

Montgomery County Employees' Retirement Board

Meeting Minutes from Tuesday, February 1, 2011

A meeting of the Montgomery County Employees' Retirement Board was held on Tuesday, February 1, 2010 at 11:00am in the Commissioner's Conference Room, 8th Floor in Norristown, PA 19404.

Members present: Commissioner James Matthews, Chairman; Commissioner Joseph Hoeffel, Vice Chairman; Commissioner Bruce Castor; Controller Diane Morgan, Secretary; Thomas Ellis, Treasurer

Also in attendance: First Deputy Controller Kevin Hoke; Deputy Treasurer Ava Tuturice; Finance Director Randy Schiabe; Retirement Manager Marisol Lezcano; Pension Accountant John O'Brien

Outside Presenters: Malcolm (Skip) Cowen, Managing Director of Cornerstone

Secretary Diane Morgan called the meeting to order at 11:15am.

Cornerstone reviewed the 1-year numbers. There was tremendous performance; the S & P was up. If you made riskier investments you made money. Therefore there was some underperformance for the Retirement Fund because the portfolio is more conservative. Red numbers in fixed income. Cornerstone will be paying more attention to bonds. Because interest rates shifted up, the value of the bonds will go down. If the feds start to tighten, rates could rise and the portfolio could face some difficulty.

Cornerstone is not concerned about the impact that the situation in Egypt will have on the market.

Right now the market is over-valued and due for a 5%-6% correction. The numbers for 2010 were quiet in terms of cash flow. There was significant positive movement. Cornerstone will be moving the Piedmont shares to ING. Money was put into indexes by defunding four investment managers.

Commissioner Hoeffel inquired about the market value of the Fund before the crash. Mr. Cowen replied that in the 3rd Quarter of 2007 it was valued at \$485 million. Since then the fund dropped into the low \$300 millions in 2009, before recovering \$100 million by the end of 2010

The Year-to-Date for the 2010 return is 10.45%, the first time performing below the median for this type of institutional portfolio. In terms of asset allocation, most of the County's peer groups have 60% exposure to stocks; the Retirement Fund only has 50% exposure. Currently, there is 35% bond exposure and Cornerstone would like to slowly trim that down, but they do not want to get out of the "bond business" entirely. Mr. Cowen believes the Fund should diversify; they have been extraordinarily comfortable with bias towards quality.

With regard to the performance of the aggregate portfolio, the 3-year numbers are holding up well. However, last year was below the expectation; the Fund was ranked in the fourth quartile of the peer group rankings. Risk statistics remain low and the portfolio is set up to withstand down markets. When interest rates go up, the value of bonds go down. It does not mean that we will have a disaster in the bond market, just that we will not make as much money.

Chairman Matthews asked if the value of the portfolio could drop if interest rates rise. Mr. Cowen explained that the Fund will not realize the loss. They are taking a total return approach and 3.25% return is expected from the bonds.

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Commissioner Hoeffel asked about the factors that would drive down performance and the rate of return. Cornerstone feels the Fund can be protected against decline. Mr. Cowen would like to trim bond investments and add to real return strategy i.e. inflation sensitive assets to 15% of the portfolio. He suggested alternatives: preferred stocks and floating rate notes. They do not get punished when rates change.

Mrs. Morgan asked, "Since bond funds lost money, how are floating rate notes different?" Mr. Cowen explained that a floating rate note is an adjustable rate bond fund and if interest rates go up, the rate of these bonds goes up.

Cornerstone cannot sell bonds and buy assets without board approval. They can move from index to bond but not sell off investments from individual financial managers. Mr. Cowen would like approval from the Retirement Board to invest in Nuveen Preferred Securities (NPSRX) and Eaton Vance Floating Rate Note Fund (EIBLX), which are in a niche asset class. Cornerstone would like to reallocate 4.8% of the portfolio; they would raise \$20 million evenly across the bond managers as a one time thing. They would like to add to the liquid alternatives asset class, which are inflation sensitive. They would also like to use mutual funds because you can get out quickly because deflation is a nightmare. You want to see a little inflation, which indicates growth in the economy. You also want to hedge a higher interest rate environment.

Commissioner Castor made a motion to allow Cornerstone to:

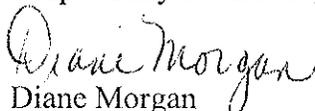
1. Raise \$20 million from three of the active managers, proportionately: JP Morgan, PMG Advisors, and Alex Brown.
2. Raise cash to 5%.

Second was made by Commissioner Hoeffel. The motion was put to a vote and unanimously approved.

On the motion of Chairman Matthews, seconded by Commissioner Castor, the minutes of the December 7, 2010 meeting of the Board were unanimously approved.

Having no additional business to discuss before the board, Commissioner Castor made a motion to adjourn the meeting, seconded by Chairman Matthews. The Retirement Board meeting was adjourned at 11:50am.

Respectfully Submitted,


Diane Morgan
Controller – Secretary