MUNICIPALITY OF ANCHORAGE

ASSEMBLY INFORMATION MEMORANDUM

No. AIM 77-2019

Municipal Clerk's Office
Accepted
Date: June 4, 2019

Meeting Date: June 4, 2019

FROM: Mayor

SUBJECT: MOA Trust Fund Status – 2018 Year in Review

This information memorandum is intended to meet Anchorage Municipal Code (AMC) 6.50.060K which requires a report on the performance of the MOA Trust Fund's investments to be provided to the Assembly on an annual basis.

The MOA Trust Fund Report:

Background

The MOA Trust Fund (hereinafter referred to as the "Trust") was established May 14, 1999 from the net proceeds generated by the sale of the Anchorage Telephone Utility. The Trust began with two components, the "Corpus" which, except under very specific circumstances, cannot be spent without a vote of the people, and the "Reserve", which cannot be spent without Assembly authorization. *Note: In 2003 the decision was made to extinguish the Reserve, with the residual balance being transferred to the Trust.*

Additions/Subtractions

No new deposits were made to the Trust in 2018.

On three different occasions during 2018, a collective total of $6.3 million in dividend withdrawals were made to fulfill the 2018 budget expectation. The timing of these three withdrawals were spread out and managed in order to reduce potential downside market timing risk.

Per its definition in AMC 6.50.060, the *annual dividend* is subject to the controlled spending policy and shall be paid no later than 15 days prior to the end of the fiscal year. The current authorized payout rate cited in AMC is 4.25% and this percentage figure is applied to the average of the trailing 20 quarters of market values marked at March 31 of each year.

Market Value

The market value of the Trust at December 31, 2018 was $151.4 million (Fund 730000, unaudited, rounded) -- this represented a $13.7 million decrease over the prior year, excluding payment of the annual dividend payment and Trust expenses. The trailing 5 years of calendar year-end market values for the Trust, as well as related annual dividend payouts and calculated annual returns, are summarized as follows:

Calendar Year	Market Value	Dividend Paid in Calendar Year	Annual Return
2014	$149.0 million	$4.9 million	5.8%
2015	$144.8 million	$5.2 million	0.8%
2016	$147.7 million	$5.4 million	6.1%
2017	$165.1 million	$6.0 million	16.3%
2018	$151.4 million	$6.3 million	-4.5%

2018 Performance (net of fees)
In 2018, the Trust's domestic stock holdings produced a return of -4.88% as compared to international stocks which returned -14.87%; fixed income returned 0.11% and direct real estate returned 6.04%. Emerging markets were added to the Trust's investment lineup in mid-June 2018, returning 1.1% during the last two quarters of the year. The Trust experienced an overall -4.5% return (rounded) in calendar year 2018 per calculation by the Trust's investment consultant (i.e., RVK based in Portland, Oregon). In 2018, the Trust outperformed its Investment Policy benchmark return by 43 basis points (i.e., 0.43%).

Other major Alaskan investment funds experienced the following *negative* returns in 2018:

- Alaska Permanent Fund experienced a -1.10% return.
- Alaska Retirement Mgmt. Board (PERS) experienced a -1.57% return
- Anchorage Police/Fire Retirement System experienced a -5.01% return.

In commenting on the Trust's 2018 performance our investment consultant (Spencer Hunter of RVK) offered the following:

> *The 2018 calendar year was characterized by a continued U.S. equity rally through the first three quarters of 2018, followed by a sharp selloff in fourth quarter. U.S. equity markets were driven by expectations of continued, but slowing, economic growth coupled with generally accommodative central bank policy. While markets remained stable for most of the year, a spike in market volatility was experienced late in the year as investors reacted negatively to the prospect of higher future inflation, rising interest rates, a partially inverted yield curve, and potential global trade conflicts. The U.S. equity markets, as measured by the S&P 500 Index, returned -4.4% in 2018 amidst mixed U.S. economic news including a continued increase in housing demands, a low unemployment rate of 3.9%, rising interest rates, and heightened fears of trade war escalations between the U.S. and China. International equity markets significantly lagged their U.S. counterparts throughout the year as future growth expectations weakened across most emerging and developed economies. A stronger U.S. dollar and geopolitical risks including newly imposed trade tariffs, and uncertainty over the U.K's decision to leave the EU were cited as primary factors contributing to the slowdown. Developed non-U.S. equity markets, as measured by the MSCI EAFE Index, lost 13.8% in 2018, while emerging markets, as measured by the MSCI EM Index, lost 14.6%.*
>
> *Jerome Powell assumed the role of Chairman of the Federal Open Market Committee ("FOMC") in February 2018, sharing a favorable assessment of the economy with the prior Chair. Through the first three quarters of the year, continued*

improvement in U.S. economic fundamentals resulted in the FOMC raising the federal funds three times, from a range of 1.25%-1.50% to 2.00%-2.25%. Despite economic and corporate earnings data suggesting a slowdown in U.S. growth, the FOMC voted to raise U.S. interest rates for a fourth time in 2018 at the December meeting, bringing the target range to 2.25%-2.50% by year-end.

The European Central Bank ("ECB") projected slowing economic growth from 2.5% in 2017 to 1.7% by 2020. Despite signs of slowing growth in Europe, the ECB maintained guidance that it would continue to reduce the pace of asset purchases and likely end its quantitative easing program by 2019. Collectively, global central banks continue to pivot away from the use of extraordinary measures to stimulate economic activity.

Interest rate hikes provided strong headwinds for the U.S. bond market during the calendar year as the Bloomberg U.S. Aggregate Bond Index returned 0.01%. Internationally, the strengthening of the U.S. dollar, turmoil in Turkey and Argentina, and escalating trade wars in the final months of the year negatively impacted international markets, as the Bloomberg Global Aggregate Index lost 1.2%. The price of oil plummeted from $73 a barrel to $45 a barrel during the fourth quarter, leading the Bloomberg Commodity Index to return -11.2%. While private real estate assets measured by the NCREIF ODCE Index (Gross) returned 8.3% in 2018, public US REITs as measured by the Wilshire U.S. REIT Index returned -4.6%, driven by a sharp selloff in the fourth quarter.

The MOA Trust posted a total return of -4.49% in calendar year 2018, while modestly outperforming its target policy index by 0.43%. The policy index consists of market indices weighted in the same proportion as the Trust's long-term asset allocation policy. While the Trust's longer term 5 year performance slightly underperformed the target policy index by -0.19%, extended 7- and 10-year periods ended December 31, 2018, exceeded the policy index by 0.31% and 0.75% on average per year, respectively.

The Trust's outperformance versus the target policy index during 2018 was primarily due to active management in US equity, fixed income, and emerging markets. In the US equity portfolio, large cap funds were relatively flat to their respective indices, while the Blackrock Small Cap Core fund outperformed its index by 2.18%. Marginal value was also added due to US core fixed income outperforming emerging markets debt during the first half of the year and their relative weightings during that time. As reported for 2017, The Trust continues to exceed its long term return objective of inflation plus 4.25%. Relative to other similar institutional investors, the Trust significantly outperformed its peers in the extended 7- and 10-year periods, ranking in the 21st, and 16th percentiles.

In summary, we believe the Trust remains well diversified and is structured to provide an appropriate long-term real return given the risk/return profile defined by the strategic asset allocation target. The Trust's balance between return-seeking, *income-producing, and preservation type assets constitutes a sound and balanced investment approach that is expected to produce competitive investment returns.*

Inflation Proofing

In April 2002, Anchorage voters approved by a 70% affirmative vote a new endowment approach to be followed by the Trust, similar to the Percent of Market Value (POMV) approach endorsed by the Alaska Permanent Fund Board. The endowment approach adopted by voters limits the amount of annual dividend distribution from the Trust to no more than 5% of the average market value of the Trust. In response to the severe 2008 market downturn the Assembly approved AO 2009-3, revising the annual dividend cap to a lower rate of 4.00%; this was subsequently adjusted to 4.25% per AO 2016-127. The current adjusted payout limit is intended to keep pace with real return assumptions (i.e., long-term expected return, "net" of long-term expected inflation) and to help rebuild the inflation-proofed corpus of the Trust.

AMC 6.50.060L states: *By March 15, 2007, and by the same date every fifth year thereafter, the municipal treasurer shall review the controlled spending policy and recommend adjustments, as necessary, to maintain the long-term purchasing power of the MOA Trust Fund.*

The first scheduled analysis of inflation proofing for the Trust occurred in 2007 and found the Trust to be in compliance at that time with inflation-proofing expectations. An updated analysis of the Trust's inflation-proofing status in April 2018 initially showed the Trust making substantial recovery in re-establishing full inflation-proofed status due to the strong market performance experienced in 2017 and early 2018; this analysis however was offset by the sharp decline in the markets that occurred late in 2018. A further update done in April 2019 projects that the Trust could be fully recovered within seven years (not counting the positive impact of anticipated ML&P sale proceeds). For the ten-year period ended December 31, 2018, the Trust generated a 8.89% nominal return and a real rate of return after inflation-proofing of 7.02% (CPI return of 1.87%) which was above the 4.0/4.25% payout rate used during the same time period.

Annual Dividend

Using the revised 4.25% endowment maximum payout formula authorized under Municipal Code, the 2019 dividend payout is expected to be $6.5 million, or $200,000 more than the 2018 dividend. With the sale of ML&P expected to be closed in early 2020, the annual dividend payout methodology is expected to be revised in Municipal Code and the amount of the annual dividend is expected to rise significantly by several million dollars.

In years where excess returns are generated (i.e., over and above a 4.25% real rate of return) these retained excess returns help to re-establish an inflation-proofed Trust so that the purchasing power can be restored and/or protected over the long-term. Accumulated excess returns also help offset down years in the market.

Investment Management

At December 31, 2018, the Trust employed ten money managers – i.e., Fidelity Institutional Asset Management, Garcia Hamilton & Associates, Western Asset Management, Ashmore, BlueBay Asset Management, Vanguard, BlackRock, Capital

Group, Franklin Templeton and UBS Realty Investors. In 2018, the Trust continued to use RVK as its investment consultant and Wells Fargo Institutional Trust Services as its custodial bank.

The Trust's target asset allocation at December 31, 2018, per the current Investment Policy Statement (IPS), was 24% fixed income; 3% floating rate short duration debt; 5% emerging market debt; 35% domestic equity; 25% international equity; and 8% direct real estate.

In 2019, additional manager and asset allocation changes will be formally considered to prepare for the receipt of ML&P sales proceeds which significantly increase the asset value of the Trust.

In 2019, the Finance Department along with the new investment consultant and Investment Advisory Commission (IAC) intend to focus on the following areas:

(1) Preparing a plan to invest newly received proceeds from ML&P sale after closing;

(2) Formally considering changes to asset allocation, risk levels and expected return, investment policy, money manager lineup, annual dividend payout policy and potential incorporation of further diversified, alternative investment strategies in light of significant new deposit expected from the sale of ML&P sale; and

(3) Receiving special presentations from specific money managers in the current lineup.

Monitoring of Investment Fund Activities

The performance of the Trust is continuously monitored to ensure compliance with the Investment Policy Statement and to track performance:

- The Trust's investment consultant issues a quarterly report focused on the performance of each of the Trust's money managers and frequently communicates with the Municipal Treasurer regarding investment-related issues as they arise throughout the course of the year.
- The Municipal Treasurer, Chief Fiscal Officer and Investment Advisory Commission meet quarterly to review Fund results.

Current Year Market Conditions

Year-to-Date (YTD) through First Quarter 2019, Large Cap domestic equities as measured by the S&P 500 index returned 13.65%; broad international equities as measured by the MSCI All Country World Ex-U.S. index returned 10.31%; and domestic investment grade fixed income as measured by the Bloomberg U.S. Aggregate Bond index returned 2.94 %.

Through April 2019 Large Cap domestic equities experienced YTD return of 18.25%. During this same time period, domestic investment grade fixed income returned 2.97%, while broad international equities returned 13.22%. The market value of the Trust as of

May 20, 2019 was approximately $159.5 million, which reflected approximately an 8.0% YTD return after adjusting for cash flow effects.

Market and economic conditions change frequently and results can vary dramatically, positively or negatively, from one period to the next. A long-term view and adherence to investment principles and guidelines are necessary to help ensure the Trust meets its long-term objectives of:

- Maintaining the purchasing power of the Trust; and
- Maximizing rates of return over time without taking undue risk.

Additional information

For additional information about the MOA Trust Fund or the endowment model please visit the Trust's website at www.muni.org/moatrust for RVK's December 31, 2018 performance report as well as executive summary charts and graphs for Fourth Quarter 2018 which were prepared by the Treasury Division. Comparable performance reports for the most recent quarter end (March 31, 2019) have also been posted to the website.

Prepared by: Daniel Moore, Municipal Treasurer
Concurrence: Alexander Slivka, CFO
Concurrence: William D. Falsey, Municipal Manager
Respectfully submitted: Ethan A. Berkowitz, Mayor