

Wisconsin Coalition of Annuitants

Minutes of Meeting July 21, 2010

The meeting was held at the Wisconsin Professional Police Association Building, 304 Coyier Lane Madison and was called to order by Chair Jim Palmer at 9:37am.

MEMBERS & ALTERNATES PRESENT: O. Berge, WARSDA; V. Cutler, UWMRFA; J. Elmer, WREA; B. Fendel, AFSCME; B. Frantz, DOT; R. Hoessel, DOT; C. Howard, WEAC-R; D. Kratz, CORR; A. Lee, WSAA; J. Miller, DNR; J. Palmer, WPPA; D. Rohweder, ESP, W. Rowe, ACE; B. Schaefer, SEA; J. Skiles, UW-R; J. Stoddard, CORR; J. Vreeland, Wauwatosa; A. Wallace, UWMRA; J. Zwadzich, SWIB.

GUESTS: S. Drew, A. Fendel, T. Freemyer, J. Gruentzel, T. Reopella, M. Stohr.

EXCUSED: J. Egan, E. Frank, J. Grosklaus, J. Maydak

MINUTES of the June meeting were approved as mailed.

GUEST: Trish Reopella, Equity Fund-of-Funds Manager, SWIB

Ms Reopella shared the annual equities staff presentation provided to the investment Board last month. She provided a handout.

The equity division has identified three themes that have been the focus the past four years with the arrival of the new CIO. Everything done in equities in the internal and external area and trading room are directed toward these three goals: 1) Better use of active risk, 2) reduce unintended risks and macro bets and 3) explore new sources of alpha. Alpha is the amount earned over benchmark or excess returns.

1) Better use of active risk is beating the benchmark and adding alpha in the most efficient means possible. US large-cap markets have become efficient and it is difficult for an investor to have an edge in stocks such as Microsoft, Apple or Coke. Internal equities staff have slowly shifted to less efficient markets with an increase in small-cap management. Three internal large cap portfolios and one internal mid-cap portfolio have been combined into one portfolio. US large cap indexing has increased from 39% to 68% in the last four years mainly with external management moved internally and then indexing. This resulted in using active risk to implement global strategy and increase exposure to emerging markets and maintaining or increasing alpha. Equities exposure in the last four years has changed considerably. Emerging markets has increased from 4% to 10% and US equities have decreased from 63% to 43%. Global exposure has gone from 0% to 23% and has both internal and external managers. This is where five portfolios were combined into one global portfolio with ten sectors, which also has resulted in a career progression for senior analysts who manage their own sector under the portfolio manager. Emerging markets and international equity is externally managed and US equities being indexed are internally managed with about seventy percent of the global being internally managed. With the 20 positions from the last budget, the internal management of total assets has doubled. Global markets include foreign and US based companies with emerging markets being separate. Small cap internal management has gone from 54% four years ago to 100% today. Small cap has greater potential for alpha and utilizes a small-cap consultant for 1 of 3 portfolios. Small cap quantitative/enhanced and indexed is externally managed which provides a good mix of investments.

2) Reduce unintended risks and macro bets is a relatively new concept for SWIB. Portfolio managers in both the large and small caps have risk measurement tools to reduce market biases and to neutralize overweight in the sector to reduce unintended risks and macro bets along with consideration of benchmarks. An example is a large cap portfolio manager focusing on mega cap exposure where the potential for growth is limited and returns are based on economics or the other extreme being a small-cap manager selecting micro cap companies that have a different set of risk factors. Also, the health care sector was over weighted having exceeded its benchmark until recent years. Establishing nine sectors and slowly expanding them the healthcare sector was added and all 10 sectors now have equal weight. Three of the sectors are indexed and managed by the index

manager until senior global analysts are available. Two new quantitative analysts provide combinations of sector exposure to monitor over and under weight. Recently, all sectors were under weighted in financials and individual financials were purchased through ETFs (Exchange Traded Funds) and are purchased and sold similar to stocks.

3) Exploring new sources of alpha. Activist funds, primarily small cap, involves taking over management to improve performance and usually on a friendly basis with board members. Activist funds begin with an external manager and eventually will be internally managed. Hedge funds will begin by the end of the year and over the next few years will have a 2% allocation. Internal idea generation and research has been encouraged by the CIO and has been valuable and successful.

Strategic initiatives implemented in internal equity division were presented to the board by Bill McCorkle. The new 10 sector portfolios with seven actively managed and three indexed transitioned to a global platform and benchmarks with new analyst positions. The small cap investment process has reduced volatility by permitting analysts to focus on one sector instead of numerous sectors. The analysts now have stock selection responsibility. Also implemented is the DCF (Discounted Cash Flow) modeling process and the development of sector quantitative screens to help identify attractive stocks and focus on research efforts. There is more emphasis on stock selection recommended by analysts along with the portfolio managers.

Potential future initiatives to enhance investment are: convert passive sector portfolios to active management, Shorting with pair trades to express symmetrical positive and negative views with the analysts, and Options by writing covered calls to generate added income.

The index and strategic implementation portfolio manager, Diane Linn, who was hired two years ago reported that the Russell 1000 index increased from \$5.5 B. as of 12/31/08 to \$13.0 B. as of 4/30/10. Ms Lynn also manages the three indexed sectors of energy, telecom and utilities. She also is researching derivative capabilities with Futures by having a liquidity account for instant purchasing and an overlay for rebalancing and an options overlay of selling and buying at specific percentage changes while collecting premiums for buying and selling. The internal staff are researching a Merger Arbitrage portfolio which would establish infrastructure for shorting. This involves tracking companies that are being sold or involved in mergers.

SWIB trading room had two retirements in the last 18 months and replacements are experienced and knowledgeable professional individuals. Accomplishments in the trading room are expanded international trading for global large-cap and sector funds, 11 each portfolios in the core and variable. Staff also is experienced in foreign currency trading and daily currency hedges. Expanded trading of futures and options includes a recent hire with experience. Trading room initiatives include implementation of new technologies with trading platforms for stocks and currency with a trading cost analysis program. Increased communication with managers and analysts has been beneficial. Likewise staff has been providing increased assistance with options strategies.

Questions: Is anyone at SWIB following the Islamic law and financial principles as it influences investments globally?

The external managers have a number of areas that are screened before any purchasing. However, there is no one following the Islamic financials. This is an item that staff will list for discussion.

Is SWIB in a position to handle deflation?

Each manager and analyst performs different economic situations on their portfolios. A risk parity concept is being implemented to review high growth/high inflation and low growth/low inflation and combinations. With the 60% stock allocation the risk is close to 90%. Risk parity will be a change in emphasis from stock returns to investment risk. SWIB will be hiring two external risk parity experts. Risk parity would direct that the most money be in fixed income but earnings would not meet the 7.8% return. The fixed income would be leveraged from 60% stocks and 40% bonds to 60% stocks and 60% bonds. New England Pension Consultants have been hired and they will be

giving a presentation to the Board at the August meeting. SWIB and ETF are considering ways to adjust annual annuities so they are not as severe in good years as well as in down years.

Does SWIB trade with other counterpart systems without going through a stock exchange and are those trades considered in the volume reports in the media?

SWIB does trade with matching networks and trades are not counted. Investors place little value on volume reports and the last few years they have become useless.

Does the ten year average returns of less than 7.8% factor into the annual adjustment? Mr. Stohr stated that it does factor in. There are systems that are reducing the expected assumed rates which then would increase contribution rates.

Do portfolio managers have an asset base for investing or a maximum dollar amount? There is no max or minimum. Internally if a portfolio gets too large it is adjusted. Externally the amount is set by SWIB for each manager.

GUEST: Sandy Drew, Legislative and Beneficiary Liaison, SWIB

The preliminary returns as of June 30 are: Core -3.2% with a benchmark of -3.0%. The Variable was -7.3% with a benchmark of -7.5%.

Save the date - Annual SWIB reception will be Tuesday September 14 at the UW Fluno Center. Guest speaker will be James Stewart columnist for "The Wall Street Journal" and author of "Smart Money".

The LAB (Legislative Audit Bureau) does a SWIB management audit every two years and the report will be available in September.

The WI Supreme Court ruled that the \$200M used to balance the budget taken from the Injured Patients and Families Compensation Fund is to be returned. SWIB manages the fund. The Circuit Court will determine the interest and payment procedure.

The Federal SEC Bill is being signed and most of the issues with SWIB have remained in the bill. Not changed was the "Too Big to Fail" issue which would pay banks before institutional investors.

GUEST: Matt Stohr, Director Legislation, Communication, Planning, ETF

Mr. Stohr provided a handout of legislative and communication updates listing the 2009-2010 legislation that would impact the WRS. None of the bills passed; however, several health insurance related bills did become law.

ETF and SWIB will be issuing a joint newsletter beginning in January 2011.

The ETF 2010-2015 business plan has three priorities: Develop online access for members and employers, expand outreach across the state, and enhance training for internal staff and participating employers.

The ETF 1310 request of \$2.5M and 14 positions was approved. ETF will have nine regions/districts in the state and will have a person, headquartered in Madison, responsible for each area. Locations will be determined for scheduled office hours and group presentations. The Waukesha office will be closing due to under utilization.

The employer contribution rate for general category was increased 0.6% the same as last year. Questions: Could the Variable be dropped two times a year rather than just one time? By statute the Variable may be dropped only at the end of the year.

Has there been consideration for changing the last three years earnings average to a longer time, say five years?

ETF internally has been discussing options. There will be a technical bill next legislative session to bring the WRS in compliance with the recent federal law changes. The ETF board will consider numerous law changes.

GUEST: Troy Freemyer, Online Technology, ETF

Mr. Freemyer provided a handout entitled “myETF Benefits”. He “walked” us through the various pages on line and how to access the system. Online access to member benefits will be available from any computer. <http://myETF.wi.gov/ONM.html> At present only health information is available covering demographic information, historical changes, and health contract information at three levels. As the system expands life insurance, disability, WRS, and other benefits will be made available.

The application or paper change process today takes 10-20 days and in the future the time will be 3-5 days with fewer potential errors and greater security of information. For annuitants the employer is ETF.

To access you will need a Wisconsin User ID or WAMS (web access management system) and a password. There is a link to register and receive a WAMS through DOA who manages WAMS. Registration requirements will take 4-5 minutes for initial access. The expiration of your WAMS is 20-30 years. This is the first of several security steps.

Every WRS member has a ETF member ID located on your payment statement, statement of benefits or Navitus pharmacy card. First time logging into the system you need to provide your social security number to verify your member ID and WAMS. This also is a security step.

The “myinfo” is the first page and includes your name, address and family members. There are several links at the top of the page that are not functional at this time. The “Help” link is the first to be developed. “Log Off” is functional.

Several in-depth pages for health insurance were shown and described.

There are security concerns and until a security risk assessment is completed retirement information will not be available.

LEGISLATIVE REPORT: None

CORRESPONDENCE: In response to the letter of invitation to the three gubernatorial candidates. Mr. Walker will not be attending or sending a surrogate. Mr. Neumann is not sure but will probably not attend or send a surrogate. Mr. Barrett will have a surrogate.

A letter of thanks and the honorarium has been sent to Professor Duddleston.

OLD BUSINESS: Website proposal by Rick Wojciak. The proposal will include a domain name, shared web hosting space, web design and graphics development, web site maintenance, and monthly emailing of information. Web site development initial cost will be \$475.00 and maintenance and hosting fees will be \$35.00 per month. Suggest a one year review.

MSC The WCOA adopts the website proposal as presented by Mr. Wojciak.

ETF Board representative. Jim Gruentzel has withdrawn consideration. Bill Ford has expressed an interest. The nomination process will be announced probably in September.

SWIB Board meeting and reception is September 14-15. Our regular meeting date conflicts with SWIB. All agreed to move the WCOA meeting to September 22

NEW BUSINESS: None

NEXT MEETING: August 18, 2010 9:30 am, WI. Professional Police Association Building.

The meeting adjourned at 12:20 pm

Respectfully submitted – Dick Kratz