POLICE & FIRE PENSION INVESTMENT BOARD

February 8, 2024

2:00 – 3:30 p.m.

Summary Minutes

The information in these meeting minutes is intended to assist Police and Fire Pension members in understanding the activities of the Investment Board. The information is not intended to provide investment or financial advice to any individual or organization and should not be relied upon for that purpose. While we attempt to keep the content accurate, we cannot guarantee that all information is current, accurate or complete.

Members present physically:

Guy Pinkman – Fire Electee (Board Chairman)
Derek Dittman – Police Electee
Eric Augustin – Fire Electee
Matt Franken – Police Electee
Barb McIntyre – Human Resources Director
Lisa Smith – Mayoral/Council Appointment
Lyn Heaton – Finance Director

Members Absent:

Vacant position – Mayoral/Council Appointment (vacant as of 2/01/2024)
Steve Hubka – Mayoral/Council Appointment (Board Secretary)

A quorum is any five physically present Board members. Action can be taken when 5 members approve.

Human Resources Staff physically present:

Paul Lutomski – Police and Fire Pension Officer
Angela Pearson – Human Resources Specialist

Others physically present:

Ian Bray - Principal, RVK Investment Advisors
Tony Johnson, Director of Midwest Consulting, Principal – RVK Investment Advisors
Keith Peters, attorney at Cline Williams law firm

Unless otherwise noted, meeting materials were provided to Investment Board members in electronic format, or printed format, a few days preceding the meeting for their advance consideration.

Documents:

Minutes of prior 11/09/2023 meeting
US bank Fees
RVK Rees
2023 Experience Study
8/31/2023 Actuarial Valuation Report
RVK 2023 Q4 Performance Report
RVK US Large Cap Equity Evaluation
Private Credit Education
Active vs Passive Study

Guy Pinkman calls the meeting to order at 2:00 p.m.

Agenda item one, edit or approve November 2023 minutes.

A motion to approve was made and seconded.
All members vote in favor.

Guy Pinkman
Motion approved.
Agenda item 2 and 3, US Bank and RVK advisor fees.

Paul Lutomski
Presents US Bank and RVK fees.

Guy Pinkman
Agenda item 4, Ian and Tony will present the RVK Q4 performance report.

Ian Bray

US equities were up 26% for the year per the s&p 500. But what gets masked in that number is just how much of that was driven by seven names, The Magnificent Seven is what they're being termed.

Those seven names were up about 85%. If you strip those seven names out and just look at the remaining 493 names in the index, they were actually only about 11%. That's interesting forward. In 2022 real estate was a positive in most institutional portfolios. In 2023 it was the opposite with real estate priced down. Outside of that, it was a strong year. A chart on page five shows what happened without the Magnificent Seven. Now seeing the s&p 500 at a record high. So if you're looking at the broader market, if you exclude those seven, it’s a flatter ride. Some of those big growth names are the ones that were the hardest hit in 2022. But they gained that and a lot more back in 2023.

Tony Johnson

That was a really good reversal for those who have value stocks. More fairly valued companies protected against downside a little bit better.

Guy Pinkman
I saw a breakdown. If you take out those seven, it's about 2% return.

Ian Braythe
We are left at an ending point of concentration, that large cap US equities have been at only a few other times in history, and those few times did not unwind well.

Page 12 just gives a kind of a high overview pie chart of all the exposures and ended the year at $315 million.

Page 13 shows the differences versus the target allocations.
We are overweight public equity and underweight private equity. Because we do not have updated marks for private equity. I would assume that marks for the end of the year, are not going to be as favorable as they have been. I would think that most of the q4 marks will start rolling in February, but most will come in March or April.

Page 15 shows plan performance, versus the policy index. And then versus peers. In a few different trailing periods. I think there's a couple takeaways here. If you were ultralight private equity light, real estate, private credit, and you had a lot of public equity and public fixed income, you look great in 2023. Correspondingly, you look terrible in 2022. So if we kind of want to take those couple years together, and also 2021, and look at that three year rank is extremely favorable, right at about 5%. Most of the portfolio's that we've looked at that are more liquid in nature, they're sitting closer to 2% on that three year mark. It's those longer term kind of trends that we're more inclined to look at.

Guy Pinkman
Could you explain to everyone why certain pensions have liquid portfolios?

Ian Bray
There's a couple reasons. 1) they don't have the scale or access to get into private markets, 2) they've got an investment belief that they don't want to be in private markets, and 3) they might have a liquidity profile that does not allow them. The more poorly funded you are, and the more net cash flow negative you are, the less ability you have to lock up capital for longer periods of time.

Guy Pinkman
There's some pensions that did really well in 2023 because they can't look long term.

Ian Bray
If we look at page 18, one year attribution versus the policy benchmark. You can see the bulk of underperformance is simply coming from the private equity portion of the portfolio that's not marked to market yet. In a year of really strong up public markets, with the PE bogey as that return plus a premium, it’s a difficult bogey to hit. And so without q4 marks that's where almost all of the underperformance came from for the year. Once we get marks for q4, that attribution would probably look differently.

Guy Pinkman
When we get those marks can we have a side by side?

Ian Bray
Yes.
PAGE 19 and 20 show composite performance.
I'll take your direction if you want to dive into any of this in more detail.

Guy Pinkman
Highlights are fine, unless there's an outlier that needs our attention.

Ian Bray
Nothing to mention, other than Paul's working on the Walter Scott mandate.

Page 23-25 commitment schedules for the private asset classes.
$21 Million of unfunded commitments.
$12M is Ares, $7M is GCM
Page 26, the fee schedule.

Lyn Heaton
While waiting for those cap calls, how are those funds invested?

Ian Bray
Those funds are invested in the portfolio alongside the approved asset allocation.

Paul Luomski
The bulk thats going to be moved is currently in a Vanguard Total Fund right now.

Ian Bray
Page 26 shows the fee schedule.

Lyn Heaton
What's asset classes have the highest fees?

Ian Bray
It would be private allocations, small, or international.

Matt Franken
Given what you said about real estate, and what's reflected here, are there better alternatives?

Ian Bray
With illiquid exposures like this you can't get your money out quickly, and PRISA actually had a pretty fantastic year at only down 7.5%. That was one of the one of the places that actually did a little bit better than benchmark in 2023. Flip-side RREEF was down 15%. To answer your question, I don't think it's a time to exit because of one year unfavorable.

Matt Franken
The horizon looks like what?

Ian Bray
There's definitely some pressures on real estate right now. Office space looks like a tough spot that's gonna have to get worked out from a macro perspective. But, the forward looking prospects for real estate are not terrible moving forward. If anything, the question was have we hit the bottom yet? Not how much further can this fall.

Guy Pinkman
The five year number is probably better to look at. Office space is difficult, are they 25% or 50%? and where's that at? Southwest or southeast, is fine, but not Seattle, New York City.

Certain areas have problems, but there's gong to be refinancing. Everybody's waiting to see how that goes. Maybe refinance at a lower margin. End of this year, beginning of next year is going to be going to be the flush out period. Would you guys agree?

Ian Bray
Yes. RREEF is about 17% office and PRISA more like 7%. That differential in office exposure probably made all the difference between the one year numbers for those two. Most of is still in the industrial, or apartment complex, multi sector homes. Some cities office prices have rebounded, other places such as West Coast have not.

Guy Pinkman
You're having a lot more corporations requiring people to come back in the last six months. Some major that weren't doing it. And now they are.

Paul Lutomski
RVK has includes a couple on pages on each, PRISA and REEF in the manager profiles.

Ian Bray
There are profile on every manager in the back of this book.

Guy Pinkman
Let's move on to large cap active management.

Ian Bray
Document page 3 sets the stage. At the last meetings there was there's a discussion about the US large cap portion of the portfolio be passively or actively managed.

Passive has been good, but how does that look going forward?

Page 4 shows this can be highly cyclical.

Page 5+ contains: One is asset class efficiency, fees, tolerance for overall tracking error in that specific section of the market and asset allocation at a total plan level. How much Alpha generation do you need from that asset class exposure.

Efficiency : Large cap equities have been historically the most efficient portion of the market, the most difficult to outperform their benchmark. Let's call it the s&p 500.

Passive management is cheap. The cheapest is an institutional portfolio in US large cap. If you have private equity, real estate, private credit, active management in international and fixed, do you need to risk tracking error or pay fees to have active here? Those the cases against active management in large gap.

The cases for it are more qualitative. Looking forward, do we think that the past 10 years is going to repeat? Seven names that make up 25% of the index. Essentially 25% of the portfolio is going to seven names.

And what are the market environments historically, when active management has done well? Active management historically has done well when interest rates have been in a more normalized zone, not at zero. We've been at zero interest rate policy for essentially a decade, money was cheap, and so growth names took off for the past 10 years.

Page 6 graph for the past 20 years. If the blue median line is underneath the dark zero line, it means that the median manager underperformed. Another way to read this loosely over the past 10 years, only about a quarter of managers outperformed, previously more outperformed.

There is the argument that the market is more efficient now, or maybe active management would make a little bit more sense in more normalized interest rate environment going forward, all else being equal.

Fees will be 35 to 50 basis points for a good active US large cap core manager. Cheaper than small cap international equity, certainly cheaper than emerging markets. It's also the biggest piece of the pie. So it has a higher weighting and dollars.

Guy Pinkman
Everybody gets stuck in the last 10-12 years. Everything's gone up, but volatility is hitting. And I don't see that going away, necessarily. There's too much geopolitical and other issues, and uncertainty on interest rates. I think a portion should be active to help reduce downside.

We are not chasing alpha in large cap.

Ian Bray
We want to help you think through the decision process. This is an asset class where the top 25th percentile manager and the 75th percentile manager have a spread of maybe 2-3%. The one place we've been adamant is not to take style risk, like over or underweighting growth, as that decision has never worked well.

Regarding the index' concentration of seven tech stocks, it makes sense to pull back a little bit on the risk that's already inherent in that portfolio. So this is really about risk mitigation strategy.

Lisa Smith

We might be looking at a new future and to make some changes. I'm not opposed to it. But I don't think looking at prior to 2008 is a good comparison given the advent of ETFs in index based investing creating efficiency in the marketplace.

Ian Bray
Yes, one could argue that the increased passive flows that have happened over the past 10 years has been fueled from the institutional side. If that starts to turn its going to take some steam out of the cap weighted market. When you go out of cap weighted, you're saying I'm not going to just continue to chase momentum anymore.

Something prudent to think about would be a split, from 6040 to 8020.

Guy Pinkman
I don't want another tech burst, but there are indicators. If we have that basket and seven stocks are driving everything, I'm a little concerned. Not that we need to pick a manager right now. I think today's discussion was to gauge if there was appetite for it. If so, what's the appetite in terms of the active basket split?

Ian Bray
We need to determine the characteristics that we want for an active manger in the portfolio. I think that sounds like protect against the downside.

Paul Lutomski
Guy, would you mind disclosing the sources of your knowledge?

Guy Pinkman
I work for a large cap active manager, one of the best out there. We can't use them here, because I work there and I totally understand that. I believe in the active management split. We've seen where active management can help. A split would be good, but what size split?

Lyn Heaton
It was mentioned earlier that institutional investors are beginning to consider some exposure to active management for large cap. I would argue for being conservative. You said 20% active, and I don't know if I'm comfortable with that much, but maybe that's too small to get any of the downside protection benefit. RVK's original advice was passive as the better approach.

Barb McIntyre
There's no way I would be comfortable with 6040.

Ian Bray
Tony and I were thinking 7030 8020 is probably more of the zone, but there's probably not a lot of benefit to it over 100% passive. I think of this from two perspectives. One is positive skew, meaning that there is generally more up periods than down periods. So you don't want to be too tilted away from that. The second piece is that active strategies are probably only going to make their money every three to five years on average.

An 8020 mix, with 80% of the portfolio still passively managed and super cheap.   You're getting your beta exposure, which is your largest growth component, by portfolio weighting ,but you're still giving yourself a chance to kind of protect on the downside.

If large institutions go more active, passive managers have their raise fees. Some of the passive fees are probably going to go up if they start losing money, having drawdowns, they're going to want to keep their revenue where it's at.

Lisa Smith
I'm think I'm hearing an appetite for some active.

Guy Pinkman
Matt, you brought this up a couple meetings ago, are you still okay with that?

Matt Franken
I think it's a good idea to consider. But, this is one of those spaces that if you pick the wrong manager, you've had a huge swinging a miss. Yeah. So that's the most important part of this equation.

Paul Lutomski
When RVK brought this up in August they recommended Northern Trust's Russell 1000 fund. It that a cap weighted Index? Would it be any good to have a non cap weighted index to mitigate risk?

Ian Bray
I've got a different client who had the same discussion five years ago. They thought instead of active, why don't we have two passive mandates, one equal weight one being cap weighted. They were crushed. My point is you are going to take massive tracking error versus the cap weighted index. You look pretty bad if you underperform particularly to a large degree.

Guy Pinkman
I'll make a motion that I want you to do a search for active management up to 30% that way you can give us what would be a mandate. All in favor?

All
Aye.

Guy Pinkman
Motion passes.
Next is private credit education.

Tony Johnson
Much like large cap, private credit, may have a different future from what we've seen.

Page 3 describes history and types of private credit.

In the 1980's it was mostly known as mezzanine lending. This is senior debt lending to companies that couldn't necessarily get additional funding from banks, so they went to private lenders at a higher interest rate to fund their businesses for the next one to three years. It's also borrowing that

private equity managers would go to when they needed additional funding to the equity capital they raised. After 2008 occurred governments cracked down on banks and the industry of private credit grew.

There have been a lot of very solid big firms focused on it. Lately you're seeing a lot of smaller shops emerging. That's what's making this market so deep is so many players chasing after private credit. The emerging shops aren't as experienced, they don't have quite the same entry into the market, they don't have quite the same sourcing of companies, and their due diligence isn't quite as strong. The debt they have is failing.

Direct lending is what banks used to do.

Specialty finance, involves cash flows, royalties coming in on drugs, equipment leasing.

Distressed, you have a couple of distressed managers in your portfolio, contain an expectation that companies will either falter or fail. These are managers that will help them out of bankruptcy. They have the legal and restructuring teams to change the management and complexion of a company to bring it out of bankruptcy.

There are still multiple areas which can benefit your portfolio.

See page 4 for characteristics of private credit, which include terms of 7 to 10 years.

> The first three years are typically calling capital, beginning the fourth year, you should expect interest payments plus principal.
>
> Asset classes tend to have a spread of about 2-300 basis points above current market rates.

See page 5 for benefits and risks.

> Certain failures are the subject of poor due diligence.

See page 6 for an Asset Class Compares of Private Credit as between Public Fixed Income and Private Equity.

The typical target return is 6-14%. The Pension target will eventually be 7%.

See pages 8-10 for RVK's approach to Private Credit including how we source and do due diligence on private credit managers. There are three points that we highlight. One is the investor's objectives and target return. The other part is the diversification at the total portfolio and within the category.

See page 10 for segments of the markets that do well under which market cycle phase.

In a slowing environment, asset backed lending does well with 40% of returns driven by that type of market. If we've skipped over recession into recovery, you'll see other items that benefit.

The balanced portfolio you have today covers multiple cycles within the economy. While we Are not going to try to time the market, we can pivot towards strategies that we believe will benefit in the next three, five years.

Ian Bray
You just need to make sure that you're not over represented in one portion of private credit. For example, people piled into direct lending as access was easy. Diversification of type and vintage year is good.

It wouldn't surprise me if institutional targets to private credit came down. The way institutions got close to their target was to pile into private markets. I think that trend might reverse a little bit but not a mass exodus.

Guy Pinkman
Thank you.
Any new business?

Paul Lutomski
As you know, Becky Ferguson retired and resigned from the Board, so we have an empty mayoral appointment position on this Board.

Guy Pinkman
Meeting adjourned.