

Spokane Employees' Retirement System (SERS)
Board Meeting, 1:30 p.m. September 30, 2015
City Hall - Conference Room 5A

AGENDA

1. Minutes of the August 26, 2015 Meeting
 - Motion
2. Director's Report
 - a. Retirements
 - Motion
 - b. Withdrawals
 - Motion
 - c. Vesting
 - Information
 - d. Deaths
 - Information
 - e. Expenditure Summary Report – August 2015
 - Motion
 - f. Schedule of Investments – August 2015
 - Information
 - g. RFP Updates
 - Information
 - h. Other Business
3. Other Business
4. Next Meeting – **Wednesday, October 28th at 11:00 a.m.**

**Spokane Employees' Retirement System (SERS)
Board Meeting Minutes
August 26, 2015**

Mike Coster called the regular monthly meeting to order at 12:30 p.m. in the 5th Floor Conference Room at City Hall.

Present: Mike Coster, Mike Cavanaugh, Jim Tieken, Jon Snyder, and Jerry McFarlane

Absent: Dean Kiefer and Brian Brill

Staff: Phill Tencick, Christine Shisler, Donald Brown, and Tim Szambelan

Guests: Jayson Davidson, Brian Loescher, Joe Cavanaugh, Richard Czernik, Natalie Hilderbrand, and John Bjork

Hyas Group, 2015 2nd Quarter Investment Performance Report

Mr. Davidson presented the Second Quarter 2015 Performance Report and discussed what has been relatively strong performance for the SERS portfolio for this quarter and 2015 year to date. Hyas will maintain the watch status on the Champlain Small Cap Fund and the Sterling Mid Cap Value Fund for performance in violation of policy criteria. The Principal Global Investors REIT Fund and PIMCO Global Advantage Bond Fund will also remain on watch for qualitative, non-performance reasons related to recent personnel changes.

As a part of the annual investment policy review, Hyas Group will evaluate the appropriate benchmark for the commodities allocation within the portfolio. Currently, the policy benchmark includes the S&P GSCI Total Return Index and Hyas has made use of the Bloomberg Commodity Index for manager specific evaluation.

The Board was notified of pending money market fund regulatory changes that could affect the SERS portfolio and go into effect in October 2016. SERS has an invested in the Fidelity Institutional Money Market Fund, which could be subject to pricing adjustments and liquidity constraints per the regulations. Fidelity has not indicated whether they will make any changes to the structure of this fund. Hyas Group will continue to monitor the situation and will provide additional information when available. The Board may consider, as an alternative funding option, governmental money market funds, which are not subject to the regulatory changes.

The Board was informed of a share class exchange from the current Altairis Offshore Levered Class D1 to Class B1 as of July 31, 2015. This change provides for a lower management expense while retaining our current perpetual high water mark provision. Hyas Group considered the changes to be positive and no action was necessary.

Remove Post Limited-Term High Yield Fund from Watch Status

The Post Limited-Term High Yield Fund had been included on the watch list for qualitative, non-performance related reasons. Hyas Group communicated their comfort with the personnel changes and recommended that the Fund be removed from the watch list.

Mike Cavanaugh moved and Jim Tieken seconded the motion to remove Post Limited High Yield Fund from watch. The motion passed unanimously.

International Small Cap Manager Search

Mr. Loescher presented the Hyas Group International Small Cap Manager Search Report. Mr. Tencick prepared a white paper summarizing the differentiating factors, style, strengths and risks of each fund included in the search report. Hyas Group and Mr. Tencick recommended replacing Epoch International Small Cap with Victory Trivalent International Small Cap Equity fund.

Jim Tieken moved and Jerry McFarlane seconded the motion to terminate the Epoch International Small Cap Fund and replace it with Victory Trivalent International Small Cap Fund, as recommended. The motion passed unanimously.

Minutes of the July 29, 2015 Meeting

Jon Snyder moved and Jim Tieken seconded the motion to approve the minutes of the July 29, 2015 meeting as presented. The motion passed unanimously.

Director's Report **Service Retirements**

<i>Name</i>	<i>Age</i>	<i>Retirement Date</i>	<i>Years of Service</i>	<i>Option</i>
Eddie L. Mitchell	62	08/02/2015	7.0	ST
Duane H. Hille	50	09/03/2015	5.8	E
Timothy J. Ryan	59	10/02/2015	25.3	ST
Robert A. Darilek	60	10/03/2015	37.0	E

Jon Snyder moved and Mike Cavanaugh seconded the motion to approve the service retirements as amended on the August Retirement Transaction Report. The motion passed unanimously.

Withdrawals for August 2015

<i>Name</i>	<i>Years of Service</i>	<i>Termination Date</i>
Kathi A. Plager	2.2	07/15/2015
Anna E. Omelusik	1.6	08/13/2015

Mike Cavanaugh moved and Jon Snyder seconded the motion to approve the requests for withdrawal as presented on the August Retirement Transaction Report. The motion passed unanimously.

Vesting

<i>Name</i>	<i>Department</i>	<i>Years of Service</i>
Grant A. Wencel	Planning Services	5.1

Deaths

<i>Name</i>	<i>Date Retired</i>	<i>Age</i>	<i>Date of Death</i>	<i>Information</i>
Harland D. Mason	08/02/1989	91	07/30/2015	No Further Benefits
Morris L. Gaylord	01/05/1982	95	08/04/2015	No Further Benefits

Vesting and death information provided to the Board for review.

Expenditure Summary Report – July 2015

The Expenditure Summary Report was presented to the Board and discussed.

Jerry McFarlane moved and Jon Snyder seconded the motion to approve the July 2015 Expenditure Summary Report. The motion passed unanimously.

Schedule of Investments – July 2015

The monthly investment report was presented to the Board for review. The estimated market value of the SERS portfolio on July 31, 2015 was \$289 million with an estimated rate of return for June of 0.11%.

2016 Budget

The 2016 Budget was presented to the Board and discussed.

Mike Cavanaugh moved and Jon Snyder seconded the motion to adopt the 2016 Budget as presented. The motion passed unanimously.

Other Business

There being no other business, the meeting adjourned at 1:50 p.m.

Phillip Tencick, Retirement Director

SERS Retirement Transaction Report

September 2015

Retirements

	Name	Age	Retirement Date	Years of Service	Option
1	Karrie L. Duncan	52	09/12/2015	18.8	E
2	Douglas C. Lewis	60	09/24/2015	11.9	ST
3	Ronald E. Triplett	63	10/02/2015	30.7	ST
4	Edward W. Robinson	67	10/03/2015	10.0	D
5	June E. Watson	58	10/03/2015	17.8	D
6	George A. Worn	58	11/03/2015	30.4	E
7	Janice L. Campbell	66	11/03/2015	9.1	E
8	Randal L. Peterson	59	11/07/2015	22.7	ST
9	Susan Creed	65	11/08/2015	18.3	ST
10	Dale E. Arnold	62	01/01/2016	39.9	E
11	Dennis C. Fredrickson	63	01/03/2016	30.0	D

Retirements YTD 64

Withdrawals

	Name	Years of Service	Department	Termination Date
1	Dwight C. Davey	0.71	Solid Waste Disposal	08/01/2015
2	Jennie E. Anderson	7.38	Library	08/18/2015

Vesting

	Name	Department	Years of Service
1	Lynn M. Schmidt	Sewer Maintenance	3.8

Deaths

	Name	Date Retired	Age	Date of Death	Information
1	Verdelle G. O'Neill	04/05/1980	89	08/18/2015	No Further Benefits
2	Darwan R. Platz	01/09/1985	93	08/23/2015	No Further Benefits

SPOKANE EMPLOYEES' RETIREMENT SYSTEM - 6100
 2015 EXPENDITURE SUMMARY REPORT
AUGUST 31, 2015

	2014 ACTUAL	2015 BUDGET	AUGUST ACTUAL EXPENDITURES	2015 ACTUAL YTD EXPENDITURES	VARIANCE	PERCENTAGE USED
OPERATING EXPENDITURES						
Departmental Salaries	126,543.74	241,313.00	19,082.61	118,333.59	122,979.41	49.0%
Departmental Benefits	45,556.51	79,608.00	5,941.98	39,023.54	40,584.46	49.0%
Reserve for Budget Adjustment	-	20,000.00	-	-	20,000.00	0.0%
Administrative Income	(6,696.46)	(15,000.00)		(9,601.95)	(5,398.05)	
					-	
Postage/Supplies/Other	11,773.73	18,700.00	767.04	8,557.56	10,142.44	45.8%
State Audit Charges	10,375.50	10,000.00	1,594.13	3,325.07	6,674.93	33.3%
Contractual Services	142,938.52	200,000.00	4,807.20	89,347.58	110,652.42	44.7%
Travel	2,559.37	15,000.00	257.50	257.50	14,742.50	1.7%
Registration/Schooling	400.00	10,000.00	-	400.00	9,600.00	4.0%
Other Dues/Subscriptions/Membership	1,013.20	2,500.00	275.00	538.20	1,961.80	21.5%
Other Miscellaneous Charges	2,837.20	4,370.00	65.00	4,229.84	140.16	96.8%
Depreciation & Amortization	18,525.92	-	-	-	-	
TOTAL OPERATING EXPENDITURES	355,827.23	586,491.00	32,790.46	254,410.93	332,080.07	43.4%
INTERFUND EXPENDITURES						
Interfund - Accounting Central Services	3,150.20	3,052.00	-	2,086.35	965.65	68.4%
Interfund - IT Phones	1,935.21	1,512.00	127.92	900.95	611.05	59.6%
Interfund - IT Communications Replacement	288.96	241.00	20.08	140.56	100.44	58.3%
Interfund - Motor Pool	-	500.00	-	-	500.00	0.0%
Interfund - Risk Management	962.00	1,121.00	280.25	840.75	280.25	75.0%
Interfund - Unemployment	500.00	500.00	125.00	375.00	125.00	75.0%
Interfund - Worker's Compensation	86.00	78.00	19.50	58.50	19.50	75.0%
Interfund - IT	16,422.69	13,892.00	1,157.67	8,103.69	5,788.31	58.3%
Interfund - IT Replacement	4,209.00	3,584.00	298.67	2,090.69	1,493.31	58.3%
Interfund - Reprographics	2,346.95	2,000.00	99.13	1,863.77	136.23	93.2%
Interfund - Warrant Costs	986.00	1,500.00	-	-	1,500.00	0.0%
TOTAL INTERFUND EXPENDITURES	30,887.01	27,980.00	2,128.22	16,460.26	11,519.74	58.8%
TOTAL ADMINISTRATIVE EXPENDITURES	386,714.24	614,471.00	34,918.68	270,871.19	343,599.81	44.1%

SPOKANE EMPLOYEES' RETIREMENT SYSTEM - 6100
 2015 EXPENDITURE SUMMARY REPORT
 AUGUST 31, 2015

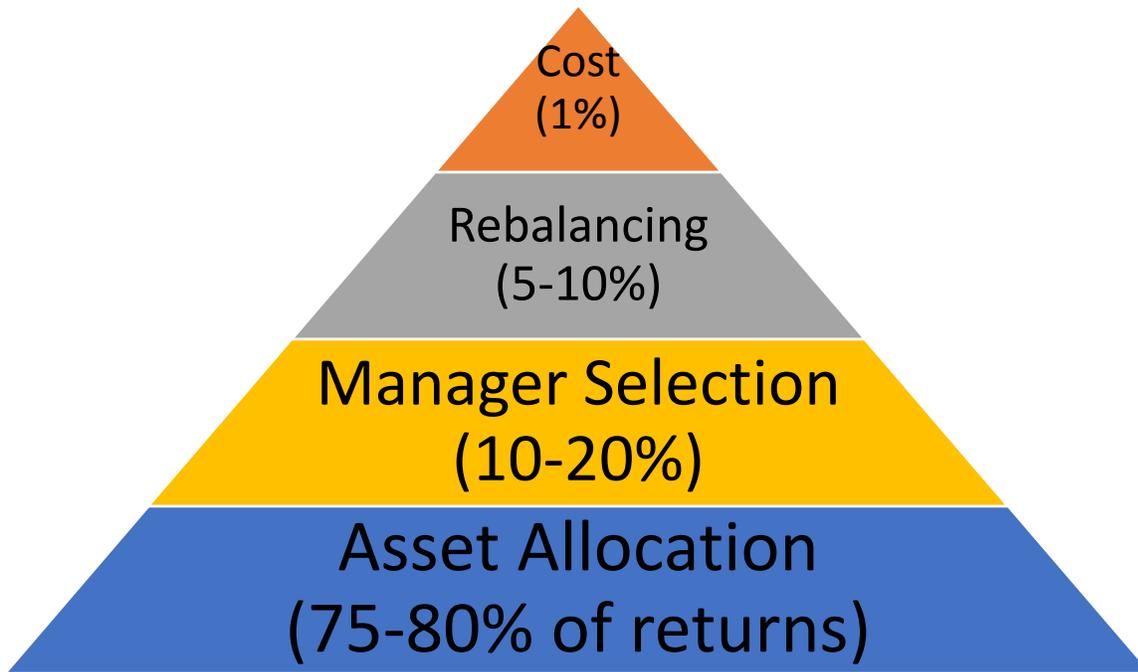
	2014 ACTUAL	2015 BUDGET	AUGUST ACTUAL EXPENDITURES	2015 ACTUAL YTD EXPENDITURES	VARIANCE	PERCENTAGE USED
PENSIONS						
Pensions-Annuity Benefit Payments	20,659,575.08	21,800,000.00	1,867,555.94	14,622,431.64	7,177,568.36	67.1%
Pensions-Disability Payments	125,328.48	160,000.00	10,444.04	83,552.32	76,447.68	52.2%
Pensions-Survivor Annuity Benefits Payments	1,473,938.36	1,500,000.00	139,305.73	1,081,149.15	418,850.85	72.1%
TOTAL PENSIONS	<u>22,258,841.92</u>	<u>23,460,000.00</u>	<u>2,017,305.71</u>	<u>15,787,133.11</u>	<u>7,672,866.89</u>	
Refunds	625,184.41	1,200,000.00	5,555.88	604,223.12	595,776.88	50.4%
TOTAL EXPENSES	<u><u>23,270,740.57</u></u>	<u><u>25,274,471.00</u></u>	<u><u>2,057,780.27</u></u>	<u><u>16,662,227.42</u></u>	<u><u>8,612,243.58</u></u>	65.9%
INVESTMENT EXPENSE*						
Advisory Technical Service	373,109.86	500,000.00	54,064.70	260,222.97	239,777.03	52.0%

* investment expenses are netted against investment income in the statement of changes of plan net assets to arrive at a net investment income amount.

SERS Schedule of Cash and Investments
August 31, 2015

9/24/2015	Type	Market	Actual Allocation	Approved Allocation
Cash and Short-term Investments:				
Cash Held by Treasurer	Cash	\$ 174,387		
US Bank	Short-term Inv	<u>1,547,780</u>		
Total Cash and Short-term Investments		1,722,167	0.6%	1.0%
Fixed Income:				
Vanguard Short-Term	Total Return - Mutual Fund	9,370,317		
Hotchkis & Wiley	High Yield - Mutual Fund	10,606,425		
PIMCO Global	International- Mutual Fund	<u>11,434,564</u>		
Total Fixed Income		31,411,306	11.3%	15.0%
U.S. Equities:				
Hotchkis & Wiley	LC Value - Mutual Fund	15,017,101		
Delaware	LC Growth - Mutual Fund	14,933,578		
MFS Heritage	LC Core	15,871,529		
Vanguard S&P 500 Index	LC Core - Mutual Fund	7,653,131		
Sterling	MC Value	7,945,323		
Vanguard MC Growth	MC Growth - Mutual Fund	7,767,838		
Vanguard MC Index	MC Core - Mutual Fund	5,105,320		
Champlain	SC Core	4,775,583		
Phocas	SC Value - Mutual Fund	4,241,867		
Bridgecity	SC Growth	4,618,554		
Vanguard SC Index	SC Core - Mutual Fund	<u>2,324,516</u>		
Total U.S. Equities		90,254,340	32.5%	
International:				
Berens	Ltd Partnership	10,251,030		
Vanguard International	LC Index - Mutual Fund	894,410		
Euro Pacific	LC Blend - Mutual Fund	11,981,116		
Artisan	SMID Value - Mutual Fund	14,371,949		
Trivalent	SC Value - Mutual Fund	<u>8,486,611</u>		
Total International		45,985,116	16.6%	
Total Global Equities			49.1%	50.0%
Alt Absolute Return Hedge:				
Altairis	LLC	5,924,944		
American Beacon	Mutual Fund	9,808,811		
Castine Capital I	Ltd Partnership	5,866,656		
Post Limited Term High Yield	Ltd Partnership	5,611,475		
Rimrock Low Volatility	Ltd Partnership	<u>9,093,483</u>		
Total Alt Absolute Return Hedge		36,305,369	13.1%	10.0%
Alt Long-Short Growth & Special Opps:				
Weatherlow Offshore	Ltd Partnership	14,978,777		
Caduceus (OrbiMed)	Ltd Partnership	10,483,948		
Royalty Opportunities I	Ltd Partnership	4,677,672		
Royalty Opportunities II	Ltd Partnership	298,190		
Troob	Ltd Partnership	3,786,499		
Beach Point	Ltd Partnership	<u>7,816,571</u>		
Total Alt Long-Short Growth & Special Opps		42,041,657	15.1%	14.0%
Real Estate:				
Legacy Partners Realty Fund III	Ltd Partnership	1,323,469		
Metropolitan Real Estate Partners	Ltd Partnership	1,208,588		
Morrison Street Fund IV	LLC	2,999,205		
Morrison Street Fund V	LLC	4,769,153		
Principal (REITs)	REITs	<u>9,248,976</u>		
Total Real Estate		19,549,391	7.0%	6.0%
PIMCO Commodites PLUS	Commodities - Mutual Fund	10,277,964	3.7%	4.0%
Total Cash and Investments		<u>\$ 277,547,310</u>	<u>100.0%</u>	<u>100.0%</u>
	withdrawals	(1,000,000)		
as of July 31, 2015		\$ 288,935,592		
	estimated rate of return	-3.60%		

Investment Consultant RFP Scoring



A plan's asset allocation decision is the biggest contributor to the long-term performance of the plan. The impact of the asset allocation decision is 4-5x as great as any other investment decision that is made. Since the last asset allocation, the relative impact for SERS is shown below:

Factor	Return	Impact
70/30 Portfolio	4.66%	
Asset Allocation	5.51%	85bp
Selection/Rebalancing	5.60%	9bp
Consultant Fees	(0.05%)	1bp

In addition to having the greatest impact on returns, the asset allocation process is the one thing over which the investment consultant has the greatest authority. Therefore, the selection of the investment consultant is the single most important decision the Board makes. Minor variances in the target allocation can result in significant impacts to the long-term health of the plan and no two consultants will recommend the same allocation.

For example, a 5% change in the weighting of stocks vs. bonds would have resulted in a 16bp increase in annual returns. However, volatility would have been much greater and funding ratios would have been even lower through the end of 2013. How much different would the plan redesign have looked then?

As a result, the investment consultant RFP scoring should reflect the impact that the asset allocation process has on the long-term health of the plan, especially compared to other factors.

	Weight
Fees	15%
Firm Resources	20%
Skill of Assigned Personnel	20%
Investment Consulting Processes	35%
Potential Conflicts of Interest	10%
Total	100%

Investment Consulting RFP Review

Request for Proposal (RFP)

The RFP for investment consulting services was issued in accordance with Board rules to evaluate service providers at the end of their contract. The RFP was issued to all consulting firms in the Pensions & Investments consulting database with at least \$1B in assets under advisement (AUA) for government defined benefit plans and the incumbent consultant.

SERS' received proposals from the following firms:

- Buck Consulting (Xerox)
- Callan Associates
- Champion Capital Research
- Hyas Group (Incumbent Consultant)
- Meketa Investment Group
- Milliman Investment Consulting
- NEPC, LCC (formerly New England Pension Consultants)
- Pension Consulting Alliance
- RVK, Inc. (formerly RV Kuhns)
- Segal RogersCasey
- State Street Global Advisors
- Verus Investments (formerly Wurts)
- Wilshire Associates

Scoring Committee

The Scoring Committee was comprised of volunteers from the Board and Retirement staff:

- Mike Coster (Board Chair)
- Mike Cavanaugh (Board Member)
- James Tieken (Board Member)
- Phillip Tencick (Retirement Director)
- Christine Shisler (Assistant Retirement Director)

Scoring Methodology

The RFP noted that scoring would be based on the following categories. The weightings for each category were subsequently determined by the Scoring Committee based on the relative impact each estimated to have on the long-term performance of SERS.

- Fees (15%)
- Firm Resources (20%)
- Skill of Assigned Personnel (20%)
- Investment Consulting Process (35%)
- Potential Conflicts of Interest (10%)

The Scoring Committee reviewed the submissions of all 13 respondents, with scoring tabulated for 12 firms. Champion was disqualified since it did not meet the submission deadline and it did not currently have any government clients with assets under advisement.

The top rated firms following the initial scoring were (in order):

- Wilshire
- Meketa
- Segal RogersCasey
- NEPC
- PCA
- Callan
- Hyas

Of these firms Meketa and Segal RogersCasey were eliminated. Subsequent to the proposal, Meketa announced the resignation and replacement of its CEO. The position was filled by two co-CEO's. This change in leadership, and the unusual governance structure provided too much risk to warrant further consideration. Segal RogerCasey's was eliminated based on the proposed team that would be assigned to SERS. The lead consultant currently covers 19 consulting clients, which is more than double the average client load for the other lead consultants proposed. Additionally, there was no back-up consultant assigned, which all of the other top-rated firms included, and the support staff was not sufficient to overcome the limited availability of the lead consultant.

Further due diligence was conducted on the remaining five firms, including reference checks. Following the additional diligence process, the Scoring Committee recommends inviting the following firms to provide in-person presentations at the October 28th Board Meeting.

- **Hyas** – The Scoring Committee is very satisfied with Hyas. As a small firm, they rely on personalized service and meeting the unique needs of the client. Jayson is highly regarded by Hyas clients to the point that other clients followed him from Arnerich Messina to Hyas. The review process did not expose any areas of concern that would warrant their replacement.
- **PCA** – PCA was the stand out mid-size firm, providing a blend of personalized service and supporting resources. PCA's asset allocation group has developed a proprietary risk factor ranking model that stood out from the other firms' process. Determining the working relationship of the two proposed co-leads will be important during the final presentations.
- **Wilshire** – Wilshire was the highest scoring large firm. As a large firm, they have extensive resources supporting the consultants in the areas of asset allocation, manager research, and market research. Despite the size, consultants have more autonomy than at other large firms to provide client-specific services. The reference checks helped overcome concerns about their independence due to the many business lines they provide. The investment philosophy of the lead consultant will be important to determine during the final presentations.
- **Callan** – Callan is a large firm with a depth of resources. They stand out in their understanding of the peer universe and attribution of returns. They seek to provide consistent services based on what has worked well for other clients. Callan's references from clients were very strong, and they were highly thought of by the plans that ended up picking another consultant. Understanding how factor risk is built into the asset allocation model will be important during the final presentations.

Asset Allocation Primer

Asset Allocation: A mathematical model that attempts to minimize risk for a targeted level of return. The model's output is the target asset class weightings. The output is influenced by the assumptions, constraints, and methodology used.

Output: Asset class weightings

The allocation study models all of the different asset class weightings to determine the combined weighting that will minimize risk for the targeted rate of return.

Asset classes can be defined broadly (e.g. stocks vs. bonds) or narrowly (e.g. large cap US stocks, mid cap US stocks, etc. vs. government bonds, corporate bonds, long duration bonds, etc.). The more narrowly defined the asset classes, the greater the likely forecast error (harder to estimate); the more broadly defined the asset classes, the greater the likely implementation error (harder to meet target returns).

Assumptions: Expected Returns, Expected Risk, Correlations

- Expected Returns – The forecast annualized investment return for each asset class
- Expected Risk – The volatility of the expected returns (e.g. how wide the range of outcomes is likely to be, or more simply, how likely you are to lose money)
- Correlations – How the returns of one asset class are related to all other asset classes. This measures how much diversification each asset class provides in the portfolio

Notes:

- 1) Each firm develops their own estimates for each of the three assumptions. There is no generally accepted standard. Small changes in the assumptions may result in significant impacts on the model's optimal weighting for each asset class.
- 2) The assumptions are *forward looking*. The allocation model is trying to determine the portfolio that will be optimal *in the future*. Some firms do extensive work trying to build forecasts from fundamental economic and market factors, while others use historic data and assume that future outcomes will match past performance. Without back testing a firm's assumptions versus actual market results, there is no definitive method to say which practice is better. Only one firm, Wilshire, provided back testing for their historic assumptions.

Constraints: Manual limits built into the model to try and eliminate extreme outcomes.

Asset allocation models will often produce results that conflict with common sense. This is because the model does not fully capture the complexity of the real world. The more constraints required, the greater the limitations of the model. Constraints can also be thought of as the "fudge factor"

Methodologies:

		Liabilities Used?	
		No	Yes
Risk Factors	Single Risk	Mean Variance Optimization (MVO)	Asset Liability Model (ALM)
	Multi Risk	Multi Factor MVO	Multi Factor ALM

- 1) **Mean Variance Optimization (MVO)** – Maximize asset returns using price volatility as the *only* measure of risk.

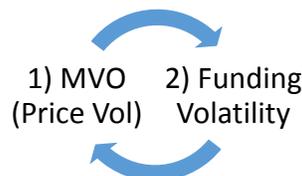
MVO models select the investments that have the highest returns with the lowest price volatility (e.g. largest Sharpe Ratio). This method favors illiquid investments since they don't have as much price volatility as publicly traded investments, even though illiquid investments have many other risks. This preference for high Sharpe investments requires significant constraints to make the model produce a workable solution.

- 2) **Multi Factor MVO** – Maximizes asset returns using multiple risk factors

Multi Factor MVO models incorporate multiple risk factors into a single measure of risk and then seeks the asset allocation that meets the target return while minimizing the consolidated risk factor. This model does not take into account the plan's liabilities and may come up with an allocation that does not minimize funding volatility (e.g. creates a mismatch between the assets and liabilities).

- 3) **Asset Liability Modeling** – Minimize funding volatility using price factor as **only** measure of risk

Asset allocation models can only solve for one risk factor at a time. To try and minimize multiple measures of risk at the same time, the risk factors must be consolidated into a single factor (see #2) or by solving for one risk factor (price volatility) and then seeing how small changes impact the second risk factor (funding volatility). The model is rerun until both measures of risk are at the lowest combined level that can be found.



- 4) **Multi Factor ALM** – Minimize funding volatility using multiple risk factors

Multi Factor ALM models incorporate multiple risk factors into a single measure of risk and then seeks the asset allocation that meets the target return while minimizing the consolidated risk factor. The model then measures how small changes impact the funding volatility of the plan and adjusts weightings until both the multi factor risk measure and the funding volatility are minimized for the targeted rate of return. This method is the most comprehensive means of modeling portfolio risk and how those risks will impact the ability of the plan to meet its liabilities.



Risk Minimization Methods

