MINUTES OF THE CITY MANAGEMENT INVESTMENT COMMITTEE

A meeting of the City Management Investment Committee was held in City Hall in the 6th floor conference room at 12:00 p.m. on October 17, 2023. In attendance, in person, were Committee members, Director of Budget and Strategic Planning, Peter Buryk, Director of Finance Christine Garczynski, Assistant Director of Finance Mike Roggow, Chief Deputy City Attorney Adam Melita, and Henry U. (Sandy) Harris, III of Cerity Partners and a Norfolk resident. Committee member Deputy City Manager, Catheryn Whitesell, was absent.

Also, in attendance, in person, were City Treasurer Daun Hester, City Debt Manager Alden Hope, and Leslie Weaber, Allison Corbally, and Floyd Simpson of PFM Asset Management. Nelson Bush of PFM Asset Management was also in attendance but appeared by remote electronic meeting service.

C. Garczynski presented, and the Committee reviewed, the minutes from the May 8th meeting of the Committee. A motion was made to approve the minutes. The motion was passed unanimously by acclamation vote.

C. Garczynski reviewed the September 30, 2023, Flash Report of the City's cash and investments. The report showed that, as of that date, the City had $513M in total funds, with $23M in cash. $40M in ARPA funds were used by the City to reimburse itself for government services, as are eligible under the Act. C. Garczynski reported that the City is in compliance with all applicable investment policies.

Two hard-copy packets, prepared by PFM Asset Management, were distributed during the meeting. One was entitled "Investment Committee Meeting," dated October 17, 2023, and the other was entitled "Pension Trust Sample Portfolio," dated October 13, 2023.

L. Weaber provided themes for Q3 2023 and further discussed the U.S. economy:

Themes

- stronger than expected growth that is supported by the resilient consumer
- inflation that remains stubbornly above the Fed's target of 2% and
- continued creation of new jobs by the labor market

U.S. Economy Overview

- Inflation picked up recently due to higher energy prices at 3.7% on a year over year basis in August 2023
- Core inflation, which excludes food and energy fell in August 2023
- Personal spending and retail sales also increased and is evidenced that the consumer is still spending
- Gross Domestic Product (GDP) remains surprisingly robust as the U.S. consumer continues to be the backbone of economic growth and historically the biggest contributor to GDP

- The Fed kept their benchmark interest rate target at their most recent meeting between 5.25 – 5.50%
- Their mantra of "higher for longer" (referring to interest rates) is reflected in their projections as they remained concerned with inflation and not falling as fast as they would like
- Chairman Powell indicated that "additional policy firming may be appropriate" and acknowledged that though jobs gains have slowed, however still strong job growth
- The Fed released their summary of economic projections in September 2023 of GDP, unemployment, inflation and the federal funds interest rate
- The Fed's September dot plot was more hawkish than June and the median federal funds rate for 2024 and 2025 was projected higher by 50 basis points
- The yield curve of U.S. Treasuries across various maturities are still elevated and are at the highest levels since 2007 and is still inverted where shorter term maturities are yielding higher than longer term maturities
- Fitch downgraded the U.S. Government however this downgrade had little impact on the markets however highlighted the growing worry about the erosion of government standard and fiscal irresponsibility
- U.S. Treasury yields did rise across the curve however on the longer part of the curve - due to sticker inflation, "higher for longer" mantra market consensus, increased Treasury borrowing weighed it down as the short end of the curve reflects the Fed and the longer end of the curve reflects investor sentiment

L. Weaber highlighted data showing the difference between yield at market and yield at cost for the City's several fixed income portfolios (operating, SWIFT project, ARPA, long term investments), as shown on pages 31-32 of the October 17, 2023, packet. Highlights include:

- For the fixed income portfolios, PFMAM is currently managing approximately $158mm in aggregate across 4 portfolios as of Q3 2023
- We will continue to see yield to maturity at cost creep up closer to yield to maturity at market over time as PFMAM invests in higher yielding securities with an active total return management approach (opportunistically buying/selling and keeping in line with duration targets)
- Q3 2023 Summary: positive return for the 0-3 year investment strategy and also outperformed the benchmark and since inception across all portfolios
- Included issuer diversification snapshot within the report to provide transparency of issuers held within the portfolios broken down by issuer name and issuer allocation by sector

The total return on the City's portfolio outperformed the benchmark for the quarter, as indicated on page 36 of the October 17, 2023, packet.

To understand the lag in the rates, C. Garczynski asked when PFMAM expects LGIP to "flip" if the Fed cuts rates again, and N. Bush responded that he expects it to take 20-25 days.

M. Roggow asked how long it takes rate cuts to affect bond yields, and N. Bush responded that there will be hardly any response at all, since the market anticipate such cuts.

A. Corbally and F. Simpson gave on overview of the financial markets as a backdrop to discussing performance results of the City's Pension Trust Fund account and made the following observations:

- The market has been resilient.
  - Large Cap equities outpaced small cap and coined "Magnificent Seven" (Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, and Tesla) continued driving 30% of the S&P 500 index.
  - Non US markets delivered positive returns for the quarter with Non US developed equities outperforming emerging markets (continue economic recovery struggles in China).
  - Fixed income impacted by rising yields delivering flat to neg results with exception of credit sensitive issues.
- The portfolio generated a positive return of 3.4% vs the benchmark return of 4.2%, as shown on page 45 of the October 13, 2023, packet. While the pension fund was up for the quarter, it is down since its inception on July 1, 2021, but exceeds the interest rate of the debt of 1.94%.
- One fund (Nuance All Cap) was terminated from the portfolio, a value manager that has been outpaced by growth favored investments.
- Neutral outlook for asset class positioning for the 3rd qtr. as continued uncertainty regarding financial conditions exist.
- Overweight to small and mid-cap removed and continue to favor an exposure to credit markets with attractive corporate fundamentals. The overweight to small and mid-cap, where performance struggled due to issues for regional banks as a result of Silicon Valley Bank and Signature Bank collapse. PFMAM remove the overweight mid quarter.
- International Equity performance was in line with the MSCI ACWI ex US benchmark and Fixed Income outperformed the Bloomberg Aggregate due to high yield and credit exposure.

In addition to the quarter review, PFMAM prepared a proposed solution for restructuring the NPT, per request of Norfolk, to decrease volatility of the current portfolio and to continue meeting the approximate $8.7M annual drawdown through 2031.

- A. Corbally outlined the proposed solution that would be to allocate $44.6M to a laddered bond portfolio that pays out approximately $8.7 per annum on 6/30/24, for six years. $18M would remain in a passive only diversified multi-asset portfolio, which would fund the outflow of approximately $8.7M for years seven and eight.
- N. Bush discussed the mechanics behind the laddered portfolio 41% corporates, 42% T Notes and residual in CP, avg yield of 5.22% (10/13/23). The proposal would remove equity volatility from the portfolio and place $44.6M into fixed income

investments. The remaining funds would be moved into the asset allocation shown on page 11 of the Oct. 13 packet.

- F. Simpson reiterated that this would address volatility in the market, as well remaindered all that this option to ladder a portfolio at 5.2% was not available at the Trust's inception 7/2021 when rates were 1.5%.
- F. Simpson reviewed projections prepared by PFMAM and displayed on pages 12-15 of the Oct. 13 packet. A 40/60, 50/50 and 60/40 model portfolio, were included for consideration.
- F. Simpson identified the 50/50 as an option, with an equity exposure in aggregate of under 20%.

The Committee unanimously recommended:

- Using a ladder approach for the pension trust fund portfolio.
- Use of the 50/50 ratio of equity to fixed income investments.
- Request PFM prepare a draft of this change in policy for review by the City within a week.

For the multi-asset portfolio, C. Garczynski inquired about changes that would need to be made to the Investment Management Agreement and/or Investment Policy Statement.

- N. Bush did not think any changes would need to be amended to the Investment Management Agreement (PFMAM legal confirmed post meeting) but most likely updates would need to be made to the IPS).

- Subsequent to the prior meeting proposed changes were made to the current IPS, which was sent to Norfolk for review 10/21/23, and electronically approved by the Board.

The Committee adjourned at 1:15 p.m.

Respectfully submitted,

Adam Melita
Acting Secretary