MINUTES OF THE RETIREMENT BOARD
May 16, 2013

A regular meeting of the Retirement Board convened on Thursday, May 16, 2013 at 8:35 a.m. in the Large Training Resource Center (TRC) Room. The meeting was called to order by President Doug Higashi.

Roll Call – The following Retirement Board Members were present: Timothy McGowan, Doug Higashi, Lloyd Sawchuk, Frank Mellon, William Patterson, and Alexander Coate.

The following staff members were present: Lourdes Matthew, Eric Sandler, Wanda Hendrix, Delores Turner, Lisa Sorani, and Elizabeth Grassetti.

Others present were Eric White from PCA, Eric Larson from 444 and George McQuary from 2019.

Delores Turner introduced Lisa Sorani, the newly hired manager of HR Employee Services.

PUBLIC COMMENT

There was no public comment.

1 - 4. **Consent Calendar** – A motion to approve the consent calendar was made by Frank Mellon, seconded by Tim McGowan and unanimously approved.

ACTION

5. **Placing Barrow Hanley on Heightened Monitoring** - Eric White of PCA recommended that Barrow Hanley be placed on Heightened Monitoring. He said that this level of performance was to be expected because Barrow Hanley has a high quality bias and that when the market jumps 15%, high quality managers underperform the market. Barrow Hanley has been sticking with their investment guidelines. Doug Higashi moved the recommendation, Frank Mellon seconded it, and it was approved unanimously. Barrow Hanley will be on monitoring for 12-18 months.

6. **Approving INTECH Fee Structure Change –** Eric White from PCA informed the Board that he met with INTECH and asked that they consider changing their fee structure to better align their fee structure with the Retirement Board's expectations. Their returns have been flat to the benchmark. They proposed to change their fee structure to one with a 5 basis point fee plus incentive fee that rewards outperforming the benchmark over a three-year period. The new fee structure was moved by Alex Coate, seconded by Frank Mellon, and unanimously approved.

INFORMATION

7. **Quarterly Performance Review as of March 31, 2013 –** Eric White of PCA presented the quarterly performance review. It was a very good quarter for the Plan, and at the end

of the quarter the Plan was at $1.1 billion, up $63.5 million for the quarter, and up $98.1 million for the year. The Plan ended the quarter overweight in equities and cash, and under weight in international equity and fixed income. Relative performance trailed benchmark by .1%. Eric White urged caution in rebalancing the portfolio because the plan may face headwinds in due to sequestration, and debt and fiscal cliffs coming in September. EBMUD had done very well against its peers, performing in the top 25% for the quarter and 3 year numbers.

8. **Fixed Income Discussion** – Eric White of PCA framed the discussion by noting that fixed income will present a big challenge for the Retirement Board because the rate of return is around 1.7%, way off its peak of 15.8%. This return rate makes it very difficult to meet the retirement systems assumed rate of return of 7.75%. Any shortfall in earnings will need to be made up by increased contributions.

   The current interest rate environment has an extremely asymmetric risk reward profile, meaning that the best outcome is to earn 2% interest on your fixed income investments. The downside potential is enormous. Looking forward, Mr. White outlined possible outcomes for fixed income investments. He presented a base case which was the ideal scenario and less optimistic outcomes.

   The base case scenario is one where the economic growth picks-up relatively quickly which reduces unemployment. In this scenario the interest rates would rise at a slow to moderate rate allowing the investors to adjust and breakeven or experience small capital loss.

   Other scenarios include cases where growth is determined by whether the government cuts costs or raises taxes, and how these actions affect the cost of debt and unemployment. In a worst case scenario a "Fed Capture" could result in monetary policy when the Fed loses independence from the Government which is a hallmark of countries in default.

   Mr. White concluded that plan sponsors must plan for interest rates rising, and it's not known how long it will be until they begin rising and how investors will react. He said that plan sponsors will need a tool box of options to choose from when rates start to rise. Options include changes to asset allocation, reducing exposure to fixed income investments and alter fixed income portfolio. In any case, plan sponsors are facing an extremely challenging situation and he concluded that there is no right answer to handle the situation because all solutions involve trade-offs.

9. **Real Return Class Education** - Mr. White presented a refresher course on the Real Return Class which is a collection of asset classes including TIPS, timber, commodities, and MLP's that should provide inflation protection and incremental returns. While they offer inflation protection, these investments are complex and can be difficult to manage.

   Mr. White defined and discussed inflation and how inflation can impact traditional asset classes. He described two views of how the fixed income scenario might unfold. The inflation doves believe that inflation is not imminent and won't occur unless there is a stronger job market and economic recovery. They believe that policy makers should stimulate the economy. Inflation hawks believe that inflation poses a real and immediate danger to the economy. They believe that the Fed should stop their aggressive monetary policy and raise interest rates.

Most institutional investors believe that inflation will pose a threat sometime in the future, and are positioning their portfolios to respond to the risk. Many are implementing real return classes and diversifying their portfolios to provide inflation hedging and produce stable returns regardless of the market environment. Mr. White recommended including a real return class in the upcoming Asset/Liability Study to determine its attractiveness versus other asset classes.

10. **PEPRA Implementation Update** – Lisa Sorani, Manager of Employee Services, presented an update on the PEPRA implementation, stating that all members of the 2013 plan are now contributing 50% of normal cost, and that the Retirement Ordinance had been updated to reflect the change to the assumed rate of return from 8% to 7.75% effective July 1, 2013.

REPORTS FROM THE BOARD

There were no reports from the Board.

ITEMS TO BE CALENDERED

- Asset/Liability Study was postponed until September

ADJOURNMENT – Doug Higashi moved to adjourn the meeting at 12:27 p.m.; Frank Mellon seconded the motion and the motion was unanimously approved.

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President

ATTEST: ____________________________
Secretary

7/18/2013