EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE

MINUTES OF THE APRIL 17, 2013 ANNUAL PENSION BOARD MEETING

1. Call to Order

   Chairman Mickey Maier called the meeting to order at 9:30 a.m. in the Grand Ballroom of the Italian Community Center, 631 East Chicago Street, Milwaukee, Wisconsin, 53202.

2. Roll Call

Members Present:	Members Excused:
Mickey Maier (Chairman)	Dr. Brian Daugherty
Laurie Braun	Norb Gedemer
Aimee Funck	Dean Muller
D.A. Leonard	Dr. Sarah Peck
Patricia Van Kampen	
Vera Westphal	

   Others Present:
   Marian Ninneman, CEBS, CRC, ERS Manager
   Mark Grady, Deputy Corporation Counsel
   Matthew Hanchek, Director of Benefits, Milwaukee County
   Daniel Gopalan, ERS Fiscal Officer
   Scott Manske, Milwaukee County Comptroller
   Brett Christenson, Marquette Associates, Inc.
   Ray Caprio, Marquette Associates, Inc.
   Larry Langer, Buck Consultants
   Jim Cavanaugh, Executive Director, J.P. Moran
   Steven Huff, Reinhart Boerner Van Deuren s.c.
   Marilyn Mayr, Prior Pension Board Member
   Bruce Richardson, Prior Pension Board Member
   Milwaukee County Retirees and other attendees

3. Pension Board Chairman Remarks

Mickey Maier introduced himself as Pension Board Chairman. The Chairman welcomed the retirees and provided an overview of today's meeting agenda.

The Chairman noted that this is his fifth year serving on the Pension Board and introduced the individual members of the Pension Board. The Chairman stated that he is pleased to be part of one of the strongest Pension Boards ERS has ever had. Collectively, the Board has very strong investment and accounting backgrounds, which are skill sets of key importance in making decisions regarding the Pension Fund. Active engagement of the Board members is one of the primary reasons for the long-term success of the ERS Pension Fund. Board members come prepared to meetings, and take time out of their normal schedules to attend continuing education courses. One of the primary goals of the Board is to determine which investments are likely to provide above-average returns, while taking below-average risks, and spending below-average fees.

The Chairman then stated that one of the key responsibilities of the Pension Board is to ensure that individuals entitled to receive pension benefits get their benefits, in both the amount and time they are entitled to. Conversely, yet just as important, the Board also investigates cases of individuals who have applied for benefits, but are not entitled to receive such benefits. The Board takes such cases very seriously, and investigates each case diligently and thoroughly, before making any final decisions. The Pension Fund is governed by the Internal Revenue Code, with many complicated rules and regulations to follow. The Board takes its duty to maintain the Pension Fund's compliance with the Internal Revenue Code very seriously.

The Chairman concluded by thanking the ERS staff for providing the important day-to-day support, which is necessary, to provide to the Board the information needed to make decisions on behalf of the retirees.

4. Benefits Director Remarks

Mr. Hanchek introduced himself as the Director of Benefits for Milwaukee County, responsible for the administration of the County's health benefit and pension plans.

Mr. Hanchek first discussed changes to the ERS staff over the past year. In 2012, there was turnover within management positions, as well as changes to some key leaders in very important roles. Mr. Hanchek noted that he began serving as Director of Benefits in 2011, and, shortly afterwards, Marian Ninneman was appointed as ERS Manager. Prior to becoming ERS Manager, Ms. Ninneman served the County in leadership roles both outside and inside ERS. Under Ms. Ninneman's leadership and guidance, ERS has employed a number of quality control measures and procedural improvements, yielding a more efficient and effective administrative system. Mr. Hanchek praised Ms. Ninneman for her efforts, acknowledging that she has done an outstanding job in keeping administrative and other processes up to date, allowing the Pension Fund to run like a well-oiled machine.

Mr. Hanchek then noted the promotion of Peggy Kubricky. Ms. Kubricky was added to ERS staff last year as a Retirement Information Systems Specialist. Recently, Ms. Kubricky was promoted to the role of Assistant ERS Manager, and assists Ms. Ninneman, as well as other ERS staff, in day-to-day pension operations. As a result of Ms. Kubricky's promotion, Tina Lausier was brought in to fill the role of Data Systems Specialist. Ms. Lausier is both talented and experienced, and her addition to ERS staff reaffirms ERS's commitment to maintaining successful operations.

Mr. Hanchek next discussed changes within the fiscal staff. Dan Gopalan was brought on last year as Assistant Fiscal Officer. Mr. Gopalan was recently promoted to Fiscal Officer. ERS is now seeking a replacement for Mr. Gopalan's old role, and hopes to fill the position in the very near future.

Despite the turnover in staff, it has been another successful year for ERS. In 2012, ERS successfully processed over 350 retirements and administered approximately $150 million in benefit payments. This serves as a testament to both the dedication and hard work of ERS staff.

Mr. Hanchek continued with a discussion of the co-development project. The project was introduced in 2011, and involves the transfer of the process of required maintenance updates to the V3 system from Vitech (the company that houses the V3 system), to in-house consultants within ERS. This allows ERS to adjust its systems, improve processes and adapt to various rule changes more quickly and efficiently. Additionally, the transfer to in-house contract services has allowed for a savings of over $500,000 in programming costs in 2012.

Mr. Hanchek next discussed the internal review process and audits which were completed in 2012. ERS is constantly looking for ways to improve the quality and accuracy of benefit payments, as well as ensuring that processing of all benefit determinations are made in accordance with the Pension Fund Rules. In 2012, ERS completed all required adjustments for administrative improvements, which were made to satisfy the recommendations from internal auditors.

Mr. Hanchek continued with a discussion of the Pension Board members. Mr. Hanchek echoed the Chairman's praise of the Board, by noting the professionalism and dedication of all members. The Pension Board meets monthly and minutes for each of the meetings, as well as ERS rules and policies, are available for public viewing on the County's website at www.county.milwaukee.gov/retirement.

During the monthly meetings, the Board, among other responsibilities, reviews investment management. Several changes were made recently to investment managers.

The Pension Board terminated Reinhart Partners Mid-Cap Growth, and transferred those funds to iShares IWP ETF in 2012. Additionally, in 2011, the Pension Board terminated the ING Clarion Global REIT portfolio, and used those proceeds to fund UBS Trumbull Property Fund in early 2012.

Despite the challenging market environments of recent years, in 2012, the Pension Fund achieved an 11% rate of return. The 2012 year will mark the second straight year of positive growth in the Pension Fund, and is a testament to the guidance received both from outside consultants, and the solid leadership skills of the Pension Board. ERS remains one of the most stable and well-funded pension plans in the country. The Board will continue to constantly review the portfolio, and work with investment managers, to ensure consistent investment returns for the future.

Mr. Hanchek concluded by stating that despite 2012 being a challenging year for ERS, including staff turnover, ERS staff worked together to provide prompt and professional service to its retirees. ERS staff members take their commitments seriously, and have implemented improvements in quality control by increasing operational efficiency. ERS provides informational retirement sessions for eligible retirees, to educate them on their available benefit options. Despite the continued inevitable challenges that will present themselves in 2013, ERS staff, in conjunction with the Pension Board, is dedicated to providing a sound, stable and well-funded Pension Fund for many years to come.

5. Comptroller Remarks

Mr. Hanchek introduced Scott Manske, Milwaukee County Comptroller. Mr. Manske has served in this role since 1992, and in April of 2012, became Milwaukee County's first elected Comptroller. As elected Comptroller, Mr. Manske serves as the Chief Financial Officer for the County, maintaining accounting books, and monitoring and reporting on the budget. Additionally, Mr. Manske provides critical guidance in the issuance of bonds, and the development of County funding policy. Mr. Manske's efforts contribute greatly to ERS being one of the most stable and well-funded pension funds in the county.

Mr. Manske first thanked the retirees in attendance for their dedicated service to the County. Mr. Manske noted that he began his career in the private sector, yet had always wanted to work in government. He is grateful for the opportunity to serve the County as an elected official.

Mr. Manske then discussed the fiscal status of the County. The County will end up with a surplus this year, as it has for the last few years. This is very beneficial, as it will provide for fewer cuts in the future, and allows the County to provide necessary services. The County is very limited in terms of funding it receives from the State, and only receives a limited amount from property tax increases, so the surplus allows reserves to be built up for future expenses.

Mr. Manske next discussed the current funding status of the ERS Pension Fund. Although the final numbers are not yet in, the Fund is currently around 85% funded. What this means is that the Pension Fund has assets to cover 85% of the liabilities. For example, for every dollar of liability in the Fund, there is currently $0.85 available to cover it. The State of Wisconsin is 97% funded, and the City of Milwaukee is 100% funded. In terms of funded percentages compared to other states, the status of the ERS Pension Fund is very good. In fact, there are only 15 other states with funded percentages over 80%. Many other states are much less adequately funded, for example, the State of Illinois is only 50% funded.

ERS was able to attain such a highly funded percentage through prudent management of investments. Additionally, in 2009, the Fund received proceeds of $400 million from pension obligation bonds issued in 2008. This helped to reduce the uncertainty as to how much to budget each year for Pension Fund contributions. The $400 million contribution covered shortfalls from previous years, as well as assuring that an adequate amount of funding had been built up. In subsequent years, and each year going forward, the goal is to fund 100% of the contribution requirement.

Besides increasing the percentage of funding, another reason the pension obligation bonds were issued was to provide savings to Milwaukee County. Currently, the Fund has an assumed actuarial rate of return of 8%. This means that for every dollar you have in the Fund, you hope to earn 8% in interest per year. In 2012, however, the rate earned was much better than that at 11%. The pension obligation debt was issued at 6.5%, with an anticipated goal, therefore, of 1.5% savings. Currently, the total issuance of debt will probably save Milwaukee County close to $250 million, compared to paying it over 20 to 30 years into the Fund. Recently, $135 million of the original $400 million debt was reissued at an interest rate of 3.28%. This will allow for an additional savings to the County of around $100 million over the course of the next 20 years.

Mr. Manske concluded by stating that his primary responsibility is to monitor and strengthen the Pension Fund, ensuring sufficient funding. Additionally, with the assistance of ERS staff and the Board, ensuring favorable investment returns which will provide for a stable Pension Fund both now and in the future.

6. <u>ERS Actuary Remarks—Buck Consultants</u>

Mr. Hanchek introduced Larry Langer of Buck Consultants. Buck Consultants has served as the actuary for ERS since 2006.

Mr. Langer first provided an overview of his role as the actuary for ERS. The Pension Fund is actuarially prefunded. Contributions are made to the Pension Fund on a member's behalf during the course of each member's career. These contributions, combined with investment earnings, are estimated to result in sufficient funds to pay benefits upon a member's retirement. It is the role of the actuary to determine the amount of annual contributions necessary to have sufficient funds available upon a member's retirement. The process used to determine the annual contribution amount is termed an "actuarial valuation."

Mr. Langer discussed the actuarial valuation process. There are many unknowns involved in the retirement process, which can present challenges, when predicting how much money in County and member contributions should go into ERS. For example, it is difficult to predict factors such as how many members will make it to retirement, how many members will die, or what type of investment returns there will be over the long-run. It is the actuary's job to develop models, called actuarial projections, which allow some of the risk to be removed from this process. These models are created by taking into consideration factual data, such as individual membership data (*i.e.*, age of member and type of benefit), amount of assets in ERS, and benefit provisions.

Once the data is collected and analyzed, actuarial assumptions are made, which are predictions based on current factual data. From these predictions, a funding request to Milwaukee County is developed based on a consensus of how much money should go into the Fund. The Board and actuary then present the funding request to the County.

Mr. Langer next discussed prudent actuarial polices. The Board follows prudent actuarial polices, which help ensure members' benefits are appropriately funded over time. First, the actuarial valuation reports are completed within five months of the data snapshot date. Data collected as of January 1, 2013, will be presented and discussed at the May 2013 Board meeting. It takes this amount of time to analyze the data and prepare the reports. Other systems have been known to take up to one year to develop and present information. Staff works hard to make sure the information is gathered and presented to the actuary, so it can be presented in a reasonable amount of time. Secondly, once the projected funding amounts are determined by the actuary, the County actually makes the recommended contributions adopted by the Board. This is a major point that should not be taken for granted. Finally, the underlying assumptions are reviewed every five years. Since the actuarial assumptions made do not always come true, it is prudent to perform experience reviews every five years. For example, points reviewed would include actual statistics, such as how many members actually retired versus the prediction, or how many members actually died versus prediction. These findings are then presented to the Board; the Board will ask due diligence questions and reevaluate the estimates.

Mr. Langer then discussed the current state of County contributions. As stated earlier, the contribution requirement is determined by the actuary and presented to the Board. The recommendation is then sent to the County Executive. The County is currently up-to-date and, in fact, exceeds the contribution requirement. As of January 1, 2012, cumulative contributions over the past 15 years have exceeded the Board recommendations by $400 million. The timing and delivery of the pension obligation bonds back in 2009 account for $397 million of that amount. The pension obligation bonds were issued at the perfect time, and have yielded great returns, securing benefits.

Mr. Langer concluded by summarizing the key points of his discussion. Currently, the Fund has sufficient assets to pay all projected benefits for current retirees. The County has contributed almost $400 million more than the actuary's recommendations. This is roughly the amount of the pension obligation bond proceeds contributed in 2009. Benefit and contribution reforms over the past few years have also benefited ERS, making it more sustainable. With a funded percentage at 85%, ERS is currently funded better than the national average, which is at 74%. Finally, ERS is well-funded due to prudent actuarial policies utilized by the Board, and the County's commitment to implement the requested funding.

In response to a question regarding the payment due date for the pension obligation bonds, Messrs. Langer and Manske stated they are due to be paid back over the course of the next 20 years.

In response to a question regarding the likelihood of ERS's funded status increasing from the current 85% to 100%, Mr. Langer stated it is the goal of the funding policy to achieve 100% funding status over the next 20 to 30 years. Mr. Manske followed up by noting when the markets dropped in 2008, both the County and State funds lost about 20% funding. One of the reasons that the State is currently 100% funded is that in addition to continued payments into the plan, it has also reduced some of the pension benefits to employees currently receiving payments. One of the main reasons that the County issued the pension obligation bonds was to recover from the loss in 2008. Each year, as the Fund continues to perform well, a little bit more money is contributed. Through these measures, it is the goal to reach 100% funded status within time.

In response to a question as to whether the County backDROP ordinance has negatively impacted ERS's funded status, Mr. Langer stated that it could perhaps have had somewhat of an impact, but would not account for all of the difference. Pension plans are very expensive and expensive to fund. People tend to take note with payments of $800,000 or $1 million dollars; however, it is important to keep in mind that a member also receives a corresponding decrease in their pension amount with the lump-sum payment.

In response to a question regarding the possibility reducing future funding requests from the County, Messrs. Langer and Manske stated that the funding requests will continue to move up and down from year to year. Although the numbers may seem high, it is important to remember that a portion of the amount is comprised of active member contributions. Additionally, the County staff works hard to ensure it is a manageable piece of the budget.

In response to a question regarding the current contribution amount of active members, Messrs. Langer and Manske stated that amount is around $8 million to $9 million. The active members are currently funding roughly half the cost of the benefits.

7. <u>ERS Fund 2012 Results, Asset Allocation Strategy and Update—Marquette Associates</u>

Mr. Hanchek introduced Brett Christenson of Marquette Associates.

Mr. Christenson first stated that Marquette Associates is an independent investment consulting firm based in Illinois. Marquette does not actually manage any money in the Fund, but acts strictly as an advisor to the Board by providing data and reporting, to aid the Board in making the best investment decisions possible. Marquette's focus is to get the best returns for the least amount of risk, to drive investment costs down as much as possible, and to find the highest quality managers.

Marquette provides monthly investment reports to the Board. These reports track the investments and highlight how well each of the investment managers are doing. This aids the Board greatly in making various decisions regarding the Fund's investments throughout the year. Additionally, if an investment manager has been underperforming for a period of time, Marquette will assist the Board in reviewing and selecting investment manager replacements. Perhaps most importantly, Marquette works with the Board on the asset allocation mix of the portfolio, to ensure the Fund is optimally designed, with the right mix of stocks, bonds and other investments. The asset allocation of the portfolio will determine more than 90% of return over the next 30 to 40 years. The goal is to meet the actuarial projected 8% rate of return, with the least amount of risk.

Mr. Christenson then discussed the summary of cash flows in 2012. Beginning in 2012, the market value of the Fund was around $1.7 billion. Net withdrawals totaled $120 million, which is normal, and represents benefit payments. The Fund had investment earnings of approximately $157 million. After all fees were paid in 2012, the Fund exhibited a strong return of approximately 11%.

Mr. Christenson next discussed the historical net returns of the Fund. As a result of the financial crisis and the difficulties in the markets, the Fund was down approximately 22% in 2008. Shortly after that, the pension obligation bonds were issued and, in 2009, there was a strong return of 18.6%. 2010 was another strong year, with returns at 12.5%, while 2011 was approximately flat at 0.5%. Another strong return was exhibited in 2012, at 11.3%. As of February 2013, the four-year net return of the Fund was at 13.3%. This rate is actually 5.3% higher than the actuarial target rate of 8%. The issuance of the pension obligation bonds provided an additional savings of approximately $21.2 million per year to the Fund, and it is hoped that this will add long-term value to the Fund.

Mr. Christenson then discussed the asset allocation mix as of December 31, 2012. Fixed income, which represents bonds, is a little over $450 million, and represents about 25.8% of the assets in the Fund. This represents the most stable investment in the portfolio. U.S. and international stocks combined represent 43.9% of the portfolio, and stocks and bonds under long-short equity represent approximately 10.5%. For diversification, and to add extra yield, the portfolio has some real estate, as well as infrastructure and private equity, totaling 17.4%. Overall, the portfolio has 75% liquidity, which means that over 75% of the assets could be sold for available cash within a few days. The overall design of the portfolio is to have very high liquidity with very low risk.

Mr. Christenson then stated that when making decisions regarding the Fund's investments, it is important to look at what other public pension plans across the country are doing with their investments. Overall, the Fund has historically been more conservative, with lower volatility and risk than the median public pension plan, or peer group. In U.S. stocks, a volatile asset class, the ERS Fund is at about 24% investment allocation, as compared to 35% for the peer group. International equities, or non-U.S. stocks, are at 20% versus 15% for the peer group, so the Fund is a little more aggressive here. Despite the volatility, the Fund needs to have equity exposure to try to meet the 8% target return. The Fund is designed to have as minimal as possible exposure to the stock market, while achieving or exceeding the target return. However, between U.S. and international stocks, the Fund is still more conservative than the peer group. Fixed income is at 26%, with the peer group coming in at 32%. Marquette will continue to strongly analyze the allocation to fixed income to determine the next best course. Although fixed income is the most stable and low-risk asset class, it currently has very low yield, and could be a drag on returns. If fixed income were to be reduced in the future, it would not go below 22% to maintain stability in the portfolio.

Mr. Christenson then took a moment to praise the Board, noting that the Board is very diligent, and Board members take a great deal of time out of their normal schedules to meet monthly for multiple hours. In addition to the monthly Board meetings, the Investment Committee meets monthly to focus 100% on investments. The Board puts in a great deal of time and hard work, and is an excellent Board to work with.

Mr. Christenson then noted the significant agenda items for 2012 and early 2013. First, in 2012, the Fund added a second manager on the private equity portion of the portfolio. Second, a mid-cap equity manager was terminated and replaced in 2012, due to underperformance. Third, 33% of the portfolio under international equity was indexed in 2012, providing a savings of over $500,000 in fees. Index funds are used in place of hiring high-cost managers to beat a certain index. Basically, an index fund replicates the Dow Jones or S&P 500, and drives down the cost of the portfolio. Fourth, the Investment Policy was reviewed and updated. Fifth, two asset allocation studies were reviewed in 2012. Marquette's research team works through research, and relies on modeling, to make recommended minor changes in asset allocation, to adjust the overall risk of the portfolio. Finally, in the beginning of 2013, a third asset allocation study was performed. This resulted in the Board's decision to slightly decrease the percentage under fixed income, shifting it over to real estate. Additionally, due to quality concerns, new manager searches are currently underway under the international portfolio.

Mr. Christenson next discussed the 2012 components of the Fund's return. The Fund earned 11.3% last year and, essentially, performed well in all areas. The U.S. stock portion of the portfolio was up 16.6%, and international stocks were up 16.5%. The real estate portfolio was up 12.3%, while infrastructure was up 9.6%. Private equity, through September 2012, was up 8.8%, and that number should increase. Long-short equity was up 6.9% and fixed income was up 4.8%. Marquette is projecting that over the next ten years, fixed income will only be earning 2.5% to 3%, and is the reason some changes were made recently under the fixed income allocation.

Mr. Christenson concluded with a high-level discussion of the portfolio's investment managers. There are at least two managers in each one of the asset classes, with six under the U.S. equity portion of the portfolio and four under international equity. The two managers under private equity include Adams Street Partners and Siguler Guff. There are two managers each under fixed income, infrastructure and long-short equity, and three managers under real estate. The main point to note from this is that there is a great deal of diversification with the managers. In addition to the Pension Fund having investments in many different areas, it also has a number of different managers under each area.

In response to a question regarding the components of the infrastructure portfolio, Mr. Christenson stated that it is very similar to real estate. Infrastructure includes real assets such as toll roads, bridges, ports, airports, water and water-purification plants, cell towers and wind farms, among others.

In response to a request to elaborate on the much noted praise and the overall strength of the Board, Mr. Christenson provided several specific examples. First, the Board members are very engaged at Board meetings, and ask a great number of insightful, in-depth questions. The Board debates the recommendations of Marquette and asks follow-up questions that are relevant to the decision-making process. Mr. Christenson noted that in his job, he sees many different boards in action, and many other boards are not as fully engaged. Second, the Board has a tremendous amount of education and experience in finance and accounting. The Chairman works as an investment consultant himself, and is therefore often able to provide simplified explanations of matters before the Board. As a whole, the Board has a very high-level understanding of the complexities of the Fund.

In response to a question regarding current number of managers and cost to the Fund, Mr. Christenson stated that there are currently 18 managers on the Fund at a total cost to the Fund of 0.5% percent per year, including fees. This is below the industry standard which is closer to 0.6% or 0.7%. Marquette works hard to ensure that these costs are kept as low as possible.

8. <u>Economic Review—J.P. Morgan Remarks</u>

Mr. Hanchek introduced Jim Cavanaugh, Client Portfolio Manager of J.P. Morgan Asset Management. Mr. Cavanaugh has been with J.P. Morgan since 1998 and is the portfolio manager for the U.S. fixed income group.

Mr. Cavanaugh first discussed the Federal Reserve Bank and the money supply. Since the 2008 financial crisis, the Fed has expanded its balance sheet to record levels in an attempt to spur growth. This was done primarily through purchases of U.S. Treasury-based securities. The balance sheet has increased from $1 trillion in 2008 to in excess of $3 trillion in 2013. With the goal to increase economic activity, the process of balance sheet extension continues today, with an open-ended policy in place to increase the balance sheet at $85 billion dollars per month.

Along with the benefits of balance and expansion, as always, there are also risks. The longer-term risk is inflation, although, so far, there has not been a large uptick in inflation. This is in large part due to the fact that the velocity of the money, or how quickly the liquidity is changing hands, has dropped off significantly. A large part of the assets that the Fed purchased, and the increased liquidity, is currently just sitting, gaining excess returns. If the velocity of money were to pick up, however, it could lead to inflation.

Mr. Cavanaugh next discussed real return on a ten-year investment of Treasury securities. Once you remove the market's expectations for inflation, what remains is called a real return. Essentially, the Fed has succeeded in decreasing interest rates rather successfully as it relates to Treasury securities.

Mr. Cavanaugh then discussed inflation. The expectations for inflation in the markets have not decreased dramatically, which is somewhat surprising, given some of the radical actions in the marketplace. Since 1960, inflation has tended to be higher than the current levels, which are around the 1% to 2% range. The historic average since 1960 has been around 4%. Thus far, there has not been a large jump in inflation, however, it is something a bond investor needs to be very concerned about and should be carefully monitored. Interest rates on bonds are very low and present a challenge for pension investors in terms of gaining significant yield in the marketplace. Broadly speaking, markets do not like inflation. During the falling interest rate environment, however, fixed income has more than pulled its weight and has an important place as an anchor in the portfolio.

Mr. Cavanaugh next discussed total returns in the bond market. Once a bond is purchased, the bond prices will fluctuate up and down. In addition, bonds also pay a coupon, which is a periodic interest payment received from the time the bond is issued to its maturity. The coupon return, plus the price return on the bond portfolio, equals the total return. During difficult market periods, when the interest rates increase, bond prices go down. In such markets, the only thing left to offset the negative price impact is the coupon. Therefore, it is important to have some yield in the portfolio to offset the falling prices. During the last several years, the Fund has greatly benefited as the prices of bonds have gone up, and the coupon continues to pay.

The first line of defense within the portfolio is to engage the marketplace and the portfolio with high quality yield to offset the potential for negative prices. As it stands today, however, with the Federal funds rate essentially at zero, there is not much yield in the marketplace to fight off any negative price returns. The Barclays Capital Aggregate Bond Index, which is the broadest measure of high quality debt in the marketplace, is yielding less than 2%. Historically, this is a very low number and presents investors with challenges. It is something investors are keenly aware of and are very focused on.

Mr. Cavanaugh concluded with a discussion of strategies employed by active bond managers in difficult market environments. First, reducing the duration of management of a portfolio may lessen its sensitivity to interest rate changes. Second is yield curve management, or building a diversified portfolio. Rates may not increase in tandem along the maturity spectrum, making some areas of the yield curve more attractive than others. Third, bond selection is exceedingly important. Selecting undervalued bonds can increase the potential for price appreciation. Fourth is protection from inflation. As mentioned earlier, inflation is not a problem right now, but should be closely monitored. Short-term Treasury Inflation Protected Securities ("TIPS") or Consumer Price Index ("CPI") swaps may help mitigate the risks of rising inflation. Fifth is sector allocation, selecting sectors in the bond market that may have less of a price impact from rising rates. Lastly, yet most importantly, is constructing a portfolio with a yield cushion. Yield may buffer portfolio returns against adverse rate movements, generating additional cash flow.

In response to a question, Mr. Cavanaugh stated that it would not be very beneficial to move everything in the portfolio into short-term securities. Due to a lull in information, it is difficult to predict the interest rate markets, and there is a big risk in doing that. Most importantly, if this strategy were to be implemented, the yield on the portfolio would essentially drop to zero.

In response to a question regarding the current rate of inflation, Mr. Cavanaugh stated that the CPI index is running around 1.5% to 2%, and is well below historical levels.

9. Questions and Answers

The Chairman first thanked the approximately 70 retirees in attendance for participating in the annual meeting. The Chairman noted that with current active retirees numbering around 3,000, and well over 7,000 deferred vested members, the annual meeting appears to be reaching a fairly small representation of that population.

In response to the Chairman's collective questioning of the retirees, they responded affirmatively when asked if the annual meetings, as well as the content, were of any value.

The Chairman then called for questions and answers from those assembled.

In response to a question regarding extending annual meeting invitations to County elected officials, the Chairman indicated that both the County Board Chair and County Executive are invited to speak. The County Executive presented at the 2012 annual meeting. Individual schedules do not always allow for attendance. The Board understands that ERS is a significant part of the Milwaukee County budget, and that the County Board and County Executive take the responsibility to fund ERS very seriously.

In response to a question, the Chairman stated that the checks and balances structure and oversight of the Pension Board has allowed the Fund to operate on a day-to-day basis without political interference. Everyone understands the magnitude and importance of their jobs and contribution requests are sent to the County based on the actuary's analysis. The feedback the Board receives from the County is payment of the requested funding amount.

10. Adjournment

The meeting adjourned at 11:30 a.m.

Submitted by Steven D. Huff,
Secretary of the Pension Board