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PENSION FUND COMMITTEE

Minutes of Meeting

August 15, 2019

The Sussex County Pension Fund Committee met on August 15, 2019 at 10:00 a.m. in the County Council Chambers, Georgetown, Delaware. Those in attendance included members: Gina Jennings, Karen Brewington, David Baker, Hugh Leahy, and Kathleen Ryan. Also in attendance were Michael Shone of Marquette Associates, the County's Pension Investment Consultant, as well as David Craik, Pension Administrator for the State's Pension Plan. Committee members Todd Lawson and Kathy Roth were unable to attend.

On August 7, 2019, the Agenda for today's meeting was posted in the County's locked bulletin board located in the lobby of the County Administrative Offices, as well as posted on the County's website.

Ms. Jennings called the meeting to order.

1. **Approval of Minutes**

The minutes of the May 16, 2019 meeting were approved by consent.

2. **State of Delaware Pension Presentation**

Mr. David Craik, Pension Administrator for the State's Pension Plan, was in attendance to discuss the State's portfolio. Questions were provided Mr. Craik prior to today's meeting by Mr. Shone. Mr. Craik noted that the State has their own investment advisor and is 100 percent externally managed for investments. Because Mr. Craik followed very closely to his written presentation, his information is not repeated here, but is attached.

Regarding the private equity program, its performance for 2019 was 15.5 percent; since inception (1982) – 15.8 percent. The State has made the decision to decrease their private equity program from 20 percent to 15, which will occur over an approximate 10-year period.

After Mr. Craik's presentation, a question and answer period followed. Topics included fees, equity managers, the State's IPS allocation for fixed income of 42 percent vs. the actual allocation of 34 percent, as well as the State's overall underperformance.

Ms. Jennings thanked Mr. Craik for his presentation.



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

Mr. Shone distributed copies of a report entitled, “Sussex County Quarterly Performance Report as of June 30, 2019”. The report includes information regarding the market environment for the second quarter of 2019, as well as quarterly and annual performances of the Pension and OPEB Plans; the report should be referenced for a detailed analysis.

Mr. Shone referred members to Exhibit II – Market Environment. Mr. Shone noted the recent volatility in the stock market, as well as his concern.

The Real GDP Growth has been positive for several years at approximately 2.5 percent; more recent expectations were 2.1 percent, but this may decrease to 1.8 percent for the second quarter. The U. S. economy is slightly less impacted by overall global trade. With the slowing of the economy, the Feds recently cut interest rates by a ¼ percent, with an additional cut expected by the end of the year. U.S. equity returns for the second quarter were 18.7 percent, and growth stocks outperformed value for the quarter as well.

Mr. Shone directed members to Exhibit III – Sussex County Employee Pension Plan.

Observations:

- As of June 30, 2019, the ending market value of the Pension Plan was \$111.7 million;
- Second quarter gain of \$3.5 million, returning 3.2 percent (vs. 3.5 percent policy index);
- Year-to-date investment gain of \$10.9 million, returning 10.7 percent (vs. 13.2 benchmark);
- 1-year investment gain of \$6.9 million, returning 6.7 percent;
- Positive attribution (exceeding benchmark) for the quarter from Schroder Global Multi-Cap Quality Trust; and
- Negative attribution for the quarter from the State of Delaware Investment Pool

Looking ahead:

- No recommended changes (with exception of rebalancing)

Mr. Shone commented on several positive points as to what Sussex County does well including increased contributions over what is required by the actuary, lowering the return assumption to 7 percent, as well as the County’s recent AAA rating.

Performance-wise, Mr. Shone recommended that the overall asset allocation mix be evaluated due to lower than expected returns as a result of the recent downturn in the economy.

The investment management fees for the Pension Fund are 33 basis points, which are lower than average, cost-wise.

Mr. Shone referred members to Exhibit IV - Sussex Post-Employment Benefit Plan.

As of June 30, 2019, the ending market value of the OPEB Plan was \$46.2 million, returning 3.3 percent, year-to-date return of 12.4 percent, and a 6.8 percent return for one-year. Positive attribution for the quarter was realized as a result of the Artisan Global Opportunities Fund, with negative attribution from MFS Low Volatility Global Equity. Looking ahead, portfolio rebalancing considerations are recommended.

The investment management fees for the OPEB Fund are 22 basis points, which are the lowest of Marquette's clients.

Committee members were referred to two separate portfolio updates for the Pension and OPEB Plans as of July 31, 2019. As of July 31, 2019, the Pension Fund was up 0.4 percent versus a policy index of 0.5; year-to-date: up 11.2 percent vs. benchmark of 13.8, with an ending market value of \$112.2 million. The OPEB Fund was up .05 percent, with an overall year-to-date increase of 13 percent.

Mr. Shone reviewed a chart regarding possible rebalancing of the additional \$5,000,000 contribution to the Pension Plan. Ms. Jennings also noted that she would like consideration to be given of possibly moving funds from the State of Delaware due to cost and performance. It was the consensus that this be reviewed during next quarter's meeting in November. For today's rebalancing, it was recommended that it be based on dollar amount, not percentages.

Mr. Baker entered the meeting at 10:45 a.m.

A Motion was made by Mr. Leahy, seconded by Ms. Ryan, to recommend to the Sussex County Council to approve the rebalancing of the Pension Fund portfolio based on the proposal from Marquette Associates, as outlined in the rebalancing column of the table presented, including Vanguard S&P 500 Index Adm (\$1,650,000), Vanguard Mid Cap Value Index (\$800,000), Vanguard Extended Market Index (\$800,000), Vanguard Total Int'l Stock Index I (\$1,000,000), and Wilmington Trust Fixed Income (\$750,000).

Motion Adopted: 4 Yeas; 1 Abstention

Vote by Roll Call: Ms. Brewington, Yea; Mr. Leahy, Yea;
Ms. Ryan, Yea; Ms. Jennings, Yea
Mr. Baker, Abstained

Mr. Baker abstained from voting due to not being in attendance for the presentation and discussion of the Pension Plan rebalancing.

Mr. Shone briefly reviewed a separate chart regarding the possible rebalancing of the OPEB Plan; no rebalancing was recommended.

4. **Asset Allocation Study**

Committee members were provided with copies of a document entitled, "Sussex County – Is Your Portfolio Prepared for the Road Ahead?", i.e., are the County's allocations sufficient to realize a 7 percent assumed rate of return. Mr. Shone reviewed several questions to consider in making this determination.

Additional information presented and discussed included:

- Inflation;
- Core Fixed Income: Yields and Returns (interest rates and bond returns have significantly decreased over past 40 years; real interest rates – inflation adjusted – have also significantly decreased; and interest rates are very good predictor for intermediate term returns);
- U.S. Equity Valuations – (higher valuations lead to lower returns, low valuations lead to her returns, and current above-average valuations imply below-average returns over next ten years);
- Building Block Returns: Historical & Projected (U.S. Equities and Non-U.S. Equities);
- What to Expect (lower than historical nominal and real – inflation adjusted – returns for next 10 years (intermediate term) including low inflation, low interest rates and high equity valuations; lower than historical nominal returns in years 11-30 (long-term); and possible increased County contributions due to low return environment);
- Outlook – What Can You Do? (Asset allocation to hit 7.5 percent today is much more aggressive – requires 55 percent increase in volatility); and
- Sussex County Asset Allocation Options were presented for both the Pension and OPEB Funds

Mr. Shone noted that possible solutions include: making no changes, lowering return assumption, changing asset allocation mix, or a combination of changing the asset allocation mix and lowering return assumption.

In the discussion to realize higher returns (outside of the typical stocks and bonds), in-depth discussion centered on the possible addition of ‘Real Estate’ to the County’s portfolio as an additional asset class. As an education piece, it was recommended by Mr. Shone and agreed to by the Committee for two firms to make presentations at November’s meeting. Mr. Shone will make these arrangements, as well as make recommendation as to diversification options if monies invested with the State are lowered. Ms. Jennings expressed concern regarding lowering the rate of return below 7 percent.

5. **Rebalance Pension Fund with Additional Contribution & Marquette Associates**
& **Service Proposals**

6.

There was a blending of discussion for agenda items 5 and 6. It should be noted that discussion was held during May’s meeting regarding rebalancing and the ability of the Committee to respond if market conditions warranted. It was noted that the County, a few years ago, entered into an agreement with Peirce Park to increase services to manage the OPEB Plan with the intent for better performance. At May’s meeting, Ms. Jennings stated that she would talk with Mr. Shone to determine if these services were needed and any additional costs involved.

Committee members were presented with a document entitled “Sussex County – Portfolio Rebalancing, August 2019”. It was explained that rebalancing is the movement of assets from one asset class to another to maintain strategic asset

allocation, not tactical market timing. Mr. Shone also discussed why rebalancing should be done (maintain risk/reward profile), the methods used (calendar based or deviation from policy target), how often it should occur, and who is responsible for implementation. In determining if rebalancing added value, Marquette compared the actual OPEB return vs. the portfolio asset class weighted average return, both on quarterly and monthly returns, as well as asset allocation efforts.

Information reviewed included an analysis (quarterly) of actual returns, weighted average return, and drift, and how to determine if rebalancing would be beneficial (compare alpha to costs). Marquette's service proposal would provide weekly rebalance sheets, review relative to rebalance policy, rebalance when outside of policy, communicate with Wilmington Trust, as well as with the County's Finance Director; possible issues would include having to develop a rebalancing policy and how to handle State impact on Pension Fund (use policy on the remaining 60 percent or consider State to be static allocation equal to their policy).

The estimated cost for Marquette to provide these additional services would be one-and-a-half basis points for each fund, or a total cost of approximately \$25,000 annually.

At the end of Mr. Shone's presentation, Mr. Leahy brought up questions regarding the document entitled "Rebalancing Position Paper – December 2018".

Ms. Jennings noted that she will place Marquette's Service Proposal on the agenda for further discussion at next quarter's meeting.

7. **Additional Business**

- Mr. Leahy questioned the method of presentation by Mr. Craik, i.e. no written documentation for the Committee's review. Ms. Jennings noted that Mr. Craik was provided a list of questions, but she will reach out to him and request some type of written format of today's presentation; and
- Ms. Jennings stated that the County had recently received a AAA bond rating and thanked the Committee for its support in this effort

8. **Adjourn**

At 11:46 a.m., a Motion was made by Ms. Ryan, seconded by Mr. Leahy, to adjourn. Motion Adopted by Voice Vote.

The next meeting of the Pension Committee is scheduled for November 21, 2019, at 10:00 a.m. in the Sussex County Council Chambers.

Respectfully submitted,

Nancy J. Cordrey
Administrative Secretary