

**OFFICIAL  
MINUTES OF SPECIAL MEETING OF THE  
STERLING HEIGHTS  
GENERAL EMPLOYEES' RETIREMENT SYSTEM**

Wednesday, March 2, 2016

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Location: Room #201      40555 Utica Road, Sterling Heights, MI 48313      (586) 446-2331

Chairperson Weiler called the meeting to order at 12:03 p.m.

**BOARD MEMBERS PRESENT:**      Richard Weiler, Chairperson  
Jennifer Varney, Acting Secretary / Treasurer  
Todd Marsh, Trustee  
Paul Henig, Trustee

**BOARD MEMBERS ABSENT:**      Brian Baker, Secretary

**ALSO PRESENT:**      Walt Hessel, Pension Administrator; Timothy Brice, Senior Vice-President, The Brice Group, Morgan Stanley Graystone Consulting

**APPROVAL OF AGENDA:**

Motion by Marsh, support by Henig, to approve the agenda as presented.

Ayes: All. Motion carried unanimously.

**CORRESPONDENCE:**

Motion by Varney, support by Weiler, to receive and file correspondence:

Reports for the quarter ending December 31, 2015 as follows:

1. The Brice Group, Morgan Stanley Graystone Consulting
2. Herndon Capital
3. MFS Investment
4. London Company

Ayes: All. Motion carried unanimously.

**PORTFOLIO PERFORMANCE REVIEW BY TIM BRICE, THE BRICE GROUP, MORGAN STANLEY GRAYSTONE CONSULTING:**

Brice distributed two Morgan Stanley research papers "Investment Perspectives" that offered an overview of the current market outlook and challenges. Broadly diversified portfolios experienced disappointing 2015 calendar year results as a consequence of the strengthening dollar and historically low oil prices. Further driving market uncertainty were the unknowns surrounding the FED's path to normalization of interest rates and China's unpredictable currency devaluation. However, the firm points toward economic leading indicators that do not suggest a recession is imminent. It is believed that the US economy is on

solid footing and that globally, a positive economic growth is possible due to a rebalancing effect from oil producers to oil consumers.

The overall bond market lost -0.6% for the quarter with high yield bonds recording the greatest decrease. Treasuries declined relative to the FED interest rate hike. Western Asset Core Plus strategy exceeded the benchmark while Boyd Watterson slightly underperformed.

The overall portfolio gained 3.6% for the quarter which surpassed the policy index benchmark of 3.3%. The SMID and international equity managers fared the best against their respective benchmarks.

Brice then reviewed the performance of the portfolio and individual managers relative to the market and their peer group as follows:

	Market Value	<u>Average Annual Return (%) / Rank*</u>				
		<u>3-month</u>	<u>1-year</u>	<u>3-year</u>	<u>5-year</u>	<u>10-year</u>
Total Fund	\$ 107,978,260	3.6/17	-0.6/67	7.8/51	7.1/46	5.4/70
Total Fixed Income						
Western <sup>1</sup>	\$ 9,118,356	0.0/6	na/na	na/na	na/na	na/na
Boyd Watterson <sup>2</sup>	\$ 18,078,476	-0.7/82	na/na	na/na	na/na	na/na
Total Equities						
London <sup>10</sup>	\$ 8,759,797	4.8/80	na/na	na/na	na/na	na/na
S&P Index <sup>11</sup>	\$ 5,392,658	6.8/na	na/na	na/na	na/na	na/na
Janus <sup>8</sup>	\$ 3,834,678	7.3/47	12.0/7	17.6/36	14.4/25	na/na
Winslow <sup>3</sup>	\$ 5,046,750	8.0/32	6.2/42	17.0/44	na/na	na/na
AMI <sup>12</sup>	\$ 5,365,367	4.4/89	na/na	na/na	na/na	na/na
Herndon <sup>4</sup>	\$ 7,205,627	2.5/92	-5.2/78	8.5/96	na/na	na/na
MFS <sup>5</sup>	\$ 7,687,895	5.6/32	0.1/23	15.2/26	12.9/21	na/na
Earnest Partners <sup>6</sup>	\$ 17,481,074	4.9/18	-3.0/84	12.8/76	11.0/64	na/na
Cambiar <sup>7</sup>	\$ 8,934,533	4.4/50	na/na	na/na	na/na	na/na
Invesco <sup>13</sup>	\$ 8,835,733	4.7/44	-3.0/59	na/na	na/na	na/na
Principal REIT <sup>9</sup>	\$ 2,237,315	6.4/na	na/na	na/na	na/na	na/na

\*Peer group ranking within style specific sample.

<sup>1</sup> Core Plus fixed income manager hired 04/01/15.

<sup>2</sup> Short to Mid-term fixed income manager hired 04/01/15

<sup>3</sup> Large cap growth equities managers hired 01/01/12.

<sup>4</sup> Large cap value equity manager hired 9/30/12.

<sup>5</sup> Large cap value equity manager hired 11/25/09.

<sup>6</sup> Small/mid cap core equities manager hired 4/30/06.

<sup>7</sup> International/emerging markets equity manager hired 10/01/15.

<sup>8</sup> Large cap growth equities manager hired 12/29/09.

<sup>9</sup> REIT manager hired 04/01/15.

<sup>10</sup> Large cap core equities manager hired 04/01/15.

<sup>11</sup> Large cap equity index strategy implemented 04/01/15

<sup>12</sup> Large cap growth equities manager hired 07/01/15

<sup>13</sup> International / emerging markets equity manager hired 10/01/14.

Brice noted that eight managers either met their benchmark or outperformed for the quarter while the rest of the managers underperformed. It was noted however, that as of the meeting date, a number of the portfolios had rebounded to either meet or exceed the respective benchmarks. Herndon Capital failed to meet their respective benchmark over the quarter, one year, three year and four year performance periods and had compiled a 96<sup>th</sup> percentile ranking since inception. To address the underperformance concern,

Brice presented a large cap value equity manager study for consideration and review after the conference call scheduled at 1:30 p.m. with Herndon was completed.

With regard to draw-downs for the payment of monthly pension benefits for the next three months, Brice recommended that the Pension Administrator continue to request monthly direction from The Brice Group. Monthly draw-downs are tactically executed in a manner that supports the asset allocation target mix and cause a timely rebalancing of the portfolio.

Brice reported that the annual capital market outlook study was still in the preparation process and would be ready to be presented at the next special quarterly meeting to be held in May.

**BREAK – (1:15 p.m. – 1:30 p.m.)**

**CONFERENCE CALL WITH HERNDON CAPITAL (Large Capitalization Value Equity):**

Herndon Capital was represented by Randall Cain, CFA and Marc Sydnor – Senior VP. The portfolio return for the December 2015 quarter lagged the benchmark return of 5.6%. Stock selection and sector allocation combined to produce a return of 2.5%. The portfolio proved most vulnerable to the decline in energy prices as the portfolio was overweight to the sector and the firm attempted to be opportunistic and add to energy positions during the decline. Cain explained how in current periods of heightened investor anxiety and fear, the portfolio would not generate the anticipated returns. Also cited, was the impact of the strong dollar which much of the holdings had exposure to. Above average returns are expected once the market movements again correlate with fundamentals. The portfolio is most overweight to the Energy, Materials and Technology sectors. Major underweighting can be seen in the Financials, Healthcare and Utilities sectors.

The Board thanked both Mr. Cain and Mr. Sydnor for the report and the efforts on behalf of the system by Herndon Capital.

**CONFERENCE CALL WITH MFS (Large Capitalization Value Equity):**

MFS staff provided the briefing to the Board. For the quarter, the portfolio matched the benchmark with a return of 5.2%. Both stock selection and sector weighting had a positive relative contribution for the quarter. An underweight to Energy, Utilities and Technology contributed to performance and an overweight to Industrials detracted. Equities with strong free cash flow characteristics are crucial to portfolio additions. The firm's history analysis suggests that Value stocks outperform Growth over the long term. The overall portfolio is extremely well positioned in both the interim and long-term outlook.

The Board thanked the MFS representatives for the report and the ongoing efforts of MFS on behalf of the system.

**CONFERENCE CALL WITH LONDON (Domestic Large Capitalization Core Equity):**

Robert Wainscott, Portfolio Specialist with London Company reviewed the investment report for the fourth quarter 2015. The portfolio return was a positive 4.8% but lagged the benchmark of 7.0% during the fourth quarter. Wainscott attributed the underperformance to stock selection with the relative weights to sector allocation being a neutral factor. He stressed that the portfolio was name specific with the focus on the selection of individual stocks as opposed to sector weights. Wainscott then reviewed both the top ten holdings and other key positions. The portfolio is overweight Consumer Discretionary and Consumer Staples. Both Financials and Energy sectors are underweight. The firm utilizes a proprietary valuation tool to determine a company's intrinsic value based upon the strength of the balance sheet.

The Board then thanked Mr. Wainscott for the report and London Company's efforts on behalf of the system.

**DISCUSSION OF LARGE CAP VALUE MANAGER STUDY AND SMID MANAGER STUDY**

Brice handed out the Large Cap Value Manager study and reviewed the four new candidates alongside the existing two managers. A multi-year risk / reward analysis, a market capture analysis, an alpha / beta analysis and a correlation matrix were some of the key dynamics evaluated. It was determined that Confluence Investment Management would be the best candidate to replace Herndon Capital as a 50% Large Cap Value allocation manager with the remaining half still managed by MFS Investment Management.

Motion by Henig, supported by Weiler, to terminate Herndon Capital Management and hire Confluence Investment Management as the new Large Cap Value manager for a 50% allocation of the Large Cap Value portfolio via the Morgan Stanley Unified Managed Account (UMA) platform.

Ayes: All. Motion carried unanimously.

Brice then distributed the Small Mid Cap Manager study and covered key aspects of the analysis. It was deliberated that the goal of the study was to help determine whether or not the portfolio allocation should remain with a single manager or be split between two or more. Discussion ensued and Varney pointed out that the current SMID manager Earnest Partners has had excellent overall performance and that a decision to make a change could be tabled until the next quarterly meeting to be held in May 2016 when the full Board would be in session. Brice pointed out that at nearly 16% of the total portfolio, Earnest was the manager with the largest percentage allocation and that managerial splits with other parts of the portfolio allocation had served the system well in mitigating manager risk and providing extra diversification benefits. By Board consensus, the Board agreed to review the study again in May and review for any new developments at that time.

**TRUSTEE COMMENTS:** Due to minimal pending Board action items, Hessell recommended to the Board to cancel out the monthly regular meeting scheduled for March 17, 2016. By Board consensus, the meeting was canceled and Hessell committed to publishing the official cancellation notice to the City's website.

**ADJOURN:**

Motion by Varney, supported by Weiler, to adjourn the meeting at 3:18 p.m.

Ayes: All. Motion carried unanimously.

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Jennifer Varney, Acting Secretary / Treasurer