

Deferred Compensation Plan

BOARD REPORT 14-39

Date: September 30, 2014

To: Board of Deferred Compensation Administration

From: Staff

Subject: Investment Committee Recommendations for Fund Selections: Active Core Bond, Small-Cap Growth, and Small-Cap Value Equity

Board of Deferred Compensation Administration
Eugene K. Canzano, Chairperson
John R. Mumma, Vice-Chairperson
Cliff Cannon, First Provisional Chair
Tom Moutes, Second Provisional Chair
Michael Amerian, Third Provisional Chair
Ray Ciranna
Mary Higgins
David Luther
Robert Schoonover

Recommendation:

That the Board of Deferred Compensation Administration approve the recommendation of the Investments Committee to make the following fund selections:

- (a) **Loomis Sayles Core Plus Bond Fund** to replace the PIMCO Total Return as the active component of the Deferred Compensation Plan Bond Fund;
- (b) **DFA U.S. Small Cap Value Portfolio** as the new active value component of the Deferred Compensation Plan Small-Cap Fund; and
- (c) **Hartford Small Cap Growth HLS Fund** as the new active growth component of the Deferred Compensation Plan Small-Cap Fund.

Background:

This special meeting is being held to expedite consideration of the replacement of the PIMCO Total Return Fund with the Loomis Sayles Core Plus Bond Fund. The Loomis Fund is being recommended as a result of a fund review selection process initiated by the Board earlier in 2014. The Board's Investments Committee completed its work for the active bond mandate earlier this week, on Monday September 29th. An expedited action to approve the new fund and transfer assets from the incumbent provider is deemed prudent by the Investments Committee, Investments Consultant, and staff. This is due to a recent significant management change involving the incumbent active bond provider, PIMCO, which may result in significant outflows for the Total Return Fund, which in turn could result in liquidity restrictions for Plan participants or, longer term, negatively impact returns. Staff is including Investments Committee recommendations for new Small Cap Active and Growth providers.

At its February 18, 2014 meeting, the Board adopted revisions to the Plan's Investment Policy Statement (IPS) incorporating the option for a mutual funds search process for filling certain investment manager mandates as approved by the Board, and further approved a proposed search schedule for the Plan's various investment options as recommended by staff.

At its March 18, 2014 meeting, the Board further approved specific search criteria for each asset category such that the Board's investment consultant, Mercer Investment Consulting ("Mercer"), could initiate its search processes and present findings to the Board's

Investments Committee for the purpose of the Investments Committee generating final recommendations to the full Board. The Investments Committee is chaired by Gene Canzano and includes Michael Amerian, Mary Higgins and Tom Moutes.

The Board’s approved searches for 2014 include the following mandates:

	Investment Menu Option	Fund Sub-Category	Presently Filled?	Incumbent Provider	Incumbent Fund	Assets	Adopted Search Vehicle
	Search Year - 2014						
ACTIVE MANAGERS	DCP Small-Cap Fund	Active Small-Cap Growth	No	n/a	n/a	\$105 million	Mutual Fund
	DCP Small-Cap Fund	Active Small-Cap Value	No	n/a	n/a	\$105 million	Mutual Fund
	DCP Mid-Cap Fund	Active Mid-Cap Growth	No	n/a	n/a	\$68 million	Mutual Fund
	DCP Mid-Cap Fund	Active Mid-Cap Value	No	n/a	n/a	\$68 million	Mutual Fund
	DCP Intl Fund	Active Intl Developed Mkts	Yes	Fidelity	n/a	\$214 million	Mutual Fund
	DCP Intl Fund	Active Intl Emerging Mkts	No	n/a	n/a	\$58 million	Mutual Fund
	DCP Intl Fund	Active Intl Small-Cap	No	n/a	n/a	\$58 million	Mutual Fund
	DCP Bond Fund	Active Bond	Yes	PIMCO	Total Return Fd	\$179 million	Mutual Fund

The Investments Committee established a review process involving a series of meetings during which the Committee reviews the fund search results in a designated order, reduces the search results to a smaller number of finalists, and then considers the finalists in greater detail in order to develop a recommendation to the full Board.

On August 28, 2014, the Investments Committee met to review the search results for the Active Bond, Active Small-Cap Value, and Active Small-Cap Growth fund categories. The Committee established a list of finalists for further review for each category.

On September 29, 2014, the Investments Committee reviewed a subsequent report from Mercer providing more detailed findings regarding the finalists in each category. Following are the results and recommendations of the Investments Committee.

(A) ACTIVE CORE BOND

The Active Core Bond category makes up 50% of the underlying allocation for the DCP Bond Fund, an option in the Plan’s core investment menu (the other half of the DCP Bond Fund is a fund passively managed by Vanguard). Based on June 30, 2014 values, the estimated mandate size for the active allocation of the fund is approximately \$179 million (including assets invested in the risk profile portfolios).

Twelve funds were initially identified as having met all of the essential criteria adopted by the Board. The Investments Committee identified the following funds as finalists for additional review:

1. Dodge & Cox Investment Managers
2. Loomis, Sayles & Company
3. TCW Group (MetWest)
4. Pacific Investment Management Company (PIMCO)

Upon review of the subsequent report from Mercer, and discussion of the merits of each option, the Investments Committee is recommending that the **Loomis Sayles Core Plus Bond Fund** (“Loomis Fund”) be selected as the new Active Bond fund component of the Deferred Compensation Plan Bond Fund. The Loomis Fund is being recommended for its strong results within a range of criteria applied to this fund search, including long-term performance, management team depth, personnel stability, portfolio construction, competitive fees, performance in different market environments, risk-adjusted returns, and other criteria reviewed by the Committee and detailed in the attached consultant report.

PIMCO Total Return Fund & Transfer of Assets – On September 26, 2014, PIMCO announced that Total Return Fund manager William Gross would be leaving the firm. This management change is deemed significant by industry observers and the Board’s consultant because of Mr. Gross’ longstanding and prominent role in managing the Total Return Fund. There is a significant possibility that a substantial amount of assets could leave the Fund in the coming weeks and months. Although PIMCO has indicated that it will maintain sufficient liquidity to honor all redemption requests, mutual fund companies have the ability to restrict fund outflows if they deem it necessary. In addition, a significant level of ongoing redemptions may serve as an immediate distraction to the portfolio management team and over the longer-term, depress returns. Given this, the Investments Committee, Investments Consultant, and staff deem it prudent to execute the fund transfer from PIMCO to Loomis as soon as practicable.

Great-West Retirement Services normally requires 60-90 days to execute a transfer between fund providers. At the request of the City, Great-West is expediting the transfer such that it will occur within approximately 8 working days of the Board action (approximately October 14th).

(B) ACTIVE SMALL-CAP VALUE

The Active Small-Cap Value category makes up one-third of the underlying allocation for the DCP Small-Cap Fund. This mandate is presently unfilled (no incumbent). The Plan’s small-cap assets are presently 100% passively managed, but upon selection of Active Growth and Value providers, the DCP Small-Cap Fund will be established with the following components: 34% passive, 33% growth, and 33% value. Based on June 30, 2014 values, the estimated mandate size for each category is approximately \$105 million (including assets invested in the risk profiles).

Fourteen funds were initially identified as having met all of the essential criteria adopted by the Board. The Investments Committee identified the following funds as finalists for additional review:

1. William Blair & Company
2. Federated Investors
3. American Beacon Advisors

Upon review of the subsequent report from Mercer, and discussion of the merits of each option, the Investments Committee is recommending that the Dimensional Fund Advisors U.S. Small Cap Value Portfolio (“DFA Small-Cap Value”) be selected as the new active value small-cap fund component of the DCP Small-Cap Fund. The DFA Small-Cap Value Fund is being recommended for its strong results within a range of criteria applied to this fund search, including long-term performance, management team depth, personnel stability, portfolio construction, competitive fees, performance in different market environments, risk-adjusted returns, and other criteria reviewed by the Committee and detailed in the attached consultant report.

(C) ACTIVE SMALL-CAP GROWTH

The Active Small-Cap Growth category makes up one-third of the underlying allocation for the DCP Small-Cap Fund. Eleven funds were initially identified as having met all of the essential criteria adopted by the Board. The Investments Committee identified the following funds as finalists for additional review:

1. The Hartford Mutual Funds (HartfordSCG)
2. The Hartford Mutual Funds (HartfordSmCo)
3. Eagle Asset Management

Upon review of the subsequent report from Mercer, and discussion of the merits of each option, the Investments Committee is recommending that the Hartford Small Cap Growth HLS Fund be selected as the new active small cap growth fund component of the DCP Small-Cap Fund. The Hartford Small Cap Growth Fund is being recommended for its strong results within a range of criteria applied to this fund search, including its long-term performance, management team depth, personnel stability, portfolio construction, competitive fees, performance in different market environments, risk-adjusted returns, and other criteria reviewed by the Committee and detailed in the attached consultant report.

Submitted by: _____
Steven Montagna