SPECIAL MEETING OF THE BOARD OF ADMINISTRATION
RETIREMENT BOARD
WATER AND POWER EMPLOYEES' RETIREMENT PLAN

MINUTES – OCTOBER 24 2002

Present:

Javier Romero	President
Dan Mirisola	Vice-President
Lilly Calvache	Board Member
Ron Vasquez	Chief Financial Officer
Norma Bertrand	Board Member

Absent:

David H. Wiggs	General Manager
Anne E. Cho	Commissioner

Others Present:

Duamel Vellon	Retirement Plan Manager
Sangeeta Bhatia	Assistant Retirement Plan Manager
Vikki Burks	Recording Secretary
Mike Wilkinson	Deputy City Attorney
Peter A. Lopez	The Boston Company
David R. Bowser	Standish Mellon Asset Management
James A. Tilton	TCW
Neil Rue	Pension Consulting Alliance

President Romero called the meeting to order at 9:09 am after the Pledge of Allegiance.

[Pledge of Allegiance]

PUBLIC COMMENTS

Mr. Vellon indicated Mr. Romero, Mr. Vazquez and Ms. Calvache were present and there were was no quorum of the Board. Upon consultation with Atty. Wilkinson it was agreed Mr. Emkin should present his June 30 Quarterly Report (agenda item 2) off the record as a Board without quorum, and when quorum is reached, this should be voted on the record.

2. **Fourth Quarter (June 30, 2002) performance Evaluation by Pension Consulting Alliance.**

Mr. Allan Emkin (PCA) approached the table.

Mr. Emkin indicated his performance report was for the period ending June 30, 2002. He reported, in the equity market, the 2nd quarter was very difficult and LADWP's portfolio, which has significant allocation to equity, did not perform well and by PCA's count lost $484 million over the last year. He expressed this was not unexpected, but part of the market cycle, looking at long-term strategic planning, assumptions used, and the process implemented.

Mr. Emkin reported LADWP's fund, in the quarter, was at the middle of the TUCS Master Trust Universe, compared to other periods when the Plan was positioned at the top. He indicated in recent periods the Plan has performed better than average, due to the fact the portfolio is structured very differently than most of its peers having cash, relatively high quality long bond portfolio and equities with value orientation. He added, over the last year one of the best places to be was in cash and LADWP has four times the amount of cash in its portfolio than its peers, but over any long period of time cash is historically, and believed in the future, to be the worst place to be. He expressed the current structure of the portfolio would be at a disadvantage in the future.

Mr. Emkin reported, over the past three-year period, LADWP ranked at the 22nd percentile with a return of 1.5%, which was 75% better than its peers due to the median fund having a negative return. He noted an important factor in the 2nd quarter, stating Highmark, who had been managing the portfolio, terminated their services and those assets were transferred to the Boston Company. Mr. Emkin reported the five-year return for the Plan's portfolio performance compounded at 6.5% per year, outperforming the benchmark (asset allocation x passive indexes) due to value added by the managers, and ranked at the 27th percentile in the TUCS Master Trust Universe.

Mr. Emkin compared LADWP's three-year and five-year annualized risk/return, to the median Plan and over both periods the Plan's portfolio had slightly higher returns at a lower level of risk in large part due to being less diversified by holding cash and having no growth stocks. He highlighted the latest quarter capital market, stating the EAFE (large cap international stocks) was the best place to be in terms of the equity world and LADWP had no exposure to these stocks. Mr. Vellon suggested, in the interest of time, Mr. Emkin move straight through the economic section of his report because Ms. Calvache would be leaving the meeting at 10:00 am and even if Mr. Mirisola arrives, quorum will be lost. Mr. Emkin indicated the Board had an opportunity to review his report and there were no surprises, stating again the managers added value to the portfolio and this outcome, by in large, was due to its structure.

Mr. Vazquez inquired if in the last quarter things have gotten worse. Mr. Emkin responded in the third quarter the market had a double-digit negative return and it was the first time there were two quarters in a row with a double-digit negative return since the "great depression". He stated the long end of the bond market has been more volatile than the equity market. Mr. Vellon commented this was the last report under the old setup where the manager structure was non-discretionary and the more significant quarter would be the September one, when the Plan managers were under full discretion and issues like turnover, performance, etc. should be noted.

Mr. Emkin suggested starting with the fixed income review. Mr. Vellon stated there was no quorum. Mr. Wilkinson inquired if the review would be just a summary report or if it required a decision, and if so, quorum was required. Mr. Emkin responded the discussion would only be informational regarding how the manager search process worked, which the Board did not need to act upon. Mr. Wilkinson inquired if there would ultimately have to be a decision made and expressed he would be more comfortable if they just waited until there was quorum. Mr. Vellon clarified, based on the agenda posting, the purpose of this meeting was to discuss investing in Core Fixed Income Securities. It was agreed to recess until quorum was present.

The Board meeting recessed at 9:25 a.m.

General discussion ensued while awaiting quorum regarding RFPs, need for an allocation study of the disability and death benefit funds, and the cost differential between active versus passive management.

Mr. Mirisola arrived at 9:32 a.m.

The Board meeting reconvened at 9:33 a.m. with quorum present.

1. **Consideration of formal Board Resolution authorizing 35% of the Plan's assets be invested in Core Fixed Income Securities consistent with the Plan Consultant's recommendations.**

Mr. Emkin expressed this was the 3rd asset class review done in the last 45 days. He indicated most of the information in his fixed income review booklet was redundant, being a synopsis of work done during the asset allocation process and suggested moving to portfolio structure considerations. He explained one of the most important aspects is selecting a benchmark wherein one should consider coverage, breadth of holdings, liquidity, how well it is accepted by investors, consistency with risk tolerance, and the Board's view on whether it is an appropriate benchmark.

Mr. Emkin gave examples of benchmarks utilizing a chart showing various indices (U.S. Treasuries, Govt./Corporate, Aggregate and Universal) which are a subcomponent of one large index with different characteristics and sector allocations at any single point in time. He reported the "Universal" index as having the highest yield, the "Treasury" having the longest maturity, but all the indices having extraordinary high quality and very high component of government securities. He stated they all have significant differences in duration and sensitivity to interest rates, the most sensitive being the "Treasury" market because it is longer, and the "Universal", having the shortest maturity, has the least sensitivity. He noted, from 1989 to present, all of the indexes basically had similar performances with no dramatic difference, with the Treasury market being the lowest returning component but also having the least credit risk. Mr. Emkin also added the Board needed to decide on a big expanded index, such as the "Universal" or a more constrained index. He reminded Board members this is a policy question, with no right or wrong answer. He stated if LADWP is more risk averse, they should choose the "Aggregate" index because it does not include the more volatile sections of the bond market, adding PCA recommends the "Universal" index, but is in no way negative towards the "Aggregate" index.

Mr. Vellon inquired if the “Universal” index has the highest yield, and include emerging markets, are these investments riskier than treasuries or cash. Mr. Emkin responded these markets do have a much higher level of volatility, when looked at as an individual component, but are not highly correlated to the government securities, so when combined the index itself is not significantly more riskier. Mr. Vellon noted the Board meetings were accessible to the LADWP retirees and some may be less sophisticated than the Board, so layman’s terms were needed for them to understand PCA recommendations of a necessary risk to diversify the Plan, for better performance over the long term. Mr. Vellon also inquired, on behalf of himself and the retirees, considering the “Universal” index has a component that is a lot riskier than the assets previously held by the Plan and the charts provided by Mr. Emkin suggest all indexes perform the same, why would one choose the “Universal” index, which includes a risk component. Mr. Emkin noted this was a very good question and explained, on an expectational basis, PCA believes the ”Universal” index should have a higher rate of return, to compensate for the slightly higher level of risk, and more importantly, it is a much broader universe, including much less efficient markets and a potential to add significant value through active managers. Mr. Vellon stated the chart in Mr. Emkin’s booklet (issued by PCA) did not reflect this. Mr. Emkin responded the chart reflects only what the index does and not how the active managers perform.

Mr. Romero inquired if there was any particular reason the chart started at the year 1989. Mr. Emkin responded, to his recollection, this was the date the “Universal” index began. He added, when looking at a portfolio for asset allocation and structure purposes, one can’t assume, for planning purposes, there will be “X” amount of added value versus a specific benchmark, but one looks more at the asset classes level and tries to make distinctions between various subcomponents of the debt market. Mr. Emkin reported, in the last three years, there has been a huge move away from corporate, towards treasuries, and today the differences between treasury yields and corporate yields are at historical levels. He added the yield spread, today, between the treasury market and high yield market (which is one component of the extended “Universal” index) is 10%, as a result of default risks, and a lot more uncertainty about the ability of the borrowers to pay back; consequently the investor is compensated for this through higher yield.

Mr. Emkin proceeded to summarize benchmark issues, reiterating they produced similar results over past 10 years because of constant declining interest rate trends. He expressed PCA’s strong belief, the broader the universe, the more securities, the less efficient the securities, the greater the potential for an active manager to add value. Mr. Emkin reviewed the function of fixed income, which is to primarily be a diversifier and provide cash flow and historically has been an asset class where the managers, in general, have added less value than on the equity side. He explained the different ways active managers add value through strategies such as interest rate anticipation, sector rotation, and security selection.   He added there is great challenge in adding risk-adjusted value, through these strategies, since fixed income markets are so efficient. He states the less efficient, the less information is available, and the more potential there is to add value.

Mr. Emkin proceeded with an active/passive discussion, explaining the differences between the types of managers and how they have performed. He concluded active management adds value, and the less efficient the sector the greater the potential for the managers to add value.

Mr. Emkin recommended LADWP adopt the “Universal” index under Option 1, stating it was an investment quality index, the most broad, 90% investment grade, had the greatest potential for the managers to add value, and its historical risk and return as an index were very similar to those of the aggregate and the government corporate. He added there were a variety of approaches to managing these assets, and in PCA’s opinion, the greatest potential to add value is using the less efficient component. Mr. Emkin indicated PCA recommended hiring two active managers to run active core, using the Lehman aggregate as their benchmarks, and two “extended segments” using the Lehman high-yield emerging market as their benchmark. He clarified the reason for the separation is PCA’s belief the Plan needs specialized managers in the less efficient parts of the market place. He added it was not necessary to hire four firms but, at least, hire two firms with different mandates. Mr. Emkin indicated if LADWP chose not to use the “extended” (more risky) components, then PCA recommended using the Lehman aggregate as the benchmark, with three active managers, which is Option 2.

Mr. Vellon clarified the Board resolution in the packet was prepared by staff and recognizes both Options 1 and 2, but in the end, only the option selected by the Board would be reflected in the final resolution. Mr. Vazquez then moved approval of Resolution 03-30 with Option 1 as recommended by PCA. Seconded by Ms. Calvache and carried unanimously after the following vote:

Ayes: Romero, Mirisola, Calvache, and Vazquez

Nays: None

Mr. Vazquez inquired about a letter from Mr. Vellon distributed to the Board, dated October 2, sent to Mr. Emkin. He noted the letter was well written. Mr. Emkin responded he did receive the letter by e-mail but was on the road and did not have an opportunity to review it. Mr. Vellon indicated the letter was a summary of all the actions the Board has taken so far, representing the formal Board mandate for PCA to take action and proceed with the RFP's.

Mr. Emkin suggested the next Board meeting agenda should include discussion of the selection process.

The Board meeting was adjourned at 10:13 AM.

JAVIER ROMERO President	DUAMEL VELLON Secretary

SILVIA TESSENEER
Recording Secretary