

# TUCSON SUPPLEMENTAL RETIREMENT SYSTEM BOARD OF TRUSTEES

Regular Meeting Minutes-Thursdays, April 24<sup>th</sup>, 2014  
Finance Department Conference Room, 5<sup>th</sup> floor East  
City Hall, 255 West Alameda  
Tucson, Arizona 85701

Members Present: John O'Hare, Elected Retiree Representative  
Silvia Amparano, Director of Finance  
Karen Tenace, Elected Representative  
Eric Kay, Elected Representative  
Curry Hale, Human Resources Director - Interim

Staff Present: Amanda Celaya-Brown, Administrative Assistant  
Michael Hermanson, Pension Administrator  
Michael Jesse, Lead Management Analyst  
Dave Deibel, Deputy City Attorney  
Allan Bentkowski, Treasury Finance Manager  
Kelly Gottschalk, Assistant City Manager  
Silvia Navarro, Treasury Administrator  
David Roels, Senior Accountant

Guests Present: Jenefer Carlin, Retiree Representative  
Maree Mitchell, Aberdeen  
Nancy Weisel, Aberdeen

Absent/Excused: Robert Fleming, Chairman  
Kevin Larson, CM Appointee

A. Call to order- Acting Chair, Karen Tenace called the meeting to order at 8:30AM.

## B. Consent Agenda

1. Approval of March 27<sup>th</sup> Board Meeting Minutes
2. Retirement ratifications for the month of April 2014
3. March 2014 TSRS expenses

**Motion** to approve consent agenda made by Eric Kay, 2<sup>nd</sup> Silvia Amparano, **motion approved 5-0** (Robert Fleming and Kevin Larson absent).

## C. Disability Retirement Application – Antonio M. Felix

Before discussing this application, Mike Hermanson provided information he had printed from the Social Security website to help Board members understand how SSI defines disability, and showing that initial approval rates during 2010 were 35%, and averaged around 20% approval at reconsideration. Mike thought it was important for Board members to have this background as they consider adding Social Security disability award letters as evidence of disability from our applicants. **Motion** to deny Antonio Felix's disability application made by Eric Kay, 2<sup>nd</sup> by Curry Hale, **motion passed 4-1** with a nay vote by John O'Hare. (Robert Fleming and Kevin Larson absent).

## Investment Activity Report

1. Annual Investment Manager Review – Aberdeen

2. Staff and Callan Associates Questions for Aberdeen. Karen Tenace informed representatives from Aberdeen the Board would like responses to these questions first during their presentation, and they would have about 30 minutes time allotted for both presentation and answering questions.

(1) *What is the investment philosophy of the EAFE Plus strategy and how is it implemented?*

A: We are bottom up investors and do our own internal research and analysis of companies. On a bi-weekly basis the global team have a conference call with each of the regional teams to hear about which companies the regional teams have met with, what they have been doing in their portfolios and any company results that have been published in the prior two weeks. In addition they are on the regional teams e-mail groups and have full access to all company notes and team notes that are posted on our internal data base. The global team can buy any of the 280 stocks but if the regional team sells a stock from their regional portfolio they have 30 days to sell the stock from the international portfolio, if they hold it, as in effect it comes out of the "buy list".

(2) *Please describe any changes to the portfolio managers and research team for the strategy. How do they interact and what is the process to include a stock in the portfolio? To sell a stock?*

A: Sadly one of our senior investment managers from the Global Equity Team, Andrew McMeningall, died in a tragic accident in July of last year during a sponsored bicycle run. At Aberdeen we are very much team based so no manager has sole responsibility for any sector or country within the Global team. Although he is very sadly missed the team manages the portfolios in the same way they did before his departure. We are looking to transfer a senior member of one of our other equity teams to the global team later this year as he is Scottish and wants to move back to Edinburgh for family reasons from London.

In regards to how a stock gets into the portfolio it is as a result of the additional analysis they do on the 280 stocks in the "buy list". However we have very low turnover in the portfolio so we would only sell a stock if there were was deterioration in the quality or the valuation of the stock.

(3) *Please explain the most significant reasons for the recent underperformance cycle.*

A: Last year markets very much driven by macro news rather than corporate fundamentals which made it a difficult environment for bottom up stock pickers like ourselves. On the whole the earnings from our underlying stocks came in line with our expectations but the stock prices did not keep up with some other stocks we did not hold in the likes of Europe and Japan. These stocks that rallied were, we believe, lower quality, higher beta stocks that rallied on hope that things are getting better in Europe and Japan and certainly not on the back of the underlying earnings of those particular companies. So not holding any of the Italian or Spanish banks, Japanese financials or automakers hurt our relative performance. As did not owning any consumer discretionary stocks which again rallied on hope rather than on fundamentals.

(4) *In what type of market environment would you expect the strategy to outperform/underperform?*

A: In momentum driven markets when any old stock is rallying and quality is ignored we will tend to underperform. When we outperform the most is when markets are falling, especially significantly like in 2008 and 2011, the quality stocks tend to hold up better and we tend to outperform. So we say we participate on the upside and protect on the downside.

(a) *When and why do you expect EAFE Plus to reverse the trend of underperformance?*

A: We have outperformed in Q1 as well as month to date in April, so YTD to close on April 23<sup>rd</sup> we are about 330 basis points ahead of the index. Many of the stocks which rallied last year, that we did not hold, sold off in Q1. In addition we have had some decent earnings results from several of our companies and their share prices have jumped on the positive news.

(5) *What is the current level of assets under management in the strategy? What have been the gross inflows and the gross outflows from EAFE Plus since January 1, 2012?*

A: As at the end of Feb 2014 our EAFE Plus assets globally were \$8.7bn. Total Global Equity assets were \$38.8bn. Inflows into EAFE Plus were \$1.596bn. Outflows were \$1.254 bn so net \$342 million inflows since 1 January 2012 to end Feb 2014.

(6) *What do you believe is a reasonable time period to evaluate the strategy's performance?*

A: We aim to outperform by 3% per annum over a 3 year rolling period so I believe 3 years is a reasonable time period to evaluate the strategy's performance.

3. TSRS Portfolio composition, transactions and performance review

Allan Bentkowski stated as of March 31, 2014 the fund was at \$713.1M compared to the net asset value as of February 28, 2014, which was \$715.7M. As of April 23, 2014, the fund was at \$711.5M. All asset classes and investment managers are within their policy allocation ranges.

Activity: Transferred out \$2.5M from the T. Rowe Price account at BNY Mellon to The City of Tucson investment pool account to cover the monthly shortfall in Fund 072 with respect retiree pension payments.

Performance: Review of Monthly returns for March, Total Fund returns were at -0.01% vs. the Custom Plan Index at 0.51%. Total Fixed Income returned -0.06% vs. -0.17% for the Barclays Aggregate Index; Total Equities returned -0.18% vs 0.32% for the Equity Composite Index; Real Estate returned 2.18% vs. the NCREIF-ODCE index at 2.47% (for the quarter ending March 31, 2014); Total Infrastructure returned 1.02% vs. .97% for the CPI+4% benchmark.

Highlights for specific managers for the month: Aberdeen returned 2.22% vs. 0.26% for the MSCI All Country World ex- U.S. (net) Index and T. Rowe Price was down -4.65% vs. -1.01% for the Russell 1000 Growth Index. Several macro-economic and stock selection factors contributed to this month's decline: The crisis in Ukraine, uncertainty about the Chinese economy, evolving Fed Policy, questions about drug pricing. Stocks in the portfolio underperforming in March: Google, Baidu, Workday, Priceline.com, Amazon.com, D.R. Horton, Gilead Sciences, Alex Pharmaceuticals, Biogen Idec.

Calendar YTD returns – (March 31, 2014) Total Fund returned 1.83% vs. 1.80%; Total Fixed returned 2.35% vs. 1.84% for the Barclays Aggregate; Total Equities posted a 1.49% gain vs 1.68% for Equity Composite; Total Real Estate returned 2.18% vs. 2.47% for NCREIF-ODCE; Total Infrastructure posted a 3.36% return vs. 2.39% for CPI+4%.

Fiscal YTD returns – (through March 31, 2014), Total Fund returned 14.76% vs. 12.63% for the Custom Plan Index. Total Fixed returned 4.10% vs. 2.29% for Barclays Aggregate; Total Equities posted a 20.16% return vs. 18.89% for the Equity Composite Index; 6 of 8 equity managers are at or above their respective benchmarks. Champlain and Aberdeen are lagging their respective benchmarks through March 31, 2014. Total Real Estate posted an 8.71% return vs. 9.48% for the benchmark; Total Infrastructure returned 9.58% vs. 4.21% for the benchmark.

#### D. Administrative Discussions

1. Mayor and Council consideration of recommended TSRS Contribution rates for FY15

Mike Hermanson reported that Mayor and Council approved the Board's recommended contribution rates approved on the May 8 consent agenda without further discussion. The recommendation set FY15 Employer contribution rates at 27.5% for all tiers, and set variable employee contribution rates at 6.75% and 5.50% for Tier I and II respectively.

2. Comparison of Arizona Pension Plan Actuarial Assumptions, Funding Rates, Funded Ratios

Included in Board materials for today is a chart that summarizes current Arizona pension system actuarial assumptions and funding data that Mike Hermanson compiled while researching discussion points on a topic he was invited to speak on entitled: "Underfunded Pensions: How did that happen and What can we do about it"? Comparisons shown in this chart are timely too, as the TSRS Board will soon need to consider TSRS actuarial assumptions recommended from completing a 5 year historical experience study. The actuary will seek approval for the assumptions, and what the timing is for assumption changes used in future valuations. The chart shows that the City of Phoenix Employees Retirement System (COPERS) recently approved certain actuarial assumption changes from their historical experience study; and will be using a 4 year implementation period for a reduced investment return assumption, moving from 8% to 7.5%, and for a change in period of amortization for unfunded liabilities, changing from a period of 25 years to 20 years.

3. May 29<sup>th</sup> and June 5<sup>th</sup> TSRS Board meetings

Mike Hermanson reminded Board members that the May 29<sup>th</sup> meeting will be very brief, requiring the Board's approval of the consent items on the agenda for the Board meeting minutes, retirement ratifications and

expense report. A quorum of 4 Board members is required to hold the meeting. The June 5<sup>th</sup> meeting agenda is set for important Board discussions of the Actuarial Historical Experience Study and the investment consultant's discussion of the Asset/Liability study results.

**E. Articles for Board Member Education / Discussion**

1. Selling back sick leave nets millions for top Tucson Police and Fire officers (Arizona Daily Star, April 6, 2014)
2. Memo: Payment of Unused Sick Leave and Computing Retirement Benefits for members of PSPRS (City of Tucson Attorney, Mike Rankin)
3. Phoenix board votes to continue police pension spiking (The Arizona Republic, March 27, 2014)
  - a. Related Article - Arizona Pension System Subpoenaed (The Arizona Republic, March 24, 2014)
  - b. Related Article - Fed grand jury seeks pension documents (The Republic, March 7, 2014)
  - c. Related Article - Special report on public pensions – Arizona pension system gave out bonuses (The Republic, Aug. 11, 2013)

**F. Call to Audience** – Jenefer Carlin had two items. She inquired about booklets received from investment managers and stated she did not see an electronic version on the TSRS website. Mike Hermanson indicated it would be posted to the website and offered to e-mail her a copy. 2<sup>nd</sup> item was regarding the quarterly statements received by retirees. March's statement shows incorrect amounts of Federal and State taxes withheld Year to Date. Mike Hermanson stated the issue was known and has been corrected.

**G. Future Agenda Items**

1. June 5<sup>th</sup> meeting: Actuarial Historical Experience Study & Asset Liability Study Results
2. Philosophy of contribution rates discussion – Board retreat item

**H. Adjournment – Acting Chair, Karen Tenace, stated we are adjourned at 10:04AM.**

Approved:

  
Robert Fleming  
Chairman of the Board

5/30/14  
Date

  
Michael Hermanson  
Plan Administrator

06-05-14  
Date