MEETING OF THE TRUSTEES

CITY OF CHATTANOOGA GENERAL PENSION PLAN

April 13, 2018

A special meeting of the City of Chattanooga General Pension Plan Board of Trustees was held on April 13, 2018 at 10:00 a.m. in the J. B. Collins Conference Room. Trustees present were Daisy Madison, Stacy Richardson, Aon Miller, Katie Reinsmidt, Carl Levi and Jeffrey Wilson. Others attending the meeting were Scott Arnwine, Gavion, LLC; Teresa Laney, First Tennessee Bank; Valerie Malueg, Office of City Attorney; and Madeline Green and Cheryl Powell, City Human Resources Department.

Definitions in the document: GPP is General Pension Plan, OPEB is Other Post-Employment Benefits

The meeting was called to order by Chair Daisy Madison.
A quorum was present at the beginning of the meeting.

Scott Arnwine stated the purpose of the meeting is to select a large cap manager or managers to replace Herndon, the manager removed in October 2017, in both the GPP and OPEB. All of the managers have been vetted through a research process and Gavion has clients with them. The exception is that the former Herndon manager, Randall Cain, is now at Sustainable Insight and his work is reflected in the Sustainable large cap results. The interviews will be presented in alphabetical order.

Scott introduced each of the managers prior to their scheduled interview.

Investment Manager Interview – Diamond Hill Capital Management

Presenters: Nate Hall, Director Institutional Business Development and Austin Hawley, co-Chief Investment Officer/Portfolio Manager
Location: Columbus, Ohio
Assets under management: $22 billion total across 15 investment strategies; $11 billion large cap
Number of employees: 46 investment personnel; 117 total associates

The guiding principle of the investment strategy is their intrinsic value philosophy – that every asset is a partial ownership interest in the company, invest with a margin of safety, and maintain a long term view (five years or longer). Employees are invested in the same strategies as the clients, so the company does well only if the clients do well. Portfolio managers have the discretion on when to close their strategies.

The presenters highlighted the leadership team and their shared values and experience at Diamond Hill and working together prior to being a part of Diamond Hill. The company has a large research organization covering all sectors, utilizing career analysts, across the entire market cap range viewed as an important characteristic for adding value through active management. The analysts make recommendations both long and short. Intrinsic value investing is not the same as statistical value investing. Instead, the investor seeks the actual worth of the investment. Lead portfolio managers make the decision to include the investment in the strategy.

Risk is not about volatility but about the permanent impairment of the client's capital. Thus, the investments are not held at a premium to intrinsic value. The firm does employ common sense guidelines to avoid over-exposure, for example, less than 30% in one sector, less than 20% in any one company, and less than 7% in any one investment. They conduct regular quarterly performance reviews across the five years prior and the expected five years forward for their holdings relative to a static portfolio. Additionally, individual names are reviewed. The sell decision is made based on the convergence of the market price toward the intrinsic value estimate. However, some other considerations are the appreciation in value above the maximum position size or if a more attractive opportunity arises.

If there is the possibility that the investment decision is wrong, a review of the fundamentals and whether expected milestones are achieved. When there is a loss of confidence in the estimate of intrinsic value, then the investment is sold.

The company is currently positioned with a preference for financial sector and reduced focus on energy sector (and a cautious long term view for this sector). They invest for long term with the goal to protect capital in the down markets and in selloffs. Manager performance is reviewed with a process consisting of components of absolute return goal (CPI + 5%), value-added goal (net 150 bp return vs benchmark), and peer comparison goal (1^{st} quartile) over rolling five-year periods.

Investment Manager Interview – Seizert Capital Partners

Presenters: Chris Heatley, Client Service and Marketing Manager and Tom Kenny, Partner/Portfolio Manager
Location: Birmingham, Michigan
Assets under management: $3 billion total in five strategies
Number of employees: 16, 8 investment professionals

The stated goal of this firm is to compound and protect the client's capital over a long-term time horizon. The investment focus is on owning undervalued businesses.

Risk is defined as the permanent loss of capital. Their investment process utilizes a model that focuses on three qualities: asset valuation, asset quality, and market reaction. A large number of factors are used to evaluate and rank investments to include in the strategy. Investments are for the long-term with price targets to determine the decision to retain or sell. Portfolio managers, not analysts, perform the research and analysis and determine value of investments themselves, including management behaviors and accounting practices. They do not rely on Wall Street or other analyst firms. Use of a probability-weighted price target and long time horizon helps to develop patience to look for investment opportunities that outperform in down markets. The sell decision is made when the price of the investment reaches the price target. Other considerations for the decision to retain or sell include a lower rank in the model or not performing as expected, appearance of multiple risk flags, and the presence of a more attractive investment opportunity.

The firm conducts quarterly reviews of performance on a rolling five year relative performance basis. The eight investment professionals form two person teams to conduct the research and analysis of potential investments. Compensation is based on both quantitative and qualitative incentives.

Investment Manager Interview – Sustainable Insight Capital Management

Presenters: Carolyn Roose, Associate, Business Development and Randall Cain, Portfolio Manager
Location: offices in London, Sydney, and New York
Randall Cain is located in Winston-Salem, North Carolina and was formerly with Herndon
Assets under management: $480 million in multiple strategies
Number of employees: 14

The firm was founded in 2013 and the investment team has worked together among other firms over the ten years prior to 2013. The majority of the clients are public pension plans and teacher plans. The company is 51% employee owned along with the Kresge family and other individuals. The employee generally does not have invested capital; however, Randall Cain does. Randall Cain joined the firm in November 2017.

The goal of the firm is to add value. The goal is to hold financially productive companies with attractively valued stocks to provide a margin of safety and outperformance against the benchmark.

Stocks are identified based upon relative value versus stocks on the Russell 1000. Stocks are selected based on potential value creating opportunities and then evaluated for sector diversification in the portfolio. Investments mid cap and above are evaluated for inclusion in the portfolio. Risk is mitigated by conducting fundamental analysis within the risk assessment framework using thirty-two (32) characteristics over five categories. The portfolio is managed using guidelines for sector weight, sector diversification and a maximum cash position. The decision to retain or sell depends upon the valuation and the stock achieving the right price. Other considerations include any erosion in the fundamentals.

There are currently about 50 stocks in the portfolio. A chart was included showing the 3 and 5 year performance for the large cap strategy and Randall Cain provided the historical explanation for the results.

The decision to purchase a stock positon begins with the models and internal research with Randall Cain making the final decision. The same holds true for the sell decision. Compensation is based on portfolio growth.

Discussion

Scott provided a summary of the action decision that the Board must make. Herndon was in both the GPP and OPEB funds. The funds that were allocated to Herndon may 1) stay in the index funds, 2) be allocated to one or more of these three managers. It is not recommended to allocate the entire amount to Sustainable Insight Capital because of its size.

The Board discussed the three firms and settled on making two allocations: one to Sustainable Insight Capital Management and one to Diamond Hill Capital Management.

Carl Levi made a motion to allocate $5 million to Sustainable Insight with $4 million in the GPP fund and $1 million in the OPEB fund. Jeffery Wilson seconded the motion. The motion carried.

The next motion provides the specifics on how to fund the allocations to the two selected managers.

Carl Levi made a motion to allocate the amount in the Russell 1000 Growth index funds from the Herndon termination to Diamond Hill Capital Management in the amount of approximately $9 million in the GPP and in the amount of approximately $11 million in the OPEB funds; and to move approximately $4 million from Wedge in the GPP to Sustainable Insights and to move approximately $1 million from the Russell 1000 Growth index fund to Sustainable Insights in the OPEB fund.

Scott reminded the Board that the purpose of the interview with Patten and Patten is to become re-acquainted with this firm that has been in the GPP portfolio since 1996. The firm has undergone changes and operates differently than it did in the beginning of the relationship. It is important to understand these changes and whether the practice and philosophy of the firm still fits within the expectations of the GPP.

Investment Manager Review – Patten and Patten, Inc. Investment Advisers

Presenters: Bryan Patten, Chairman and CEO/Portfolio Manager (1996); Raymond Ryan, President/Portfolio Manager (1999); Mark Fleck, Principal/Portfolio Manager (2008); William Decosimo, Portfolio Manager/Research Analyst (2011); Yelena Lyashevskiy, Research Analyst (2016)

Bryan Patten began by introducing Ray Ryan, current President and Portfolio Manager at the firm. He is credited with creating the research capabilities far exceeding what was in place previously.

Ray Ryan described how Patten and Patten operates today. The firm focuses on a large cap growth objective. To build the portfolio, the firm seeks to own businesses that they understand and own them for a long time period. The portfolio includes assets selected because they have not yet reached their full value. The firm seeks to know where they are in the cycle to make the decisions to buy using an in-house analysis system and selecting sectors that are attractive by a top down and bottom up analysis.

Currently, the firm believes that the cycle will extend, that the impact of tax cuts are yet to be felt, that there will not be a global trade war, and that there are opportunities for long term investing. They do acknowledge that the cycle is closer to the end than the beginning, if the beginning is marked at March 2009. He believes market opportunity has narrowed significantly. Typically, at the late stage of a bull market run, investors abandon discipline and move funds into index funds or ETF's and this activity is being observed.

Yelena Lyashevskiy described the research process employed at the firm. The firm has its own financial model. Effort is made to understand the business model and two examples of the depth of the research are included in the appendix of the presentation. The research is time intensive and comprehensive. When complete it is presented to the investment committee with recommendations. The investment committee reviews the reports to understand the research results and the business model in order to make the buy and sell decisions for the portfolio.

William Decosimo discussed the investment performance of the firm in 2017 and since inception. The benchmark for performance referenced in the presentation is the Russell 1000 Growth index. The 2017 results were characterized as disappointing. On an absolute basis, results were good. Relative to the benchmark, there was material underperformance. Two of the main factors behind the results are

1) security selection - 4 holdings accounting for 10% of portfolio and 50% of underperformance, and
2) the portfolio mix or what the portfolio did not own - primarily technology sector, Netflix, Amazon. Technology accounted for 50% of the market return in 2017; however, Patten and Patten's model displayed a preference for financials and did not follow the momentum into the technology sector.

The GPP portfolio does include some higher performing assets, for example Apple, Inc., that could not overcome the detractors in 2017.

Mark Fleck detailed the current composition of the portfolio on page 11 of the presentation. The current portfolio includes 31% allocation to the technology sector. Several sectors are overweight or underweight to the index. Most notable is the overweight in the financial sector, a result of the long term discipline and research process. There are three factors that will influence performance of financial sector:

- Rising of interest rates
- Significant deregulation in the industry
- Corporate tax cuts benefits firms that have more domestic business models

The weightings are a result of the modeling discipline to not put too much in one sector and to not chase momentum. Patten and Patten is not comfortable with a higher weight to technology. Additionally, position size is actively monitored and trimmed when the asset exceeds a comfortable size.

Ray Ryan addressed the question of why the firm still owns J. C. Penney. He believes that this stock does not belong in a growth portfolio. J. C. Penney had a change in leadership (Marvin Ellison) and Patten and Patten bought into the new management strategy. The strategy did not work according to expectations and the stock price fell from 45 down to 8. Patten and Patten had waited too long to act and the value now is too low to sell. It was a regrettable decision to include it even though it seemed to be a good idea initially. J. C. Penney should survive with a decent balance sheet and liquidity and may have a value higher than its current price. It is being held in the portfolio to avoid a second bad decision.

Scott asked Patten and Patten about the preferred benchmark for performance and their preference is the S&P 500 as a benchmark instead of the Russell 1000 Growth index. Scott indicated that an adjustment may be made in Gavion's presentation of results in the quarterly reports to the board.

There was some discussion about the conclusion to be drawn from this review. In the end, the board expressed the opinion that it is important to have local managers that manage a part of the assets of the GPP so Patten and Patten will remain as a manager.

The meeting was adjourned at the end of the review.

APPROVED:

Daisy W. Madison

Chairman

Katie Reinisch

Secretary