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FINANCE DIRECTOR



Sussex County

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PENSION FUND COMMITTEE

Minutes of Meeting

November 19, 2014

The Sussex County Pension Fund Committee met on November 19, 2014, at 10:00 a.m. in the County Council Chambers, Georgetown, Delaware. Those in attendance included members: Gina Jennings, Todd Lawson, Karen Brewington, Jeffrey James, David Baker, and Hugh Leahy. Also in attendance was Michael Shone of Peirce Park Group, the County's Investment Consultant. Committee member Kathleen Ryan was unable to attend.

On November 10, 2014, the Agenda for today's meeting was posted in the County's locked bulletin board located in the lobby of the County Administrative Office Building, as well as posted on the County's website.

Ms. Jennings called the meeting to order.

1. **Approval of Minutes**

The minutes of the August 21, 2014 meeting were approved by consent.

2. **Performance Reports of the Pension and OPEB Funds**

Mr. Shone provided copies of the "Sussex County Investment Performance Report – September 30, 2014", which included 2 subsections for the County's Pension and OPEB Funds, as well as an introductory section regarding the overall Market Environment for the third quarter of 2014. Also provided were a quarterly newsletter, "Peirce Park Perspective – Fall 2014", as well as a October 31, 2014 update on the OPEB Fund. Although the Investment Performance Report should be referenced for a more detailed analysis, highlights discussed include:

Market Environment – 3rd Quarter

- The U.S. economy rebounded in the second quarter of 2014, with the real Gross Domestic Product growth increasing at an annual rate of 4.6 percent;
- Unemployment rates continue to decline;
- Equity markets performed very well;
- The United States is the economic driver of the world, with some countries/regions going into recession;

- The County's Pension Plan ranked in the top one percent last year of all pension funds nationwide (out of approximately 200 funds), with the OPEB ranking in the top six percent for the third quarter;
- 10-year Government Bond yields have remained steady for the past year-and-a-half;
- U. S. Equities were up 7.0 percent year-to-date while International Equities were down 5.9 percent for the quarter and down 1.4 percent year-to-date. Emerging Market Equities were down 3.5 percent for the quarter and up 2.4 percent year-to-date;
- Large and mid-cap stocks all posted positive returns, with small cap posting very negative returns for the quarter after leading the market in 2013. DuPont Capital is the manager for large cap stocks for the County, with Fidelity managing mid-cap. Equities outperformed fixed income;
- International equities were negative for the year, or only slightly positive; and
- Long-term maturity Treasury Bonds (fixed income) outperformed those of shorter maturities. Fixed Income returns were up .2 percent year-to-date for short-term government bonds, 1.6 percent for intermediate, and 15 percent long-term.

Tab II – Pension Fund

- As of September 30, 2014, the ending market value of the Pension Fund was \$70.2 million and realized a third quarter loss of \$109,000 (net of all investment management fees), or -0.2 percent; a year-to date gain of \$4.27 million (net), or 6.1 percent;
- Very strong peer group rankings;
- The Pension Plan outperformed the policy index by almost 3 percent over the last year; Mr. Shone stated that this level of outperformance is unusually high relative to a plan's benchmark. All managers performed very well;
- The Plan added Vanguard Extended Market by transferring half of Fidelity's Low Priced Stock assets;
- Looking ahead/items to consider: GASB 67 and 68 implementation and a possible replacement for Fidelity Low Priced Stock;
- The ending market value of the Sussex County Pension Plan as of September 30, 2014 was \$70,246,309, which included DuPont Capital Investment - \$13,413,373, Fidelity Low Priced Stock - \$5,152,472; Operating Account - \$152,844; State of Delaware Investment Pool - \$44,303,564, Wilmington Trust Bonds - \$7,224,055, and Wilmington Trust Short Term - \$0;
- The County has a target asset allocation mix of 60 percent stocks and 40 percent bonds. As of September 30, 2014, Sussex County's Pension Asset Allocation included: State of Delaware – 63.1 percent; Cash – 0.2 percent; Domestic Fixed Income – 10.3 percent; and Domestic Equity – 26.4 percent;

- For the quarter, the Pension Fund ranked in the top three percent nationally; year-to-date in the top 2 percent; and in the top one percent for the year; and
- In the up markets, the County’s Pension Plan performs closely with the policy index. The County’s pension plan has also had very good protection in the down markets.

As a result of questions raised by Mr. James regarding Fidelity’s Low Priced Stock Fund, Ms. Jennings requested Mr. Shone to present Peirce Park’s review at this time. At the August 2014 meeting, the Committee asked Mr. Shone to present possible alternatives in replacing the Fidelity Low Priced Stock Fund. Committee members were provided with a report entitled, “Sussex County – Fidelity Replacement Search November 2014”. While the fund has done well, over the years it has drifted away from its original investment style (it holds a material amount in large cap stocks and non-U.S. stocks). Peirce Park recommends complementing current managers with an investment in U. S. mid-cap value stocks. More specifically, the report presents two options: (1) Vanguard Mid Cap Value Index and (2) Victory Established Value.

The below manager information was provided for Fidelity, DuPont and Vanguard as of September 30, 2014:

| | Fidelity Low-Priced Stock | Vanguard Mid Cap Value Index | Victory Established Value |
|-----------------------|---------------------------|------------------------------|---------------------------|
| Location | Boston, MA | Malvern, PA | Brooklyn, OH |
| Firm Inception | 1946 | 1975 | 1894 |
| Firm Assets (\$B) | 1,980 | 2,875 | 18 |
| Style | Fundamental, bottom-up | Index | Fundamental, bottom-up |
| Strategy Inception | 1990 | 2006 | 1983 |
| Strategy Assets (\$B) | 48.5 | 6.1 | 3.0 |
| Expense Ratios | .83 | .09 | .67 |
| Vehicle | Mutual Fund | Mutual Fund | Mutual Fund |
| Preferred Benchmark | Russell 2000 | CRSP U.S. Mid Cap Value | Russell Mid Cap Value |
| No. of Holdings | 916 | 205 | 70 |

Although a relatively new benchmark, Mr. Shone is comfortable with the use of the CRSP index.

Cumulative Returns Annualized (%) include:

| | Q3 | YTD | 1 Year | 5 Year | 7 Year |
|-----------------------|------|------|--------|--------|--------|
| Fidelity | -1.5 | 3.3 | 11.5 | 15.9 | 8.0 |
| Vanguard | -2.2 | 6.6 | 17.8 | 17.0 | 7.7 |
| Victory | -3.6 | 4.2 | 14.6 | 15.3 | 8.8 |
| Russell 2000 | -7.4 | -4.4 | 3.9 | 14.3 | 6.0 |
| CRSP Mid Cap Value | -2.3 | 6.6 | 17.9 | 17.7 | 7.7 |
| Russell Mid Cap Value | -2.6 | 8.2 | 17.5 | 17.2 | 7.3 |

Mr. Shone advised that a manager should not be selected based only on best performance.

Yearly Returns (%) include:

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|-----------------------|-------|------|------|------|------|------|
| Fidelity | -36.2 | 39.1 | 20.7 | -0.1 | 18.5 | 34.3 |
| Vanguard | 36.5 | 37.7 | 21.8 | -0.3 | 16.0 | 37.3 |
| Victory | -29.1 | 34.2 | 21.5 | 0.5 | 12.5 | 34.9 |
| Russell 2000 | -33.8 | 27.2 | 26.9 | -4.2 | 16.3 | 38.8 |
| CRSP Mid Cap Value | -37.9 | 35.2 | 24.6 | -0.4 | 17.9 | 37.4 |
| Russell Mid Cap Value | -38.4 | 34.2 | 24.8 | -1.4 | 18.5 | 33.5 |

While Vanguard had the best performance in 2013, Victory performed better in the down market of 2008.

In reference to the Up/Down Market Participation, Mr. Shone stated that Vanguard performed slightly better than the benchmarks in the down markets, while Victory and Fidelity had similar performance in up markets – although Victory offered more protection in down markets. In the context of the County’s overall portfolio, Mr. Shone noted that possible considerations for the Committee include who would provide more protection in down markets or who would have better performance in the up markets.

Pros and Cons include:

| | PROS | CONS |
|----------|---|---|
| Fidelity | Solid Long Term Track Record Mutual Fund Vehicle | Extremely Large Fund Many Off-Benchmark Holdings Tracking Error |
| Vanguard | Very Inexpensive Approach Mutual Fund Vehicle | Less Downside Protection |
| Victory | Solid Long-Term Track Record More Downside Protection Mutual Fund Vehicle | More Expensive Tracking Error |

Mr. Leahy questioned if there were any holdings of concern for either Vanguard or Victory. Mr. Shone noted the number of holdings should be taken into consideration, with a preferred methodology that would offer a little more protection in the down markets. The Committee also considered expense ratios, the fact that the plan is already very well protected in the down markets, price earnings ratios, and indexing. Ms. Jennings and Mr. Leahy noted their slight preference toward Vanguard.

A Motion was made by Mr. James, seconded by Mr. Leahy, that the Sussex County Pension Fund Committee recommend to the Sussex County Council to transfer all funds out of the Fidelity Low Priced Stock Fund to the Vanguard Mid Cap Value Index Fund.

Motion Adopted: 6 Yea.

Vote by Roll Call: Mr. James, Yea; Ms. Brewington, Yea; Mr. Lawson, Yea,
Mr. Leahy, Yea; Mr. Baker, Yea; Ms. Jennings, Yea

Mr. Shone continued with the Performance Report for the OPEB Plan.

Tab III – OPEB

- As of September 30, 2014, the ending market value of the OPEB Fund was \$29.8 million and realized a third quarter loss of \$193,800 (net of all investment management fees), or -0.6 percent; a year-to date gain of \$1.0 million (net), or 3.5 percent. The OPEB Plan outperformed its benchmark by 15 basis points, which put the plan in the top 6 percent in the InvestorForce Universe for the past quarter;
- Looking ahead/items to consider: Fund changes/consolidation, consider Consulting Plus, and GASB Exposure Draft. Mr. Shone noted that he felt that the County's OPEB Plan is one of the best funded nationwide;
- As of September 30, 2014, the Sussex County's OPEB Asset Allocation are all within the ranges contained in the Investment Policy State and include: Domestic Equity – 45.1 percent; Global Equity – 3.5 percent; International Equity – 11.9 percent; and Domestic Fixed Equity – 39.6 percent.
- For the quarter, the OPEB Plan ranked in the top six percent nationally, a year-to-date return of 3.5 percent (71st percentile); one year return of 9.2 percent (49th percentile), and two year return of 10.3 percent (54th percentile); and
- Mr. Shone referred members to a separate one-page handout, "Sussex County OEPB Trust – Total Fund as of October 31, 2014". For the period February 1, 2014 to October 31, 2014, the OPEB Fund realized a 7.8 percent return, with an ending market value of \$30,046,536. The one month return was 1.8 percent and year-to-date 5.4 percent.

3. **Update on Peirce Park's Performance to Weekly Monitor OPEB Fund**

At the November 2013 meeting, the Committee voted to enter into a temporary agreement with Peirce Park Group – fees deferred for 6 months to a year – for their weekly review of the OPEB Fund with the intent to realize improved performance. At the end of the trial period, if the County determined the services to be worthwhile, Peirce Park would receive compensation for their additional consultant services. Mr. Shone provided copies of "Sussex OPEB – Consulting Plus Review November 2014". Consulting Plus included the following additional services:

- (a) Portfolio structure and implementation
 - (i) Swift manager changes based on most recent information
 - (ii) Rapid implementation of Peirce Park Group best ideas (current projects include real estate and fixed income)
- (b) Disciplined portfolio rebalancing
 - (i) Maintain adequate exposure to asset classes
 - (ii) Implement immediate adjustments if necessary
- (c) Weekly portfolio review
 - (i) Assess cash needs
 - (ii) Evaluate manager performance

Prior to Consulting Plus (January 2014), review was provided quarterly, ad hoc portfolio rebalancing, and slower implementation with less than optimum portfolio structure (performance lagged policy index).

Before Consulting Plus, annualized returns for the OPEB Plan were 6.0 percent, with a policy index of 9.0 percent. After Consulting Plus, annualized returns were 5.6 for both the OPEB Fund and the policy index.

At the beginning, Consulting Plus may have increased the value of the OPEB portfolio by approximately \$2.5 million, improved risk-adjusted returns, lessened administrative burdens, and maintained investment continuity. The report included a review of portfolio changes and possible next step options.

Peirce Park had originally quoted a price of 10 basis points (\$30,000) for the Consulting Plus Services. After discussion with his partner, Mr. Shone stated that the fee would now be 7 basis points, or \$20,000.

Ms. Jennings stated that the additional services, specifically noting the weekly reports and more responsive rebalancing, had been very helpful and recommended compensating Peirce Park Group for the Consulting Plus services provided during 2014. She noted that the County was now on a good path and the plan was well balanced. As a result, she recommended that the County not continue with Consulting Plus Services for 2015, but closely monitor the fund's performance with the option to renew services at a future time.

A Motion was made by Mr. Leahy, seconded by Mr. James, that the Sussex County Pension Fund Committee recommend to the Sussex County Council to discontinue the Consulting Plus Services and to compensate Peirce Park Group 7 basis points, approximately \$20,000, for Consulting Plus Services provided in 2014.

Motion Adopted: 6 Yea.

Vote by Roll Call: Mr. James, Yea; Ms. Brewington, Yea; Mr. Lawson, Yea;
Mr. Leahy, Yea; Mr. Baker, Yea; Ms. Jennings, Yea

4. **OPEB Portfolio Options**

For prior review, members were emailed a report entitled "Sussex OPEB – Portfolio Options November 2014" prepared by Peirce Park Group; hard copies were distributed. The Committee had requested Mr. Shone to prepare the report to assist in deciding whether the equity target should remain at 60 percent, style targets, number of managers in the portfolio, large cap equity manager – DuPont or Vanguard, as well as a possible change to the traditional consulting services provided by Peirce Park.

As background, Mr. Shone noted:

- (1) Sussex County recently lowered the OPEB assumed rate of return from 8 percent to 7.5 percent;
- (2) Given the fixed income environment, could the current asset mix meet a 7.5 percent assumed rate of return;

- (3) The investment committee expressed a desire to condense the OPEB investment manager lineup; and
- (4) The report reviews various options that the County could consider, such as equity target, style/cap tilts, large cap equity manager (DuPont or Vanguard), and the number of managers.

Several points that the Committee now needs to consider include: the percentage allocation to equities, equity capitalization and style targets, number of managers in the portfolio, and the possible decision to select DuPont or Vanguard as the large cap equity manager.

Although the report should be referenced for a more detailed analysis, following is a brief summary of the information presented:

Asset Class Returns include:

| | 75 Year | 20 Year | 10 Year | 5 Year |
|----------------------------|---------|---------|---------|--------|
| U. S. Stocks | 10.9 | 9.2 | 7.4 | 17.9 |
| Non-U.S. Developed Stocks | - | 5.7 | 6.9 | 12.4 |
| All non-U.S. Stocks | - | 6.3 | 8.0 | 13.3 |
| Bonds (Intermediate Gov't) | 5.4 | 5.4 | 4.4 | 2.9 |
| Inflation | 3.8 | 2.4 | 2.4 | 2.1 |

Over a 75 year period, stocks have outperformed bonds by approximately 5 percentage points a year, 10.9 versus 5.4. Stocks have outperformed inflation by 7 percent and bonds by approximately 1.5 percent. During the last 5 years, stocks have outperformed bonds by approximately 15 percent, 17.9 percent versus 2.9. Bonds typically perform approximately 2 percent above inflation.

Ms. Jennings reported that the County auditors were pleased with the 7.5 percent assumed rate of return for the Pension Plan, but would like the County to consider possibly lowering this same rate of return for the OPEB Plan and/or an increasing the equity target to 65 percent.

With the current equity target of 60 percent, the portfolio realized a return of \$135,046,548 from 1994 to 2013. Using a 65 percent equity target, it was estimated that the OPEB Plan would have realized a return \$139,582,602 over the past 20 years, or an increase of \$4.5 million.

Mr. Shone explained that with a 5 percent equity target increase (65 percent) and in the worst equity market year (2008), a plan would have lost an additional two percentage points; this extra loss would have increased the County's contribution by approximately \$80,000 per year. The question to be considered is whether the Plan could tolerate a potential increase in contributions, given the higher expected return.

Historically, implementing tilts toward mid cap and value stocks in an equity portfolio has been beneficial over the long-term by increasing the return at a lower level of

volatility. Mid cap stocks have generated earnings at a much higher rate than their large and small-cap counterparts, leading to their historical outperformance.

Manager Information as of September 30, 2014 include:

| | DuPont Large Cap Structured Equity | Vanguard Institutional Index |
|--|---|------------------------------|
| Location | Wilmington, DE | Malvern, PA |
| Firm Inception | 1975 | 1975 |
| Firm Assets (\$B) | 37 | 2,875 |
| Style | Quantitative and Fundamental, bottom-up | Index |
| Strategy Inception | 1994 | 1976 |
| Strategy Assets (\$B) | 0.7 | 354 |
| Fees (expense ratios for mutual funds) | .35% | .04% |
| Vehicle | Separate Account | Mutual Fund |
| Preferred Benchmark | S & P 500 | S & P 500 |
| No. of Holdings | 162 | 510 |

Mr. Shone noted that the fee charged by DuPont – 35 basis points – for a portfolio of its size, is very fairly priced.

Cumulative Returns Annualized (%) include:

| | Q3 | YTD | 1 Year | 5 Year | 7 Year |
|-----------|-----|------|--------|--------|--------|
| DuPont | 1.5 | 10.1 | 22.5 | 15.9 | 6.0 |
| Vanguard | 1.1 | 8.3 | 19.7 | 15.7 | 6.0 |
| S & P 500 | 1.1 | 8.3 | 19.7 | 15.7 | 6.0 |

DuPont and Vanguard both realized returns of 6 percent over the last 7 years.

Yearly Returns (%) include:

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|-----------|-------|------|------|------|------|------|
| DuPont | -36.9 | 25.1 | 11.1 | 4.8 | 15.1 | 33.5 |
| Vanguard | -37.0 | 26.6 | 15.1 | 2.1 | 16.0 | 32.4 |
| S & P 500 | -37.0 | 26.5 | 15.1 | 2.1 | 16.0 | 32.4 |

Given their similar performance, Mr. Shone noted that Peirce Park did not have a preference as to the selection of Vanguard or DuPont.

Pros and Cons include:

| | PROS | CONS |
|------------------------------------|--|-------------------------------|
| DuPont Large Cap Structured Equity | Long-term track record Manage U.S. Equities for County Pension | Benchmark-like performance |
| Vanguard Institutional Index | Very inexpensive approach Mutual Fund Vehicle | No value tilt |

Mr. Shone reviewed the new manager summary for MFS Low Volatility Global Equity.

The Committee also discussed splitting funds between Vanguard and DuPont, the portfolio size (dollar amount) DuPont would be willing to manage, modeling the 65%-v1 (DuPont) and 65%-v2 (Vanguard) for a quarter with a decision to be made at a later date, and the possibility of selecting Vanguard while modeling DuPont to determine if a future switch may be warranted. Taking into consideration concerns expressed by the County's auditors and reporting methods, Ms. Jennings stated her preference to increase the OPEB equity target allocation to 65 percent.

A Motion was made by Mr. Leahy, seconded by Mr. James, that the Sussex County Pension Fund Committee recommend to the Sussex County Council to modify the OPEB Investment Policy Statement to reflect a 65 percent equity target and to adopt the 65V2 (Vanguard) implementation strategy while monitoring DuPont's performance and clarifying whether they would accept a \$5 million portfolio.

Motion Adopted: 6 Yea.

Vote by Roll Call: Mr. James, Yea; Ms. Brewington, Yea; Mr. Lawson, Yea;
Mr. Leahy, Yea; Mr. Baker, Yea; Ms. Jennings, Yea

Ms. Jennings thanked Mr. Shone for his time and presentation.

5. **2015 Meeting Dates**

Ms. Jennings announced the quarterly meetings for 2015:

February 26, 2015
May 21, 2015
August 20, 2015
November 19, 2015

All meetings begin at 10:00 a.m. and are held in the Sussex County Council Chambers.

6. **Additional Business**

(a) Mr. Leahy expressed concern regarding the actuarial methods used for municipal and governmental plans and any possible shortcomings there may be when compared to corporate pension plans. He also questioned the possible repercussions of the County's long-term strategies as it relates to maintaining compliance with actuarial standards, which could change dramatically in the future. In their report, Ms. Jennings noted that the actuary will discuss both reporting and funding methods.

(b) Mr. Baker inquired if Wilmington Trust held the securities. Ms. Jennings noted that Wilmington Trust is the custodian for the OPEB and Trustee for the Pension Plan. The County is currently working with Wilmington Trust to have them act as Custodians for both funds. Mr. Shone noted that Wilmington Trust charges 7 basis points for the Pension Plan and 4 basis points on the OPEB Fund.

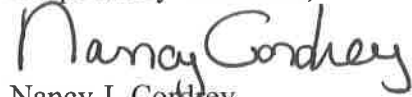
It should be noted that Ms. Jennings intends to bring the Committee's recommendations to Council at their December 16, 2014 meeting, with Mr. Shone in attendance.

7. **Adjourn**

At 11:46 a.m., a Motion was made by Mr. Leahy, seconded by Mr. James, to adjourn.
Motion Adopted: 6 Yea.

Vote by Roll Call: Mr. James, Yea; Ms. Brewington, Yea; Mr. Lawson, Yea;
Mr. Leahy, Yea; Mr. Baker, Yea; Ms. Jennings, Yea

Respectfully submitted,



Nancy J. Cordrey
Administrative Secretary