Pension Board Minutes – May 11, 2022

Attending: Alderman: Sharon Davis, Carrie Savage, Bill Gillam and Anna Tadio: School Commissioners: Charlene Seward, and Cathy Solsaa and Chair, Mary Markowski

Absent: Alderman, Matt Whitcomb, and School Commissioners, Tricia O'Connor, MaryBeth Lennox-Levins.

Others Attending: Stephanie Stoodley, School Commissioner, Ted Plemenos, Rutland Public Schools; Peter Amons and Lazaro Guzman, Empower (via zoom).

The meeting was held in person at the Rutland School Building on 6 Church Street. The meeting was called to order at 5:30pm.

There were no additions or deletions to the agenda.

The first order of Business was review and approval of the minutes of October 14, 2021. The motion to approve the minutes was made by Sharon Davis and seconded by Carrie Savage, motion passed.

The Chair introduced Lazaro Guzman from Empower, formerly Prudential Retirement. Lazaro explained that Empower acquired all of the Prudential retirement business, including defined benefit, defined contribution and non-qualitied plans. Lazaro was part of the Prudential defined benefits team and transitioned to the Empower defined benefit team. Lazaro will continue to service the City Pension plan and oversee the plan investments. At this point the service should move forward with few changes. Empower defined benefit now acts as the plan fiduciary, which includes managing the plan asset allocations and managing individual funds by closely monitoring funds and vetting individual fund managers.

Peter Amons asked about the plan holdings in the Prudential proprietary funds. He questioned whether the fund managers would be going with Empower or staying with Prudential. Lazaro noted that there are a couple of funds that have Prudential in the name, particularly on the fixed income side. Some of those funds that are held in the City portfolio did not come over to Empower. The fund managers stayed with Prudential and they will continue to manage the funds on behalf of the Empower clients and their own clients. They are now treated as a third-party investment manager similar to other funds in the portfolio. Ted asked about the impact to fund fees given the third-party relationship. Lazaro noted that the fund fees will remain the same. No fee changes are anticipated as a result of the acquisition. Stephanie asked whether there would be a move out of the Prudential funds or if the plan would stay with those funds. Lazaro commented that these funds would continue to be subject the same criteria as other funds in the portfolio. Third party and affiliated funds are held to the same standard.

The discussion moved onto the economic outlook as outlined in page 27 of the packet. Lazaro noted that there has been a lot going on in the economy, including, impact of COVID and war in Ukraine leading to potential increased inflation and increased interest rates. The economy weakened during the first quarter and could weaken further depending on the path of the war in

Ukraine and energy markets. Real GDP growth of 3.5% is possible this year followed by growth of 3% in 2023. Economic challenges include supply chain issues. The first quarter definitely came with a lot of challenges and that is reflected in the market returns for the quarter end and the market drops following the quarter end.

Financial Market returns were reviewed on page 28. World equity markets were a rollercoaster ride with major stock indices suffering their worst performance in two years. The S&P index reported its worst performance since the start of the pandemic. Investment grade bonds dropped nearly 6% resulting in its largest quarterly loss in more than 40 years. Beyond the first quarter results there continues to be significant market volatility.

From a sector perspective, most sectors were negative for the quarter with the exception of Energy and Utilities. Telecomm Services and Consumer Discretionary were the weakest performing sectors during the first quarter. The Energy Sector performance was supported by the surging demand and fears of supply cuts due to the Ukraine crisis. Lazaro stressed that these results really underscore the need for a diversified portfolio. He noted that the City retirement plan has energy exposure throughout the portfolio within the various fund holdings.

Lazaro provided a review of the fixed income portfolio. He noted that fixed income returns were down for the quarter and for the one-year returns. Interest rates have been moving upwards and the Fed has been adjusting rates to manage inflation concerns.

On page 34, Lazaro reviewed the Economic & Market Outlook noting the overall market volatility. He noted that last year inflation was considered "transitory" and that he believes that some of the inflation is transitory due to pent up demand with reduced spending during COVID. A big part of the inflation is here to stay and the Fed rate increases should ease inflation but after the easing there may be an uptick in inflation. With respect to Fed tightening, the economy should continue to grow and equities can deliver positive returns with the initial stages of Fed tightening. The wild card is the war in Ukraine and the impact to the global markets and the possibility of throwing economies into recession. This is what is driving the negative returns in the market. The war has really derailed the outlook for 2022 and has created the increased volatility. The market risk is different than what has been experienced in the past, however, Empower continues to manage with a long-term approach, including, maintaining fixed income positions and a well-diversified portfolio.

Charlene questioned whether this was an opportunity to take advantage of the inflationary period by increasing energy holdings. Lazaro noted that the way to take advantage is when we have big drops in equity positions then there would an opportunity to re-balance the portfolio. In the first quarter the portfolio dropped by 5% and that is expected to drop further in the second quarter. The rebalance would shift from over-weighted fixed income to the under-weighted equity positions. At the individual fund level each manager may shift fund positions to take advantage of opportunities as they arise.

Peter asked about the flow of funds on a monthly basis. Lazaro noted that there is roughly $8 million going out of the fund annually and only $5million coming in on a cash flow basis. On a strict cash flow basis there is more going out than coming in. Prior to the last quarter, asset returns were very positive. Sharon noted that the payout versus the revenue coming in will continue to be negative due to the city participation going down. This ratio of funds going out and coming in will continue. Based on the projected return on the portfolio the Actuary can project the funding requirements.

Ted asked about the yield curve on page 33 and if there are concerns about the flatness of the curve from year 3 to year 30. Lazaro noted that many analysists view the flat yield curve as an indicator of a recession. He noted concerns about the yield curve and the possibility of a recession in the next few years. The portfolio is positioned to weather an economic recession. There may be some negative returns but the long-term position provides offset to negative returns. Ted asked about the rebalancing and whether it is done during the quarter or at the end of the quarter. Lazaro stated that it is usually at the end of the quarter but it is not done as one time trade date.

Peter asked about inflation and whether it hurts stock investments or helps bonds. In the initial stages of inflation, stocks can go up, however the bigger impact is how the Fed manages inflation. If the Fed really starts to increase rates, you'll see the impact on stocks. That isn't what's been seen at this point. The biggest impact on stock prices is the ability to pass price increases on to consumers.

The current portfolio allocation is 60% equity and 40% fixed income. The fixed income portion accounts for roughly $40 million available to cover about five years of disbursements. This provides a buffer to the equity exposure. In periods of heightened volatility this buffer provides the ability to purchase equities versus selling to meet cash needs. The 10-year return on the fund was 8.3%. The assets are delivering on fund expectations based on the long-term actuarial expectations that is 7.5% or less.

Lazaro provided additional review of specific holdings in the portfolio. On page 36 of the packet the executive summary outlines the funds in the portfolio and rates the managers to the specific index or Morningstar rating. Funds that "meet the performance criteria" should outperform the index over the 3-5yr period or maintain a top half ranking in the peer universe for the same period. As of the end of the 1st quarter, the majority of funds meet the performance criteria with approximately 16% of the portfolio in funds that are not meeting the performance criteria.

The three funds that are not meeting the performance criteria are:

Core Bond Enhanced Index – The fund objective is to track the Bloomberg US Aggregate Bond Index. This represents about 7% of the portfolio. No replacement is recommended at this time.

Int'l Blend/Pictet Asset Fund and Int' Growth/Artisan Partners Fund – These funds represent about 9% of the portfolio. The Artisan fund has started to rebound and is competitive in the 10-year return. There is no recommendation to replace this fund. The Pictet fund is on the watch list and it did underperform. There may be a change in the manager if the performance does not improve. This fund is being monitored very closely. Replacing the manager impacts all clients invested in the fund. Charlene asked about the three underperforming funds and whether it was typical to have those in a portfolio. Lazaro explained that they strive to have all funds that are performing but it's not uncommon to have 10-15% of the portfolio in funds that are not meeting their criteria. This is still in the acceptable range. Empower will continue to monitor the Pictet Fund and may need to take action at the organizational level. The first quarter has been very volatile so it's not unusual to have a portion that is underperforming. Of note with the combined portfolio the two international funds have less than one-half of a percent with direct exposure to Russia.

In summary, there are a couple of funds to continue to watch and the first quarter has been very volatile. The overall portfolio is well diversified and well positioned going forward. The long-term view on the portfolio has been effective and Empower will keep that same approach going forward.

Lazaro will be available for an in-person meeting in the fall. The committee agreed that a combined meeting with the Actuary would be helpful.

With no other business the meeting adjourned at 6:33pm.

Respectfully submitted,

Mary A. Markowski