

COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF FINANCE
OTHER POST EMPLOYMENT BENEFITS TRUST FUND

* * * * *

IN RE: SEMI-ANNUAL BOARD MEETING

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BEFORE: JENNIFER GULA, Chair
Michael Lamb, Member
Paula Kellerman, Member
Krysia Kubiak, Member
HEARING: Wednesday, April 12, 2023
2:00 p.m.
LOCATION: Department of Finance
414 Grant Street
Pittsburgh, PA 15219
WITNESSES: NONE

Reporter: Allison Walker

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1 A P P E A R A N C E S

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1	I N D E X	
2		
3	DISCUSSION AMONG PARTIES	5 - 6
4	PRESENTATION	
5	By Attorney Frank	6 - 7
6	PRESENTATION	
7	By Mr. McFarland	7 - 15
8	QUESTIONING BY BOARD	15 - 18
9	PRESENTATION	
10	By Chair	18 - 19
11	CERTIFICATE	20
12		
13		
14		
15		
16		
17		
18		
19		
20		
21		
22		
23		
24		
25		

1

E X H I B I T S

2

3

Page

4

Number

Description

Offered

5

NONE OFFERED

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1 P R O C E E D I N G S

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3 CHAIR:

4 It is April 12th. The time is 2:01 p.m.

5 I'm going to call to order The Other Post Employment
6 Benefit Trust Fund semiannual board meeting. Call the
7 roll. Paula Kellerman?

8 MS. KELLERMAN:

9 Here.

10 CHAIR:

11 Krysia Kubiak?

12 MS. KUBIAK:

13 Here.

14 CHAIR:

15 Controller Michael Lamb? Council
16 President Teresa Kale Smith? Jennifer Gula, Chair,
17 here. And Mr. Michael Lamb has just joined the group.
18 And now it's time for public comment.

19 Is there anyone wishing to make any statements?

20 Seeing none, we'll move to the approval of the
21 minutes, to approve the minutes from the last biannual
22 meeting of November 9, 2022. Can I have a motion to
23 approve the minutes?

24 MR. LAMB:

25 So moved.

1 CHAIR:

2 Second?

3 MS. KUBIAK:

4 Second.

5 CHAIR:

6 All in favor?

7 ALL RESPOND AYE

8 CHAIR:

9 Okay. The minutes are approved. Next
10 on the agenda is bills and communication. The report
11 from the chair, which is myself. So the fund balance
12 as of the first quarter ending March 31st, 2023, the
13 balance is \$34.2 million. The balance of the disabled
14 firefighters OPEB account as of March 31st, 2023 is
15 just over \$124,500. And we are continuing to make the
16 transfers to the police arbitration fund as well as
17 the fire arbitration fund from the City's general
18 fund. Now for the solicitors report. Mr. Solicitor?

19 ATTORNEY FRANK:

20 Thank you. There has been no activity
21 since our last meeting other than we do have both the
22 statement of financial interests that are due on May
23 1. And I sent a reminder of the trustees that you
24 have to do that in your capacity as a trustee, as well
25 as your other capacities.

1 MR. LAMB:

2 Under the new rule with statewide, we
3 filed --- I already filed statewide and included my
4 title, this title in that form. Doesn't that cover
5 me?

6 ATTORNEY FRANK:

7 Yes.

8 MR. LAMB:

9 Okay.

10 ATTORNEY FRANK:

11 You also have to file a copy to the city
12 clerk.

13 MR. LAMB:

14 Okay. Okay.

15 ATTORNEY FRANK:

16 And then the only other thing is that we
17 have to have an annual disclosure statement for the
18 State Pension Act from professional service providers,
19 which are affirmed in fifth-third, and I sent out the
20 reminder. So they're also due. But other than that,
21 there's no been no reply to it.

22 CHAIR:

23 Okay.

24 Now for the Fifth Third report.

25 MR. MCFARLAND:

1 Okay. As I somewhat started to discuss
2 prior to the meeting, I'll give a review of the market
3 over the last year, where the portfolio sits now, and
4 what we see going forward. If you turn to page four,
5 that's where I'll start. I'm not going to go over
6 every single page in the report, but it'll give a
7 quick summary of the markets and give some perspective
8 of where we are right now.

9 The last year, year and a half has
10 provided a lot of volatility in the market. 2022, we
11 saw the S and P 500 down over 18 percent. Stocks have
12 really been on a roller coaster. We've seen them
13 recover somewhat here at the beginning of 2023, but
14 several things still are at the forefront, and that's
15 inflation, the Federal Reserve, and more recently, I
16 don't want to call it a bank crisis, but the little
17 bank hiccup, which was really segmented to a very
18 specific part of the market with a specific bank that
19 was in one sector of the market, but it kind of spread
20 to other banks, though we've seen that settle at this
21 point.

22 And part of that was made a little bit
23 worse because of what is going on with the Fed and
24 interest rates rising, which put some of their bond
25 portfolio underwater because they had to raise cash to

1 meet deposit demand. That has --- the Fed came in and
2 they've arranged buyers for all of those banks that
3 were impaired. And we've seen that area of the market
4 settle over the last few weeks. The other thing
5 that's happened with the Fed continuing to raise
6 interest rates, and today we saw CPI come in a little
7 bit lower than expected. So it's giving an indication
8 of what the Fed has done over the last year is
9 beginning to have some impact. And so the Fed may be
10 in a position to slow down or at least stop raising
11 short-term interest rates. At some point, we expect
12 that interest short-term rates will come down. And if
13 you look at the inverted yield curve, the yield curve
14 is telling us that as the Fed really sets the short
15 end of the curve, the market, the longer end of the
16 curve.

17 So what that caused was that in 2022, we
18 saw very highly correlated correlation between stocks
19 and bonds in that the first three quarters of the
20 year, we saw for the first time in history, the
21 Bloomberg Aggregate Index and the S and P 500 were
22 negative for three consecutive quarters. That's never
23 happened. And if we looked at bond returns, simple,
24 because principle goes down when interest rates go up
25 was negative for the year. So what usually acts as a

1 buffer in a balanced portfolio didn't happen in 2022.
2 We've seen that somewhat reversed in the first part of
3 2023. On page four, you'll see the S and P 500 and
4 we're roughly there now up 7.48 percent. EFO, which
5 is international of 8.47 percent emerging markets up
6 just under 4 percent.
7 We go to the next page looking at the
8 bond markets, and I'll just focus on the top index,
9 which is the Bloomberg U.S. Intermediate GOV credit.
10 It's up year to date 2.33. And that's a function that
11 interest rates, particularly further out on the curve,
12 have actually come down. And that's a sign that A,
13 the market believes that inflation will be under
14 control and that at some point, the Fed will have to
15 lower interest rates. Going to skip ahead a few
16 pages. Pages 7 through 11 really give Fifth Third's
17 view of the market. I hit the highlights, but I want
18 one page that I like to highlight when we have
19 volatile markets, particularly when you look at the
20 equity markets. On page 12, this looks at the return
21 of the S and P 500 since 1928 in a year over year
22 basis. And you see that there have been six times
23 where the market was down more than 20 percent, 8
24 times when it was down 10 to 20 percent. But the
25 right hand side of the page shows you the market was

1 up 19 times more than 20, well, 10 to 20 percent and
2 up 36 times over 20 percent. So we know we have the
3 left hand side of the page, we remember more, but
4 generally we're on the right hand side of the page.
5 And if you look at it on a year over year basis, the
6 market is up 75 percent of the time. And the only
7 message here is that you have to be invested in the
8 market to keep up with inflation. Trying to time the
9 market is fool's gold because all you have to do is be
10 wrong once.

11 Just a quick look at the portfolio.

12 You'll see on page 13, this is a look at the asset
13 allocation as of 3/31 and you'll see we were just
14 under 50 percent equity, real assets, which includes
15 REITs at 4.6 percent. Our target for equities is 60
16 percent. Fixed income is at 35 percent. And we also
17 have some alternative strategies, which are a hedge
18 against fixed income at just under 4 percent. So
19 we're right on the asset allocation target as
20 indicated in the trust agreement.

21 Starting on page 14, we'll look at the
22 assets that we hold. And on the fixed income side, we
23 have two fixed income funds, double line and Dodge and
24 Cox, which provide us some diversification. You'll
25 see where it says Fifth Third Intermediate GOV Credit.

1 That is a portfolio of individual bonds that you owe.
2 And that is a good thing when you have volatile fixed
3 income markets because we actually own those bonds.
4 So they're going to mature at par. So whatever is
5 happening now in the market, it doesn't matter if you
6 have \$100,000 bond that is valued at \$95,000 because
7 it's going to mature at par. So this interruption in
8 the fixed income markets is really only temporary and
9 we have built in return within that part of the fixed
10 income portfolio.

11 The equity portfolio is diversified
12 amongst funds in all different categories. A lot of
13 the investments now are passive. In the time that
14 we've managed it, we've moved to more passive
15 investments, particularly in domestic equities because
16 over that time, particularly in the core space, active
17 managers haven't consistently added value. So just
18 being invested in the space in the cheapest way
19 possible is of value to the portfolio. So if we go
20 over to page 17, just look at the return and we'll
21 look at the gray lines. The cash at the top, you'll
22 see the one year return at 3.6, which is the first
23 time I've been able to put a whole number in front of
24 the decimal point in several years. And that's
25 because ---.

1 CHAIR:

2 I'm sorry. What page are you on?

3 MR. MCFARLAND:

4 On page 17.

5 CHAIR:

6 Okay.

7 MR. MCFARLAND:

8 Yeah. So if you look at that return,
9 and that right now, money market funds are paying
10 around four and a half percent. And depending on what
11 the fed does that could move up a little, but it will
12 likely remain stable for some time to come. We
13 believe at some point the Fed will start to bring
14 short-term rates down to some level, but we believe
15 that will probably be at least 6 to 12 months down the
16 road.

17 Equities year to date up 6.4 percent.

18 You see the other line there, fixed income, 2.7

19 percent. Real assets down slightly year to date.

20 Alternatives down at the bottom, up 0.5 percent year

21 to date. The other thing I want to point out is if

22 you look at the five year return, look at that fixed

23 income at 1.4 percent. Remembering we're coming out

24 of an extremely low interest rate environment,

25 equities up, including what's gone on in the last

1 year, year and a half are still up on average 7.1
2 percent over the last five years. And since inception
3 in 2014 up an average of 8.3 percent versus the MSCI
4 All Country World at 7.3 percent.

5 The entire portfolio net of fees for the
6 one year, it's negative, but year to date, we're up
7 4.4 percent. And if you take that at five years net
8 of all fees, the overall portfolio is up 5 percent,
9 and since inception, 5.3 percent. So, still
10 continuing to produce return. And that's keeping in
11 mind that we had a market last year where we had both
12 fixed income and stocks down significantly for the
13 first time ever. And so we've seen those markets
14 start to improve.

15 The next group is just the firefighters
16 account, which is invested similarly, but not all the
17 same investments because of the size of the portfolio.
18 So if you go to page 22. And it's been invested much
19 shorter time frame, but you'll see the similar
20 returns. And I'll just go to the bottom page on 23,
21 you'll see year to date 5.2 percent, the one year
22 negative 7.4 percent. And since inception, again,
23 this was initially invested in cash until we improved
24 to invest it the same way as we invested the other
25 fund, up 3.8 percent, and that's since 2019. So with

1 that, are there any questions, predictions for the
2 market?

3 MS. KUBIAK:

4 Can I ask, can you talk a little bit
5 about the international seems to be doing well year to
6 date. Is that ---?

7 MR. MCFARLAND:

8 Yeah. That's --- if we look at COVID
9 and the impacts on the market, we were well ahead.
10 Remember, our markets recovered very quickly in the
11 summer of 2020. So our markets recovered. That
12 wasn't the same case if you look globally,
13 particularly the emerging markets in China, which had
14 their zero failing, zero COVID policy. So we've seen
15 that actually that start to recover more recently as
16 they realize that if the rest of the world is open,
17 they have to be, too, if they want to participate. So
18 everything is cyclical. They're kind of following.
19 They were down longer and at a greater rate. So their
20 recovery has just now started, as we've seen those
21 markets start to improve now.
22 Now, they also were impacted somewhat by
23 the banking crisis. As you know, Credit Suisse had to
24 be acquired as well. It's a different issue, and that
25 issue has actually been going on a longer time.

1 Wasn't the same as what was happening here, but those
2 financial stresses affected that market. But again,
3 their recovery started a little bit after. And so
4 they've come back stronger in the last year because
5 were already a little bit ahead of the game.

6 MS. KUBIAK:

7 Okay. And do you think the bond market
8 is going to get --- is it back to where it was yet, or
9 is it ---?

10 MR. MCFARLAND:

11 No, no. If you look at a yield curve,
12 and I'm going to draw here for --- and if you look at
13 the yield curve, this is the short end of the curve
14 and rates are higher at the short end than they are at
15 the longer end. That tells you the market believes
16 the only way an inversion gets fixed to a normal way
17 when longer term rates are higher, short term rates
18 come down, longer term rates go up. If we saw
19 inflation continuing to increase, we'd see these
20 longer term rates go up. But we've seen inflation
21 since it peaked last June come down consistently. So
22 that means short term rates, and we've already seen
23 that in the last couple of weeks, will likely come
24 down over a period of time. We may see longer term
25 rates go up slightly because the market doesn't know

1 where this is going to end up. The Fed's long term
2 target for inflation is two percent. Don't know if
3 we're going to get there really quickly, but probably
4 --- getting to four, three and a half will be easy.
5 That last part will be a little bit harder and take
6 longer, but we'll likely see rates go up.
7 And then the bond market, we've already
8 seen it recover somewhat. And you'll see fixed income
9 produce returns more consistent with whatever the
10 prevailing interest rates are. And again, money
11 markets are now at four and a half percent. Fed funds
12 is at five. So we're going to start to see those kind
13 of returns more consistently going forward.

14 MS. KUBIAK:

15 Okay. Thank you. All my questions.

16 MR. LAMB:

17 I just have a question for you. Remind
18 me. Was there a budget commitment this year?

19 CHAIR:

20 There was.

21 MR. LAMB:

22 How much?

23 CHAIR:

24 A million.

25 MR. LAMB:

1 \$1,000,000?

2 CHAIR:

3 Uh-huh (yes).

4 MR. LAMB:

5 And does that happen once or over

6 quarters or how's that happen?

7 CHAIR:

8 We usually split it up over quarters,

9 but I think with it being smaller, we just sort of
10 determined when we would do it. I don't know if you
11 scheduled it yet as part of ---.

12 MR. MCFARLAND:

13 No, no.

14 CHAIR:

15 So it hasn't happened yet this year?

16 MR. MCFARLAND:

17 Uh-uh (no). No.

18 MR. LAMB:

19 All right. Thanks.

20 CHAIR:

21 Anything else?

22 MR. MCFARLAND:

23 That's all I have.

24 CHAIR:

25 All right. Okay.

1 We have one resolution on the agenda
2 today. It's resolution 2 of 22. It's resolution
3 authorizing the payment of professional services
4 rendered by Frank, Gail, Bails, Merco and Pocrass,
5 P.C. in the amount of \$578.00 for the months of
6 November 2022 to March 2023. Can I have a motion to
7 approve the resolution?

8 MR. LAMB:

9 I move to approve.

10 CHAIR:

11 Second?

12 MS. KUBIAK:

13 Second.

14 CHAIR:

15 All in favor?

16 ALL RESPOND AYE

17 CHAIR:

18 Okay. Resolution is approved.

19 Is there any new business for today?

20 No. Continue business? Okay. Meeting adjourned. It
21 is 2:17 p.m. on April 12th.

22 * * * * *

23 MEETING CONCLUDED AT 2:17 P.M.

24 * * * * *

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CERTIFICATE

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I hereby certify, as the stenographic

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reporter, that the foregoing proceedings were taken

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stenographically by me, and thereafter reduced to

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typewriting by me or under my direction; and that this

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transcript is a true and accurate record to the best

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of my ability.

10

Dated the 27 day of April, 2023

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Amber Garbinski,

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Court Reporter

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TRANSCRIPT OF PROCEEDINGS

April 12, 2023

\$	11:21	14:20	50	
\$1,000,000	17	2:01	11:14	9
18:1	12:20 13:4	5:4	500	9
\$100,000	18	2:17	8:11 9:21	5:22
12:6	8:11	19:21,23	10:3,21	
\$124,500	19		6	A
6:15	11:1	3		account
\$34.2	1928	3.6	6	6:14 14:16
6:13	10:21	12:22	13:15	acquired
\$578.00	2	3.8	6.4	15:24
19:5		14:25	13:17	Act
\$95,000	2	3/31	60	7:18
12:6	19:2	11:13	11:15	active
	2.33	31st	7	12:16
0	10:10	6:12,14		activity
0.5	2.7	35	7	6:20
13:20	13:18	11:16	10:16	acts
1	20	36	7.1	9:25
	10:23,24	11:2	14:1	added
	11:1,2		7.3	12:17
1	2014	4	14:4	adjourned
1	14:3	4	7.4	19:20
6:23	2019	10:6 11:18	14:22	affected
1.4	14:25	4.4	7.48	16:2
13:23	2020	14:7	10:4	affirmed
10	15:11	4.6	75	7:19
10:24 11:1	2022	11:15	11:6	agenda
11	5:22 8:10		8	6:10 19:1
10:16	9:17 10:1	5		Aggregate
12	19:6		8	9:21
10:20 13:15	2023	5	10:23	agreement
12th	6:12,14 8:13	14:8	8.3	11:20
5:4 19:21	10:3 19:6	5.2	14:3	ahead
13	22	14:21	8.47	10:15 15:9
11:12	14:18 19:2	5.3	10:5	16:5
14	23	14:9		

TRANSCRIPT OF PROCEEDINGS

April 12, 2023

allocation 11:13	19:3	Bloomberg 9:21 10:9	14:23	17:9
alternative 11:17	average 14:1,3	board 5:6	categories 12:12	consistently 12:17 16:21 17:13
Alternatives 13:20	AYE 6:7 19:16	bond 8:24 9:23 10:8 12:6 16:7 17:7	caused 9:17	Continue 19:20
amount 19:5	B	bonds 9:19 12:1,3	chair 5:3,10,14,16 6:1,5,8,11 7:22 13:1,5 17:19,23 18:2,7,14,20, 24 19:10,14, 17	continuing 6:15 9:5 14:10 16:19
annual 7:17	back 16:4,8	bottom 13:20 14:20	cheapest 12:18	control 10:14
approval 5:20	Bails 19:4	bring 13:13	China 15:13	Controller 5:15
approve 5:21,23 19:7, 9	balance 6:11,13	budget 17:18	city 7:11	copy 7:11
approved 6:9 19:18	balanced 10:1	buffer 10:1	City's 6:17	core 12:16
April 5:4 19:21	bank 8:16,17,18	built 12:9	clerk 7:12	correlated 9:18
arbitration 6:16,17	banking 15:23	business 19:19,20	coaster 8:12	correlation 9:18
area 9:3	banks 8:20 9:2	buyers 9:2	comment 5:18	Council 5:15
arranged 9:2	basis 10:22 11:5	C	commitment 17:18	Country 14:4
asset 11:12	beginning 8:13 9:9	call 5:5,6 8:16	communication 6:10	couple 16:23
asset allocati on 11:19	believes 10:13 16:15	capacities 6:25	CONCLUDED 19:23	cover 7:4
assets 11:14,22 13:19	Benefit 5:6	capacity 6:24	consecutive 9:22	COVID 15:8,14
ATTORNEY 6:19 7:6,10, 15	biannual 5:21	case 15:12	consistent	Cox 11:24
authorizing	bills 6:10	cash 8:25 12:21		CPI 9:6
	bit 8:22 9:7 15:4 16:3,5 17:5			credit 10:9 11:25

TRANSCRIPT OF PROCEEDINGS

April 12, 2023

15:23 crisis 8:16 15:23 curve 9:13,15,16 10:11 16:11, 13 cyclical 15:18	Dodge 11:23 domestic 12:15 double 11:23 draw 16:12 due 6:22 7:20	9:11 expected 9:7 extremely 13:24	23 12:2,8,9 13:18,22 14:12 16:16 17:8 focus 10:8 fool's 11:9 forefront 8:14 form 7:4 forward 8:4 17:13 frame 14:19 Frank 6:19 7:6,10, 15 19:4 front 12:23 function 10:10 fund 5:6 6:11,16, 17,18 14:25 funds 11:23 12:12 13:9 17:11	generally 11:4 give 8:2,6,7 10:16 giving 9:7 globally 15:12 gold 11:9 good 12:2 GOV 10:9 11:25 gray 12:21 greater 15:19 group 5:17 14:15 Gula 5:16
D	E	F	G	H
date 10:10 13:17, 19,21 14:6,21 15:6 decimal 12:24 demand 9:1 depending 13:10 deposit 9:1 determined 18:10 disabled 6:13 disclosure 7:17 discuss 8:1 diversificatio n 11:24 diversified 12:11	easy 17:4 EFO 10:4 emerging 10:5 15:13 Employment 5:5 end 9:15 16:13, 14,15 17:1 ending 6:12 entire 14:5 environment 13:24 equities 11:15 12:15 13:17,25 equity 10:20 11:14 12:11 expect	ailing 15:14 favor 6:6 19:15 fed 8:23 9:1,5,8, 9,14 10:14 13:11,13 17:11 Fed's 17:1 Federal 8:15 fees 14:5,8 fifth-third 7:19 file 7:11 filed 7:3 financial 6:22 16:2 fire 6:17 firefighters 6:14 14:15 fixed 11:16,18,22,	23 12:2,8,9 13:18,22 14:12 16:16 17:8 focus 10:8 fool's 11:9 forefront 8:14 form 7:4 forward 8:4 17:13 frame 14:19 Frank 6:19 7:6,10, 15 19:4 front 12:23 function 10:10 fund 5:6 6:11,16, 17,18 14:25 funds 11:23 12:12 13:9 17:11	generally 11:4 give 8:2,6,7 10:16 giving 9:7 globally 15:12 gold 11:9 good 12:2 GOV 10:9 11:25 gray 12:21 greater 15:19 group 5:17 14:15 Gula 5:16
				half 8:9 13:10 14:1 17:4,11 hand 10:25 11:3,4 happen 10:1 18:5,6 happened 9:5,23 18:15 happening 12:5 16:1 harder

TRANSCRIPT OF PROCEEDINGS

April 12, 2023

17:5 hedge 11:17 hiccup 8:17 higher 16:14,17 highlight 10:18 highlights 10:17 highly 9:18 history 9:20 hit 10:17 hold 11:22 how's 18:6	inception 14:2,9,22 included 7:3 includes 11:14 including 13:25 income 11:16,18,22, 23 12:3,8,10 13:18,23 14:12 17:8 increase 16:19 index 9:21 10:8 indication 9:7 individual 12:1 inflation 8:15 10:13 11:8 16:19,20 17:2 initially 14:23 interest 8:24 9:6,11, 12,24 10:11, 15 13:24 17:10 interests 6:22 Intermediate 10:9 11:25 international 10:5 15:5	interruption 12:7 inversion 16:16 inverted 9:13 invest 14:24 invested 11:7 12:18 14:16,18,23, 24 investments 12:13,15 14:17 issue 15:24,25	Krysia 5:11 Kubiak 5:11,12 6:3 15:3 16:6 17:14 19:12 <hr/> L <hr/> Lamb 5:15,17,24 7:1,8,13 17:16,21,25 18:4,18 19:8 left 11:3 level 13:14 lines 12:21 long 17:1 longer 9:15 15:19,25 16:15,17,18, 20,24 17:6 looked 9:23 lot 8:10 12:12 low 13:24 lower 9:7 10:15 <hr/> M <hr/> made 8:22	make 5:19 6:15 managed 12:14 managers 12:17 March 6:12,14 19:6 market 8:2,10,18,19 9:3,15 10:13, 17,23,25 11:6,8,9 12:5 13:9 14:11 15:2,9 16:2,7, 15,25 17:7 markets 8:7 10:5,8,19, 20 12:3,8 14:13 15:10, 11,13,21 17:11 matter 12:5 mature 12:4,7 MCFARLAND 7:25 13:3,7 15:7 16:10 18:12,16,22 means 16:22 meet 9:1 meeting 5:6,22 6:21 8:2 19:20,23 Merco 19:4
<hr/> I <hr/> impact 9:9 impacted 15:22 impacts 15:9 impaired 9:3 improve 14:14 15:21 improved 14:23		Jennifer 5:16 joined 5:17 June 16:21 <hr/> K <hr/> Kale 5:16 keeping 14:10 Kellerman 5:7,8 kind 8:19 15:18 17:12		

TRANSCRIPT OF PROCEEDINGS

April 12, 2023

message 11:7	O	Pension 7:18	17:10	R
Michael 5:15,17	OPEB 6:14	percent 8:11 10:4,5,6, 23,24 11:1,2, 6,14,15,16,18 13:10,17,19, 20,23 14:2,3, 4,7,8,9,21,22, 25 17:2,11	principle 9:24	raise 8:25 9:5
million 6:13 17:24	open 15:16		prior 8:2	raising 9:10
mind 14:11	order 5:5		produce 14:10 17:9	rate 13:24 15:19
minutes 5:21,23 6:9	owe 12:1	period 16:24	professional 7:18 19:3	rates 8:24 9:6,11, 12,24 10:11, 15 13:14 16:14,17,18, 20,22,25 17:6,10
money 13:9 17:10	P	perspective 8:7	provide 11:24	real 11:14 13:19
months 13:15 19:5	P.C. 19:5	Pocrass 19:4	provided 8:10	realize 15:16
motion 5:22 19:6	p.m. 5:4 19:21,23	point 8:21 9:11 10:14 12:24 13:13,21	providers 7:18	recently 8:15 15:15
move 5:20 13:11 19:9	pages 10:16	police 6:16	public 5:18	recover 8:13 15:15 17:8
moved 5:25 12:14	par 12:4,7	policy 15:14	put 8:24 12:23	recovered 15:10,11
MSCI 14:3	part 8:18,22 10:2 12:9 17:5 18:11	portfolio 8:3,25 10:1 11:11 12:1, 10,11,19 14:5,8,17	quarter 6:12	recovery 15:20 16:3
N	participate 15:17	position 9:10	quarters 9:19,22 18:6, 8	REITS 11:15
negative 9:22,25 14:6, 22	passive 12:13,14	Post 5:5	question 17:17	remain 13:12
net 14:5,7	Paula 5:7	predictions 15:1	questions 15:1 17:15	remember 11:3 15:10
normal 16:16	paying 13:9	President 5:16	quick 8:7 11:11	Remembering 13:23
November 5:22 19:6	payment 19:3	prevailing	quickly 15:10 17:3	
number 12:23	peaked 16:21			

TRANSCRIPT OF PROCEEDINGS

April 12, 2023

Remind 17:17	8:12	10:12	18:8	summer 15:11
reminder 6:23 7:20	roughly 10:4	significantly 14:12	spread 8:19	
rendered 19:4	rule 7:2	similar 14:19	stable 13:12	T
reply 7:21	S	similarly 14:16	start 8:5 13:13 14:14 15:15, 21 17:12	talk 15:4
report 6:10,18 7:24 8:6	scheduled 18:11	simple 9:23	started 8:1 15:20 16:3	target 11:15,19 17:2
Reserve 8:15	sector 8:19	single 8:6	Starting 11:21	telling 9:14
resolution 19:1,2,7,18	segmented 8:17	sits 8:3	State 7:18	tells 16:15
RESPOND 6:7 19:16	semiannual 5:6	size 14:17	statement 6:22 7:17	temporary 12:8
rest 15:16	service 7:18	skip 10:15	statements 5:19	Teresa 5:16
return 10:20 12:9, 20,22 13:8,22 14:10	services 19:3	slightly 13:19 16:25	statewide 7:2,3	term 16:17,18,20, 22,24 17:1
returns 9:23 14:20 17:9,13	sets 9:14	slow 9:10	stocks 8:11 9:18 14:12	thing 7:16 9:4 12:2 13:21
reversed 10:2	settle 8:20 9:4	smaller 18:9	stop 9:10	things 8:14
review 8:2	short 9:14 16:13, 14,17,22	Smith 5:16	strategies 11:17	Third's 10:16
rising 8:24	short-term 9:11,12 13:14	Solicitor 6:18	stresses 16:2	time 5:4,18 9:20 11:6,8 12:13, 16,23 13:12 14:13,19 15:25 16:24
road 13:16	shorter 14:19	solicitors 6:18	stronger 16:4	times 10:22,24 11:1,2
roll 5:7	shows 10:25	sort 18:9	Suisse 15:23	title 7:4
roller	side 10:25 11:3,4, 22	space 12:16,18	summary 8:7	
	sign	specific 8:18		
		split		

today 9:6 19:2,19	W	
top 10:8 12:21	weeks 9:4 16:23	
transfers 6:16	wishing 5:19	
trust 5:6 11:20	world 14:4 15:16	
trustee 6:24	worse 8:23	
trustees 6:23	wrong 11:10	
turn 8:4	Y	
U	year 8:3,9 9:8,20, 25 10:10,21 11:5 12:22 13:17,19,20, 22 14:1,6,11, 21 15:5 16:4 17:18 18:15	
U.S. 10:9	years 12:24 14:2,7	
Uh-huh 18:3	yield 9:13 16:11,13	
Uh-uh 18:17		
underwater 8:25		
V		
valued 12:6		
versus 14:3		
view 10:17		
volatile 10:19 12:2		
volatility 8:10		