TOWN OF LEESBURG
Town Hall
25 W. Market Street
MINUTES
TOL OPEB Trust Finance Board
November 19th, 2021
10:00 am
Lower-Level Conference Room 1
Finance Board Members and Others

---

1. **Call to Order** by Clark Case 10:05am

2. **Approval of Agenda of 11-19-2021 meeting**

   • First order of business is the approval of the agenda. On a motion by Clark Case and seconded by Lisa Haley.

3. **Approval of Minutes of 08-20-2021 Finance Board meeting**

   • Next order of business is to approve the minutes from August 20th, 2021, Finance Board meeting. Does anybody have any corrections or changes? No corrections or changes. On a motion by Lisa Haley and seconded by Clark Case.

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 or asset allocations since last meeting or pending changes
   e. Discussion of status of PFM Contract renewal review and approval

Mr. Bush's comments:

- In the main quarterly report on page 2 you can find the broad market indices returns for the past quarter, past year, past 3-years, past 5-years, etc. I would like to point out the past quarter, from July 1st through September 30th. It was a bit of a letdown, after several quarters where returns were strong in many sectors.
- Large-cap domestic equities had decent returns.
- Fixed income was very flat during the quarter.
- Small-cap, mid-cap equities and international equities, especially in emerging markets, were challenged, primarily because of the emerging impact of the Delta variant of the Coronavirus which has been particularly difficult in emerging markets, where many things are produced, where ports, shipping facilities and

many other facilities were shut down for many weeks during the quarter. This led to supply chain problems.

- Thankfully, what we've seen from Coronavirus spread, has been declining. For the most part is declining quite a bit here in United States. It seems to be that it is only spreading among the folks who have not been vaccinated, although I'm living proof that it is possible to be vaccinated and to get the Delta variant of Coronavirus.
- Year-to-date returns have been strong since we got through the end of September.

  **Interrupted by emergency fire alarm*.*

- The GDP, for the quarter, was somewhat muted and less than expected due to the current Coronavirus issue.
- We've seen employment behave erratically. The August and September numbers were far less than expected. The October read (middle of September to middle of October) has been stronger.
- The unemployment rate is now down to about 4.6%. There are still a couple of million fewer jobs now, than there were at the beginning of the Coronavirus pandemic. We may finish the year to what we were in January of 2020.
- One of the issues that exists is that we are not going to be back where we were in January 2020, unless a lot of people come back to the workforce, and they take the many jobs that are available right now. At the end of October there were about 5 million people unemployed in the United States. Being unemployed means not having a job and you are looking for a job, but there were 11 million job openings. That is a lot more than job seekers at that time. It is mismatch, and this mismatch is for a lot of different reasons like, people locations, skill requirement, wages, benefits, etc.
- There are two groups of people who really haven't come back to the workforce. Folks who stepped out of the workforce during the Coronavirus pandemic who are over 55, and women. If you look at the Bureau of Labor Statistics, estimates on the percentage of people over 55, who they would count to be in the workforce that have stepped out of the workforce, the pace pre-Coronavirus was down to 1 million and half that haven't return to work. This amount puts a big dent in that job mismatch. The second group, women, is particularly the case in larger urban areas, where women have stepped out of work, maybe they were forced out of work, maybe they voluntarily moved out of work to take care of the kids or their parents who are sick, maybe they had family members moving in with them. Many of these women can't go back to work because they can't find childcare. Childcare is a big issue because they can't find workers.
- The Fed still wants to maintain its policies to help employment grow, but we have more job openings than we have unemployed people. The result is wage inflation.
- *Mr. Case: One of the problems is skills mismatch. A lot of the jobs that have been created post pandemic are especially skilled, for example, we have a Senior Buyer position that we haven't been able to fill yet. It took me 9 months to find a Controller. We have a Senior Accounting Associate position open, and we are having trouble filling it because people who have local government accounting*

experience are rare because baby boomers have retired out with their skills. We don't have people with those skills available in the workforce. The other challenge is that we are being outbid by other local governments. That is a problem. You can't just go out and buy a senior local government buyer and say we will train him up in a year. It is a job that takes five to seven years to learn.

- *Ms. Haley: I think we are going to be facing another tide wave of this because, there was a pause for some people when the pandemic hit that were retiring, they were on their way of retiring and they waited. Now that the market is the way it is, they are getting to retire, so we are going to have another wave.*
- I think in a place like Virginia, Maryland, or Washington DC where there is growth in jobs, but not the same level of overall population growth, plus a lot of retirements coming in Virginia, that wave has started.
- *Mr. Case: It is difficult to recruit people from elsewhere in, because of how high housing is here. Getting someone new from southern Virginia to here or even Washington State to here is hard.*
- I haven't heard much of this and I need to support or reject this idea. The CFO for the Alexandria Sanitation Authority lives in Charlotte, and she comes in to work for Board meetings, that's when she is in the office. The day-to-day investment manager for Prince William County lives in Pennsylvania, and he comes down about once a month just to show his face. That is happening, it is a non-starter for some government entities, and it is a satisfactory approach for others.
- *Mr. Case: Our Budget Officer is a 100% telecommuter from Winchester, and he comes in for Board meetings. Lisa, who is the Treasurer, telecommutes almost 90% of the time. That is kind of the new reality. And I've had people that want to apply for my jobs that want to telecommute from day one. My perception is that you must learn the job before you can telecommute. You need to be on-site for some time to learn the job, the team, the culture and all those things. Once you have done that, then we can talk. Where I'm going with that is the Fed has been saying that the inflation is transitory, I think the Fed is wrong because there is wage inflation. I see it coming in our own plans for compensations be it police officers or skilled positions, and I think it is coming simply because of this need to try to recruit and fill positions is taking more money. That is wage push inflation, and people have started to build it in their plans for the coming year. That tells me that this is part of the change, but what is changing here is wage inflation. Over the last 20 years employees had no negotiating cloud at all, that's changed.*
- I couldn't agree with you more. Leisure and hospitality are the areas in the job market that are sort of the most behind, the most affected by the coronavirus and the place where the most job openings are. You can't perform those jobs remotely you've got to do them in person…. wage inflation. Once wage inflation happens, it doesn't go away. The supply chain will correct itself, the additional cost for transportation, the current challenges with petroleum prices and natural gas prices we are having right now, those things will eventually subside, they will eventually fix themselves. But wages aren't going to go down in six or nine months. The Fed who has expressed that inflation is transitory, there is a growing movement of people who just seem to think that they are wrong. In their last meeting, the Fed seemed to begin to acknowledge that maybe inflation is a bigger issue.

- CPI came in last week; it is over 6%. Even if you take out the food and energy to get to the core, core inflation was over 4%. These are high inflation numbers that we haven't seen since 1990. Yes, transportation costs are part of it and durable goods, in some cases, are part of it too. Pick-up trucks go up 30% year over year, but that will subside. The wage inflation is probably impossible to subside.
- The Fed has started to taper, they have taken the stimulus program and what they've been doing to try control longer term interest rates, and they have started to back off that. They are still in stimulus mode, they were buying 120 billion dollars a month of treasury and agency mortgage-backed securities, this month they are only buying 105 billion a month, next month they'll only buy 90 billion, the month after that they'll only buy 75 billion. They are tapering by 15 billion a month, that is still stimulative, they are still stimulating those long-term yields through that purchase program.
- The Fed has done nothing with the Fed's funds target rate yet. The Fed funds target rate is the short-term end of the yield curve. For us, in the local business, we want the short-term yields to rise and the long-term yields to stay where they are at. We like to borrow low; we like to invest high. In the last meeting, there are some Fed members who have expressed that they believe the Fed funds target rate will need to move as soon as 2022. Members are a little split. Many members think there is only going to be one Fed increase next year, others believe there is going to be two Fed increases this year. We look forward to their next meeting in December when, unless their heads are completely in the sand on this wage inflation issue, we are going to see them thinking a little bit more aggressively. We still don't think that they are going to move the Fed funds target rate until they are done with the tapering. If they keep up with this plan, they will be done in June, so they could begin to move the Fed funds target rate up, as early as, in their July meeting, and they will need to if inflation is up at this pace. They want to keep things low.
- The Fed thinks the mindset of people is supportive, a lot of this is all psychology. It is all mentally helping consumers think that it is very inexpensive to borrow money. Mortgage rates are unbelievably low now compared to where they normally are, and if they go up 50 basis points, they are still going to be unbelievably low compared to long-term averages.
- *Ms. Haley: Nelson, you just articulated exactly why the Fed had to say that it was transitory. If they say otherwise, the markets will lose their minds, people will lose their minds.*
- Yes, absolutely. They are the economy's Chief cheerleader. It is all about psychology and communication to them. They can cautiously admit that things are well, that the GDP is strong, that the labor force is improving; and then they can admit that inflation is a little bit higher. The Fed funds target rate is in a position of being very stimulating. Inflation right now is at 5% or 6%, the core CPI is at 4.4%, that means if you have a pot of money, if inflation stays at 4.4%, from an economic standpoint you can buy a 4.4% less stuff in a year than you can buy because prices are going up by 4.4%. So, if you are investing in an overnight investment and getting 10 basis points right now, economically you are losing money. If you can borrow at a rate that is below 4% right now, economically your borrowing rate is

free, that is very stimulating on the economy. We don't know how long the Fed can wait. The market doesn't think that they can continue to wait.

- *Mr. Mason: Two parts of disfunction, one is maximum employment, and the other is controlled inflation. It seems to me they fail at 50% of the job.*
- Yes, for them whether they view themselves as being right or not, they are not looking for inflation, they are looking at average inflation. Inflation is challenging.
- *Mr. Case: Bring it back to the markets, when the Fed finally must face up the reality and start pulling things in, what is the likely impact? What is it going to do to the stock market? Are we in for a bad year in the investment portfolio in 2022 or 2023? Or is it something that you think they are going to be able to fix?*
- What we think is volatility. Price-to-earnings ratio is high right now. The multiples you pay for stock suggest that earnings need to be much higher going forward, that is a concern. If multiples were sort of a long-term average, we would say stock market, historically, does well in inflation. One of the best hedges against inflation is the stock market, but where price-to-earnings is at right now, it is somewhat concerning.
- On the fixed income side, it is hard to suggest that we are in for positive returns, because interest rates have been so unbelievably low. I know some interest rates have risen a bit here in the last couple of months, but they are not much higher than they were at the end of the first quarter of this year. In the second quarter of this year and the beginning of the third quarter of this year, interest rates fell a little bit. So, depending on what rate you look at the 30-year US treasury is not much different from where it was at the beginning of the year. The 5-year, 10-year and 20-year are surely a bit higher. It does mean that the market expects that the Fed may be wrong in the short-term on inflation, but probably isn't wrong in the long-term on inflation. Still, a 30-year treasury at a rate of 2.05% or 2.10% is still very low. You are letting somebody borrow money at a rate that is lower than the Fed wants long-term inflation to be at. There surely is risk in a 30-year treasury security.
- On page 16 is your asset allocation. The allocation has changed a little bit since the end of September. At the color bars at the bottom, the gold lines are your targets in your blended benchmark. The blue line is your actual allocation as of this period.
- What you can see at the end of this period is that we are basically at equal weights in domestic equity and international equity. That is not what I would call a defensive position, but it is also not what I call an offensive position. It is a position that you might go in if you are concerned a little bit about volatility.
- We are underweighted to fixed income. That 6.1% at the end of the quarter it is now at about 7.2% underweighted to fixed income. It's naturally moved a little bit in that direction because of returns during the period. Fixed income is the segment of the market that normally is really hurt by inflation because the Fed raises rates, and the market demands higher rates of return. When they lend their money to an issuer, whether is the federal government or the municipal government or a corporate entity, they demand higher rates of return when inflation is higher because they want to earn some sort of a return when they lend money for 5, 10 or 20 years or whatever the period is.
- We have some tactical asset allocations in there right now. We have other growth in other income that we'll talk about when we look at the actual performance.

- Today we are modestly overweight to international equity, that is where the overweight in equity is right now. As I mentioned before, we are in the 7% underweight to fixed income range.
- We are not really committed to go into overweight in domestic equity, even though equities normally are a good place to be when inflation is around, we are not committed to being overweight to domestic equity because we are concerned about price-to-earnings multiples. Stocks are kind of expensive compared to their earnings right now.
- We think that the international marketplace hasn't recovered to the extent that the United States has. The United States tends to lead in economic activity. The developed markets in Europe and Asia tend to fall a little bit behind the United States, so we are a bit overweight to international equity right now. That's our current position, that is our current thinking for the near term. If corporate earnings were to somehow rise significantly and those multiples dropped a bit, I think you would see us go overweight to domestic equity. We would feel better about having the portfolio positioned for inflation, if we could do that, but we are somewhat concerned about the price-to-earnings ratios, and that's why we are not overweight in that sector right now.
- *Mr. Case: Can we jump to portfolio performance?*
- Sure, turn to page 12. The quarter was disappointing, domestic equities were down a little bit, more than the benchmark. The decline was led by the mid-cap ETF. That was just recently put in the portfolio; from the performance standpoint we are tracking it as October 1st, but that allocation was put into the portfolio at the beginning of September.
- The active management fund was somewhat helpful during the quarter, but domestic equity was just kind of modestly down.
- International equity was tough, it had a bad quarter. The performance was roughly in line with the benchmark. The active managers, in some cases, like J.O. Hambro or the Artisan International Small/Mid-cap fund were not down as much as the benchmark, but the allocation to emerging markets, as represented by the Hartford Schroders Emerging Markets Equity, was particularly challenged during the quarter, primarily the result of the Coronavirus. We did move some money out of that earlier on in the quarter, but that small allocation was still there.
- Some of the underweight to fixed income have been allocated to this Barclays Convertible Share's ETF that you can see at the bottom of page 12 and was allocated to the iShares Preferred and Income Securities that you can see at the bottom of page 13. The returns in the quarter of those allocations that were just done in September, didn't have a dramatic impact on the overall quarterly returns, but the return impact was positive in the preferred shares fund by a small amount and not positive for the convertible bonds. Those allocations were taken from fixed income.
- Fixed income is at the top of slide 13, you can see what the returns were for the quarter, very modestly positive. But in a period of volatility, it helped the overall portfolio to have that allocation there.
- Those are the returns for the quarter.

- *Mr. Case: Do you want to talk about the month of October? Because October pretty much undid the quarter.*
- In the separate hand out, which is the flash report for October, it was better. There were strong returns in domestic equity and in international equity. You can see for domestic equity about 6.7%, and international equity 3.34%. Domestic equity is close to the benchmark, international equity was better than the benchmark almost a full percent.
- The convertible allocation, which is an allocation from fixed income, was positive.
- The preferred shares allocation at the bottom of page 2 was positive.
- The fixed income returns have been negative, that performance continued through the 12th of November. The returns are a little bit higher as we made it halfway through November. I only have the returns through November 12th at the top line. Through this date the portfolio, quarter-to-date have returned 4.59%.
- The blended benchmark's return was 4.2%.
- There is some continued outperformance. The quarter-to-date returns so far, have been good. It has put the portfolio back on track for the calendar year, at least. So, calendar year-to-date the portfolio's performance has been a little over 10%. Positive things for the portfolio overall.
- *Mr. Case: What we read from all this entire report is volatility.*
- Yes, it is volatility and that's how the portfolio is positioned. We are underweighted to fixed income because we expect nothing but a drag on returns there, but we are not really overweight to normal equities. We have these allocations to convertible bonds, that although we've decreased it recently, the convertible bonds are still a little over 2% of your portfolio. We have an allocation to the preferred stocks, which although we've decreased it a little bit, it is still over 2% of the portfolio. It is about 4.25% of the portfolio combined, that is most of that underweight that you saw on the fixed income side of the portfolio.
- That is how we are moving forward. We feel better about equities, both domestic and international, than we do about fixed income. We don't have tremendous confidence in emerging markets, so we are sticking more to the developed markets, than we are the emerging markets. We are not as optimistic quite yet about small-cap and mid-cap, so the domestic equity side in the portfolio has a strong bend toward just an index fund. There are some smaller allocations to an active manager who has outperformed recently in this mid-cap ETF, which is an index allocation in that space, but we don't have strong confidence that it will outperform large-cap. That's the way we are allocated right now, in our minds it is a little bit defensive, it does look defensive, but it is defensive against inflation.
- The original contract's termination date was in the June timeframe. We have discussed this in prior meetings. We talked about performance and comparison to some other peers, you all decided to continue with PFM. There has been some back and forth on the contract language, every time I've asked my lawyer to look at the contract again, he comes up with some brand-new change. The last thing he is for was some stuff related to insurance. I hope we can have that signed soon.
- *Mr. Case: It wasn't an unreasonable change, I get where he is coming from, but I don't think those were necessarily necessary changes. The issues that are slowing*

our contract down are technicalities of the legal language in the contract, not major contract issues or anything negotiable or that needs to be negotiated.

- The one big difference between last contract and this contract are the fees. In this contract the fees are lower. The invoices, so far, have been at a higher fee, but once we get this contract signed, there will be an adjustment back to the start date of this contract.
- *Mr. Case: Joe, do you have any questions?*
- *Mr. Mason: Not currently.*

5. Additions to Future Board Meetings

a. None

6. Information Memorandums

a. None

7. Members Statements/Comments

a. None

8. Adjournment

Ms. Haley made a motion to adjourn at 10:59 am. And seconded by Mr. Mason. Approval was unanimous