Memo

To: Investment Committee – FELRA / UFCW Pension
From: Richard Sichel, Jr., and David A. Russell
Date: April 15, 2014
Re: Roadmap for Asset Allocation Materials

To assist the Investment Committee with a review of asset allocation alternatives, IPS has provided three reports: Asset Allocation and Glide Path Review dated June 10, 2013, Recommended Asset Allocation and Glide Path Update dated April 3, 2013 and the attached Comparison of Expected Risk / Reward of Various Asset Allocations dated April 15, 2014

Considering the amount of detailed information provided, we suggest you use this memo as a roadmap for reviewing the materials.

1) What is the forecasted return and risk of the current policy asset allocation targets?

June 10, 2013 Report – The forecasted return, using 2013 assumptions and policy target allocations was 7.2% (page 2) with a standard deviation of 10.5% (page 8).
April 15, 2014 Comparisons – The forecasted return, using 2014 assumptions and policy target allocations is 7.8% with a standard deviation of 10.9%.

2) As we wind down the plan how much should we keep invested in stable and conservative liquid assets?

June 10, 2013 Report, pages 3 & 4 – IPS recommends that 12 months of projected benefit payments (net of contributions) be invested in short- to intermediate-term fixed income investments for stability of principal and liquidity. Higher fixed income allocations lowers future returns, while lower fixed income allocations increases asset volatility.

3) What is the impact of a substantial decline in the stock market?

June 10, 2013 Report, page 5 – IPS noted that if the stock market had a sustained (12 month or longer) decline of more than 10% in the early years of the wind down, the negative impact on the fund's assets would materially shorten the number of years benefits could be paid. During 2013, the fund has experienced exceptionally high equity returns and is almost $40 million in assets ahead of forecasted asset values. (See April 3, 2014 Update, page 2).

4) Because Risk Parity and GTAA use multiple asset classes how different is our actual "look-through" asset class exposure from our stated policy targets?

April 3, 2014 Update, page 4 – As of December 31, 2013, the plan's effective asset allocation on a "look-through" basis is approximately: 47% Equity, 23% Bonds, 15% Real Estate, 12% Hedge Funds, and 3% Commodities, Currency and Cash. A comparison of this effective allocation to current Policy Targets is shown in the April 15, 2014 Comparison information on page 3.

5) Is this too much equity exposure? Should we have a more conservative allocation?

June 10, 2013 Report, pages 8 to 15 – The exhibits evaluate more conservative (20% equity) and more aggressive (60% equity) alternatives to the current 47% equity allocation on a look-through basis. The conclusion drawn from the analysis was:

- Reject the more aggressive approach, as an adverse equity event could reduce benefit payments by as much as 2.5 years.
- Reject the more conservative approach, as the most probable (expected or median) return would shorten benefit payments by 6-9 months.
- Maintain the current effective allocation to equities, as there is only a small projected difference in the down-side protection in an adverse equity event compared to the more conservative approach, and almost the same most probable (expected or median) result as with the aggressive approach.

IPS's recommended asset allocation approximates the effective asset allocation of the current policy statement, i.e., the equity allocation; the expected return and standard deviation are very similar – only the recommended implementation strategies are different.

Our understanding from the August, 2013 meeting, based on the materials presented during the meeting and the ensuing discussion, was that the Trustees were comfortable with the current effective (look-through) asset allocation. The current allocation has provided the fund with high returns due to exceptionally high equity returns during 2012, 2013 and through the first quarter of 2014.

6) What are the implementation strategy changes and why are you recommending them?

IPS has recommended three changes:

- Fixed Income: Shorten durations to reduce interest rate risk
  - The plan moved to short-duration high yield bonds (Chartwell).
  - The plan moved to intermediate duration investment grade bonds (SBH).
- Equity: IPS recommends transitioning from active management to index funds incrementally over the next 3-4 years.
  - Lower cost – lower asset levels will result in higher effective active management fees.
  - Eliminates the difficulty of managing small portfolios.
  - Lower tracking error and eliminates the risk of under-performance.
  - Increased liquidity for the fund's cash needs.
- Risk Parity: Eliminate the allocation to Risk Parity:
  - Risk Parity over-weights and uses leverage on long duration bonds.
  - There is no hedging of the interest rate risk.