CITY OF LOS ANGELES
BOARD OF DEFERRED COMPENSATION ADMINISTRATION

PROPOSED MINUTES
REGULAR MEETING SEPTEMBER 18, 2012 – 9:00 A.M.
700 E. TEMPLE STREET, ROOM 350

BOARD MEMBERS:

Present:
Eugene K. Canzano, Chairperson
John R. Mumma, Vice-Chairperson
Clifford Cannon, First Provisional Chair
Tom Moutes, Second Provisional Chair
Michael Amerian
William Raggio
Robert Schoonover

Not Present:
Sangeeta Bhatia, Third Provisional Chair
Margaret Whelan

Staff:
Personnel: Steven Montagna
Natasha Gameroz
Esther Chang

City Attorney: Curtis Kidder

1. CALL TO ORDER

The meeting was called to order at 9:04 a.m.

2. PUBLIC COMMENTS

There was no public comment.

3. MINUTES

A motion was made by Mr. Moutes, seconded by Mr. Cannon, to approve the August 21, 2012 minutes; the motion was unanimously adopted.

Mr. Amerian arrived at 9:15 a.m. Mr. Schoonover arrived at 9:23 a.m.

4. INVESTMENT PERFORMANCE REVIEW & INVESTMENT PROVIDER PRESENTATIONS

Mr. Devon Muir, of Mercer Investments Consulting, stated that he would be presenting a brief economic overview as of the second quarter. He stated U.S. equities had shown negative performance but were doing well year-to-date and had outperformed international equities. He stated in a market that rewarded safe haven assets, bonds had tended to perform well, and longer maturity securities performed better than shorter term securities. He stated the most economically sensitive sectors of U.S. equities were lagged in performance while the more stable sectors, such as consumer staples, utilities, telecommunications, and other dividend paying stocks tended to show positive performance. He stated that within the international equity landscape, the United Kingdom tended to perform similarly with the U.S.; however, other developed European countries tended to underperform, and emerging market economies underperformed relative to developed economies. He stated that year-to-date, U.S. equities had shown an 18% return, while developed and emerging were up about 13%. He indicated a shift back to risk since the end of the second quarter.

Mr. Canzano asked about the underperformance of Germany. Mr. Muir indicated Germany had been a major producer in the Eurozone; as such, the economic slow-down there was having a significant effect on Germany's market. Mr. Matt Clark, of PIMCO, stated that as Europe was still dealing with its debt crisis and regional coordination issues, the main difference since last year was that policy makers and central banks were more engaged in trying to address market challenges. He stated the result of Europe's central bank's decision to support peripheral bond yields of countries such as Spain, Italy, and Portugal by buying their bonds, with conditions, was providing additional time to resolve structural challenges. Mr. Mike Norman, of Galliard, stated the U.S. was still considered the safe harbor worldwide. He indicated that while Moody's was now also considering a credit downgrade of the U.S. as S&P had done a year ago, there should still be a high demand for U.S. government securities, though there may be a bit of volatility should a downgrade occur.

Mr. Clark stated that two major concerns were overall price stability and the level of unemployment. He indicated that PIMCO's 3-5 year outlook predicted low levels of growth across the world relative to what was enjoyed prior to the financial crisis. He stated that expected real GDP growth in the U.S. may range between 0-2%, when normal growth of GDP was around 3%. He stated that in Europe, growth would struggle to remain at a positive level and would hover around 0% growth. He indicated that developing countries may also see a 4-5% growth rate when normally growth is at 7-9%. He stated that PIMCO anticipated Treasury yields to remain at about 2% for the next two years as the federal government attempts to provide time for policy makers to deal with a possible fiscal cliff. He indicated that in January, there will potentially be a $700 billion fall out of the U.S. market due to the expiration of Bush tax cuts and other budgetary cuts that may come into effect. He indicated it was difficult to foresee what central banks may do as they have been acting in a nontraditional manner. He indicated that inflation was almost at 2%, with almost 8% unemployment; though there was no large risk in the next year, he stated that there was a risk concern with the 3-5 year outlook. Mr. Clark indicated active management, especially in the case of a worst case interest rate scenario, would be best to mitigate risk.

Mr. Muir asked if there were any concerns regarding the stable value market. Mr. Norman explained that a stable value fund consisted of an underlying fixed income portfolio and an insurance contract issued by a bank or insurance company which acted as a “wrap” around the portfolio. He stated that wrap insurance providers allowed participants to transact at book value, which was principal plus accrued interest, rather than at market value. He stated that the insurance companies covered the difference between the two values. He indicated that wrap providers have begun to take a stronger stance on risk management, and have increased fees and have attempted to contract investment guidelines. He indicated that wrap capacity was slowly returning to the stable value space, but wrap providers were focusing on select stable value providers in order to focus efforts on fewer firms to understand how the firms operate and their investment strategies. He indicated that all rising interest rate environments were not always the same; he stated that should inflation rise, the Plan’s portfolio would be managed accordingly.

Mr. Clark stated that PIMCO was managing a little over $170 million for the City’s PIMCO bond fund. He indicated year-to-date performance through June was at 5.8% after fees, and that the fund had outperformed its benchmark by 338 basis points. He stated that the PIMCO fund had returned 8.6% since inception, which was around 200 basis points above benchmark. He indicated there had been negative performance in 2011, but the fund had since recovered in 2012. Mr. Muir asked about the portfolio’s construction, as PIMCO had eliminated Treasuries completely in 2011. Mr. Clark stated that they had been worried about the return on the Treasury market, however, the economic market then deteriorated and the Treasury market had experienced an unprecedented rally. He stated PIMCO had since recalibrated its Treasury exposure but maintained some elements in 2011 which had also been hurtful but rallied well in 2012. He indicated that more recently, in the last one to two months, PIMCO had pulled back on interest rate exposure anticipating movement of the federal government. He added that PIMCO was also pulling back on 30-year Treasuries, substituting them with 30-year TIPS to better offset inflation concerns.

Mr. Norman indicated Galliard’s Stable Value Fund has had very consistent performance. He stated that year-to-date the fund has returned 1.46%, net of fees, which outperformed the benchmark at 0.46%. He indicated that since the fund’s inception approximately 12-13 years ago, the fund had returned over 2% above its benchmark. He indicated that the Fund currently totaled $842 million in assets. He stated that in anticipation of rising interest rates, Galliard was moving to decrease the effective duration on bonds.

Mr. Cannon asked how realistic it would be to see a downgrade in the U.S. credit rating. Mr. Clark indicated unless there was a credible agreement to address the trajectory of deficits and the overall level of domestic debt, a downgrade was a real possibility. He stated however that even with a downgrade, it may not significantly affect the desirability of U.S. bonds unless non-U.S. economies improve. Mr. Norman stated he believed Moody's would eventually fall in line with S&P.

A recess was called at 10:11 a.m. The meeting reconvened at 10:23 a.m.

Mr. Muir reviewed the Plan's remaining investment options, including recent performance, and the Plan's fees and assets. He additionally stated that he and staff were in the initial stages of discussing alternative investment options and asset classes that might serve well in an inflationary market. He indicated there were investment options such as a REIT fund, a TIPS fund, or a type of commodities fund, if structured in a risk managed fashion. Mr. Montagna stated that staff and Mercer would explore the potential components of such a product and determine if there were products on the market or if a custom solution would be necessary; he stated recommendations would be brought before the Board.

5. BOARD REPORT 12-46: BANK OF THE WEST CONTRACT AMENDMENT

Mr. Montagna stated staff had finalized an amendment to the Bank of the West contract. He stated the purpose of the amendment was to reduce the interest rate floor from 1% to 0.75%. He indicated this was part of the larger discussion related to the FDIC-Insured Savings Account, where the Board had previously approved a proposal to shift a larger portion of the total assets in the fund to one bank if the bank was offering a significantly higher interest rate than the other banks. He stated Bank of the West, even with the reduction in interest rate, would be offering a significantly higher interest rate than the other two banks. He stated once the Board approved the amendment, the funds would be shifted on November 1, tentatively. He indicated there were approximately 10,000 participants invested in the fund, however, only 20 individuals would actually be affected by a decrease to their maximum FDIC insurance coverage. He stated the participants would still have an option through the self-directed brokerage if additional coverage was desired. He indicated the information would be directly communicated to those affected as well as to all participants through the Plan's newsletter. Mr. Canzano asked for clarification on those impacted; Mr. Montagna indicated it would be for those participants with balances above $500,000 invested in this option.

A motion was made by Mr. Mumma, seconded by Mr. Schoonover, to approve an amendment to the City's contract with Bank of the West, incorporating a reduction in the interest rate floor, and to authorize the Board Chairperson to execute the amendment; the motion was unanimously adopted.

6. BOARD REPORT 12-47: STAFF REPORT

Ms. Chang stated the report was recommended for receive and file. Mr. Canzano asked if there was any particular reason for the increase in counter activity. Ms. Chang indicated there might have been a slight increase due to inquiries related to a letter sent to participants earlier in the month that was related to a rollover fee that had previously not been applied. Mr. Canzano also commented on Roth participation and indicated it was gradually increasing. Mr. Montagna indicated staff had recently discussed an idea about a short, monthly newsletter that could assist in the repetitive delivery of these types of messages. Mr. Raggio inquired if there was a method to routinely distribute information through the City's email system. Mr. Montagna indicated the Plan has communicated via the City-wide email system to distribute information related to annual contribution limit changes, Roth implementation, and National Save for Retirement Week.

A motion was made by Mr. Mumma, seconded by Mr. Moutes, to receive and file staff's report; the motion was unanimously adopted.

7. REQUESTS FOR FUTURE AGENDA ITEMS

8. NEXT MEETING DATE – OCTOBER 16, 2012

9. ADJOURNMENT

A motion was made by Mr. Cannon, seconded by Mr. Amerian, to adjourn the meeting; the motion was unanimously adopted. *The Board adjourned at 10:51 a.m.*

Minutes prepared by staff member Esther Chang.