

July 13, 2010  
Minutes #461

**Minutes of the Board of Trustees' Meeting -1-**

- Call to Order:** Chairman, Donald Pinard called the meeting to order at 8:35 a.m.
- Present:** Trustees: Chairman, Donald Pinard, Jennie Angell, Richard Molan, Paul Porter and Chuck Hungler  
MECRS Staff: Gerard Fleury, Sandi Aboshar and Suzanne Wilson
- Absent:** Trustees: Mayor Ted Gatsas and Bill Sanders
- In Attendance:** Attorney John Rich of the McLane Law Firm  
Mr. Kevin Leonard and Sebastian Grzejka of New England Pension Consultants

**Approval of the Public Hearing Minutes, June 8, 2010 on Administrative Rule, Part 6, Additional Contributions:**

A motion was made by Trustee Hungler to approve the public hearing minutes held on June 8, 2010, seconded by Trustee Angell and passed unanimously by all those trustees present.

**Approval of the Minutes of the Previous Board Meeting:**

A motion was made by Trustee Angell to approve the minutes of the June 8, 2010 board meeting, seconded by Trustee Hungler and passed unanimously by all those trustees present.

**Approval of the Immediate Meeting Agenda:**

Trustee Angell made a motion to accept the immediate meeting agenda, seconded by Trustee Molan and passed unanimously by all those trustees present.

**Report of the Executive Director:**

Monthly Status Report on Pension Administration System Upgrade/Replacement – Mr. Fleury reported that the MECRS Administration & Accounting Committee had just met prior to the start of the regular board meeting to discuss the Pension Administration System, RFP. Proposals to the MECRS' RFP were received on schedule from two firms with a third opting not to bid. A preliminary review of the proposals revealed that one proposal would retain the software and data in house while the other would operate remotely via the internet. He informed the trustees that the A&A Committee will continue with a more detailed analysis of the proposals and will report back to the board at a future date. One noteworthy issue was that neither proposal can

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satisfy the deliverable in less than one year and that costs estimates are not as straight forward as was hoped for.

Letters have been sent to the three references listed by each bidder with a requested response date of mid July. Mr. Fleury also noted that if responses from public plans currently using either application indicate a willingness to host a visit, that site visits to those locations will be scheduled for late July or early August in order to gain a better understanding of the application and its developer's viability.

Expanded Internal Control – Next, Mr. Fleury informed the trustees that MECRS is now using existing applications to achieve a higher degree of internal control. Accounts payable data which correlates to cash flow has been linked to another application with graphic analysis capabilities. Data was back loaded for 2009 and 2010 year-to-date, which allows for an easy comparison of spending trends in a graphic format. As an example of this analytical ability, the trustees received a graph which was attached to their Executive Director's Report depicting the effect on custodial fees from the addition of separate accounts to the manager mix. He explained that this type of analysis is available for all administrative accounts and can quickly detect payments made outside the normal payment period, payments which might be keyed to an incorrect expense category or inflationary or volume related variances. Such graphic ability should prove valuable at budget time to project trends and display comparisons on demand during budget deliberations.

Digressing from his report in response to a question, Mr. Fleury noted that MECRS would be funding Lexington Partner's first meaningful capital call in the amount of \$83,000 the next day.

Replacement Administrative Rule Booklets – In concluding his report, Mr. Fleury reminded the trustees that the MECRS Administrative Rules had been amended in June to include changes recommended by counsel in the "Additional Contribution" program. Each time the Laws, Rules or By-Laws are amended, the staff generates replacement booklets for the trustees use and reference. He noted that the trustees had been provided with a copy of Version 4, of the Administrative Rules dated June, 2010 and that any earlier versions that the trustees might have may now be discarded. He informed the trustees that the new version of the Administrative Rules have also been posted to the MECRS web site, [www.manchesterretirement.org](http://www.manchesterretirement.org).

**Report of the Administration & Accounting Committee -**

Committee Chairman Angell confirmed Mr. Fleury's statements made during his Executive Directors report, regarding the status of the RFP for a replacement pension administration application. She reiterated the A & A Committee's commitment to continued analysis of the RFP's received and of its intent to investigate details in the weeks to come.

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#### **Previous Business:**

Acceptance of the 2009 MECRS CAFR – Trustee Molan moved to accept MECRS 2009 Comprehensive Annual Financial Report, (CAFR), seconded by Trustee Hungler.

Mr. Fleury explained that there have been changes in the way that the System's Auditors, (Berry, Dunn, McNeil and Parker) conduct the presentation of audit results since certain components have also become part of the CAFR. One such change before the board now, is the need to first approve the CAFR prior to the auditors issuing a final letter. Subsequent to approval of the draft by the trustees, the auditors will submit their final letter to the MECRS and the System will have the authorization to go to press with the final version inclusive of the auditor's letter.

Chairman Pinard called for a vote and the motion passed unanimously to accept the MECRS 2009 CAFR by all those trustees present.

#### **Consent Agenda:**

Trustee Molan moved to accept the consent agenda, seconded by Trustee Porter and passed unanimously by all those trustees present.

#### **New Business:**

Summary Recommendation for Disability Retirement – Trustee Molan moved to grant Mr. Francis Binette a disability retirement, seconded by Trustee Angell and passed unanimously by all those trustees present.

Request of the Executive Director, 2009 Gainful Occupation Report – Trustee Molan moved to accept and place on file the results of the December 31, 2009 Gainful Occupation Summary Report for disability recipients, seconded by Trustee Angell and passed unanimously by all those trustees present.

Information Item - Trustee Porter asked that it be noted on the record that the Anthem health insurance for retirees has recently increased significantly, coupled with the fact that it is the second consecutive year that the MECRS Board has voted not to grant a cost of living increase to retirees. He felt a sense of obligation to state his concerns on the record and to ensure that the trustees would be aware of the heightened premiums facing current retirees.

Investment Related Matters – Chairman Pinard called upon Mr. Kevin Leonard and Mr. Sebastian Grzjeka of NEPC to review items of financial relevance. Mr. Leonard began with the Investment Performance "Flash Report" for the period ending May 31, 2010, distributed to the trustees at the beginning of the meeting. He noted that the assets were just under \$128 million, and on a year-to-date basis the total portfolio has a 0% rate of return with no gains and no losses.

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The policy index however was down 50 basis points. In relation to the overall policy, the portfolio did gain 50 basis points of alpha. Calling attention to the allocation index which was down 90 basis points, Mr. Leonard stated that those values indicate that active management was able to add positive performance in comparison to the benchmarks.

Moving on, Mr. Leonard reported that on the domestic equity side, the overall composite is up 230 basis points relative to the S&P which was down 150 basis points. For portable alpha managers, results show that both Benchmark and Gottex are outperforming their indices with Benchmark up 80 basis points and Gottex down 130 for the year in comparison to the S&P, which was down 150 basis points. Both managers therefore added significant alpha relative to the S&P.

Moving on to domestic equity managers, Mr. Leonard stated that Pzena Investment Management was up 350 basis points, significantly outperforming the Russell 1000 value benchmark of plus 50 basis points for the same period. Growth manager, Sands Capital, showed a negative result year-to-date at minus 130 basis points but outperformance relative to their benchmark for the first five months of the year which was down 230 basis points.

Mr. Leonard explained that in weaker markets like those present in the first five months of 2010, that diversification in the MECRS Portfolio is working favorably because of the exposure it provides to different asset classes.

Regarding the international segment of the portfolio, Mr. Leonard stated that both Gryphon International and Causeway are significantly outperforming their benchmarks for the trailing year although both managers are down year-to-date. City of London, which is an emerging market manager, is lagging its benchmark, both of which are down year to date, with the manager down 6.3%.

Mr. Grzjeka reported that while Core Bond Manager, Income Research & Management, had performed in line with its benchmark over the last month, and had outperformed it year-to-date by 30 basis points for a positive return of 2.1%. For the 12 months ending May 31<sup>st</sup>, IR&M posted an impressive return for a fixed income manager of 12.9%. He also provided the trustees with returns for two other fixed income managers, Loomis Sayles and Seix Dislocation Fund with Loomis outperforming the Barclay benchmark by 15% for the past twelve months.

The year-to-date results for MECRS' two Hedge Fund Managers were in line with NEPC's expectations, with Archstone showing a small positive return and Attalus with a slightly negative return.

Mr. Leonard interjected a suggestion that the trustees invite Attalus to appear before the board in the coming months to review their under performance relative to their benchmark.

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In closing, Mr. Grzejka, reported that Wellington Diversified Inflation Hedge was unfortunately off to a bad start with a -7.9% return for their first full month as a MECRS investment manager.

Mr. Leonard then referred to a generic June Market Update segregated by sector which had been distributed to the trustees at the beginning of the meeting. From that handout, Mr. Leonard reviewed performance for each sector through June 30, 2010. He concluded his review of June performance numbers in anticipation of an interview of representatives from Rothschild Asset Management who arrived for their scheduled appearance before the board.

**Previous Business:**

SMID Cap Manager Review – With the indulgence of Chairman Pinard, Mr. Leonard ushered in representatives from Rothschild Asset Management who were present to review their performance, to discuss the effectiveness of their quantitative model, and to prognosticate on performance for the coming year.

Ms. Diedre Guice, Managing Director and Mr. Dan Oshinskie, Portfolio Manager introduced themselves to the trustees and began their presentation.

Referring to a handout, Ms. Guice directed the trustees to page 11, Portfolio Performance, and noted that Rothschild became part of the MECRS portfolio in March, 2009, a time period which she described as one of the most difficult times to invest. She noted that the 2<sup>nd</sup> and 3<sup>rd</sup> quarters of 2009 were periods of strong performance for the Russell 2500. Ms. Guice further noted that Rothschild's performance tends to lag during periods of strong performance by the Russell 2500 index, and that she would address that phenomenon later in her presentation. She called attention to the fact that in the second quarter of 2010, Rothschild outperformed the benchmark by 206 basis points and year to date has outperformed the benchmark by 78 basis points. Since inception however, Rothschild's returns as a MECRS manager had been disappointing.

Referring once again to the booklet included in the trustee's packets, Ms. Guice referred to page 16, and Small/Mid-Cap Core – Quintile Returns. She explained that Rothschild's portfolios tend to outperform when market returns are moderately positive or negative, and that they tend to underperform when the market is the strongest. Ms. Guice claimed that Rothschild is most effective in providing down side protection when the markets are the weakest and when the Russell is down around 8%. In such times, Rothschild will outperform the Russell 2500 benchmark by an average of 213 basis points. As market returns diminish, Rothschild's performance tends to increase.

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Next, Ms Guice referred to page 25 of the handout materials, providing the trustees with a graph of Rothschild's long-term performance record. She noted under performance in 1999 and again in 2003, when the market was very strong. During other periods however, the graph indicated an outperforming of the benchmark by Rothschild's portfolio. Ms Guice asserted that long-term performance is key.

Moving on, she referred to page 27, which depicted a Rolling Five Years Period, and she noted that since 2003, Rothschild has had very strong performance. As of 3/31/2010 Rothschild's ranking was very competitive when matched against peer managers. Ms Guice stated that she realized the importance of long term performance within the MECRS portfolio and further stated that Rothschild is optimistic and currently is still being considered for new business opportunities. Rothschild's process has not changed and the team is still together with no turnover of investment professionals. Unfortunately, Rothschild's performance has not kept up with the market during this period. She then turned the meeting over to her colleague, Dan Oshinskie, Portfolio Manager.

Mr. Oshinskie began by referring to page 5, Investment Philosophy and Process Overview. The process starts with a foundation in a quantitative ranking system which evaluates the universe of stocks everyday based on a variety of factors that Rothschild determines through quantitative back testing. The investment process also includes a fundamental analysis and the portfolio construction which creates a diversified portfolio of attractive stocks.

Mr. Oshinskie stated that the investment process used at Rothschild Asset Management for almost 20 years, has delivered above-average long-term returns with below-average risk.

For the 12 months ending March of 2010, relative performance suffered during a time of unprecedented gains in the stock market. Since April 2010, when investors started to focus on company-specific business trends and valuation, Rothschild Small/Mid-Cap strategy outperformed the Russell 2500 benchmark by 230 basis points.

Mr. Oshinskie highlighted the outperformance of High-Beta Stocks by referring to a chart on page 17. He explained that beta is one measure of volatility or risk in a stock. The higher the beta of stock, the higher the volatility or risk in the performance of the company's stock price.

He explained that the underperformance last year was more severe than Rothschild anticipated. As Rothschild struggled through that period of underperformance last year, they looked for factors in their system that was least effective and tried to find a way to enhance the ranking system which is the front end of their investment process, trying to make sure that it is as good as can be and to evolve it.

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Mr. Oshinskie explained that an extensive study was conducted and that 24 different variables were tested. As a result, an enhancement was made in the way that Rothschild calculates price momentum in a stock while continuing to provide the downside support associated with weaker market environments. That change should continue to generate positive alpha in more normal environments and also reduce Rothschild's underperformance in these very strong up markets.

He described in detail, a graph of the old ranking system compared to the new ranking system, showing that the enhancement helps mitigate shortfalls that have occurred in strongest up markets like 2003 and 2009. Referring to page 22, the return profile, Mr. Oshinskie reiterated that Rothschild believes that this modest change is likely to help improve the return profile in those very strong up markets without meaningfully changes in the investment process. Rothschild employs the same people, same process, is dedicated to addressing any weaknesses within the organization, and is committed to the goal of generating positive alpha over a market cycle while minimizing the risk of underperformance in very strong up markets.

Trustee Hungler asked for clarification of what Mr. Oshinskie called "the same process."

Mr. Oshinskie explained that only one of the fourteen factors in the ranking system had been changed. The weightings of some of the variables have been adjusted, in the momentum calculation. Previously the momentum calculation was done on a 12 month trailing basis which has now been shortened to a 7 month average.

Attorney Rich asked Mr. Oshinskie whether he believed that Rothschild could comply with the System's investment policy requirement of returns exceeding the benchmark over a market cycle. He noted the significant underperformance that had occurred in 2009 versus the benchmark and how the historic record of outperformance only slightly exceeded the benchmark in "good years". Mr. Oshinskie stated that he believed that Rothschild's performance would exceed the benchmark over a longer period of time.

Ms. Guice interjected that there has always been a quantitative committee that meets on a regular basis, looking for ways to enhance the ranking system.

Mr. Fleury asked when the recent enhancement to the momentum variable went into effect.

Mr. Oshinskie replied that the enhancement went into effect in February, 2010.

In conclusion, Ms. Guice stated once again that Rothschild is optimistic, that they can and will outperform the benchmark, and that they are proud of their performance record, despite the knowledge that 2009 had been a difficult year.

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After a few more questions posed by the trustees regarding Rothschild's investment process, Mr. Oshinskie and Ms. Guice thanked the trustees for the opportunity to address the board and departed at 9:45 a.m.

After lengthy discussion and a review of the Rothschild's presentation, Mr. Leonard stated that NEPC is recommending that the MECRS continue with Rothschild as part of their portfolio and believes that Rothschild has the ability to make up ground relative to the benchmark.

Also, Mr. Leonard mentioned that NEPC's Research Group has conducted research on Rothschild and that NEPC continues to recommend Rothschild and is not formally recommending that the MECRS put Rothschild on a watch list at this time.

The board took no action in response to Mr. Leonard's report, effectively accepting his recommendation.

Mr. Fleury took the opportunity to quiz Mr. Leonard about his earlier suggestion of bringing Hedge Fund managers before the board. It was agreed that the details would be worked out via email at a later date and that the August 10<sup>th</sup> meeting would be used as a tentative date.

Mr. Leonard and Mr. Grzejka prepared to take their leave.

**Motion to Adjourn:**

Having concluded all of the items of business for the day, Chairman Pinard entertained a motion to adjourn. Trustee Hungler moved to adjourn at 10:10 a.m. seconded by Trustee Porter and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury  
Executive Director