TOWN OF LEESBURG
Town Hall
25 W. Market Street
MINUTES
March 5, 2021
2:00 p.m.
Lower Level Conference Room 1

Finance Board Members and Others Present:
Clark Case, Lisa Haley, Nelson Bush, Joe Mason

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1. **Call to Order** by Clark Case 2:06 pm

2. **Approval of Agenda**
   - Case: We have a quorum of people, but not a quorum in-person to take any actions at this meeting. We will proceed with the items for discussion and presentation of materials and any questions and answers the attendees will have.

3. **Approval of Minutes of 11-20-2020**
   - Case: We have a quorum of people, but not a quorum in-person to take any actions at this meeting. We will proceed with the items for discussion and presentation of materials and any questions and answers the attendees will have.

4. **Items for Discussion**
   a. Economic context and outlook
   b. Quarterly investment report
   c. Discussion of market results since quarter-end
   d. Discussion of any other changes to investment managers since last meeting or pending changes

- *Mr. Case: We will pass the approval of the agenda and the approval of the last meeting minutes, and we will proceed directly to the items of discussion with Nelson. This is a recorded session that will be posted in the Town's website so we need to speak clearly and introduce ourselves. I am Clark Case, Director of Finance and Administrative Services for the Town.*
- *Mr. Bush: I am Nelson Bush from PFM Financial Management, we are the investment advisor on the OPEB Trust.*
- *Mr. Mason: Joe Mason with Davenport Company, Member of the Finance Board.*
- *Ms. Haley: Lisa Haley, Deputy Director of Finance, Town of Leesburg, Member of the Finance Board.*
- *Mr. Case: We also have Maria Alcalde who records all of our meetings and serves as the secretary.*

Mr. Bush's comments:

- I'll give a broad introduction to the economy, I'll talk a little bit about fourth quarter performance and then I'll talk about the position of the portfolio as we move forward.
- The three main topics regarding the economy are: economy is recovering, the developed markets and both, the United States and much of the developed world, have continued to open up.
- There has been a resumption of business activity and personal spending. Economies have been on the upside, and you can see that in things like the gross domestic product.
- The US gross domestic product for the third quarter of calendar 2020 was recently revised up at 33.4%, which is obviously a significant recovery. Although, the market dropped by 5% and over 31% in the first and second quarters of 2020.
- We ended the year with a quarterly GDP growth of 4.1% in the United States, which was continued good growth in the US economy.
- For the year, the US economy declined about 3.5%.
- The Fed is currently projecting growth in the range of 3.2% for the first quarter of 2021 and 4.5% for the year.
- Depending on the economist that you follow, economists are forecasting US economic growth from 2% to 7% this year. Someone from Goldman Sachs just came out yesterday and said that their new forecast for the US economy is a growth of 6.1% for the year.
- If growth follows the forecast, we would have gained back all we lost in GDP at some point in the second quarter of this calendar year.
- Some developed markets around the world are a little bit better, some are worse, but in similar positions.
- Stock markets continued to cooperate and are up here today on expanded estimates of growth in the US and developed markets, on expanded supply of the vaccine, and the view that once we reach some sort of herd immunity the economies would be able to accelerate out of the position we found ourselves in.
- The position we found ourselves in is well illustrated in the US by the job market.
- The US economy delivered about 379,000 new jobs in February. The survey had the expectation to have network for 200,000 new jobs, so the jobs number surprised to be upside the unemployment rate of 6.2%.
- Recently, the downside in the employment numbers are a combination of two things, the labor participation rate is still fairly low and many of the unemployed Americans had jobs in the hospitality industry.
- In February of 2020 the labor participation rate was at 63.3%. The labor participation rate in the US economy had been right around 63% for more than the past seven years, so 63% has been about the average labor participation rate.
- Labor participation rate in February was 61.4%, there are about 4 to 4.5 million Americans who have been unemployed for more than 6 months or longer and they are having a challenging time finding jobs. Many of the jobs are in the hospitality industry. Those are the areas that jobs continue to be very hard to get.

- The best news of the February job's report was that the vast majority of the new jobs created were in the hospitality, travel and leisure industry. Companies appear to be starting to rehire in advanced of expected acceleration in vaccine distribution and vaccine reception. Depending on where you live the vaccines are more popular in one place than another, but there are some groups of people in the US who are in multiple lists to get the vaccine. Some people are hesitant in receiving the vaccine. We'll have to see how all that goes.
- The US economy is doing fairly well with the exception of those jobs that just haven't come back yet.
- The Fed believes that the actual unemployment rate is somewhere closer to 10%. They believe that is the combination of the current 6.5% unemployment rate plus the people who have checked out of the labor market and who probably would want a job in their estimation when the time comes that they can have a job again.
- The Fed in the US and central banks in much of the rest of the developed market places remain very accommodative in monetary policy. The Fed has renewed their view that it is going to be an extended period of time before they raise the Fed fund's target rate. Although, we have seen five year and longer fixed income rates rise quite a bit just in the past few days, it seems that the Chair of the Fed believes that that rise isn't significant enough to warrant extra action from the Fed, but the Fed is continuing to buy tens of billions of dollars of US treasury securities, and tens of billions of dollars in mortgage securities in order to keep longer term interest rates low.
- The Fed is able to control short term interest rates through setting the Fed fund's target rate which is currently effectively a 0. In fact, there are overnight investment vehicles across the country right now paying 1 or 2 basis points.
- The Fed will control longer term rates by dramatically increasing demand in the market place by their own buying of treasuries and agency securities. We'll see if they need to step that up in the near term. Jerome Powell's remarks yesterday about the market appeared to be somewhat dovish and some market participants have demanded much higher yields just in the last couple of days.
- Manufacturing continues to expand, the housing market continues to do very well. There are lots of positive things that you can find inside the United States economy.
- The last thing I'll mention from just an economic stand point, is the United States Treasury. Right now, the 10 year US Treasury is trading at about 1.6%. At the time of the print of this book, this book has data as of December 31st, the 10 year treasury was at about 92 basis points. So, interest rates have risen in the 10 to 30 year range about 60 to 70 basis points. And that has particularly been the case just in the past two weeks, because economic news have been modestly better than expectations. The Fed appears a little bit dovish, so the market has been pricing in the expectation that inflation will start at some point.
- Inflation, as the Fed measures it, is still running at only 1.5%. The Fed wants to be accommodative in monetary policy until the inflation rate has been averaging 2%, they are not looking for inflation to rise to 2%, what they are looking for is for it to rise to 2%

or above and average 2% for some period of time. They won't tell us what that period of time is.

- The market's reaction, to the Fed causing 10 and 30 year bond to rise, suggests that the market believes that inflation is going to recur, maybe because of the federal stimulus package that was likely to make it to the President's desk this weekend. They will increase unemployment benefits, send checks out, give $350 billion to state and local governments and a lot of other funds for other purposes. That sort of economic stimulus should have an impact on spending and the economy. Congress is trying to put the money in hands of people that will spend the money, not people that will save the money, because if they spend the money, they know that jobs will come back.
- If you look at page 2 (page 5 of the PDF), you can see the different sectors in index returns for the past quarter. If you look at those you will notice that they were all positive or very positive or extremely positive during the fourth quarter of 2020, even fixed income total returns were positive, although there's been a turnaround in all these sectors just in the past couple of days.
- Domestic and international equities had very strong returns. Small-cap and mid-cap generally outperformed large-cap in the broad market, as investors believe that with additional stimulus, the businesses that will benefit the most here and in the near future are the small-cap and the mid-cap firms. Many of the large-cap firms have had very strong performances through this entire period of time. Money is aimed toward mid-cap and small-cap with the expectation of getting strong performance in those sectors.
- On page 9 (page 11 or 12 of the PDF file) we have the map that suggests how PFM feels about the different sectors. You can see that changes over the past quarter are really in international equities, and it is across the board. We are feeling better about international equities, both, from looking at their valuations and looking at the support for those economies by central banks.
- We do not have strong opinions that fixed income is going to provide positive returns in the near future. Interest rates have gotten so low that is hard to see them doing much other than going up.
- We feel a little bit better about credit sensitive sectors, than we do at true high credit quality sectors, but this is surely impacting our portfolio's strategy.
- At the bottom of that chart you can see some reference to alternatives. We do not have alternatives in your portfolio so any views that we have there don't necessarily impact you, although I'd be happy to talk about it.
- The risks that we see out there are that Covid-19 is a big unknown. We know that there is a growing number of variants to Covid-19. It seems that some of the vaccines produced by some of the large pharmaceutical companies have had very good success against some of the variants, and other variants are just too new to tell. That is the big elephant in the room and we will have to see if that elephant turns out to be a stuffed animal or something much larger that we have to deal with in the coming weeks and months.
- I'll be happy to try to answer any questions you may have about the economy or PFM's view on the near future.

- *Mr. Case answered that they didn't have any questions. He invited Mr. Bush to talk about the portfolio's performance.*
- The portfolio's performance during the quarter and the year is pretty good in comparison to the performance benchmarks. The things that I'm drawing your attention to are, if you look at US equity, there's been strong performance in the mid-cap and small-cap index. Our mid-cap manager didn't particularly have a good quarter, but the small-cap manager has performed well. We did just move this into your portfolio near the end of the year looking forward to performance in the near future.
- The performance of domestic equity blended together for the quarter was roughly in line with the index.
- International equity trailed a little bit for the quarter, primarily based on the performance of one of the managers, but international equity for the year had very strong outperformance. It is not a typo that the 12 month return in international equity in your portfolio was just north from 22% in comparison to the index of about 11%. That outperformance has surely been beneficial to your portfolio.
- The fixed income outperformance during the quarter was in line. The extra value in your portfolio from a fixed income stand point has been small but dedicated allocation to investment grade corporate securities. They performed very well during the quarter. Investment rate corporations rated AAA, AA, A, BBB. Their market values performed really well, in part because there has been a significant decrease in supply of those note issues and there is great demand for yield anywhere you can find it, so that helped the performance in that part of the portfolio.
- Overall, your portfolio in domestic equity at 14.72% and international equity at 16.5%, compared to the fixed income return of 1.5% suggests why PFM believes that the value in your portfolio will be found in equities here and still in your near future, so we continue to maintain an asset allocation which is within the guidelines of your investment policy in all regards, but we maintain an asset allocation that is a bit overweight in domestic equity, a bit overweight in international equity and, since there are two sectors that are overweight, there needs to be one that is underweight and that is in fixed income.
- It is hard to foresee that fixed income investments are going to provide strong positive returns of any level here and the near future. If the economy continues to grow, if jobs continue to improve, hourly wages continue to grow, we would expect spending to continue. Spending on behalf of folks like you and me is 65% or 70 % of the United States economy. If the economy continues to grow, interest rates will eventually rise and that will lead to negative returns on that portion of your investment portfolio.
- We expect to still growth in equities, so we will maintain an underweight to fixed income of about 5%, and an overweight in domestic and international equities combined of about 5 %.
- As of a week ago Thursday, the quarter-to-date returns were 0.64% which was in line with the benchmark's return of 0.65%.
- PFM's 60/40 model portfolio has a slightly different asset allocation than your portfolio, but I think this is useful to contemplate, PFM's 60/40 model has a total return quarter-to-date of -0.88%.

- In the last two days the market has interpreted the FOMC's comments and then, Chairman Powell's comments yesterday to suggest that interest rates are going to keep rising here and perhaps are going to rise significantly, and that the Fed may not step in to do anything about it.
- PFM doesn't think that they would just let go, but that's the market's sense. The market had a couple of bad days, in fact the decline quarter-to-date is 88 basis points, so we started Wednesday positive, we ended Thursday down -88 basis points, because of stock market declines in the last 2 days.
- Those stock market declines, US domestic equity and international equity are entirely related to the perception that some investors have that the Fed is going to allow interest rates to rise, and that by allowing interest rates to rise, it will hurt economic growth, because companies will have increase growing costs and therefore they may not rehire people as quickly.
- Today, I was listening to the radio on the way here, market seems to be up about 1% and if they were up 1% today then you will have a positive return quarter-to-date again.
- There is some volatility, the volatility is around the Fed's monetary policy and the direction of interest rates. The perception of the direction of interest rates is based on dovish language of the Fed's Chair, positive finds of economic growth in the United States' economy and an acceleration of vaccine distribution inside the United States.
- *Mr. Case asked if they were contemplating further changes in the portfolio.*
- Not at this time, we are not.
- *Mr. Case asked to the other board members if they had any questions.*
- *The answer was no.*

Mr. Case made a motion to adjourn at 2:38 pm.

Mr. Mason seconded.

Approval was unanimous.