

NORWALK MUNICIPAL EMPLOYEES' PENSION BOARD MINUTES

Revised 3/1/2006 CITY OF NORWALK
MUNICIPAL EMPLOYEES PENSION BOARD
FEBRUARY 1, 2006

ATTENDANCE: Charles Pirro, Acting Chairman; Michael Sweeney; Gerald Moran; Michael Salvator; Patricia McCormick (6:15 p.m.)

STAFF: Sara LeTorneau, Director of Personnel & Labor Relations; Fred Gilden, Comptroller

OTHER: Ellen Petrino, EAI (6:10 p.m.); Carolyn Nelson, Marco Vangelisti – GMO (Via Phone)

CALL TO ORDER

Acting Chairman Pirro called the meeting to order at 6:05 p.m.

APPROVAL OF PENSION APPLICATIONS

Mr. Frank A. Harris, BOE Food Services Director; 38 yrs, 6 months of service; age 83; regular pension; final average salary \$92,533.29; option #3; annual benefit \$48,780.00; monthly benefit \$4,065.00; commencement date March 1, 2006.

Acting Chairman Pirro confirmed with Ms. LeTorneau that she had reviewed the information with Mr. Harris, and that he was in agreement with it. She said Mr. Harris was appreciative of the advice he was given and amended the application.

**** MR. MORAN MOVED TO APPROVE THE PENSION APPLICATION FOR MR. HARRIS.**

**** MR. SWEENEY SECONDED.**

**** MOTION PASSED UNANIMOUSLY.**

APPROVAL OF MINUTES FOR JANUARY 11, 2006

**** MR. MORAN MOVED TO APPROVE THE MINUTES FOR JANUARY 11, 2006 AS PROVIDED BY MS. PETRINO AND REVISED 1/24/06.**

**** MR. SWEENEY SECONDED.**

**** MOTION PASSED UNANIMOUSLY.**

Ms. Petrino arrived at 6:10 p.m.

GMO - CAROLYN NELSON/MARCO VANGELISTI (VIA PHONE)

Ms. Nelson, from the Client Relations Team in Boston, and Mr. Vangelisti, from the Emerging Markets Team in California, gave a brief update on the firm, the emerging market equities outlook, and the portfolio.

Ms. Nelson explained that they remain steadfast to their value-oriented style of investing by using a risk-control approach. They are in private partnership with 39 partners. They have \$112B in assets under management, up from \$80B from a year ago. They have primarily an institutional client base. Over 40% of their clients have been with them for more than 10 years. By asset breakdown, 40% of their clients are public and corporate plans, 25% are endowments and foundations, and 25% are in the advisory business. Their median client has \$14M in assets. The asset allocation strategies have a variety of products with varying degrees of aggressiveness that utilize the equity, fixed income, and absolute return products. Asset allocation is an important part of their business. She mentioned that since March of 2003, their inception date, they delivered just shy of 50% annualized, which is 3 ½% over the benchmark.

Ms. McCormick arrived at 6:15 p.m.

Mr. Vangelisti explained that the real return asset class forecast is shown on page 8, and the colored part of the bar shows their yearly expectations for a passive index; the white part of the bar is the value added number, or what they think they can deliver above the index. If the equity asset class is fairly valued and fairly priced, they should deliver a 6 ½% real return on a yearly basis. The profit margins they have seen for emerging markets companies is above the trend, and he thinks that profitability will come down. Also on page 8, they would expect the emerging markets to deliver 6.7% instead of 3.6% in a normal environment. He recommends that they diversify as much as possible and compensate for the very low expected returns for asset classes. Going forward, he felt it would be unlikely that they would be compensated for taking additional risks. Moving into cash or conservative hedge funds right now would be recommended. On page 11, it shows the price to earnings ratio. They are at a peak right now in terms of earnings, and he doesn't feel that the level of earnings they had in the past is sustainable. The asset class is 40% over valued, but they don't see the risk of a meltdown in the asset class. It has been phenomenal for the asset class. On page 17, it shows the risk return profile of every asset class they follow. In the last two years, they got 23% (real return) for every 15% of risk that they had taken. The normal return to risk is 6% real return for 15% risk. He felt that they had been compensated well in the past for taking risks, but that trend might not continue in the future. He does recommend that they diversify as much as possible, move toward cash or cash equivalents if possible, and consider hedge funds, or hedge funds of funds. He confirmed for Ms. Petrino that each green dot shown on page 8 represents each asset class they follow. In general, it's the return they get for taking risks. The historical return for emerging markets is 6.7% when they are fairly priced. He said Ms. Nelson will send them information on the expected returns for all the asset classes.

Mr. Vangelisti then explained the positioning process of the portfolio. He said they don't use value momentum built at the country level. He said they like a country when it has grown slowly, or when it has emerged from a recession. They like currencies that are

cheap and not vulnerable. At the country level, the momentum they measure is mostly price momentum, as opposed to macro-economic factors. He confirmed that the word active, relating to the benchmark comparison, means the percentage weight to the country for the portfolio. He clarified that the EMF category on page 28 is their portfolio, not the emerging markets free index. On page 33 and 34, he spoke of the momentum vs. value, and that in the long run, both work, but at different times and over different years. The performance is shown on page 38, and there is no longer a small cap value bias. It is still a value portfolio, and it is not too far from the benchmark. He said they are a quantitative shop, and they build a quantitative way of determining the quality of a company. They look at the level of profitability of a company based on return on equity. They look at the stability of that profitability over time, and they look at the debt to equity ratio. He said that Mr. Amit Bhartia, located in Singapore, is the Fundamental Portfolio Manager who keeps in close contact with the brokers and performs the quantitative screening process. He said that they don't hire managers because they manage all the money, but within the optimizer, they set up a system in which they pick two portfolios, and they don't let the two portfolios trade with each other. Their goal is to outperform their benchmark, so whether the market is cheap or expensive as an asset class, it doesn't impact the way they make selections. He said they have been surprised by the resilience of emerging markets in the face of very high commodity prices. They looked at three major rallies of 100% in emerging markets in the 1990s. In the last three years, they had a 200% return. Most of that value has come because of earnings growth. He sees a shift in emerging markets, due to interest rates coming down and inflation being tamed.

Mr. Vangelisti explained the metrics for the currency and vulnerability. He said they don't see contagion at all. Currency is measured relative to the basket of currency of the trading partners of that country. Vulnerability is based on a particular number which is provided by Morgan Stanley. The model isn't complex. The dollar is at 7% of GDP, and it's actually a bit cheap now.

Ms. Petrino thanked both Ms. Nelson and Mr. Vangelisti for their presentation.

Some discussion followed regarding the presentation and the portfolio performance.

EAI – ELLEN PETRINO – YEAR END PERFORMANCE REPORT

Ms. Petrino distributed copies of her year end performance report. She said that Zesiger currently own 9 stocks in the portfolio in which, as a firm, Zesiger owns more than 5% of the shares outstanding. They are all small cap stocks. The Uranium Resources stock has gone up 100%, from \$.68 to \$1.38. This is now one of the larger market cap companies, and they own 21.6% of that stock. The cost basis was \$360,000, and the value is \$3.3M. It was 1% at cost when they bought it, and it's now at 8.7%. She said it's a big percentage of their portfolio, but a small percentage of the Norwalk portfolio. Mr. Pirro said that this is something they had talked about in previous years for each of the managers, and he thought that they needed to review the limits and guidelines for each of them. Ms. Petrino said that she and Ms. Zesiger had reviewed the guidelines, and they found that they were not in violation. It was agreed that they would discuss this at the next meeting.

Ms. Petrino reviewed commodities with some information from Goldman Sachs. She said institutions invest in the index futures, not spot commodities. It's an index fund of futures and constructed in such a way that you own the current contract that comes due in the next month. That's the way the Goldman Sachs and AIG indexes work. Within 5-9 days of expiration, they roll the contract to the next month. Active managers can gain the way the indexes roll, and they can try to outperform the index. That's where PIMCO would try to add some value, if they were rolling a contract. But instead they buy a SWAP, which is a total return of the index from Goldman Sachs or AIG, for example, and they are going to pay AIG LIBOR plus a certain rate. The IRS has told all managers that SWAPS will be treated unfavorably for tax purposes. It will be short-term gains, and it will be taxed at a higher rate. PIMCO is now going to do structured notes. She just received notice of this today, and she will provide this information in writing. She then explained a scenario in which you can buy a contract for less and sell for more, due to the spot price going up and depending on the price of the original contract. She then discussed backwardation and contango. Backwardation occurs when the spot price is higher than the roll price. It happens when you have a supply or demand shock, and it happens often with oil. Contango occurs when you have to pay more for the next contract. On the next page, she explained that there are four phases to commodities, and in two of those phases, commodities can outperform stocks and bonds. Commodities were up 40% last year due to commodity price rises even though the oil portion of the index lost about 12% in the rolls because it was in contango (it still is, but Goldman expects it to revert to backwardation as the supply glut diminishes). The PIMCO Commodity Real Return Fund is a great portfolio diversifier, and it has a volatility of 13%, which makes it less than stocks and more than bonds. It's historical return is about 12% which makes it a stock-like return. It has a negative correlation to both stocks and bonds.

DISCUSSION ABOUT ASSET ALLOCATION CHANGES

Ms. Petrino confirmed that the proposal was to take \$7M from Zesiger and \$8M from GMO. The reason they were going to take from emerging markets was that the stocks have done so well that they represent too much of the portfolio. There was some discussion of reallocating money between managers.

Ms. McCormick left at 8:05 p.m.

The commissioners (Board members?? Are they commissioners?) continued their discussion regarding the risk in the portfolio and reallocating money between managers.

**** MR. MORAN MOVED TO APPROVE TAKING \$5M FROM GMO.**

**** MR. SALVATOR SECONDED.**

**** MOTION PASSED UNANIMOUSLY.**

**** MR. GILDEN MOVED TO APPROVE MOVING \$5M INTO THE PIMCO ALL ASSET FUND.**

** MR. SALVATOR SECONDED.
** MOTION PASSED UNANIMOUSLY.

OTHER BUSINESS

Acting Chairman Pirro said that there has been a negative impact in the press regarding the city budget being high because of the pension fund not producing. In an effort to dispel that negative impact, and have everyone better informed, they discussed some opportunities to get this done. Chairman Murphy is in the process of getting something set up.

ADJOURNMENT

** MR. MORAN MOVED TO ADJOURN.
** MR. SWEENEY SECONDED.
** MOTION PASSED UNANIMOUSLY.

The meeting was adjourned at 8:35 p.m.

Respectfully submitted,

Carolyn Marr
Telesco Secretarial Services

