

**TOWN OF LEESBURG**

Town Hall  
25 W. Market Street

**MINUTES**

August 20, 2021

10:00 a.m.

Lower-Level Conference Room 1

Finance Board Members and Others Present:

Clark Case, Lisa Haley, Diane Starkey, Joe Mason, Nelson Bush

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**1. Call to Order** by Clark Case 10:00am

**2. 3. Approval of Agenda**

- Mr. Case: We have Joe Mason attending virtually, Lisa Haley, Diane Starkey and Nelson Bush in person. Maria Alcalde is taking the notes. We have a quorum.
- First order of business is the approval of the agenda.  
On a motion by Clark Case and seconded by Lisa Haley.

**4. Approval of Minutes of 05-21-2021**

- Mr. Case: Next order to business is to approve the minutes from May 21<sup>st</sup> 2021 Finance Board meeting, they were sent out a week ago. Does anybody have any corrections or changes?  
No corrections or changes.  
On a motion by Clark Case and seconded by Joe Mason.

**5. Items for Discussion**

- a) Economic context and outlook
- b) Quarterly investment report
- c) Discussion of market results since quarter-end
- d) Changes to portfolio related to Investment Policy decision related Commodities and Real Estate ETFs
- e) Discussion of any other changes to investment managers since last meeting or pending changes
- f) PFM and US Bank Merger

Ms. Bush's comments:

- I'll start with a summary of the market tendency from the 2<sup>nd</sup> quarter of 2021, page 2 on the report.
- Quarter-to-date and year-to-date returns have been very strong in domestic and international equity. Very additive to the portfolio.

- Unsurprisingly, fixed income has had lower returns than equities. We will always expect fixed income to have lower returns than equities, unless we are in a period of tremendous economic turmoil and rates are falling quickly, like the first quarter of last year, when stocks took a nosedive and fixed income returns were very strong.
- For much of 2021, the economy in the United States has continue to grow. GDP was released and revised for the first quarter and the nation's economy grew at a pace of about 6.3%.
- The advanced estimate of the GDP for the second quarter has also been published, the results were in the 6.4% range, so the US economy has been growing quite strongly.
- In the second quarter, results of the US economy have been growing beyond where it was before the Coronavirus. Back in January 2020 we had this massive decline and now we have a very significant recovery.
- Economists are forecasting continued strong growth for the remainder of the year, not at a 6% pace, more of a 4% pace.
- This last quarter was a time of significant new job creation and employment. The most recent read of unemployment was for late June – early July timeframe. The unemployment rate was down from 5.9% to 5.4%; the underemployment rate was taken down from 9.9% to 9.2%. Jobs increased by 943,000 according to the July report, which was 10% higher than expectations.
- Weekly jobless claims have also continued to decline. Most recently weekly claims dropped from 375,000 to 348,000. Continuing jobless claims dropped to 2.82 million. This continues to be the lowest since January 2020.
- In some cases, the challenge in jobs right now seems to be more about folks not wanting to go back to work because the government subsidies are paying them more. More of an issue is the fact that many jobs are in places where people aren't located, so there is a real mismatch of skills growing over the years, but now there is even a mismatch of job location.
- Some companies are adapting. Companies who, for one reason or another, want people to work in a certain location or a certain city, particularly if the job requires a college degree, they are having a hard time finding good candidates to work at their companies. It's much harder in the big cities.
- A lot of people have moved in the past year and a half, they've moved someplace else. They may be continuing in the same jobs, but there has been a lot of relocation around the United States.
- Now, there are more job openings than there are unemployed people who were seeking work. Most retail store places have a help sign at their doors. It is amazing. I'm not saying that all those jobs are good or high pay jobs, but they sure are a ton of jobs out there. And part of it is compensation, but part of it is also a workforce location issue.

- *Mr. Case: Clearly, one of the issues is to find an affordable job. Half of the unemployed people can't go back to work because they can't find childcare to be able to return to the job.*
- Yes, and we don't know when that issue will get resolved. There are many factors. It could be a compensation issue, a job training issue, a location issue, etc. We don't know yet the full impact of people who have stepped away from work to care for their children, who are expected to go back to work.
- Today, inflation has been in commodities, in supply and demand. The supply chain is having a very hard time getting things from one place to another for people to buy. Some ports are shutting down due to Covid concerns. It is a significant challenge. It will recover, in fact, some of the commodity prices have recovered. The pressures are on how to lure people back to the work force who otherwise, are undecided and on the side lines. That is what we worry about in the future, wait pressures that got a long-term permanent implication.
- The Fed believes that inflation is transient forward, supply chain disruption will get fixed, some amount of Covid related challenges will go away and things will get back to normal.
- The second thing we are more concerned about is Covid. At the end of June 30, when we put together this chart that is on page 10, we had Covid on the green category. Covid is not on the green category today.
- The Delta variant is clearly infectious and having a dramatic outcome in people who choose not to vaccinate. There are people that got vaccinated and got the Delta variant, but it didn't affect them much.
- The United States government went all in with vaccinations; however, you see massive supplies of vaccines that have reached their expiration dates and had to be destroyed. There are countries out there who haven't seen a vaccine yet, or if they have seen a vaccine, it is a vaccine that doesn't work against any variant.
- In the international sector, Covid is even more of a concern. Some countries are shutting down again, it doesn't help with their economy, but it can keep people safe. Is it better to shut down and keep people safe at home? Or is it better to mandate masks and keep social distance not keeping people at home? We'll see.
- The Governor in Virginia has gotten rid of the emergency order so, there is now more closeness. Kids must wear masks to go to school, but they are going to school. We are taking the track of medication efforts, masking, socially distancing, with hopes that it will enable our society to roll forward. But there are other developed markets where that's not their plan. Their plan is to stay closed. Every time New Zealand, for example, comes down with one Coronavirus case, they immediately shut down.
- At this time, we are concerned about inflation in the US. If wage inflation takes off, it's just a different ball game.

- *Ms. Starkey's: Well, it is interesting. With all the challenges what is positively driving the economy?*
- Corporate earnings are very strong. People have saved for it, people have invested more, the very low interest rates are enabling people to make big purchases like houses, even when housing prices are still up so dramatically.
- The travel & leisure industry is still way behind where it was in 2020, but everything else has seemed to uptake in sales.
- For the folks who haven't returned to work, there has been fiscal stimulus from the United States government that is enabling them to, in some cases, make more than what they were making in their jobs before. In many cases, it has enabling them to get by. We'll have to see how the job dislocation turns out, how wages are impacting, what additional fiscal stimulus comes, and how this trend changes monetary policy.
- We've had a few difficult phases in the stock market recently, simply because the Fed released its minutes from its July meeting and the minutes said that there are Fed Governors who are now talking about removing some of the stimulus that the Fed put out. We have seen inflation higher than the Fed's target; the Fed believes that this inflation is transitory, that it is only going to be around a short period of time, but the market has some concerns about it.
- The Fed has goals of getting inflation to an average of 2%. The Fed believes that inflation at a 2% level is healthy. The most recent CPI reading was 5.4% on everything; 4.3% on the measure that excludes the price of food and energy. This 4.3% reading was down from its prior reading of 4.5%. This is high inflation. If it is around a long time, it has implications on the United States economy; if it's transitory like the Fed thinks, then the implications are muted. Some Fed board members look at this and say that we have achieved the policy goal of 2%, and it is time to raise interest rates and slow down economic growth. There are other economists and voting members who say that we need to see unemployment like we had back in January 2020 before we take any of the stimulus away. Fed's Chair is going to have to make the call at some point.
- PFM's opinion is that they will start tapering their bond buying program before the end of the year. We think that at their November meeting they will come out with a formal plan, and we think they will start to taper. That will naturally stabilize the Fed's balance sheet, but they will continue to buy until they stop buying, and it will take them a year before they stop buying those long-term bonds.
- *Ms. Haley: Didn't they stop buying around January 2020?*
- You are right. They have been running their bond buying program post to credit crisis, from 2008/2009 for many years. What they are doing right now is using the tool they used before, that was very successful at keeping longer term rates low, they are being very successful now. We'll have to see what that means for long term rates. Long term rates may matter a great deal in this portfolio, if it has

a target allocation to fixed income of about 40%. Fixed income is a necessary part of your portfolio.

- *Mr. Mason: What's PFM's opinion or thoughts on what happens in this whole inflation factor that you've been discussing, if we pour 4.5 trillion dollars of additional stimulus?*
- Surely, in any new stimulus, whether is the infrastructure program which does include money for bridges, tunnels, roads and things like that, any new building project has impact on jobs and wages and that could influence inflation. As for the next program, which will look to a healthcare, college cost, unemployment benefits; it is far more focused on social programs, it is a little bit hard to know, but it should be stimulating on the United States economy, it should impact inflation, but it will depend on how that's rolled out. It's hard for us to know right now. We do think that, in general terms, it will influence inflation, although it seems like the Fed prefer keeping interest rates low longer. We do think that they have about a year before they have to start increasing interest rates to slow down the United States economy.
- *Mr. Case: What do you think on the foreclosure risk? There are a lot of people who've been unemployed that have not been paying their mortgages or rent. Foreclosures and evictions could have a negative effect.*
- There is two ways of answering your question. I'm going to separate the renters from the homeowners. Believe it or not, according to the Mortgage Bankers Association most recent information, the volume and the value of foreclosures have really dropped very significantly in the last couple of months.
- *Mr. Case: Yes, they have a moratorium on it, but I think the moratorium comes off at the end of the month. Then nothing prevents the mortgage company to go ahead and foreclose.*
- Yes, and one might think that if they could foreclose on a property that has increased in market value by 25% higher than last year, why should they wait. That's a concern. If you are a big property company, the big property companies have their ways to deal with these things. But, if you are a personal property owner, and you, in many cases haven't been able to collect rent for a year and a half, those things are real challenges, and we are still yet to see what's going to come from it. So far, it seems like the corporate space should've been bad. At PFM, we've gotten rid of 5 leases in the past year, and in some places like New York or San Francisco, those property values have created huge challenges for the local and state governments. But, in large, except for these two cities, commercial real estate held up. You look at other real estate indexes and they've done well. Will the rental market be the same? We don't know at this point. The only good thing I can say about the home foreclosure market is that if you could refinance, it can sure reduce the amount you pay, interest rates are unbelievably low. Our expectation is the small property owners are in for a very rough ride, but at the same time there is still a very significant demand for housing, not in New York or San Francisco, but in many other places, and there are people who

have been able to afford leaving their rental to buy a house, but the way house pricing has been is crazy; still a very strong demand for the rental market. The big property owners, we think, are just going to make it through, but the small property owners are going to be particularly challenged.

- We'll look at your performance for the quarter on page 12 and 13. It was a good outperformance from the benchmark this quarter. In fact, the outperformance for the year was better outperformance from the benchmark. This didn't happen because the domestic equity manager outperformed the domestic equity benchmark, and it wasn't because the international equity managers outperformed their benchmark. It is really the overall asset allocation portfolio. Right now, your portfolio is about 2% overweight to domestic equities, there is about 1% overweight to international equities and that means there is about 3% underweight to fixed income.
- Fixed income returns were reduced dramatically lower during the quarter. If you look at the Bloomberg Barclay's US Agg on page 13, this is part of your blended benchmark, so 40% of the blended benchmark return was 1.83% and the other influences on the blended benchmark come from the Russell 3000 Index which is under domestic equity, and the MSCI All World Index which was 5.48%.
- The passive managers in the equity market did what they did, they provided returns very close to the benchmarks. Some of the active managers, particularly in international equity outperformed, but most of the active managers, particularly in domestic equity underperformed in this past quarter.
- I know there is discussion among your investment committee about the mid-cap and small-cap allocations in your portfolio, but if the economy recovers normally, small-cap and mid-cap recover first and then the large-cap picks up. You can see when we added in the mid-cap about a year ago, it did contribute to performance and in some periods, it really helped performance. Small cap was a contributor, but not in the past 4 months, they really brought down overall domestic equity returns, so they are an element of concern.
- In international equity, our concerns are emerging markets. Emerging markets are not dealing with Covid well. In many cases, there are some countries that haven't been able to obtain a vaccine, they are much more commodities driven, whether is manufacturing or raw materials, the supply chain dislocations are a real impact there.
- Those are the areas of focus for our investment committee right now. You'll notice fixed income is still very active, because the active managers have been outperforming its benchmark or at least, outperforming the Barclay's Agg.
- Going forward, we continue to look for opportunities to take more out of fixed income, to underweight fixed income. We think the next change is the United States government starting to taper in its bond buying program and we are concerned that it will have an impact on long-term rates. However, there is still the reminder that there are still a lot of investors in US fixed income instruments that are from outside of the country, and many of them are in countries where the

rates of bonds that they can buy are still negative. There is still a real demand for US government debt from foreign investors. The Fed's decreasing their stimulus then tapering should have a notable impact on long-term rates, but it may not if international investors decide to up their own buying of their securities.

- I do have some investment manager information to send over to you. We'll like your take on it before we implement it. It is an ETF that is vesting in preferred stocks. This would be an allocation that we will take out of fixed income. We will send that information over to you.
- The other changes that occurred were that we removed the commodities allocations; we removed the Reid allocations. The commodities allocations, because of the fluctuations in commodities pricing, resulted in a small loss, a few thousand dollars in your portfolio. The Reid allocations provided significant gains to your portfolio. Those combined allocations were added to your portfolio for the time they were in, but we agreed that is not your investment policy. So those allocations were broadly reallocated across your portfolio.
- On the last pages of the report, you can see your performance for the month of July. In the domestic equities the small-cap and mid-cap were primarily the real detractors from your portfolio again.
- Fixed income had positive returns during the month. This is a re-emergence from Covid. We saw rates rise in June and early July in the fixed income markets because investors began to believe the Fed will have to start doing something sooner. The Fed came out and said that they won't be doing anything with the rates any sooner, that the rise was transitory. Then the rates fell a little bit and then the impact of the Delta variant of Covid began to be felt, which is when the rates fell a little bit more, and that's the reason you see the positive returns in fixed income.
- Quarter-to-date the total return performance, this is from July 1<sup>st</sup> through last Thursday, was 1.89% which was right in line with the benchmark.
- *Mr. Case: The only thing we have left in the agenda is the discussion of the PFM and the US Bank Merger.*
- On the 8<sup>th</sup> of July the owners of PFM's Asset Management Business, which consists of PFMI, which is our holding company, PFM Financial Advisors, LLC, PFM Asset Management, LLC, reached an agreement with US Bank Asset Management to sell PFM Asset Management to them. That is a transaction that is partly scheduled to close in early December. There is obviously a lot of moving pieces to get worked out from HR staff, and people selecting new benefits, offer letters, replacement of laptops, work cell phones and everything in between. US Bank Asset Management, at the end of June had about 170 billion managed primarily under money market mutual funds, but they offer several others. About 70 billion of that is under money market mutual funds, the rest of the money they manage under short term fixed income investment portfolios. It's all in the fixed income space. Most of their clients are corporations. These are corporate clients of the bank, they use the bank for cash management services, lending,

construction loans, investment advisory purposes. US Asset Management is the division of US Bank that is acquiring PFM. PFM will continue to be a registered investment advisor. Our name will change from being PFM Asset Management, LLC to PFM Asset Management, a division of US Bancorp Asset Management. You will see very few changes like, email addresses and email signatures, but people, processes and systems are the same. Some of that could change a couple of years down the road. We manage more money than the bank manages in short-term fixed income. Their clients are all corporations, our clients are all State governments, local governments, and education institutions by and large. There are two different portfolio accounting systems. We have our own portfolio accounting system. The other portfolio accounting system is the one we dropped 5 years ago. So, are they going to come to ours, are we going to go to theirs, are we going to buy something else? I don't know if there will be an integration of systems right now. They don't do any work with local government investment pools, we run 18 local government investment pools across the country. They don't have any State or local government political subdivision plans, it is just not the work they do. That division of the bank doesn't have any multi-asset class business. They are very interested in this multi-asset class business. They are interested in how they might be able to use it. But the people who work at this right now are the people that will be doing it in the future, there isn't anybody at US Bank Asset Management who could step in and do this work, they just don't have anybody who does it. The US Bank Asset Management team right now is about 85 people, PFM Asset Management has 324 people, we are having to shrink, so we will take 304 people with us. We are bigger than them and that means that I will move from being on PFM's Management Committee to being on the combined legal entities of Management Committees, so we have a big role and a big say. With my partners, we will be 8 of the 11 people in that Management Committee. We are surely being acquired, but I do want to tell you that you will still have me, unless you decide to change that. We are going to be replacing our web system later this fall. We've been working on it for the past year. That has nothing to do with the US Bank merger other than they said to us as a condition of the sale, all of the technology processes we have in place have to keep going. So, you are going to see some changes from us as it relates to our web system, security in the web system, and we are glad that we have merged with a company that spends more money each year on cyber security than PFM earns in revenue. I'm excited about that, I'm excited the scale and the new resources I think we will get. The team that works for me in Virginia, Texas and Florida is still the team that will be working for me. There is one notable person that will be leaving right now and that is the founder of our Asset Management Business. He founded our Asset Management Business back in 1980 in Pennsylvania and, although he will be in a consulting role to US Bank Asset Management CEO, he will not be a full-time employee of PFM Asset Management at the time that the deal closes. He is 77, he was on a retirement



track, his successors were named a couple of years ago, Ken Schiebel who is the head of our Portfolio Strategy Group will transition into being the CIO, he's been at PFM for 26 years. John Bonow will step up from his role to be our COO, he's been at PFM for about 20 years. So, we are implementing the succession plan as we transition over to US Bancorp. I hate to see Marty go. Its impact will be most felt in the local government investment pools, but I think our business is fully prepared, I don't expect any challenges in that regard. Marty is on the investment committee; he has been replaced by Ken Schiebel already.

- *Mr. Case: The one issue I've always had is that I've always maintained the separation of duties between our fiduciary trustee and our investment manager. The philosophy being that the investment manager never has access to the assets they are managing and by having them in separate companies, that's always left a very reliable wall between the investment manager, who decides what is invested in and personnel holding assets. The question is if the firewall that was existing before the merge of the companies is still going to be there between your fiduciary trust arm and your investment management?*
- I'm very comfortable with our response to that. That is a different group in the bank; it is a different division. They have a whole different site of systems. We will not share any systems with them other than the HR and 401K platforms. They have separate federal regulators and auditors, they have a whole separate chain of control. As we have talked about relocating, we have an office in Virginia right now, the financial advisors will continue to keep that office, so where does PFM Virginia office go? I've been talking to my new boss about that office being in Richmond because there is a US Bank presence in Richmond, but according to the SCC that would only work if there were actual separation. It's got to be separate networks, separate systems, and even separated physically. And the people in Richmond are not the people who did the work on this OPEB Trust, that group is in Minneapolis. So, the physical location in Richmond doesn't change much of anything. We believe we have a strong separation; we are not going to have any influence or oversight in that business in any way, shape or form.
- *Mr. Case: My concern is that in bigger picture scheme of things, to know what banks are getting out of the fiduciary trust business, like Wells Fargo for example. They are out of it; they don't take fiduciary responsibility anymore. Fiduciary responsibility says that they cannot do anything with our assets that is not in our best interest, and they have a positive obligation to protect those assets, and to make sure that PFM does not do nothing with those assets that is outside of the Trust, and by the way, neither can we. They have a positive obligation to make sure that what happens with the money in the trust is under provisions of that trust. Most banks are no longer doing that. They are glad to hold your assets, but they are not taking any responsibility for what happens. That market is now mostly divided up between Bank of New York Mellon and US Bank, they are about the only two big players that I'm aware of in that market. There are some small*

*regional banks that will do it for you, but they don't have the robust systems and same level of staffing, and people who really specialize in the fiduciary trust holdings, especially for OPEB and local government pensions.*

- The business that you find from a typical local bank is really a Trust officer who is in the retail environment. They are working with people in the community who have Trusts. They are helping them invest money. It is not an institutional focus. If this was brand new and you were to issue an RFP, the ones that will respond would be US Bank, Bank of New York Mellon, Willington Trust a division of MBT Bank, and BB&T Bank may also respond. The last client that we helped, City of Northwood, created a Pension Funding Trust a few months back, they issued a bid, and they got US Bank and Bank of New York Mellon. So, Bank of New York Mellon's fee was four times the price. Bank of New York Mellon is a good bank at what they do and if your portfolio is a 2 billion dollars portfolio, they will provide very aggressive prices.
- *Mr. Case: And that means that US Bank was more economical.*
- Wells Fargo sold their custody business and their trust business about two years ago. They sold their custody business to Principal, and they sold their trust business to company called Computer Share. The Principal side of the deal is finally being completed in some parts of the US. Principal immediately re-engaged Wells Fargo's people to keep providing the custody services, they are transitioning group by group starting now through November. Computer Share is a company that tends to automate absolutely everything. My understanding is that getting a hold of a person at this company is next to impossible. They are going to start transitioning this fall. In a year I might be able to tell you how that looks, but I have no idea right now. Wells Fargo was a good business provider. These are two non-bank entities. They are not banks; they have stepped in to play those roles. That's the challenge. You can get Bank of New York Mellon, but is going to be more expensive. US Bank is a better service provider. If you develop comfort level with the separation of the duties, I think it will be well served

#### **5.F) Decision to issue an RFP or continue forward with US Bank**

- Mr. Case: We need to make a decision. Do we move to issue an RFP to replace US Bank, or do we continue forward with US Bank? I would move to stay with US Bank until such time an RFP is needed or we perceive a problem.  
On a motion by Diane Starkey and seconded by Joe Mason.

Mr. Case comment: I just want to make sure on the record that we will address any issues. PFM should be aware that this is something we are going to monitor. If US Bank decides to invest themselves in that business, we will resume the right to move the Trustee relationship.

**6. Additions to Future Board Meetings**

- a. None

**7. Information Memorandums**

- a. None

**8. Members Statements/Comments**

- a. None

**9. Adjournment**

Mr. Case made a motion to adjourn at 11:20 am.

Approval was unanimous.