Response to The Hartford Citizen Article

I strongly disagree with the characterization in the May 1, 2016, *The Hartford Citizen* that the investment performance of the Municipal Employees' Retirement Fund (MERF) has been "poor", as the article assumes that raw investment return relative to a peer group is the only way to judge the MERF's performance. Please understand, as a very competitive person, I want the MERF to outperform all of its "peers" in terms of raw returns over all measurement periods. However, as the fiduciary of a pension fund that provides retirement security for more than 5,500 people, I must guide its investment program in a prudent manner, which means making sure that the MERF's investment program is able to withstand short-term volatility and remain healthy for the long term. The MERF employs actuarial and investment experts to help build and execute such an investment strategy. I am proud to say that, over my tenure, the MERF has outperformed the customized benchmark that is consistent with its long term goals.

The MERF invests over a long term (25 to 30 year) horizon, in the process avoiding excessive risk taking and volatility of returns in order to prevent significant loss of principal and unanticipated spikes in the City's required annual pension fund contribution. This has been the MERF's approach for many years and it has proved successful as evidenced by long term investment results. A full understanding of the MERF would confirm that such an approach has not only been successful over time and over many market cycles, it would also reveal that it is the most prudent approach. The reason why is due to the mature demographics of the MERF's participants and the high level of required benefits payments (approximately $100 million dollars, or 10% of the trust per year). In order to make these payments on time, the MERF must be conservative and well diversified, generating current income and able to annually liquidate roughly 5% of its principal. This need for significant current income and ready liquidity is a critical consideration with regard to short term volatility, as liquidating investments in down markets locks in capital losses that cannot be recouped. Therefore, even short term down side volatility can have a serious effect on the MERF's funded status.

The situation the MERF faces as noted above differs from that of many of its peers. That is why the MERF does not invest like its peers. It has a unique allocation that is geared to its actuarially determined long term rate of return and also has a customized asset allocation target. A custom benchmark index that comprises the asset classes and the allocations to each is what embodies the MERF's investment goals. By equaling or exceeding this benchmark, the MERF will, over time, achieve its long term rate of return with the lowest possible volatility, ensuring its viability into perpetuity.

The critique in the article relies on an exhibit that is not an appropriate standard to use when attempting to draw conclusions about the MERF's performance. For example, the article stated that the MERF's performance over the past five years was in the 81st percentile. However, as an updated exhibit shows (below), just 3 months later, the MERF's five year trailing return improves to the 69th percentile. Moreover, the MERF's Last Quarter percentile rose from 81st in the Fourth Quarter of 2015 to 13th in the First Quarter of 2016! Judging from these sharp differences, it is clear that this data is volatile and focusing on it in order to assess the MERF's performance can lead to flawed and erroneous conclusions.

Total Return

	Last Quarter	Last Year	Last 3 Years	Last 5 Years
Total Composite	1.8	0.3	4.6	5.8
Rank	13	20	80	69
Median Public Funds	1.4	-1.0	6.0	6.4
Policy Index	2.0	-0.6	3.8	5.3

Periods longer than one year are annualized

*Rankings versus total Public Fund s1=best, 100=worst.

Instead, I suggest that the focus be placed on the actual measures that the Treasurer's office and the Pension Commission use to ensure that the MERF remains healthy. For example, the MERF's asset base stands at nearly $1 billion dollars, and the MERF's funded status stands at 77%. In terms of the MERF's *long-term* investment performance, it should be appreciated that the MERF's 8.1% net annualized return since inception (in 1986) is **above** the MERF's key metric of its long term (30 year) Assumed Rate of Return (which is 7.75%). Such returns have been generated with low volatility and, most significantly, low down side volatility as evidenced by the MERF's standard deviation and Sortino ratios, respectively. Moreover, the MERF is able to pay out retiree benefits of nearly $100 million dollars per year to its 3000+ pensioners. Very importantly, as long as the City of Hartford maintains its ADEC (Actuarially Determined Employee Contribution) payment at the levels determined by the MERF's actuarial consultant and its Pension Commission, the MERF will continue to fulfill its purpose into perpetuity, despite the market outlook for unusually low investment returns and ongoing market volatility for the foreseeable future.

The MERF's goal is to achieve its actuarially determined rate of return on average over the long term with an acceptable level of risk, and to achieve a real rate of return of 3.5% above the rate of inflation. The specific strategy used to achieve this goal varies over time but the strategy has always been defensive, diversified and focused on the long-term and prudent risk-taking.

Regarding the MERF's assumed rate of return of 7.75%, it should be noted that (as of May 2016), many public funds have adopted an assumed rate of return of between 6.50% - 7.25%, in recognition of lower return expectations for the next 5 to 7 years . The importance of this is that, were the MERF to reduce its assumed rate of return in line with many other public funds, the City's ADEC payment would rise significantly, requiring the City to contribute millions more dollars on an annual basis into the MERF. So far, the MERF's investment performance, disciplined risk-taking and the discipline of paying the actuarially determined ADEC have kept the MERF in a solid funded status of 77% funded and all pensioners are being paid. Over the long-term, I expect that the MERF will continue to exceed its assumed rate of return.

As of this writing, the asset value of the MERF stands at $991 million dollars.

For more information on the MERF, I invite you to visit the City Treasurer's website at http://treasurer.hartford.gov/

Adam M. Cloud
Treasurer, City of Hartford
May 20, 2016