

Investment Practices and Performance Evaluation of the Amarillo Firemen's Relief and Retirement Fund

Performed by the Alpha Consulting Group of Wells Fargo Advisors

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Disclosure

This evaluation is being prepared by the Alpha Consulting Group of Wells Fargo Advisors (Alpha). Alpha has served as the Investment Consultant for the Amarillo Firemen's Relief and Retirement Fund (AFRRF) for over 30 years. Wells Fargo, including any related entities, does not manage any of the investments of the AFRRF nor does Alpha have sole responsibility for selecting or terminating investment managers. The only remuneration received by Wells Fargo from AFRRF is the asset based fee stated in the Investment Consulting contract.

1) Investment Policy

The Amarillo Firemen's Relief and Retirement Fund (AFFRF) has a written Statement of Investment Policy (Policy). The Policy is to be reviewed at least annually for its appropriateness. Roles and Responsibilities are covered for the Board of Trustees (Board), Investment Managers, Custodian and Investment Consultant. The Policy does not take into consideration the current funded status but it does include the contribution amounts for the City and the participants. The Policy follows industry best practices but it does not include language about fees.

In the Policy, AFFRF is to meet three of their four Investment Goals over time (not less than three years). They have been successful in reaching those goals therefore achieved their Investment Objectives of Preservation of Capital and Long-Term Growth of Capital.

AFFRF has been able to weather the shocks to the markets over the last 30 years well. While there may be short-term (less than three years) periods where the investment managers will not be able to meet the Investment Goals, over the longer-term (greater than three years) they should. The Board reviews their expected return and asset allocation every year or so. The most recent asset allocation study was produced by the Investment Consultants in September of 2019.

2) Investment Asset Allocation

a. Asset Allocation Process

The Investment Policy Statement covers the strategic asset allocation. The asset allocation is reviewed every year or so to ensure the allocation is in line with the expected return. Also, the Board looks at additional asset classes to be included in the portfolio. The Board engaged the Investment Consultant to do a Risk Posture Assessment in February of 2019 to marry their appetite for risk with their ability to take risk. Additional asset classes have been reviewed in this process such as domestic small cap and international equities. Those asset classes have been added to the portfolio but the Board has chosen not to add Alternative Investments.

The asset allocation is crafted to achieve the expected rate of return in the most efficient way possible using the asset classes approved by the Board. The Investment Consultants work with the Actuary to make sure the expected return is reasonable given the current market conditions.

The Plan does use a tactical allocation for the equity allocation. That allocation is monitored by the Investment Consultant.

AFFRF's asset allocation differs from other Plans of their size because they do not use Alternative Investments.

b. Expected Risk and Return

The strategic allocation is 70% in equities and 30% in fixed income and cash with a maximum allocation to equities of 75%. This is monitored each month. The tactical allocation is 4.8% in international small caps with the remainder of the equity allocation is to be invested in domestic equities.

The Asset Allocation Study reviewed in September 2019 included the expected return and risk (standard deviation) of the following:

Asset Class	Expected Return	Standard Deviation
US Large Cap	8.6%	16.0
US Mid Cap	9.6%	17.0
US Small Cap	10.3%	20.0
Int'l. Developed Small Eq.	9.7%	20.0
Intermediate-term Taxable	3.6%	3.8
Cash	2.2%	1.0

The Capital Market Assumptions listed above are for a 10 to 15 year time horizon and are derived by the Wells Fargo Investment Institute. The mix of assets necessary to achieve an expected return of 7.5% based on the Wells Fargo assumptions is 44.3% US Large Cap, 15.1% US Mid Cap, 7.5% US Small Cap, 4.8% International Developed Small Cap, 25.3% Intermediate-term Taxable Bond and 3% to Cash.

AFRRF has historically only used active managers. They have incorporated passive management to their portfolio but a majority of their portfolio is actively managed. While this may be different from other retirement systems, their managers have been successful in beating their underlying indexes.

c. Alternative Investments

AFRRF does not use any alternative or illiquid investments at this time nor are they currently considering their addition.

d. Future Cash Flow and Liquidity Needs

In the Risk Posture Assessment presented to the Board in February of 2019, future cash needs were part of the process to determine the equity allocation that would be appropriate for the Plan.

3) Investment Fees and Commissions

The Policy does not specifically address the monitoring of investment fees but AFRRF does engage Abel Noser to provide an analysis of the commissions paid. The Plan has reviewed the cost of the investment managers and other service providers such as the Investment Consultant, Custodian and Legal Advisors.

4) Governance Processes Related to Investment Activities

The Board does not have a stand-alone governance policy but the Board does follow the recommendations of the Pension Review Board (PBR) and the Texas Local Firefighter Retirement Act. The Board is made up of three firefighter representatives, the Mayor, a city employee (usually an assistant City Manager or Chief Financial Officer) and two civilian members. They recruit members who have an understanding of investing or financial background. The civilian members of the Board include bankers, financial advisors and former City employees with specific pension experience. Board members must meet the minimum educational requirements set forth by the PBR, which includes fiduciary training so the members understand their personal liability.

Board meetings are held monthly on the third Wednesday of the month at 10:00 a.m. Agendas and prior meeting minutes are available to the public on the City's website. The meeting minutes have a sufficient amount of detail. Each month the Board approves an Investment Resolution which includes all investment transactions from the prior month. They also review a summary of revenues and expenses. All payments are approved by the Board. The Investment Consultants provide quarterly performance reviews of the external investment managers retained by the Plan. The Board meets annually with Abel Noser who reviews the commissions paid by the investment managers. The active investment managers meet with the Board annually.

All of the AFRRF's assets are held at Frost Bank or SEI. The Investment Consultant is paid an asset based fee and does not receive any soft dollars. The investment managers used by the Plan are independent of the Board or any of the Plan's service providers.

5) Investment Manager Selection and Monitoring Process

The Board in consultation with the Investment Consultant is responsible for selecting and retaining investment managers. When an additional asset class is approved or an investment manager is under-performing, the Investment Consultant will present to the Board investment managers that are recommended by their Global Manager Research (GMR) analysts. GMR analyzes investment managers using qualitative and quantitative data that looks at the Firm, Investment Personnel, Investment Philosophy & Process and Product Performance & Viability. These four foundational components are broken down into 13 major components and 75 sub-sectors.

When the Board is comparing multiple managers, emphasis is placed on managers with attractive risk-adjusted returns, who protect assets in down-markets and have consistent returns. Conflicts of interest for both investment managers and Board members are considered when evaluating managers.

The Investment Consultant provides a quarterly performance review. In the review, overall Plan level performance as well as individual investment manager performance is covered. Risk metrics are also included using standard deviation, beta and Sharpe ratio. The Plan and each manager is compared to their own specific benchmark and universe. The current benchmark for the total Plan performance is 65.2% Russell 3000 Index, 4.8% MSCI ACWI ex US Small Cap, 28% Bloomberg Barclays US Aggregate Index and 2% 91 Day T-Bill Index. Each manager is evaluated against their respective index.

Luther King: 70% S&P 500, 28% Bloomberg Barclays and 2% FTSE T-Bill 3 Months (benchmark) and All U.S. Balanced (universe)

Kayne Anderson Rudnick Small Cap Core: Russell 2000 (benchmark) and U.S. Small Cap Core Equity (universe)

Vanguard Small Cap Index: CRSP US Small Cap (benchmark) and U.S. Small Cap Core Equity (universe)

Kayne Anderson Rudnick Small Cap International: MSCI ACWI ex US Small Cap (benchmark) and ACWI ex US Small Cap Equity (universe)

The performance is reviewed gross-of-fee since the benchmark indexes do not include an investment cost.

Investment managers will be reviewed for replacement when there is a meaningful change to the primary portfolio management team, sustained under-performance, a change in expenses which the Board deems to be unacceptable, an increase in risk in the portfolio or for any other reason the Board feels making a change would be in the best interest of the participants and the beneficiaries.

Recommendations

It is recommended that language is added to the Statement of Investment Policy regarding the evaluation of Plan expenses. Language should also be added to address that investments into mutual funds, exchange-traded funds or comingled investment trusts that may not follow the investment stipulations of the Statement of Investment Policy.