November, 2014 Special Meeting

POLICE AND FIREFIGHTERS' PENSION BOARD
SPECIAL BOARD MEETING
888 South Andrews Avenue, Suite 202
Fort Lauderdale, FL 33316
Monday November 10, 2014, 10:00 a.m.

Present
Michael Dew, Chair
Ken Rudominer, Vice Chair
Richard Fortunato, Secretary
Scott Bayne, Trustee
Dennis Hole, Trustee
Jim Naugle, Trustee (arrived 10:22)
Lynn Wenguer, Executive Director

Absent
Jeff Cameron, Trustee

Also Present
Amanda Cintron, Assistant Administrator
Laurie DeZayas, Pension Secretary
Jim Ingersoll, President of the Retirees' Association
Kevin Schmid, CapTrust
Stephen Schott, CapTrust
Paul DeBold, Retirees' Association
Sean Conroy, GCM Grosvenor
Craig Goldsmith, GCM Grosvenor
Gregg Hymowitz, Entrust
Kevin Manning, Entrust
Jack Farland, Entrust
Lisa Edmondson, Recording Secretary, Prototype Inc.

Communications to the City Communication
None.

Note: Items were discussed out of order.

ROLL CALL/CALL TO ORDER
Chair Dew called the meeting to order at 10:00 a.m., roll was called, and a quorum was determined to be present.

PLEDGE OF ALLEGIANCE/MOMENT OF SILENCE
The Pledge of Allegiance was followed by a moment of silence.

COMMENTS FROM PUBLIC:
None

ASSET ALLOCATION PORTFOLIO
Mr. Schmid distributed an Asset Allocation booklet.

Chair Dew had sent a letter on October 6 to CapTrust explaining some of his concerns regarding the asset allocation. Other public sector funds had better returns and Chair Dew wondered if the Board should reconsider their policy compared to their peers. He noted they were also paying a lot of fees for consistently losing money.

Chair Dew stated in a down market, they had lost as much as other funds, but they did not recover as much when the market was up.

Chair Dew looked at the objectives he had learned at the Wharton School of Portfolio Management Concepts and sent an email to Mr. Schmid and Mr. Schott asking them to address these objectives.

Mr. Schott stated they could create alternative asset allocation models if the Board wished. Their aim was to achieve their return goal with the least risk. Chair Dew stated retirees had not received a COLA since 2001 and with the current rate, they never would. In his investigations, Chair Dew had discovered that other plans consistently outperformed theirs by 3-4%. He questioned whether they had the right money managers, not necessarily the right allocation.

Mr. Schott pointed out that the plan was not originally set up to pay a COLA; this would require a different asset allocation. Mr. Schmid said the actuary rate of return helped determine the funding status. The problem with the COLA was they had a built up, cumulative actuarial loss. The objective they had set four years ago was to have an asset allocation that beat the actuarial rate of return with the least amount of risk.

Chair Dew was seeking money managers who could provide higher returns with the same amount of conservative risk. Mr. Schott stated "90% of the decision of getting there is going to be the asset allocation" regardless of the manager. Mr. Schmid explained that the current asset allocation had been designed to diversify the portfolio and not be dependent on any one particular risk, but over the past several years, diversification had not worked; equities had done dramatically better than other asset classes. The higher their return objective, the greater the probability was of beating 7.5% but the lows would be lower and the highs would be higher. Chair Dew was concerned they were not beating their own policy. Mr. Schmid said the alternative investments were difficult to benchmark and they were not keeping up with the 70/30 equity/bond blend he used for comparison.

Mr. Schott remarked this was an "all weather portfolio" and he felt they would be remiss to change the asset allocation now unless goals were changed. Mr. Schmid discussed the current asset allocation and alternatives and mentioned the additional risk that could be involved.

Mr. Hole appreciated Chair Dew's research and felt their anticipated rate of return was realistic. He wondered why they did not look at the managers they had not selected. Mr. Hole felt they were in a "long up market" and making changes now could come back to bite them.

Mr. Ingersoll noted the pension fund was a "thousand mile trip" and the plan indicated they could invest 70% in equities. The retirees were not asking for a drastic change in policy but he felt the risk bar had been set too low. Chair Dew reminded Mr. Ingersoll that the City was responsible to make up losses in the fund.

Mr. Schott explained that every pension fund was unique and different asset allocations were used depending on how much they were funded and what the liabilities were. Mr. Schmid referred to his comparisons and said if they concluded they wanted to increase exposure in equities, this should be done over time because valuations were not great right now. Comparing active management to indexes, he found that the difference over 10 years represented a 3 basis point fee savings if they invested entirely in index funds.

Mr. Bayne said he was not concerned about other plans' returns; they were not in a competition. Chair Dew remarked that their Sharpe Ratio and standard deviation was the same as other plans but others were making more, so perhaps they should look at what the other plans were doing, specifically regarding money managers. Mr. Rudominer felt they had become too risk averse since 2008, but noted that according to Mr. Schmid's comparison, tripling the risk would only increase the return by .8%.

Chair Dew confirmed with Board members that they were comfortable with the diversification. They also wanted CapTrust to evaluate managers and the Board could discuss this at their investment seminar. He felt they had missed opportunities and he wanted to stop playing catch-up.

Mr. Rudominer asked if an unconstrained bond fund was considered alternative and where the managers they were interviewing today fit into CapTrust's presentation. Mr. Schott provided an example of a bond fund that had suffered double-digit losses when things went wrong. He said they wanted to take the risk on equities, where they got paid for it. They also wanted more liquidity when they needed to get out. Mr. Schmid said these managers should perform well when things went haywire, and had a higher risk/higher return target.

Mr. Schott disclosed that he personally invested in EnTrust.

Mr. Schmid's intention was to fund today's alternative investment from existing alternative investments. They could also use some of the PIMCO funds.

INVESCO
Mr. Schmid explained that Mr. Cypen had reviewed Invesco's collective trust vehicle and Invesco was unwilling to provide the Board indemnification in the event the pension plan lost its qualified status, which Invesco believed could be catastrophic to their comingled trust. Invesco had been unwilling to accept Mr. Cypen's language or offer an acceptable modification. Mr. Schmid stated Invesco also offered a mutual fund, which was twice the fee of the collective trust vehicle. The mutual fund was similar in cost to GMO's mutual fund.
The Board took a brief break.

PRESENTATIONS
<u>Entrust</u> Gregg Hymowitz, Kevin Manning, Jack Farland
Mr. Hymowitz provided a booklet to Board members. He stated they had made a commitment to some institutional investors in 2008 that they would charge no fee on capital pledged for three years and they would not invest at all unless they found opportunities that could net the investors 20% IRR or better. The first fund had returned 18-19% IRR through 2011. In 2011 they had launched Fund II, which produced an IRR of 23-24% net of all fees. They were now working on Fund III, which would close in January.

Mr. Hymowitz stated they paid their managers an average of 57 basis points and the average performance fee was 10.5, but most current fee deals were 0 management fee and 10% upon distribution. He believed that in Fund III, the manager would actual pay the investors. Mr. Hymowitz explained that the reason they raised so much capital was because the more capital they had, the more deals they could source. More capital also allowed them more latitude when negotiating fees. He stated equity markets were up and leverage in the system was at an all-time high. They wanted to have capital available to take advantage of these opportunities.
Mr. Hymowitz said people always associated higher risk and higher return but he felt this was not always the case. Higher returns could be realized by making investments at cheaper prices. They had built this fund without taking significant risks.

Chair Dew asked how decisions were made and Mr. Hymowitz explained they had 24 analysts, each of whom had a specific role. There was also an investment committee comprising himself and two other firm partners. Investment decisions must be unanimous among committee members. Mr. Rudominer wondered when they would get paid on their alternative investments. Mr. Hymowitz felt it was all about expectations and he felt it was unfair to compare an alternative portfolio to the equity markets. The reason hedge funds were at peak assets was because many institutional investors felt that equity markets had been overvalued.

Chair Dew asked about indemnification and Mr. Hymowitz stated this would be structured exactly the same.

Ms. Wenguer asked what people did with the investment before the capital was called and Mr. Hymowitz explained that capital was called a few percent at a time and most investors left the funds invested elsewhere until it was called.

<u>GCM Grosvenor</u> Sean Conroy, Craig Goldsmith
Mr. Conroy distributed a booklet to Board members and described the company. Mr. Goldsmith stated currently, they had $10 billion invested in various credit strategies and more than half their investments were outside the United States. The Opportunistic Credit Fund 4 had an 18-month investment period and targeted 10-12% returns.

Mr. Schmid asked if Mr. Goldsmith anticipated calling 100% of the capital and Mr. Goldsmith said they felt very comfortable they would deploy $500 million out of a possible $1 billion. If they felt they could not hit the target return, they would expedite return of the money and accept no additional commitments.

Mr. Goldsmith said the opportunities did not require them to use a lot of leverage and had very low interest rates. One of their basic tenets was downside protection; in a bad market, this would protect principle. Mr. Goldsmith described the basics of the fund: $500 million to $1 billion; January 1, 2015 launch date; the structure was private equity style with an 18-month investment period; cash would be returned as they received distributions; fees only once capital was invested in the fund; the target return was 8% before any incentive fees. Investments were in three main areas: deleveraging of the financial sector, securities issued in 2005 through 2007 and emerging markets.

Mr. Conroy summarized the terms: a one-year commitment period and an 18-month investment period, followed by a 3.5-year harvest period, during which time investors would get money back on a quarterly basis. Certain investments could take longer than 3.5 years. Fees were 80 basis points on the first $25 million. The fee was only on invested capital.

Mr. Conroy stated they saw opportunity and then identified the best managers to exploit that opportunity. He informed Chair Dew that they currently had no Florida public sector clients in this fund. Chair Dew asked about indemnification and Mr. Conroy said this was a big issue in 2003 and they had built them into the contracts now. They were comfortable with the Florida State indemnification laws.

Mr. Rudominer felt this was as much a fixed income investment as an alternative one. Mr. Conroy explained there were different ways to look at it. It was not core or high yield fixed income but was very fixed income driven. He stated this was not a distributed product. Roughly half the return came from a coupon and half from appreciation.

<u>Presentation Recap</u>

Ms. Schmid stated Entrust had a much higher return target than Grosvenor and Entrust also had a longer commitment period. There could also be a longer call period for Entrust. Entrust's higher interest was commensurate with their higher risk/return target. He felt Entrust met more of the objectives they were trying to achieve. Mr. Schmid felt it would make sense to invest another $10-15 million with Entrust. He said they usually had enough cash available in fixed income when the investment call came. Mr. Schmid wished to target 5% of the plan to Entrust in their flagship and special opportunities funds.

Mr. Hole thought the management fees and incentive fees might balance out between Grosvenor and Entrust. Mr. Schmid noted there was also a difference in return targets so even though there was a 45 basis point difference in fees, there was the potential for 8% higher returns. Chair Dew recalled that Entrust had indicated that it was possible the fees could be cheaper depending on negotiations with managers.

Mr. Hole said Mr. Hymowitz had taken a group of his people to Las Vegas and a theme for the trip was that were investing for pensioners, which he appreciated.

Chair Dew wondered if $10 million was enough to invest and wanted to choose one of the funds. Mr. Rudominer felt they did not need to choose; they could invest in both.

Mr. Schmid reminded the Board that 15% of the plan was earmarked for alternative investments 5% had been in PIMCO, 5% was with Entrust and 5% with Lazard Global Infrastructure. He imagined this investment would come out of the higher-fee, less liquid portion of the portfolio. He agreed there might be some overlap in the types of investments made by Grosvenor and Entrust and he did not want to tie up so much of the alternative section in two similar investments.

Ms. Wenguer wanted to explore negotiating fees with Entrust but Chair Dew did not believe this was possible.

Motion made by Mr. Fortunato, seconded by Mr. Hole, to invest with Entrust, provided Mr. Cypen approved the contract. In a roll call vote, motion passed 6-0.

The Board discussed how much to invest.

Motion made by Mr. Fortunato, seconded by Mr. Hole, to invest 5% of the portfolio in the Entrust Special Opportunity Fund, with a maximum total of 7.5% with Entrust.

Chair Dew wanted to consider a total of 8%. Mr. Fortunato withdrew his motion.

Motion made by Mr. Naugle, seconded by Mr. Fortunato to invest $35 million in the Entrust Special Opportunity Fund, with a maximum of 8% of the portfolio invested with Entrust. In a roll call vote, motion passed 5-1 with Mr. Bayne opposed.

The Board discussed what to do with their PIMCO investment. Mr. Schmid recommended putting 70% in RhumbLine Large Cap and 30% in cash. Ms. Wenguer clarified these percentages would be $25 million in the RhumbLine S&P 500 index and $11 million in cash. Mr. Schmid advised that if they were not going to reallocate the PIMCO funds to another liquid alternate, he recommended putting the money to work.

Mr. Schmid recalled that they had considered PIMCO to be a tactical allocation vehicle. If the Board did not like any of the tactical allocation choices that had been presented to replace PIMCO, he suggested they look at the first section of his report, which included multi-sector/unconstrained bond funds. Mr. Hole wished to hear the entire report. Mr. Bayne wanted to consider a mutual fund.

Motion made by Mr. Hole, seconded by Mr. Bayne to invest $25 million in the RhumbLine S&P 500 and leave $11 million in cash. In a roll call vote, motion failed 3-3 with Mr. Fortunato, Mr. Bayne and Mr. Rudominer opposed.

Motion made by Mr. Bayne, seconded by Mr. Rudominer to move forward with the Invesco Mutual fund. In a roll call vote, motion failed 2-4 with Mr. Naugle, Mr. Fortunato, Mr. Hole and Chair Dew opposed.

Motion made by Mr. Rudominer, seconded by Mr. Hole to invest $25 million in the RhumbLine Large Cap Index Fund and leave $11 million in cash. In a roll call vote, motion passed 4-2 with Mr. Fortunato and Mr. Bayne opposed.

INVESTMENT SEMINAR SPEAKER

Ms. Wenguer stated there would be no speaker during dinner on Wednesday. Chair Dew asked that the speaker from Stranahan House giver her presentation during lunch.

There being no further business to come before the Board at this time, the meeting was adjourned at 2:25 p.m.

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