

TOWN OF LEESBURG
Town Hall
25 W. Market Street
OPEB Finance Board Meeting Minutes
TOL OPEB Trust Finance Board
May 20th, 2022
10:00 am
Lower-Level Conference Room 1
Finance Board Members and Others

1. Call to Order by Clark Case am

Board Members Attending in-person: Clark Case, Lisa Haley, Diane Starkey and Nelson Bush.

Board Members Attending virtually: Joe Mason.

Ex officio attendees: Nelson Bush, Managing Director, PFMAM, Investment Consultant to Finance Board and general presenter in the meeting.

2. Approval of Agenda of 05-20-2022 meeting

First order of business is the approval of the agenda. On a motion by Lisa Haley and seconded by Joe Mason. Unanimous approval.

3. Approval of Minutes of 03-11-2022 meeting

Approval of March 11, 2022, minutes moved by Joe Mason, Seconded by Lisa Haley. Unanimously approved.

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

Nelson Bush of PFM presentation:

- Nelson is projecting his presentation on the screen. No hard copy, but electronic copies sent in advance and publicly available.
- 2021 finished in good condition. Covid was retreating and GDP was growing. First quarter of 2022 inflation concerns became more in focus. Covid is still an issue although less in US today, it is still impacting world economy and supply chains. The Russia and Ukraine situation is also having a big impact. Discussion of continuing aspects of Covid. Shutdowns in US have mostly ceased, but China has cities shutdown.

China is still a major manufacturer and is critical to supply chain and shutdowns are affecting supply. This does impact the US especially on inflation. CPI was down some but still near 8.4% and the highest in 40 years. Spending shifted from services to goods in the pandemic. This ran up goods prices. Things are shifting to services and people are going big on pent up travel and other services. Car prices had soared, but we are seeing some slowing in this now. Plane tickets are up about 20% in April alone. Those prices are up on supply/demand imbalances. Supply of people to do the work is part of the problem. There are 1 million fewer people in Airline, travel and hospitality jobs. There twice as many open jobs as job seekers.

- Russia and Ukraine have created even larger challenges in the energy sector. Europe is slowing its purchases of energy products from Russia it is driving up prices across the world. Fuel prices are climbing along with labor rates and the consumer has not slowed much yet. Spending was up, but down on an inflation adjusted basis. Consumer is still spending overall. Inflation is a problem world-wide. Japan is seeing inflation for the first time since the 1980's.
- Fed has seemed asleep at the wheel. Thought inflation was transitory. Fed reversed its narrative starting in January. Raised rates significantly and will raise 50 bps in June and July and September and this will take the Fed Funds Target rate from 0 in March to 2.5% by September. Has not raised rates this much since the early 1980's. Doing rate increases over 6 months that they usually do over years.
- Safe space is hard to find in investments. All major equity indexes are down by big percentages. International equity is down a bit worse. Real Estate was thought to be a safe haven and it is down too, just not as much. Fixed Incomes are down about 5.9% to 6.0% overall. Market moves ahead of the Fed and is looking out 6 months. Markets have already priced in the expected Fed actions. A ray of sunshine, may be short-lived, are in commodities, food, fuel, etc. Ukraine and Russia are major producers of wheat and grains as well as fuels.
- Page 12 shows Portfolio return for first quarter. Negative return was -7.1% because all equities and fixed incomes were all negative. Benchmark was -5.53%. Under performance came from Jenson Quality Growth Active Manager. They are focused on technology which had a really awful quarter. Allocation to small cap iShares Core Small Cap ETF also under performed. Large Cap companies are in technology in the S&P 500, and they suffered. The five biggest tech companies made up half of the loss in the index. Index managers are based upon the value of each company in the market. The big under performance of the portfolio overall was primarily due to International Equities. The active managers in this space **really** under performed. Most were overweight to Russia and China, technology and overweight to consumer products. These managers were the result the portfolio under performed the benchmark.
- Removed a convertible fund to fixed incomes. Credit spreads widened so corporate bonds rates went up more than federal securities. The overall allocation of Fixed Income was under weighted to the markets.
- Market results since quarter end. Performance was bad in first quarter and second quarter so far has been worse. The Ukraine war has been worse and longer than expected. Germany has quit buying Russian energy which is slowing German and European growth which has impacted corporate profits too. Markets are seeing longer negative impacts than they originally thought. Inflation may be more long lasting than expected. Others

think that the Fed is going to overreach and push the economy into recession, so profit expectations have dropped. Total portfolio was down about another 8.4%.

- Our long-term returns are well above the 6.5% assumed returns. Actuary will blend the years so the very strong returns will mostly offset this one bad year at least for a year or so.
- PFM reduced international and domestic equity as well as fixed income. Moving to 8% into the government money market funds. Cash is generating positive returns and will protect principal until markets stabilize. Removing small mid cap allocations in international equity entirely. Artisan and Virtual will be eliminated and moved to cash or a broad market index. May consider higher allocations to cash.
- Slide 10, while Fed actions are aimed at reducing demand to calm inflation, Washington is not doing much else. Even if cars and oil begin to decline. Gas is around 4.40 generally even as high as 4.99. Shelter makes up one third of CPI, which are rent prices, and it takes about a year to make it into the indexes. Right now, it is a lagging indicator, but it may be a longer-term supporter of inflation. Rents are not going up 10 - 20% and this will be higher than the other elements and will be longer lasting.
- The expectation is that Putin is not going to back off and may escalate the war. Corporate fundamentals are still strong, but consumer Co's like Walmart and Target are hitting headwinds in the last week or so. Big financial companies are doing well.
- Only good news is unemployment is still only 3.6%. First quarter GDP was negative, and we could have a second one largely due to trade imbalances and inventory disruptions. Could already be in a technical recession, but it is not a jobs recession. People can still find work if they have the right skills and geo location.
- **Questions and answers.** Lisa Haley said that inflation is not going back to the very low inflation we had before the pandemic. Could be a new normal. Nelson: is the Fed right about putting inflation down to 4%? Markets don't think so. Would need 100 bps more than they are projecting. Fed wants 2% over the long term. Could be higher than 2% for a while and that might be OK. What are the longer-term implications for US production becoming more domestic? Used to produce micro chips in US and that all went to China.
- Housing prices on same units if it remained the same, the interest rate increases mean the payment is 20% more, so this should have some dampening effect. Fed cutting its portfolio holdings will hasten/increase this effect. It is selling off its holdings of mortgages rates.
- People who have student loans may have to start paying on them again. This will be a drag on spending. Do we want the federal government to be the major backer of student loans? The university industry is a big part of the problem with unbelievable price increases with unlimited credit availability. You can borrow money for a career that will never pay back the cost of the loans.
- Joe: people are starting to opt into ARMS and other variable loans which we saw the hazards of 15 years ago. Manufacturers are becoming dependent upon rare earths and other materials that aren't domestically sourced. Are we considering value managers looking forward? Nelson: buyers are turning to adjustable-rate mortgages, and it is a challenge. One hopes lending standards are more restrictive than they were before. Institutions are stress testing the candidates. This could cause a housing bubble. Don't think we are there yet, but it could bear close watching. We don't see the increase in sub-prime lending beyond cars and credit cards. Sub-prime defaults have increased, but they

are not in the mortgage market right now. There is not a big move to on shoring manufacturing. Hard to know if political or real supply and demand. Not a lot of talk about it now. No tax credits or other incentives. There is no political will to incent it for big companies. We must replace our microchip production for military needs but no widespread indications of a trend. Allowing rare earths mining is terribly disruptive but no federal impetus to do anything domestically. Looking at growth vs. value? Reducing the Growth allocations but want to see where the economy is going to go before making those decisions. Value plays can work in longer term downturns. Would be a tactical allocation change rather than a strategic change. Will be more of the reductions to growth first.

- Motion moved by Lisa Halley to adjourn and seconded by Joe Mason.

5. Additions to Future Board Meetings

- a. None

6. Information Memorandums

- a. None

7. Members Statements/Comments

- a. None

8. Closed Session

- a. None

9. Adjournment

Mr. Case made a motion to adjourn at 10:40 am. And seconded by Ms. Haley. Approval was unanimous.