DEPARTMENT OF CITY CLERK

CITY HALL

AUGUST 23, 2012

The Board of Investment Commissioners meets this day at 12:00 o'clock P.M., in The Conference Room, Third Floor, City Hall.

PRESENT: Vice-Chairman James J. Lombardi, III, City Treasurer; Aaron Simon, Ted Mocarski and Mark A. Tracy – 4.

ABSENT: Mayor Angel Taveras, Michael Pearis, Finance Director and Councilman John J. Igliozzi – 3.

Also present are Eric Bertonazzi, Wainwright Investment Counsel LLC; Lori L. Hagen, Second Deputy City Clerk and Sheri A. Petronio, Assistant Clerk.

(Subsequently Councilman Igliozzi joins the meeting)

I INVESTMENT PERFORMANCE ANALYSIS

1.) Recent Performance Estimate

2.) Portfolio Structure and Performance Summary: Asset Class

3.) Manager Performance: Benchmark vs. Manager Analysis

A.) US Equity Managers
B.) International Equity Manager
C.) Fixed Income Managers

II DISCUSSION RELATIVE TO THE DEXTER DONATION FUND AND OTHER TRUST ACCOUNTS INCLUDING THE CASH BALANCE OF THE FUNDS.

VICE-CHAIRMAN LOMBARDI: Okay, we will take the first item on the agenda, Investment Performance Analysis. Eric, do you want to identify yourself for the record.

MR. BERTONAZZI: I am President and Chief Investment Officer of Wainwright Investment Council. You have in front of you, which is our standard procedure, the most up-to-date returns, results that I can give you. We ran these numbers through Tuesday afternoon's close, and we're having a good year. This market has been turned into the Rodney Dangerfield market, on that doesn't get any respect, but still tends to do well so far. As you can see down at the bottom we're up 8% year-to-date and that's pretty good. We basically hit our actuarial expected return for the year. Now, who knows what happens next month or in the 4th quarter, but so far things have been going our way. It's been a volatile year. The first quarter was up very strongly the equities markets especially and they have since recovered to about where they were at their highs earlier in the year. Most of the activity you will see in your portfolio has been driven. There are lots of things, but the dominate factor has been the European Debt Crisis again. So, when that flares up and looks bad, the equity markets sell off, the debt markets in Europe will sell off. They will probably rally here in the United States and vice versa. When Mario says something he's going to do whatever it takes to support the euro and the Germans, the French, the Spanish and the Italians hold hands and make it look like they will cooperate at least. Then equity markets globally rally, Spanish and Italian yields come in relative to Germany and the dollar weakens a little bit and the euro strengthens. So, we've been going through this dance. Now unfortunately I think it's going to continue for a while. It will flare up and get better and flare up and get better and we're going to be subject to the volatility that's coming out of Europe for the foreseeable future. Recently our own elections and fiscal situations are starting to get the attention of the markets, especially the equity markets. The elections are uncertain in what's going to happen. Regardless of who wins this November, whoever wins, the odds are pretty high that there is going to be some kind of deal struck in 2013 addressing the tax system to have some sort of tax reform, raising revenue, cutting expenditures, some sort of a longer term like that. The markets are going to demand it and you will get something that's at least minimally acceptable. Whether or not you get a grand slam or home run or a grand deal compromise, that's questionable, but something will get done probably and at least buy a little time. Maybe a little time is a couple of years, maybe it's five or ten, but that's the type of thing that I think markets are expecting. If President Obama is re-elected and he remains a slight favorite I think to win re-election this deal will be slightly more in his favor, and if Romney were to win the deal will be slightly more Republican, but you're going to see some kind of a deal with raised revenues, some sort of reform and some sort of spending and reductions in growth at least. I doubt you will see anything huge. If nothing is done you have heard of the fiscal cliff then between the expiration of all the tax cuts, the temporary tax cut in the FICA tax, the withholding tax, unemployment benefits, sequestered spending from the deal of last year. That's something like 3% or 4% of GEP that would slow the economy. It doesn't seem to be on either side the left or the right to let that happen. So, markets are acting as if that they will punt in some way or another after the election. That's the way markets are acting and what they're predicting. That's not a certainty, but that's the way they're acting and it's one of the things that allows markets to rally. We see that our equities are doing very well. The domestic equities are up anywhere in the sort of 10%, 15% range year-to-date. Those are good numbers and very strong. You look at Brandes, our international equity manager, they're about a third of the way down the page. They're only up 5.9% year-to-date. Two reasons; Europe, they're our international equity managers, they have European and Japanese exposure. U.S. is leading the world in terms of returns this year on average and currency. The dollar has strengthened a decent amount so those two headwinds are holding them back relative to our domestic managers. Their long term numbers are spectacular and the highest of any of the mangers we hold, but his year in fact those two factors are holding them back relatively speaking. Loomis Sayles, our bond manger, is up about 4% year-to-date and that's actually pretty good for what they do. Again, short duration, cooperate credit and government exposure. They're going fine. You might see that their exposure is down to 14% over the portfolio and the overall exposure in the portfolio to fixed income of all kinds is just under 21%. Now, our target is 29%. So, we're below target and there are two reasons for that. The main reason is that we're taking 6½ million dollars a month out of the portfolio. So, you're talking over 3% of the portfolio is being burned each month right now and we had earlier in the year rebalanced the portfolio. You may recall we took money from equity and spread it back over fixed income. Loomis Sayles is the liquidity reservoir for the portfolio for the newer members. That's where the city takes the money once a month and right now it's running at 6½ million a month, $90 million a year, very large relative to the size of the portfolio. So, we have at that up at 20%. Sometimes it's 7½, sometimes it's 6½, it's sort of bouncing around. It's large though and we're running a $90 million run rate or so for the year. Now, we had that balance about two or three months ago, but of course equities have done very well, which raises their percentage exposure and we have burned the debt exposure by making the monthly payments. Now, it's almost time for the city's contribution. That normally comes the 1st of October sometime or early October. I was hoping to get an update on that actually as we go through this. Is there any information on that?

VICE-CHAIRMAN LOMBARDI: I don't know the exact date, but is was my recommendation to pay it immediately. We have the money to pay it, but the administration for whatever reason wants to hold it until that October date and I don't know the exact date.

MR. MOCARSKI: Given a new deal with the pension plans, are we going to get a benefit in order to withdraw as much next year.

VICE-CHAIRMAN LOMBARDI: Not as much. It will be flat. I would expect it to be float rather than go up.

MR. MOCARSKI: Do you know what the number is?

MR. SIMON: It has to be the same as what it is now.

MR. MOCARSKI: We go up and down a little bit on a monthly basis right now.

VICE-CHAIRMAN LOMBARDI: I don't know why it fluctuates.

MR. BERTONAZZI: Historically, once you get to sort of the new level you stay pretty close to that level and that's $6½ to $7 million dollars right now and it's been like that for six months or a year, actually closer to a year now. So, we had to jump up. We were running at 5½ or 6 and that's pretty much what's gone on historically over the last sixteen or seventeen that I've been doing it. It jumps up to a new level, stays there for a year or two and then jumps up to a new level. I don't know what this effect will have going forward.

VICE-CHAIRMAN LOMBARDI: I think there is an agreement that there is going to be no COLAs for ten years. It's going to be flat.

MR. SIMON: It will just stay like this.

VICE-CHAIRMAN LOMBARDI: Right.

MR. SIMON: Is the city going to decrease its contribution as well, not this one coming up.

MR. BERTONAZZI: Do you know what this number is this year.

VICE-CHAIRMAN LOMBARDI: I know what we have to out of the bank for the General Fund is $40 million for the pension plan.

Councilman Igliozzi joins the meeting.

COUNCILMAN IGLIOZZI: We are underfunding it. The administration is going to short change it by ten this October.

MR. BERTONAZZI: Is the $40 million the total amount as far as you understand as well.

VICE-CHAIRMAN LOMBARDI: It's supposed to be $50 million. The normal payment would be $50 million.

COUNCILMAN IGLIOZZI: So, they're underfunding it.

MR. MOCARSKI: Would it be possible to see a model for the next year or two just because it ties into the investment decisions we're going to make to understand the liquidity needs.

MR. BERTONAZZI: I don't have that data. So, in any event traditionally when the city makes this contribution once a year, which it does around October, we use that money to rebalance the portfolio. Traditionally, that means it goes to the fixed income manager because we've been burning it down all year. So, we bring it back up to our target and reallocate it up to the total exposure of about 29% on fixed income. So, whatever amount of money does ultimately comes from the city, the first claim on that as far as our recommendations historically to the investment commission is to rebalance the portfolio, which means going to Loomis Sayles and if there is left over money then of course we rebalance that through the rest of the portfolio, but the first place it goes is to Loomis Sayles. So, any information that we at Wainwright can get that helps us with our recommendations to you for rebalancing etc.

VICE-CHAIRMAN LOMBARDI: I can present to you what the administration has told me.

MR. BERTONAZZI: Thank you. That will be helpful.

VICE-CHAIRMAN LOMBARDI: It's their call.

MR. BERTONAZZI: Okay, but if it is going to be around the October 1st timeframe then that's important because if it were to be delayed or what have you I would want to come back next meeting with a recommendation for a rebalancing, because at 21% fixed income when we're suppose to be 29% that's a little below my comfort level in terms of risk control, but if we're getting the money in six weeks or so then it's not something that concerns me as much.

COUNCILMAN IGLIOZZI: Well in theory the money for October should be put aside from last year's budget. That's how it works. Our payment in October is from last fiscal year. The money should be there, but of course it's not.

What they did was they over spent the last budget so what happened is we ended up with a deficit of about $28 million dollars in last year's budget approximately. They minus the ten because they're kind of not showing it, that the ten is the underfunding of the contribution for this October. So, that's gone, but they did represent that they were going to make the payment in October. Now, that number may even be lower because they told the state they only had an $11 million dollar deficit so now they have to try to figure how to get closer to that.

VICE-CHAIRMAN LOMBARDI: My office just got back to me. It's the third week in October.

MR. BERTONAZZI: Then maybe I will come back next month with a short term rebalancing plan that perhaps I an ask the committee to vote on next month, which would at least get us partially towards our target and then in October we could fill it out. I guess that's what I would recommend.

MR. SIMON: We should also be thinking about intermediate or even long term rebalancing. If $40 million is coming and $80 million to $90 million is going out don't we need a little bit more liquidity all the time. The 60% that kind of spooks me a little bit, if there is a $50 million dollar hold in terms of what's coming in verses what's going out.

MR. BERTONAZZI: Well, we won't be quite that high. We're 29% fixed income and we have around a 16% to 17% target on hedge funds. So, equity itself is a little lower than that, but the question you raise is the asset allocation correct for the long run based on the liquidity requirements. That's a fair question. We addressed it in detail the last time we adjusted our asset allocation, which was about a year and a half ago and we could do it again. I think as long as these agreements are predicted to hold and the cost control is predicted to hold and perhaps the growth rate and the burn rate will not increase at the rate it has in the past, then I would say approximately 30% fixed income and these other hedged exposures etc., is probably okay, but if it is the case that the city is funding situation deteriorates further or is in fact worse then it was a year or so ago when we did this then that might call for that.

MR. MOCARSKI: A couple of meetings ago the city was going to get back to us about what we should be thinking about on return targets because if we're going to reallocate into fixed income I mean we would have lost that swing on the equities and now our 8% return is going to be 6%, and is that are target or is 7% or 7½% still or target.

MR. BERTONAZZI: We went through this because back in the 2008 crisis we increased the fixed income allocation in the target. The committee changed its mind and went back down a little bit subsequent to that based on the effect of what happened on long term returns. Also, with ten year treasuries at 1.75% the question becomes what is the long run expected return of fixed income going forward. If we're looking at 7½% to 8% those types of returns in the long run it's going to be difficult to get that from fixed income. So, it would be a trade off and it might be one that the committee should consider. Liquidity, yield verses returns. You would be wrestling with the same issues that every other municipality in the state are dealing with right now. What can we reasonably expect to generate in terms of return going forward.

MR. SIMON: Correct me if I'm wrong, Loomis's portfolio can go up to 10% in high yield.

MR. BERTONAZZI: That is correct. In their investment guidelines, at their request, the board voted that they would be allowed to go up to 10% high yield in their exposure, but it's still short duration. So, that's a pretty low volatility portfolio.

MR. SIMON: Can we add to that.

MR. BERTONAZZI: In what way?

MR. SIMON: Go up to 15% to get a little more potential return without increasing the standard deviation of the portfolio to much. What would that entail?

MR. BERTONAZZI: Ten percent has been the maximum they have traditionally requested in their portfolios. So, is that available as an option, it is but they have not asked for it traditionally, but we could let them do that. They manage all kinds of portfolios, some quite high risk. So, the answer is yes, that could be requested and we could ask them to come in if you would like and see what they think. Okay, I'll continue. Our hedge fund portfolio continues to add value on average up close to 8% year-to-date. It was dominated this year by Renaissance a long/short computer model. U.S. equity exposure Quellos Strategic that is a fund to funds up 4.1%. Graham Global low risk, quantitative model trend following commodities trend following fixed income currency player very diverse. Macro type strategies. Pretty low return this year, but they've done very well in years past, but on average the hedge fund are doing quite well at 7.8% and the portfolio up 8% year-to-date. I can tell you you're going to be ranked very highly against your peers again in the top 10% again. I'm referencing the State Street Universe, which I have referenced in the past. We're always in the top 10% over the five, seven and ten year periods, and I expect that is where you will be again this year. If this type of relative behavior continues, you will be ranked very highly against your peers, but as we've talked about in the past there is no reasonable return or expectation that we can expect that will cure the problems of this plan. It's spending, which is being addressed, and that's where you have a chance to make it a lasting portfolio.

MR. TRACY: Are these gross of fees?

MR. BERTONAZZI: These are all net. Everything we report to you is net.

MR. TRACY: What are we paying for the fund to funds?

MR. BERTONAZZI: It works out to be around 1% to 6%. They have strange benchmarks and things like that. It's a complicated formula, but it works out to be about the standard fee in the fund to funds area. Renaissance is 75 basis points and ten on the carry and, Graham is actually 1½ and 20, which is a more standard fee. Any questions I can answer?

COUNCILMAN IGLIOZZI: In light of the negotiating of the pensions and stuff like freezing the COLAs for ten years, have they put together for you what's supposedly the new arc and all that good stuff.

MR. BERTONAZZI: I would love to find that out. That's basically behind my questioning today. I know these things have been in flux and there have been negotiations going on so any information that I can be provided, Wainwright can be provided and what the actuary can provide that will be helpful for us.

COUNCILMAN IGLIOZZI: So, you haven't been briefed on the negotiating settlement.

MR. BERTONAZZI: I only know what I've read in the paper and heard today. I have tracked the process in the last six months to a year and I've followed it that way and I know some things were done, but anything that's happened in the last month or so since our last meeting I'm not award of.

COUNCILMAN IGLIOZZI: Basically, the COLA freezes are for ten years and what happens this January 2013 will be the next COLA bump out, but they won't get that. So, whatever the number is now it stays. So, for the next ten years will have the attrition. The rate will go down and people will get the 5% compounded COLAs, which is about six hundred people I guess and they figure that will dwindle in ten years. Right now and for the next few years you're still going to be stuck with that. What's our burn rate now?

MR. BERTONAZZI: It's about 6½ million to $7 million a month right now.

COUNCILMAN IGLIOZZI: So, our burn rate is probably going to be pretty much the same or close to it because all that means is next January we're not going to do the bump up for the COLAs. So, a person who is making $115,000.00 will continue to make $115,000.00. So, that's going to stay.

MR. BERTONAZZI: Have you heard any news on the city's ability to fully fund in the future.

COUNCILMAN IGLIOZZI: Do you mean making the full contribution it should on a yearly basis or do you mean fully fund the pension account.

MR. BERTONAZZI: The actuaries recommended contribution.

COUNCILMAN IGLIOZZI: You're carrying over a $28 million dollar deficit, which you're carrying over the deficit from the previous year. We have for next year three things that the city is going to do. One, there is pay raises next year for everybody and that was negotiated for this year. Carry over deficit for two fiscal cycles ago, which you have to put together a five year plan and I think that's a million a year and although they kind of fudged it, they added like a couple more million so that kicks in again. So, the second deficit five year plan kicks in for next year to and of course your probably going to burn the same thing where next October they're probably going to have to lower their contributions because I sure there is going to be another tax increase. Normal business is 4% to 5%. So, we can't go back to all these institutions and start shacking them down because that's done and that's it. So, next year you will have a tax increase and you probably have a little more in the funding in the pension contribution. You will have the five year bail out deficit and of course you get the pay increases and maybe they can try renegotiate.

MR. MOCARSKI: Will there be a decrease in the contribution to the plan on a yearly basis. That should go up, right?

COUNCILMAN IGLIOZZI: No. The other contributions are going up because we pay for three pensions for the 1033 people. We pay this pension, we pay Social Security and we pay the Laborers' pension and the administration negotiated an accelerator clause every year. So, every year our contribution to the Laborers' pension account goes up every year by like 6%. So, that's the other thing that's going to kick in next year. So, you have the acceleration clause for

1033, you have the pay increases for 1033 and you have the two past fiscal year plans together. So even if you raise taxes it's not going to cover the nut. The cash flow we're able to, right?

VICE-CHAIRMAN LOMBARDI: The cash flow right now we're okay.

COUNCILMAN IGLIOZZI: The cash flow is okay and then next year we're asking for the state to give us an advancement again on money for school construction costs. The thing is with cash flow is at least we're able to pay our bills, but the deficit is still there.

VICE-CHAIRMAN LOMBARDI: That's assuming the budget is accurate to.

MR. MOCARSKI: Would there be a way to revisit the Charter. Not just the committee today, but the committee over the next few years because with this pool of money, what are we suppose to do, what should we be thinking about. So, when the Mayor brings some ideas to the table we at least have some context with which to make a decision.

COUNCILMAN IGLIOZZI: Just so you know Wainwright has been with us for sixteen years. They had about $300 million when they first came in and they got close to $300 million after, but you have to remember the burn rate has consistently gone up and up and no matter what kind of interest rate you get we have to get a 40% interest rate to deal with it. So, everybody was getting an 8% rate of return and that's pretty good. The problem is we need more because our burn rate is higher then our interest. So, basically the commission has been trying to keep as close to that $300 million as possible. That's really what it's come down to because there is only so much you can do because at the end of the day there is two choices. Either you try to maintain the amount of cash you can for the next ten, twelve or fifteen years and hopefully freeze the other COLA and the attrition rate kicks in and eventually there will be a point where we still have some money in it. I know way before Cianci got in there were city employees managing these accounts. It was crazy. So, it has to do with how much you have and basically trying to get as much interest as possible to balance off the burn rate. That's what I've been trying to focus on because you don't have enough interest to get tot hat $7 million.

MR. BERTONAZZI: Well, let's say it's $7 million to 7½ million next year you're talking $90 million dollars that will come out of the portfolio next year and the city is able to put in fifty or sixty let's say. I don't know. Maybe that's too much. Then you're talking $30 million for $40 million net burn on the portfolio, which is 10% of the portfolio, which means we have to make 10% just to keep the dollar value from going down.

MR. MOCARSKI: That's been the discussion we've been trying to have the last couple of years. We're never going to fix it from the return perspective. Give us a job that we can do and if it's keep it flat at 250, all right we can make investment decisions accordingly an assume the contribution rate, assume the burn rate then we can make investment decisions.

COUNCILMAN IGLIOZZI: Maybe we should have Buck Consultant come to the next meeting and maybe they can present because they're the actuary. They will probably be able to give you some numbers on what they see. I think it would give us more understanding.

VICE-CHAIRMAN LOMBARDI: Do you want to ask Buck to be here for the next meeting.

MR. MOCARSKI: It might be helpful to see what their assumptions are because once we know their assumptions we can at least tie into our thinking.

MR. SIMON: I'm going say $50 million comes in October, but from October to September $90 million leaves. So, we go from $300,000.00 to $210,000.00. To maintain $250,000.00 we need about a 16% return to do that.

MR. MOCARSKI: That's right.

MR. SIMON: We can't manage this flat unless that through all the work that the city does that because you've answered one part of the equation saying it's going to be $90 million for the next ten years, but that $50 million dollars needs to step up every year, which it's impossible to see that right now, but eventually it's going to have to.

MR. MOCARSKI: Assuming long terms trends in the markets stay the same and we don't get a 30% run up in equity.

MR. SIMON: Well, I will give you the opposite. What happens if we have another 2008?

MR. MOCARSKI: That's what worries me even more. The problem with this portfolio is there is a bigger penalty then there is upside in managing this portfolio because there is not enough upside to fix the problem and if we loose more then what we were expecting to lose we have a much bigger problem. So, I think actually the reality is I do agree with Aaron.

MR. SIMON: I think you have to manage for risk in the short term meaning the next three years hoping that through the reforms you guys are putting together that businesses come in and income comes in. So, if tax revenues go up we start feeling more comfortable about putting more money into the pension. Maybe we will get a surplus here and there and this becomes healthier. I know you guys are working as hard as you can. I know you guys see the problems the same way we all see the problems, but the solution is a lot more difficult then just saying we have a problem.

COUNCILMAN IGLIOZZI: Well, a lot of the solution is actually out of this board's hands.

MR. SIMON: The solutions are out of the city's hands. The state has been saying screw you to Providence for the last thirty years.

VICE-CHAIRMAN IGLIOZZI: Could I ask the Clerk to write a letter to Buck Consultants inviting them to the next meeting and ask them to bring the last actuarial report and updated actuarial reports based upon the ten year COLA freeze.

COUNCILMAN IGLIOZZI: They've must have ran the numbers by now. Does anyone have anymore questions?

MR. BERTONAZZI: I have covered everything that I wanted to. If there are any questions I would be glad to go over it.

VICE-CHAIRMAN LOMBARDI: Did we do the Dexter Donation.

MR. BERTONAZZI: We didn't, but we can certainly right now. Very quickly for the newest member there is this thinner black book. It goes over some other portfolios that the Board of Investment Commissioners have purview over and they are small so we use mutual funds and we've been managing them for a long time. So, if you turn to page one of tab one you will see what the Dexter Donation Trust has done. It's up 9.4% year-to-date. It doesn't have any hedge funds in it and these other portfolios are all managed almost the same. They're a little different. Some pay out a little bit more money then others so their asset allocations are slightly different, but they're all managed basically the same. So, they have more equity as well instead of fixed income. These are about 80/20 portfolios on average. That's what they're rebalanced to and that's why you will see that the Dexter Donation is up 9.4%. If you went to page one of tab two, you would see Ebenezer Knight Dexter is up 9.1% and so on and so forth. They're all up in the nines. I have no recommendations for adjusting the portfolio or changing any managers at this time. We're actually having another good strong year for these portfolios.

VICE-CHAIRMAN LOMBARDI: Eric, do you want me to put on the agenda or do you want to put on the agenda the rebalancing for next meeting if we need it.

MR. BERTONAZZI: We have a once a month conversation with the Clerk, and I would be glad to make sure that's on there as well.

VICE-CHAIRMAN LOMBARDI: Okay, great. Anybody have any questions? Motion to adjourn.

ADJOURNMENT: On motion of Mr. Mocarski, seconded by Mr. Simon, it is voted to adjourn the meeting at 12:40 o'clock P.M.

Lori L. Hogan

Second Deputy City Clerk

Sheri A. Petronio

Assistant Clerk