

Welcome to The Retirement Connection!

Message from

March 27, 2020

Chief Investment Officer Prabhu Palani, CFA



These are difficult times. Our hearts go out to all victims of the coronavirus tragedy around the world. While the spread has slowed in China, we are expecting to see the number of cases grow in the weeks and months ahead. We are also witnessing first hand an unprecedented mandatory lockdown in California. As you observe the human tragedy unfold, you may also be following the impact it is having on financial markets globally. Many of you may be worried about the impact these declining markets have on our pension plans. Are we prepared for a market melt-down such as this? What impact does it have on returns? How does it affect our funding ratios?

At the time of writing this message, many global markets including the US are officially in 'bear' market territory. A bear market is defined as a 20% drop in market value. Of particular note is the fact that this has been one of the quickest declines in modern history. The US markets had peaked as recently as February 19th. We can never be completely insulated from a stock market crash; the only way to do that would be to invest all your money in the equivalent of a checking account, which would never produce any meaningful returns. Instead, our boards have done a tremendous job in ensuring that we manage resilient, globally well-diversified portfolios that can produce meaningful risk-adjusted returns for the long term. For every \$1 of your plan that is invested, only about 50 cents of it is invested in public and private stocks, while the rest of it is invested in short-term bonds, real estate, and other asset classes that aim to lessen the pain of a stock market collapse. The fact that we run a well-diversified portfolio is one of the reasons why in the raging bull market of the past decade, our returns often appeared 'average' compared to what some of you may have experienced in your personal investments. It is precisely to prepare for an eventuality such as this. Unless markets dramatically recover before the end of this fiscal year, we will most likely see a decline in our funding ratios. Adding to the woe of asset value declines is the fact that bond yields have plummeted, and this will increase the present value of pension obligations. However, we maintain a liquid portfolio to take advantage of attractive market opportunities as well to as ensure that we always maintain sufficient funds to pay near term benefits.

Is there a silver lining in all of this? The steep decline of the past month has erased stock price gains of the past three years and many assets are trading at much more attractive levels. Asset prices have been overvalued for the past few years and the fact that they are now trading relatively 'cheaper', gives us an opportunity to utilize our liquid portfolio to buy such assets at more attractive levels. Your boards have acted decisively in taking advantage of the market correction in March and increased both Plans' allocation to equities, increasing the expected return of the portfolios over the long term. The human and economic toll of the pandemic will be considerable, but we remain optimistic about a strong recovery.

Please stay safe. Wishing you and your family the best in these difficult times.

Quarterly Question

Q: Each year, the financial audit shows that the City of San José Retirement Fund yields less in returns on its investment than other public pension funds. It appears that the latest audit will be no different. Why aren't we earning more on our investment?

A: This question is one that arises regularly from members, City officials and others who follow our Retirement Fund and want to see stronger earnings. While investment strategy is a complex issue, at its core, the main factors in returns are a straight forward risk-reward calculation. Any investment portfolio is comprised of segments of investment allocated according to risk pools, with higher-risk investments obviously those that have the potential to produce the greatest earnings but also the greatest risk of loss. Whether it is your own private portfolio or multi-billion dollar portfolios such as San Jose's Retirement

Funds, the strategic decision is how to appropriately balance investing in low-risk, moderate-risk, and higher-risk investments to provide overall stability and safety, but also increase returns when possible.

Our sponsor, the City San José, is an outlier among California public plans in terms of both the maturity of the retirement plans as well as the outsized impact that annual city contributions have on the City's finances. The Great Financial Crisis (GFC) of 2008-09 had a significant and long lasting negative impact on the Plans' funding ratios. To avoid a repeat of such a scenario, our Plans' adopted a somewhat more conservative stance than many of our peers, whose profiles are very different. It is a strategy that both Boards continually consider and regularly re-evaluate in their efforts to serve our members.

Actuarial Report

The annual actuarial reports that track our retirement funds' balances and ability to pay for pensions and health benefits over the long term is in, and the results show both funds with some work to do to ensure their future strength.

These studies are done each year, with the latest actuarial report covering the state of the funds as of June 30, 2019 – the end of that fiscal year. They not only provide a snapshot of the health of our funds and ability to pay obligated benefits to retirees now and in the future but help guide decisions about the level of City and employee contributions needed to meet those obligations.

Actuarial studies and their dense language can be confusing. But below are the significant takeaways from the report. Members who want more detail can review the Final Actuarial Valuation report, posted on the Federated website at: https://www.sjretirement.com/Uploads/Fed/Final_Actuarial_Valuation_June_30_2019.pdf and on the Police and Fire website at: https://www.sjretirement.com/Uploads/PF/Final_Actuarial_Valuation_June_30_2019.pdf.

The Police and Fire Final Actuarial Report as of June 30, 2019 showed that the plan is about 74.3% funded, which in the long term, means it is about \$1.28 billion short of what is expected to be needed to pay benefits members have earned. This is comparable to CalPERS, and state and national averages.

The Federated Final Actuarial Report as of June 30, 2019 showed that the plan is about 53.1% funded, translating to about \$1.97 billion short of the amount expected to be needed to pay benefits members have earned, and lower than the state and national average funding levels.

While these numbers are big, it is important to know that public retirement plans rely on long-term financial planning, investment returns, adjustments to assumptions and other factors such as longer lifespans, for which both Retirement Boards have wisely planned.

Both plans have funding policies to reach 100 percent funding in a little more than 20 years, if assumptions upon which the policies were developed are met.

The funds dedicated to paying for retirees' health care benefits were also assessed. They showed that Police falls \$259.1 million short of what is expected to be needed to pay benefits members have earned with a 32.5% funding ratio, while Fire is \$165 million short of what is expected to be needed to pay benefits members have earned with a 27.0% funding ratio, and the Federated plan has a \$246 million shortfall of what is expected to be needed to pay benefits members have earned for a 54.5% funding ratio. The long-term funding strategy addresses these shortfalls, too.

Employees will receive a letter showing the contribution rates for the Fiscal year 2020-2021, including the date they become effective. **Note: Current Financial market conditions will be considered on the June 30, 2020 Valuation reports that will affect contribution rates in future fiscal years.**

COVID-19 Update

We remain committed to providing you the most essential services in the best way possible during this difficult time.

The Office will remain closed to the public until the Santa Clara County shelter in place order is lifted. We will post updates on our website at www.sjretirement.com. ORS staff is providing assistance via telephone at 408-794-1000 or 800-732-6477, please leave a voice mail or you can email us at csj_retirement@sanjoseca.gov.

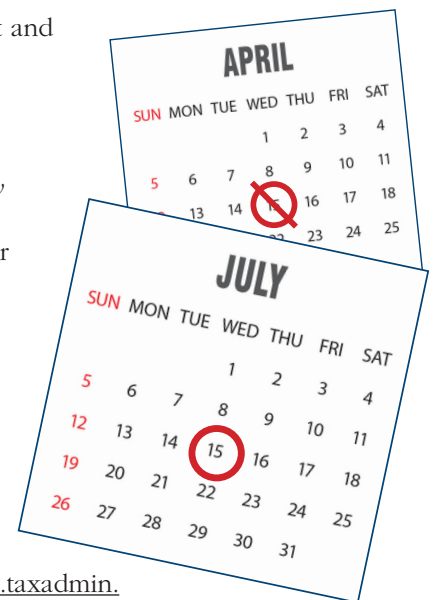
- **Monthly Pensions payments will continue per normal schedule.**
- **ORS Office is closed and In-Person Office Visits are suspended.** Assistance is still available via telephone and e-mail at the email and numbers above, please leave a voice mail.
- **Group Retirement Counseling Sessions are Suspended.** If you are scheduled to attend a group counseling session that is impacted due to office closure you will be contacted with instructions for submitting your retirement application and required documentation.
- **Retirement Applications** – All Retirement applications will be processed through e-mail, if you need assistance, please call our office and leave a voice message. You will be provided with instructions for submitting your retirement application and required ancillary documentation.

Tax Filing

Deadline Extended

The Treasury Department and Internal Revenue Service announced on Friday, March 21st, 2020 that the Federal income tax filing due date is *automatically* extended from April 15, 2020, to July 15, 2020. For updated information go to the the IRS website at: <https://www.irs.gov/coronavirus>.

State filing and payment deadlines vary and are not always the same as the Federal filing date. More information is available at: <https://www.taxadmin.org/state-tax-agencies>.



Introducing Prabhu Palani, CFA Chief Investment Officer

Prabhu is a veteran of the investment industry who brings over 20 years of investment experience with global investment leaders including Barclays Global Investors, Franklin Templeton Investments, and Mellon Capital Management. He was Managing Director and Senior Investment Strategist at Mellon Capital Management where he helped build the firm's quantitative equity capabilities. Previously he was an SVP and Portfolio Manager at Franklin Templeton Investments managing structured equity portfolios. He has also held fixed income portfolio management positions at BGI and NatWest Bank. Prabhu holds a Masters of Art from Stanford University and a Master of Science from the University of Delaware.

It takes only minutes of conversation with Prabhu Palani, to realize our Retirement Boards selected a Chief Investment Officer who understands his business from every perspective and will serve active and retired members well. Just two years into the job, he has used his diverse background working with both asset managers and the allocation side and the allocation side of the investment business to broaden San Jose systems' vision for the future and understanding of how to get there. Here are his thoughts on his role and the future of San Jose's retirement funds.

Q: Tell us how you came to lead San Jose's investment efforts on behalf of both retirement funds?

A: I came to San José with more than 20 years of background with both public and private-sector retirement plans, much of it as a portfolio manager and investment strategist, investing for institutional pension clients of such world leaders as Barclays Global Investors, Franklin Templeton Investments, and Mellon Capital.

I was privy to strategic decisions made by investment firms. Today, that experience greatly enhances our ability to conduct due diligence in finding investment managers whose thinking is aligned with ours and with whom we can work over the long term. I also feel it is important to bring private sector efficiency to a public process.

Q: Two years in, what do you see as your most important accomplishment?

A: Without question, I'm proud of everyone's effort to restructure our governance. We have deeply committed and knowledgeable trustees, and they worked very hard on a deep dive into establishing clear roles and responsibilities for trustees and staff in order to strengthen the team approach toward the long-term health and wealth of both funds.

Q: How did your own experience help that effort?

A: In addition to my long private-sector background, I was also privileged to serve as a Trustee of San José Federated Employees Retirement System, where I learned first-hand the difference between serving in the public sector for a public sector clientele and fund, and investment in the private sector.

It was an eye-opener when first coming to the public sector. But, it positioned me well for this job and the search for that sweet spot between private-sector efficiency in investment and the public sector demand for performance without high risk.

Q: What is one of your goals with respect to our future approach to investment that might pay off in increased earnings?

A: In the coming years, we hope to leverage our location in the wealthy Silicon Valley to pursue opportunities that would increase returns on the Funds' investments without significantly increasing risk.

Q: Tell us about your family and how you relax away from this demanding work.

A: It seems I'm devoted to a diverse portfolio in terms of my play time, too. I am an avid reader, like to play golf, and volunteer with the Fremont Police Department. I live in Fremont with my wife and two sons, one of whom is a high school senior while the other is a senior in college.



The Retirement Connection

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Upcoming Board Meetings

COVID-19 virus has had an impact on our operations. This may cause meetings to be cancelled or held by teleconference. Please check our website for the latest information.

POLICE AND FIRE BOARD MEETINGS are held on the 1st Thursdays of each month. Upcoming meetings will be held on the following dates:

May 7 and June 4.

FEDERATED BOARD MEETINGS are held on the 3rd Thursdays of each month. Upcoming meetings will be held on the following dates:

April 16, May 21, and June 18.

There are no meetings in July.

All meetings unless otherwise posted on the Agenda, are at City Hall, 200 E. Santa Clara Street, Wing Rooms 118-120. Meetings are also live-streamed on our website at www.sjretirement.com. **While the shelter in place is still in effect, live streaming will be available and meetings will be held by teleconference.**

Upcoming Office Closures

May 25

Memorial Day

July 4

Independence Day

CONTACT US!

408-794-1000 or 1-800-732-6477

Our staff directory can be found on our website at:

www.sjretirement.com

Click on "Contact us" or email us at retirement.dept@sanjoseca.gov