highs. Good earnings are expected to continue. It was noted DF Dent is cutting back on the equities in order to rebalance the portfolios. It is anticipated the equities within the portfolio will generate reasonably good returns. Mr. Dent indicated many of the companies referred to by Mr. Morrill are reporting very good results and continuing to grow both domestically and internationally. The overall global economic and corporate profit growth is accelerating.

With regard to interest rates, the Federal Reserve has sent signals they will be reversing the low interest rate policy of the last five to eight years and will periodically raise interest rates so that inflationary forces do not become too powerful. In addition, the Federal Reserve is shrinking their balance sheet in a very controlled manner to reverse what was done for the last nine years. Their idea is to “tap the brakes” on the economy. With \$4.4 trillion in mortgages and government debt, their balance sheet is much larger now than it has ever been. It is not anticipated interest rates will start impacting the growth in the economy until it reaches 5% or so and the Federal Reserve will be very cautious as they get close to 4%/4.5%.

Market Outlook – S&P 500 Forward 12-Month PE Ratio: 10 Years -page 19

Mr. Dent reviewed the Market Outlook chart which is in line with the 5-year average of the S&P. In terms of valuation against earnings we are pretty much average because earnings have also been moving up nicely.

Market Outlook – S&P 500 Calendar Year Bottom-Up EPS Actuals & Estimates – page 20

With regard to the projections for EPS for the benchmark, Mr. Dent noted most of the strategists and analysts are seeing reasonably good earnings going forward.

Market Outlook – U.S. Treasury Benchmark Yields – page 21

Mr. Dent reviewed the U.S. Treasury Benchmark Yields from December 31, 2016 to March 31, 2018. It was noted long term rates have come down fractionally while short term rates have quadrupled. In relating this to the portfolio it means there is an opportunity now at the short end that was not there a few years ago.

Portfolio Appraisal (as of 03/31/18) – page 22

Mr. Dent referred to the Fixed Income section which includes a U. S. Treasury Inflation Protection security known as a TIP. He said the TIP is adjusted based on inflation and is a low coupon but is structured to offset value against inflation. He indicated the Federal Home Loan Step matures on September 22, 2032; in years 2030 to 2032 the coupon goes from 6% to 8% and keeps stepping up. The strategy on that bond is when interest rates are that high most bonds will have a tremendous loss in value, but because of the stepping up of the coupon it holds its value. Step ups provide good protection against both rising interest rates and inflation which would be the source behind rising interest rates. It was noted there are additional step ups in the Fixed Income portfolio.

NEW BUSINESS

Mr. Kraynik reminded the Pension Advisory Board about the Joint Meeting with the Board of Supervisors on Thursday, April 12, 2018.

OLD BUSINESS

ADJOURNMENT

There being no further business before the Pension Advisory Board, it was moved and seconded to adjourn the meeting at 6:39 p.m. None opposed. Motion was unanimously approved.

Roseann McGrath
Vice Chairperson

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Minutes Approved: 6/13/18

Minutes Entered: 6/13/18