

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

Wednesday, March 1, 2017

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

Chairperson Weiler called the meeting to order at 12:06 p.m.

BOARD MEMBERS PRESENT: Richard Weiler, Chairperson
Jennifer Varney, Vice Chairperson
Julie DeClercq, Acting Secretary / Interim Treasurer
Paul Henig, Trustee
Todd Marsh, Trustee

BOARD MEMBERS ABSENT: None.

ALSO PRESENT: Walt Hessel, Pension Administrator; Timothy Brice, Institutional Consulting Director, Morgan Stanley Graystone Consulting – The Brice Group

APPROVAL OF AGENDA:

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

Ayes: All. Motion carried unanimously.

CORRESPONDENCE:

Motion by Marsh, support by Henig, to receive and file correspondence:

Reports for the quarter ending December 31, 2016 as follows:

1. Morgan Stanley Graystone Consulting – The Brice Group
2. Confluence
3. MFS
4. London

Ayes: All. Motion carried unanimously.

PORTFOLIO PERFORMANCE REVIEW BY TIM BRICE, MORGAN STANLEY GRAYSTONE CONSULTING

Brice handed out the 2017 Outlook – On the Markets research paper that presents the firm’s position on current markets and an economic preview for 2017. A very strong global economic recovery from the 2015 global downturn has led to a more positive investment climate. Additionally, the recent change in domestic policies toward lower taxes, less regulation and enhanced fiscal spending has also contributed toward the ‘euphoria’ that has recently inspired equity markets. The secular stagnation point of view appears to have peaked during the summer of 2016 with the all-time low yield on the 10-year US Treasury and the negative nominal yields in the sovereign debt market. Equities appear inexpensive compared to bonds and the firm expects stocks to largely outperform the debt market in 2017.

Furthermore, the recent OPEC production cut agreement appears to have stabilized oil prices which will allow for further recovery in the domestic oil industry with crossover benefits to durable goods orders and industrial production.

The total retirement system gained 0.9% for the December 31, 2016 quarter against the policy index of 0.8%. Gains in equities were largely offset by negative returns in fixed income and REITS. The fixed income portfolio lost approximately 3.0% in the fourth quarter due to the surprise spike in interest rates after the presidential election. Six of ten equity managers posted positive results for the fourth quarter. Some managers with negative returns were overweight in politically sensitive sectors such as healthcare which performed poorly. As of the meeting date, nearly all managers had surpassed their respective benchmarks and made up for the underperformance through year end. Brice commented that overall, the surprise November presidential election outcome created a whipsaw effect to the markets which proved challenging to a number of the portfolio managers, however going forward active management will have an opportunity to stand out.

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	\$ 106,521,896	0.9/44	6.4/64	4.1/69	8.7/40	5.0/82
Total Fixed Income						
Western ¹	\$ 9,515,097	-2.2/24	5.2/22	na/na	na/na	na/na
Boyd Watterson ²	\$ 18,011,927	-3.1/90	2.3/96	na/na	na/na	na/na
Total Equities						
London ¹⁰	\$ 7,480,018	3.7/57	11.3/44	na/na	na/na	na/na
S&P Index ¹¹	\$ 4,552,984	4.0/na	12.1/na	na/na	na/na	na/na
Janus ⁸	\$ 3,307,241	-1.2/74	3.3/61	8.6/26	15.8/12	na/na
Winslow ³	\$ 3,627,782	-3.2/92	-0.9/89	5.1/83	12.6/79	na/na
AMI ¹²	\$ 4,379,975	-1.5/77	0.7/84	na/na	na/na	na/na
Confluence ⁴	\$ 5,835,776	2.5/95	na/na	na/na	na/na	na/na
MFS ⁵	\$ 6,275,855	5.0/71	15.3/43	8.7/33	15.6/22	na/na
Earnest Partners ⁶	\$ 17,759,728	5.5/65	16.2/61	8.1/51	14.9/56	9.2/42
Cambiar ⁷	\$ 8,790,303	0.3/19	-0.8/79	na/na	na/na	na/na
Invesco ⁷	\$ 8,605,053	-4.3/68	-1.8/86	na/na	na/na	na/na
Cushing MLP Alpha ¹³	\$ 6,012,999	na/na	na/na	na/na	na/na	na/na
Principal REIT ⁹	\$ 2,367,159	-3.3/na	na/na	na/na	na/na	na/na

*Peer group ranking within style specific sample.

¹ Core Plus fixed income manager hired 04/01/15

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

³ Large cap growth equities managers hired 01/01/12.

⁴ Large cap value equity manager hired 04/01/16.

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

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

⁷ International/emerging markets equity managers hired 10/01/15.

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

⁹ REIT manager hired 04/01/15

¹⁰ Large cap core equities manager hired 04/01/15

¹¹ Large cap equity index strategy implemented 04/01/15

¹² Large cap growth equities manager hired 07/01/15

¹³ MLP manager hired 01/01/17

Brice recommended that the fixed income portfolio be divided evenly between the two existing managers as opposed to the current 2/3rd core and 1/3rd core plus allocation. Brice believes that the current fixed income outlook is well suited for core plus performance and that a shift back to a more conservative allocation can be quickly done should deterioration in economic conditions merit.

Motion by Varney, support by Henig, to reallocate the fixed income portfolio evenly between core manager Boyd Watterson and core plus manager Western Asset.

Ayes: All. Motion carried unanimously.

Brice advised that the underperformance by both international portfolio managers was due largely to their collective underweight to emerging markets and that potentially a third manager could be brought in to exclusively manage emerging markets. A study will be forthcoming and presented at the next special meeting. Brice also stated that the official Morgan Stanley annual capital markets study was soon to be completed as well for the next special meeting.

CONFERENCE CALL WITH CONFLUENCE (Domestic Large Capitalization Value Equity):

The Confluence Large Cap Value portfolio underperformed the benchmark for the quarter with a 2.5% return versus 6.7%. Market returns in 2016 were headed up by Energy, Banking and Telecom, all sectors underweighted in the portfolio. By design, the portfolio limits holdings within these sectors as they are commodity related and highly regulated industries, not desirable to a fundamental bottom-up manager style. The firm's motto is to acquire "great companies" trading at bargain prices. Typical companies held in the portfolio have durable competitive advantages, free cash flows and capable management. The firm is confident in its current portfolio structure and welcomes an investment environment where equity valuations will be rewarded by fundamentals in 2017.

The Board expressed its gratitude for the presentation and the firm's efforts on behalf of the system.

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

Gary Hampton, CFA reviewed the fourth quarter 2016 performance results where the portfolio earned 5.0% against the benchmark's 6.7%. The Financial Services sector contributed to and the Health Care and Consumer Staples sectors detracted from fourth quarter performance. Hampton explained that the portfolio is designed to outperform when there is a decreased appetite for risk and conversely lag market returns when the appetite for risk is on such as with the current "Trump" trade. Hampton reviewed recent portfolio changes noting the rationale for various purchases and sales within the portfolio. The firm's internal metrics signal a positive outlook for actively managed portfolios in 2017.

The Board thanked Mr. Hampton for the report and the firm's efforts on behalf of the system.

CONFERENCE CALL WITH LONDON (Domestic Large Capitalization Core Equities):

Robert Wainscott, Portfolio Specialist provided the portfolio review for the fourth quarter ending December 31, 2016. For the quarter, the portfolio returned 3.7% compared to the benchmark of 3.8%. Wainscott deliberated on the defensive nature of the portfolio where lower downside capture has generated excess returns over the years. Ideally, the portfolio captures about 90% of the upside while only participating in 70% of the downside. The up/down over a five year average is 84/76. The high conviction portfolio produces a premium dividend yield with long-term appreciation potential and considerably lower risk than the benchmark.

The Board thanked Mr. Wainscott for the report and efforts of the firm on behalf of the system.

DISCUSSION OF ASSET ALLOCATION AND PASSIVE INDEX RECOMMENDATIONS

Brice reviewed the GIC's US Active/Passive Model which provided active vs. passive tactical and strategic allocations. Since active managers have been struggling to meet or exceed their benchmark

returns continually over the last five years, it is tactically wise to allocate a portion of the portfolio to the passive strategy. Brice handed out the multi-phase implementation plan for incorporating more passive indexing into the portfolio and recommended that the Board proceed cautiously with a four phase step process.

Brice then distributed the Large Cap Growth Manager study and reviewed the new candidates alongside the existing managers. A multi-year risk /reward analysis, a market capture analysis and an alpha / beta analysis were some of the key dynamics evaluated. By consensus, the Board decided to hold off on any change in manager and implement the phase I target allocation for the entire Large Cap Equity portfolio.

Motion by Varney, supported by Weiler, to implement phase I passive allocation for the Large Cap Growth by transferring \$850,000 from the Winslow account to the iShares Russell 1000 Growth ETF (IWF) and to draw \$600,000 from Confluence and MFS each respectively for the allocation for the Large Cap Value index iShares Russell 1000 Value ETF (IWD) for a total of \$1,200,000.

Ayes: All. Motion carried unanimously.

The IPS is in need of update due to the recent additions of MLP's under the alternative asset classification. Brice stated that he would be working with Pension Counsel Tom Michaud to update the IPS accordingly. Hessel commented that the IPS may also require some updating for the core plus fixed income manager to the extent high-yield is held in the portfolio.

TRUSTEE COMMENTS - None

ADJOURN:

Motion by Henig, supported by Marsh, to adjourn the meeting at 3:03 p.m.

Ayes: All. Motion carried unanimously.

Julie DeClercq, Acting Secretary / Interim Treasurer