

The Minutes of the
Meeting of the
Lancaster County Retirement Board
August 16, 2019

The meeting was called to order by Commissioner Joshua Parsons at 9:00 a.m. in Conference Room 703, at the Lancaster County Offices, 150 North Queen Street.

Members Present: Commissioner Joshua Parsons, Commissioner Dennis Stuckey, Commissioner Craig Lehman, and Controller Brian Hurter.

Others Present: Michael Shone (Marquette Associates, left at 11:30 a.m.), Ray D'Agostino (left at 10:15 a.m.), Dan Foltz (arrived at 11:30 a.m.), and Kathy Kunkel.

Not Present: Treasurer Amber Martin

Commissioner Stuckey moved to approve the May 10, 2019 Retirement Board minutes as circulated. Commissioner Lehman seconded. The motion carried unanimously.

As a follow-up to the Board's approval at the May 10, 2019 meeting to terminate the EmStone Managed Yield Plus Collective Investment Trust (CIT) within EmStone Advisors Short Duration U.S. Fixed Income fund and redeem its investments in the CIT, the Board invited Craig Moyer, CFA - Emstone, and Mark Schlegel, Senior Vice President - Emerald Advisors, to the meeting to give an update on the process for the divestiture and distribution of the CIT funds.

Mr. Moyer and Mr. Schlegel attended the meeting at 9:20 a.m. Mr. Moyer referenced the memo sent on July 1, 2019 to clients of the CIT that explained the procedures for the wind down and liquidation of the fund.

Mr. Moyer stated that the original strategy for adding the CIT to the EmStone Advisors Short Duration U.S. Fixed Income fund four years ago when the EmStone fund began investing in the CIT, was to enhance the total returns of the EmStone fund. Mr. Moyer noted that four years ago the return of the EmStone fund was 10 to 20 basis points. They looked to enhance the returns with an investment of approximately \$3.5 million (approximately 15%-20% of the EmStone fund) in the CIT to purchase short term 3-5 year consumer loans as an incremental asset within the overall liquidity portfolio. The goal was to increase the returns of the EmStone fund due to how low returns were on traditional fixed income investments. Mr. Moyer noted that over time, as larger firms led by Goldman Sachs entered the short-term consumer loan market, the opportunity for EmStone to purchase short-term loans for the CIT was squeezed out and the return on investment decreased. Mr. Moyer noted that the option to move away from investing in only high-quality loans would lower their standards and was not a direction EmStone wanted to go. Mr. Moyer stated that due to Lancaster County and other investors requesting to pull their funds from the CIT, the decision was made to unwind the CIT.

He stated that if all the investors voted to immediately divest from the CIT that would be done; however, there was an investor that wanted to let the fund unwind. As a result, the CIT trust document sets the period to unwind the CIT over the next 90 days plus 365 days.

Mr. Moyer emphasized that the CIT investment outperformed the benchmark for the fund over the four-year period and did not lose money. He reviewed a chart that showed the CIT's annualized earnings of 3.55% from inception through May 31, 2019, compared to the benchmark's return of 2.12%. This resulted in a total investment gain over the investment period of \$444,304.87 which was \$184,910.58 greater than the benchmark's return for the period of \$259,394.29. He noted that the current market value of approximately \$3.5 million includes a historical default rate incorporated in the value. Mr. Moyer stated that if the CIT would have been divested immediately, there would have been a haircut of approximately 4% of the market value of the CIT. He also stated that they feel due to the maturity of the remaining loans in the CIT, the loans are less likely to default. Mr. Moyer stated that EmStone is waiving its management fee beginning on July 1, 2019. There will still be a fee from the trust. Mr. Moyer stated that quarterly cash distributions will be issued from the CIT beginning in September 2019. He stated that those payments would be issued proportionally based on each investor's percentage ownership in the CIT. Mr. Moyer stated that those payments can be added to the fixed income investment ladder to meet the cash flow needs for the Lancaster County Retirement Fund. Mr. Moyer stated that he thought the CIT fund was a good investment for the next twelve months.

Mr. Shone asked for a report of the underlying maturities of the CIT and a breakdown of the loans due each quarter. Mr. Moyer said he had already sent him the information but agreed to resend it to Mr. Shone and the Board.

Controller Hurter reiterated that the EmStone Advisors Short Duration U.S. Fixed Income fund is set up to provide for the Fund's cash needs, which was confirmed by Mr. Moyer.

Following the discussion and questions from the Board and Mr. Shone, the Board thanked Mr. Moyer and Mr. Schlegel for their review of the CIT. Mr. Moyer and Mr. Schlegel left the meeting at 10:00 a.m.

Following discussion, it was the consensus of the Board that they were disappointed in the liquidity of the CIT and the inability to receive the full proceeds with the closure of the CIT fund. However, the Board noted that if the CIT investment plays out as Mr. Moyer believes it will over the unwind period, that there will not be a negative impact on the fund especially since EmStone agreed to waive their fees. In addition, the Board agreed that before making any new type of investment, it would be valuable to have a conversation about the rules for the closure and divestiture of the fund and the liquidity.

The Board will continue to monitor the CIT and EmStone fund through the unwind period.

Mr. Shone presented the Fund's performance report for June 30, 2019. The total Retirement Fund was valued at approximately \$301,801,796 with a second quarter net return of 3.5% compared to a policy index return of 3.3%. He reported that the first quarter net investment gain was \$10,381,192. Mr. Shone noted the following portfolio returns: 1 year 6.5%, 3 years 9.1%, 5 years 6.0%, and 7 years 8.6%. Mr. Shone reviewed the individual managers' performance. Mr. Shone noted that after the stock market downturn in the fourth quarter 2018, the stock market has rebounded in the first and second quarters.

Mr. Shone reported that as of June 30, 2019, the market capitalization for the Fund's mid cap holdings are overweight at 25.3% compared to the benchmark of 14.6%. He suggested that a 20% investment in mid cap holdings may be more appropriate. Mr. Shone will provide options at the October Board Meeting for transitioning a portion of the mid cap investments to the Vanguard S&P 500 ETF and/or Fidelity Index.

Mr. Shone reviewed performance updates as of July 31, 2019 and August 14, 2019.

Controller Hurter reviewed the projected operating cash balance for the Retirement Fund. He reported that the County's final 2019 Actuarially Determined Contribution (ADC) contribution of \$1,048,000 will be made in August and the County's 2019 ADC of \$5,048,000 will then be fully funded. Controller Hurter stated that benefit payment funding is needed in September 2019 in the amount of \$1.3 to \$1.5 million. Following discussion, Commissioner Parsons moved approving Controller Hurter transferring up to \$1.5 million from the EmStone Advisors Short Duration U.S. Fixed Income fund to meet cash needs. Commissioner Stuckey seconded. The motion carried unanimously.

Controller Hurter stated the Board will discuss how to meet cash needs through March 2020 at the October and November Retirement Board Meetings.

Mr. Shone presented an education piece "Is your Portfolio Prepared for the Road Ahead" that included an asset allocation study of current allocations with expected returns and expected volatility with options for change. He reviewed the various asset allocations along with the expected return and volatility and discussed meeting the actuarial rate of return and the volatility/risk of the options presented compared to the current portfolio. Mr. Shone reviewed charts on inflation, yields and returns on core fixed income, and returns for domestic equities and international equities. He noted that he expects lower than historical nominal and real inflation adjusted returns for the next ten years and in the long term (11-30 years). Mr. Shone stated that for an asset allocation to hit 7.5% return today, it needs to be more aggressively invested which would increase expected volatility by 55%. Mr. Shone reviewed a chart of asset

allocation options including increasing real estate to 10% (adding 3%); remaining at 7% for real estate; and making various changes to a combination of domestic stocks, international stocks, and fixed income. The chart showed the reallocations, with the next ten years annualized expected rate of return and annualized volatility. Mr. Shone suggested transferring some monies from international funds, changing the benchmark for fixed income, and adding real estate.

Following discussion, the Board requested that Mr. Shone present proposals at the October Board Meeting to increase real estate from 7% to 10% with taking 3% from fixed income and to increase real estate from 7% to 10% with taking 2% from fixed income and 1% from international stocks. It was the consensus of the Board, if the decision is made to invest more in real estate, to add monies to Morgan Stanley rather than JP Morgan. In addition, they asked that Mr. Shone provide a breakdown for transferring a portion of the mid cap investments to the Vanguard S&P 500 ETF and/or Fidelity 500 Index as stated earlier.

Controller Hurter discussed a change to the information discussed at the May meeting regarding Korn Ferry's valuation report of January 1, 2019 showing the impact of implementing the public sector mortality tables and discounting accumulated deductions. Korn Ferry had originally estimated that implementing the new mortality tables would increase the ADC by \$2,300,000 and discounting accumulated deductions would lower the ADC by \$1,700,000 which totals a net increase to the ADC of \$600,000. Controller Hurter reviewed Korn Ferry's updated projections for the 2020 ADC which he summarized in a memo sent to the Board on July 8, 2019. Controller Hurter summarized the updated information as follows: moving to the new public sector mortality table will add \$2,300,000 to the ADC and discounting accumulated deductions will reduce the ADC by \$2,900,000 which totals a net decrease to the ADC of \$600,000. These projections are based on the January 1, 2019 actuarial valuation, so to the extent that during 2019 we are over or under our assumptions, that will also impact the ADC. Controller Hurter noted that it costs approximately \$1,000,000 to \$1,100,000 to decrease the assumed rate of return by .25%. Depending on the impact of the change in mortality tables, discounting accumulated deductions, and market returns, the Board could consider changing the return assumption without causing the ADC to be more than this year. Controller Hurter stated that this summary was just an update of the projections and that any options to lower the assumed rate of return will be for discussion at a future Board Meeting. Mr. Shone noted that Korn Ferry could probably put together an estimate to determine the impact. Controller Hurter stated that he will discuss this with Korn Ferry when providing the information to receive an estimated ADC for the 2020 budget.

Controller Hurter provided an update on the pension calculator. He stated that the calculator was installed in May and instructions to use the calculator were sent to the employees. He noted that information from PeopleSoft is provided to the employee and

must be reentered into the pension calculator on Korn Ferry's website. Controller Hurter stated that there are companies who can maintain the data on a single site so that an employee only has to enter their employee ID to complete the calculation. He noted that if the Board was interested in reviewing this option, there is a cost for the service, but it could be paid from the pension plan. He also noted that his staff is reviewing whether they can track the employee usage of the pension calculator.

Controller Hurter reported that he received a letter from Bolton, an employee benefits, actuarial, and investment consulting firm, stating that the Government Finance Officers Association (GFOA) recommends that pension plans have an actuarial audit conducted at least once every five years. Following discussion, it was the consensus that services provided by Korn Ferry are adequate, and an outside audit was not needed. Controller Hurter offered to send an email to members of the Controller's Association to see if other counties are getting actuarial audits.

Controller Hurter gave an update on the progress of the Request for Proposal (RFP) for Investment Consultant Services for the Employees' Retirement System for the County of Lancaster. Dan Foltz, Purchasing Senior Buyer, attended the meeting at 11:30 a.m. Following discussion about the responses to the RFP, it was the consensus of the Board to narrow the vendors down to three firms; AndCo Consulting, Cornerstone Independent Asset Management, and Marquette Associates. The Board set the next Board Meeting of October 11, 2019, to have presentations from the selected firms. Starting at 9 a.m., each firm will have an allotted time for a 10-minute presentation and 10-15 minutes for questions and answers. The Board requested that Mr. Foltz contact the selected vendors regarding the date and time. Controller Hurter will work with Mr. Foltz to put together a letter to the firms outlining the presentation and providing specific questions for the firms to answer during their presentation. This letter will be shared with the Board prior to sending it to the firms. The final selection of an investment consultant will occur at the November 8, 2019 Board Meeting, and the effective date of the contract will be January 1, 2020.

Commissioner Stuckey moved to adjourn the meeting at 11:57 a.m. Commissioner Lehman seconded. The motion carried unanimously. The next regular meeting is October 11, 2019, at 9:00 a.m.

Respectfully submitted,

Brian K. Hurter
Secretary