SOUTH CENTRAL CONNECTICUT REGIONAL WATER AUTHORITY

PENSION & BENEFIT COMMITTEE

JANUARY 23, 2025

MEETING TRANSCRIPTION

[PENSION & BENEFIT COMMITTEE MEETING BEGINS AT 12:31 P.M.]

David:

Thank you. Heard that. All right then we are now in your committee, our Pension and Benefit. Thank you. [inaudible 00:02:24].

Catherine:

Good afternoon everybody. First, well let me just check. Is Morgan Stanley on? Okay, great.

Stephen:

Steve is here.

Catherine:

Thank you. The first order of business is the approval of the minutes from the October 24th meeting, a regular meeting of the Pension and Benefit Committee.

Mario:

So moved.

David:

Second.

Catherine:

It's been moved and seconded to approve the minutes of the meeting. Are there any comments? Okay. All in favor?

Committee members:

Aye.

Catherine:

I would say an aye.

Catherine:

Opposed? Minutes are approved. I'm going to now turn the meeting over for the presentation from Steve and his team.

Stephen:

Thank you, Catherine, and a happy, healthy 2025 to all. I think we would be remiss in beginning without pausing for a moment and appreciating both what you've all been through and Larry's work with us in this committee over the years. We haven't seen you since we found out that he had passed away. We obviously respected Larry in an enormous manner and felt he added huge gravitas to everything, at least we saw, that you do for your people. So sincere condolences to all of you and your organization on that front and I think it's a loss for all of us who dealt with him. There's no doubt.

Catherine:

Thank you very much. We wholeheartedly agree with his sentiments.

Stephen:

Yeah, it's sad. I pause myself almost. What a great guy and what... I use the word gravitas again; I just felt his depth and heft when he made a comment. So, at any rate, that being said, our business at hand here is to move forward and this is the regular report on the pensions and the VEBA. Unless anyone disagrees, we're going to start with a little market commentary. What went on last year, what we see looking forward. I think we're pretty brief today on the asset allocation investment matrices. We're not looking at the asset liability mix today. I might refer to it, but we're not going into that level of detail on anything today. We don't have any extra items today unless anyone has any to add. No? Okay.

So please, obviously as usual, add them as we go, as you think of them. So, what happened in the market last year? Obviously, the S&P continued to climb. Interesting enough, it ended the year at 21.5 times earnings again. I think that's the same number it was at about a year ago now. And if you look in the box in the upper left, in January of '22, it was 21.4 times earnings. So, it's kind of interesting, '22 was a big down market in the market. '23 and '24 were strong up markets. Yet the market's still roughly the same valuation. How is that possible?

It's obviously possible when you go down and back up you would expect to be at the same valuation. But then the climb that we've had in '23 and '24 really has been earnings driven. So earnings have grown and ultimately they've grown to the point where the valuation of the market hasn't budged. Meaning it's 21.5 times earnings a year ago, two years ago, three years ago. Kind of interesting. And we're like broken records on this. Is that expensive based on history? It's on the high end. Yet if earnings keep growing at that pace, maybe it can hold there, right? You'd think that rising interest rates would hurt it, it hasn't. You'd think things that happened through the election would hurt it before, during and after might hurt it. It hasn't. Non-political comment, I have to throw that in there.

But it's still holding this strong value. That value is extraordinary. You can jump to the next slide. That value is still extraordinarily heavily and unusually influenced by seven companies. The top seven companies in the S&P, all being tech companies, which are great companies. Their earnings growth... This slide's a little confusing, I'll refer to it but probably not go too specific. I'm going to use the bottom right. The earnings of those seven tech companies like Nvidia and Google and Microsoft, et cetera. Their revenue growth since... They really had a very rough run, like Tesla for example lost half of its value as did others, during '22. But since then, they've been on a run.

And that run is unprecedented in how narrow it's been. Seven names making up the vast majority of the returns from the whole 500 names. We're seeing some changes there as we look forward. If you look in the bottom right, the gray bars are large cap, which those would be included in but much broader. The green are mid and the blue are small. Look what starts to happen. Because the earnings growth of those

companies were so vast, like 50-some-odd percent from '22 to '23, then 30-some-odd percent last year. Forecasted to be more like 16% this year or so. So the earnings growth of those companies we expect to be abating, because obviously it's coming off of '22, they were huge.

But what ideally you'd see now, and what we suspect you will see now, in the bottom right, look at the blue bars. Small caps which have had negative earnings growth over the last year, they're forecasted by Wall Street... This isn't us; this is the Wall Street consensus. The growth should start to come from the medium and small companies in earnings and revenue, and still be strong from large caps but not be the comps of 50 and 36% and then 16 that we've seen, but likely to be something more sober, if you will.

So hopefully what will happen is we could have a market correction. We're definitely due for one. But we're hoping that we will see a handoff from the leadership we've had. Not that those companies are going anywhere or going bad, but that their earnings comparisons are going to be... They're much more difficult than they were two years ago. So we're believing that we will see what we see in the bottom right here, which is growth coming from other parts of the market. Which would be healthy. Frankly, a broadening would be very healthy. This is an extraordinarily narrow market.

Could jump ahead, please. You actually see by the end of last year that 36% of the entire value of the S&P is in seven companies. Or 10, sorry, that's 10. But that's the historic high. Is this unusual, what we've been seeing? Where growth stocks or tech, really seven tech names, have been leading and everything else has been lagging. It's not unusual. As a matter of fact, this slide I think lays it out quite nicely for the long term even. There's a horizontal line, when dark blue is above the horizontal line like it is in the far right, we're in an era where growth stocks are outperforming dividend paying or value stocks. When it's light blue, as it was prior to '22 inclusive, you see that the dividend yielding, or value names are outperforming.

And look at history. In history, what we're seeing is normal. The only abnormal thing we're seeing is the concentration, not the fact growth is outperforming value that runs, as you can see, it runs in cycles, historically. What we're seeing currently doesn't even look like that big or long of a spike there. But what it is, is it's extraordinarily and historically narrow. So that worries us a little bit. We like to see broad participation. You're seeing signs of broad participation returning over the last two quarters, I would say, but nothing consistent. Year to date you're seeing the average stock outperforming by quite a bit versus the index, but we're 23 days into the new year, so that's not exactly a trend.

So this does ebb and flow over time and it's probably due to do that or at least broaden out at a minimum. And these are great companies, don't take it wrong, but it's an interestingly narrow market that we've been in. If we could jump ahead, please. Bond market. So what happened? The Fed lowered rates 100 basis points since they started late last year. They've gone down a full 100 basis points yet the bond market only made 1% last year, far right. Each gray bar is a calendar year. 6% the year before, that was after the two down years.

What's going on? What went on is, although the Fed lowered rates at the short end, and I think we have a slide right after this if you want to jump ahead. The Fed lowered rates on the short end, but actually the long rates went up a full point. So it's pretty interesting that if you look at where we are on January 14th and have come down a bit, that dark blue line. You almost have a normal yield curve, right? You've got shorter rates lower, longer rates higher, generally speaking. And it's almost back to normal as opposed to inverted where it was last July. Or a July and a half ago.

What you still see odd, and it's not that odd anymore, is that short end. You see the little check market on the left side there, the three months to one year looks like it still needs to finish coming down. What the market's telling us is the Fed needs to cut rates one or two more times, 25 basis points each, and

then the curve would be normal. We went back to an upwardly sloping curve that we haven't seen since early '22 when inflation arrived. And that's a normal curve. A healthy economy typically has an up, shorter rates are lower, longer rates are higher.

But what's happened since we last met, the whole curve went up. Quite a bit. It went up. So rates went higher except on the short end. So, as you probably mostly know, mortgage rates are higher than they were when we last spoke. They're higher than they were the time before, even though the Fed has cut rates a full 100 basis points. Because the markets are still concerned. They're concerned about two things, I think. They're concerned about inflation not being fully tame yet, and it's not. You can't declare victory yet, I would say on inflation, but we've made huge progress, A. B, we've also been borrowing an enormous amount of money, trillions of dollars since Covid began, and we really haven't slowed down since Covid more or less ended. Or the crisis part of it ended clearly.

And the buyers of bonds are demanding higher rates at the moment. So you see here the 10 years is at 4.8%. And the curve we're at today looks like the curve... Believe it or not it looks like, last time we saw a curve that looked like this, it was June of '07. It was before the global financial crisis occurred, before Covid occurred and rates have been unusually low since then. And I would argue, I don't know if this will be true or not, but it almost looks like we're back to normal interest rates historically as opposed to super low or super high.

Whether that holds or not, it's not a prediction, but if you overlaid a chart here from '07, pre-financial crisis. Because rates went really low during the financial crisis to bail things out and stayed low for a long time to get things bailed out. And then when they were starting to return to normal, Covid came and they went low again. We've bounced back up over the last six months. So what does that do going forward? And we could jump ahead.

What that says going forward is, geez, you've got 4.6 to 4.8% on a ten-year treasury. You've got mortgages at 7%. It says the opportunity set for bonds going forward is real. It's more real than it's been since we first met. You've got actual real yields, most of them above five, many of them into the sixes or higher, that the bond portion of your portfolio that's been a drag almost since we've met should be very much participatory going forward. Whether that starts tomorrow or starts in six months or 18 months. I'm not trying to predict that. But we do know if we buy a bond today, especially a corporate bond or a mortgage-backed bond, we're going to get 5, 6% plus.

And what we know going backwards is that those have returned more like 1, 2% with rates at 0 for so long. And then having to get through the push to higher rates actually caused a negative in '22. So very interesting I think. The opportunity set on this side of the equation is better than it's been since we met. We could jump ahead please. What do the Fed think is going to happen? So, if you look at the far right here, the market expects the Fed to get to just under 4%. Not much further. That would be one to two rate cuts, period.

The Fed still thinks themselves that they'll likely get a little lower over time, probably closer to 3, 3.5%. But the market's not agreeing right now. The Fed might be behind the market at the moment, but the thinking is yes, another rate cut this year, maybe two, not more than two. So that should create some nice stability in the bond market, one would expect. But we have a lot of things going on out there as we all know. If we're going to worry about anything, I know a lot of folks are worried about tariffs. We are as well. We're worried if they come in too quickly what impact they have. Too quickly or too big, what impact would they have on the market? Hard to know, if that even happens.

The other thing that I'm more personally worried about is the government spending is very high as a percentage of GDP. The borrowing is very high. We know there's movement under the new

administration to cut government spending. And my fear is not the cutting so much, but if we do it too quickly, do we create a recession? Do we create unemployment? Do we create an economic slowdown? Do we create an earnings slowdown? Hard to know. In a perfect world if that cutting occurs, the private sector would simultaneously pick it up. So, it's going to be an interesting economic scenario to watch.

I could go on and on with others I'm sure, but we'll keep moving here. This all affects the portfolio, right? It affects the portfolio because it affects... Your starting point is stocks at 21.5 times earnings. Historically, that wouldn't be a super attractive entry point. Bonds are having a higher yield than they've seen since '07 or as high as it's been since '07. That historically would be a great entry point. So we'll see what happens, but it's very interesting. Makes sense? Questions, comments? Take a breath.

I failed to mention this at the beginning and in case I forget at the end, Alan Kantapin is here with us today and this will be, very sadly on our end at least, Alan's last meeting with you. Alan is moving out of the country even, and Alan is starting a new venture with his wife, and he's been with us 18 years and I just wanted to also acknowledge his contribution to this effort on the behalf of Connecticut Water and to our team for the last 18 years. So thank you, Alan.

Catherine:

Thank you.

Suzanne:

Thank you.

Alan:

Thank you, thank you all.

Stephen:

Alan's been deeply involved in your accounts and transactions, et cetera over the years. So let's jump into those. The salary and union plans. So today in the box, the pie chart tells the story, but the box in the upper right I think tells it a little easier to read so you don't have to have your calculators out and add up those little boxes.

The salary and union plans are basically 58% in equity, 78,155,000 upper center. These are all December 31st numbers. The equity exposure is 3/4 domestic and 1/4 non-domestic. By the way, the international markets are about as cheap as they've ever been on an earnings basis. And if you look at the bottom right, the portfolios for stability purposes, the portfolios are more weighted in value or dividend yielding securities, something we talked about over the years. And less in growth securities. So in a market where growth goes straight up with seven names, you don't go up quite as much. But still good participation.

And likewise, like you saw in '22 when they go down, they don't go down quite as much. So we talked the last time, and I won't go there today unless someone pulls me there, and I'm not asking for that. But we talked about the fact that, as these pensions mature both in funded status and in age of population, more importantly, that the statistics are telling us that at some point, it's not mandatory by any means, but it would tell us that the equity exposure should probably be peaking at this level and going down a bit over time. As the liability stream is growing each year. As you have more pensioners as the years go by.

So just a thought to keep in mind. We said the last time we'd addressed it again next year, but it's in my mind that as we approach 60%, the statistics were telling us, Alan could probably tell us, but it's closer to the 50% range that it's starting to look like 50, 55 depending on the pool of money. Just from an asset liability perspective. We're jumping ahead. Where are we over- and under-weighted at the moment? We are over-weighted in US stocks a little bit. Russell 3000, almost two points under-weighted internationally. This is just versus the benchmark.

We are over-weighted in bonds domestically because we have no exposure still globally in bonds. That's the minus three. We have very little exposure to alternative assets. So that's the other minus three and a half. We're light in exposure to real estate globally and we are light in cash. So a little overweight to equities and some overweight to bonds. Not all of those long-term by any means.

The VEBA looks similar. 10,430,000, upper center. I won't read you all the statistics, but basically 58% in equity and those exposures are relatively similar to what we just saw. The over- and under-weights on the next page are also relatively similar to what we just saw. A little bit more overweight in domestic equities, a little less underweight in bonds. But overall, the same thesis. How are the recent results and then the long-term results? The fourth quarter was a little bit difficult in certain areas. It was a volatile quarter.

The pools of money here are in the upper left. Salary plan, union plan, VEBA. And then the matrixed trust accounts. So, the payee accounts if you will, where the money deposits and withdraws from to make pension payments. Your total in all of those accounts, 90 days earlier, September 30th, it was 90,771,486. You had net deposits into the matrix accounts of 12,293 during that timeframe. And transfers between us and matrix were slight during that timeframe and they equal zero. That's just money moving within the corpus, if you will.

Thus, your net invested is almost the same number, 90,783,000. 89,209,000 on December 31st. So, there was a loss of 1.75% net, 1.66 gross during the quarter. That obviously does not... The actuaries never account for a down quarter, but the actuaries need 1.69 for that quarter. So that didn't do that for the quarter. The benchmarks say we would've expected it to come in between 1.18 and 3.07 for the quarter. Those are the midpoints.

And obviously we're just about dead center of those, right? Where was the weakness in the quarter? It wasn't US as much. The average stock was down 1.87 even though the market cap weighted S&P was up 2.41. But more importantly, the international exposure down 7.60, 8.11, 8.11. And the bond market with rates rising, despite the fact the feds were cutting rates, the bond market was down 3.06 for the quarter.

So, the bond market had quite a dramatic impact during the quarter. We're underweight in real estate, but real estate was down 9.48 for the quarter as rates went up. If we jump ahead, it looks a little nicer as we go further out. Your fiscal year. So, this was June 1 to December 31, so this is seven months. So again, tell me if you want me to read the numbers, but you can read left to right. The 85,500,000, 759,000,000 net has gone out from Matrix Trust. 23,000 net transferred in.

Your investment corpus from June 1st, if you will. 84,813,000. Same ending value. So, you're up about 4.4 million for the fiscal year so far, which is 5.22 net and 5.43 gross. The actuaries need 3.94 for that timeframe. So from an actuarial perspective, which is the singular most important number, looking good for that perspective. Benchmark markets 5.43 gross. We benchmark it to 6.54 and 4.30. It's in the midpoint there, not surprising given the divergences in the market still.

We got out a little longer. And we look at the calendar year. Calendar year, the fund paid out... I think the important numbers are the fund paid out a net 1,110,000. That's net of deposits. So that's the point

where I'm talking about where contributions come in, pension payments go out, and the pension payments have been outstripping the contributions coming in. Thankfully in a year like last year, the corpus grew, third column from the right, by 8,172,000 or just over 10% net and 10.50 gross. That obviously, the actuaries are looking for 6.75. So the actuaries will be happy with that result. And interest rates rose last year. So that typically helps the actuary calculations as well. Even though short rates went down, the bond market rates went up.

And there you see big divergences in the midpoints. 10.76 would've been for all market cap weighted. 7.23 would've been for all in the average stock. So we're closer to the high end of that range. It's on the higher end of what I personally would have expected knowing the value orientation of a portfolio in that timeframe. But that's good news. You go out to, I think we have three years. Three years has still got 2022 in it. Stock market was down 18%, bond market was down 13. So still distressed here from an actuary perspective.

Same theme, not a lot. So, the theme here is the $1,070,000 went out in net. Dollar gain is 6,273,000. So corpus grew net of distributions and contributions, but only 2.49 net and 2.86 gross. So you're not meeting the actuary return over the three year time period. No surprise given that you had '22 in there. But the benchmarking from a gross perspective, which is how we do the benchmarks, gross to gross, year above. Both midpoints there, which were 2.70 and 1.20. Now you start to see that heal when you add some time to it and we go to five years. We got out to five years, and you see the healing begin. There was 69,000,000 five years ago. Still over the last five years, a net withdrawal from the corpus, 2,829,000. A dollar gain though over five years of 22,151,000. 5.82% net and 6.20 gross.

So there you're not quite at what the actuaries need, but you're getting a lot closer again. And your midpoints are 6.54 and 5.24. Basically again, near the higher end of those two, which is actually a little better than I would expect given the divergence of the market. But if you notice, the divergence of the market, I'm going to go to the bottom right, starts to mitigate and become more normal. You've got the SMP up 14.5, you've got the average stock up almost 11, 10.76. Narrowing. And it narrows and narrows when you go out longer. We go out to... What do we have next? Eight years? I think I took seven years out because we have so many time frames. Tell me if you want it back, but I said let's start pushing them out.

This is interesting I think. Because you look at eight years. Eight years ago, the corpus of all of the funds had 48,000,754. Third column from the left, total. Over eight years you've had net deposits in, so net of any pension payments or benefit payments, of 3,111,000. So that's the first time we've seen net deposits in. So, your net invested is the 51,865,000. The 89,209,000 is the ending value of the same. So, 37,344,000 has been made over eight years. And over eight years, it's 7.03 net and 7.42 gross. And indeed, as you get to longer term, as we saw at the last meeting too, you are absolutely meeting the actuary rates of return, which were 7% in the beginning of our history with you. And they were lowered to 6.75 at one point. So today the goal is 6.75, but longer term it was 7. So, I'd say somewhere in between is what we're looking for. Call it right around the center of those two. And you netted 7.03.

Benchmarking, again, you're benchmarking almost to the higher midpoint at 7.59, not quite at it. 6.43 and you see the equal weight in the average stock evening out there. But what you still see the drag over this timeframe, it's very interesting. If you look towards the bottom right, you see the Bloomberg aggregate, that's the bond benchmark. Up only 1.29 because rates were 0, COVID happened and then we had rates go way up. That's what we don't think will repeat. We think a normalized stock market would make 8 to 10% a year. So that's been a little high. But a normalized bond market would make 4 to 6 at least.

So, we think that looking forward, we think it's highly likely that we have a normalized bond market that makes even 6% going forward. That alone would make a massive delta. And if stocks stayed equal and the bonds came alive, you would actually be vastly outperforming the actuaries. But what we think is stocks will likely, not to overuse the word, but stocks will likely sober up on the returns, broaden out and sober up, which would probably be both good things. But the bond market will normalize. So, we still think that the rate of return is totally achievable. Even if stocks soften a bit because bonds are going to pick up the weight that they have not been able to pick up.

And then we go out to, since inception. What's interesting, this is exactly nine years since we began. So by the end of this year, assuming you keep us where we are, we'll have our 10th year anniversary. But so when we first started back in December of '15, there was 41,761,000. You've made, again, the net deposits broke early in the life, at least that we're aware of, for nine years. There were more net deposits going in. And then later are the withdrawals have grown over time, obviously, as the population has aged on average.

So, 7,325,000 in deposits over that time, your net invested is 49,000,000. We know that the 89,000,000 is a current value. So, there's just over a $40 million gain over those nine years. 6.94 net and then 7.34 gross. The actuary is probably about 6.85, when they blend those two rates of return together. So absolutely making the goals that set out for nine years ago. Nine years and 23 days I guess right now. And from a market perspective, again, up closer to the higher midpoint. But note how the midpoints got closer and closer together as we go out. 7.52 is 6.59 now because the average stock has made 11.74 a year over those nine years, where the S&P still way ahead from recency bias at 14.49.

But that gap closes as you keep going out further. If we had 15 years, 20 years, it closes completely. Your bond market during that timeframe. Still pretty soft, right? 1.44 and 1.78. The bond benchmarks in the bottom right there. And again, not to over repeat myself, but that's what we factually know if we hold bonds, that they're going to earn more than that because they're yielding a lot more than that now. And that is where I personally, and the firm thinks, you're going to get power from that going forward where we think there'll be a little less power, a little less propulsion from the equity market. And a little more propulsion from the bond market as we move forward in time.

What is on the next page? I'm now not sure. Yeah, that's why. There's an appendix with excruciating detail. I think we did that pretty quick because we didn't, not purposely, but we didn't really have any side topics today, if you will. Unless you have any for us.

Catherine:

Any questions from the members? Suzanne, did you have any questions?

Suzanne:

No, thank you.

Stephen:

No? Thank you all. So I guess I'll end with, out there somewhere on the horizon are the pension payments. Some of them are more near-term than longer out, so I'm just replanting that thought, as you know. That's my final thought.

Catherine:

These are definitely things we need to think about and keep in mind. So keep reminding us and we'll remind you as well.

Stephen:

All right, that sounds fair.

Catherine:

And again, thank you Alan and best of luck to you going forward.

Alan:

Thank you very much.

Catherine:

Thank you, Alan.

Catherine:

Thanks.

Stephen:

And again Godspeed to Larry again.

David:

Thank you.

Stephen:

Thank you all. Please reach out in the meantime between meetings if you have any additional concerns or questions.

Catherine:

We'll take you up on that.

Stephen:

Stay warm.

Catherine:

Thank you.

Stephen:

Bye-bye.

Catherine:

That would conclude the matters for the Pension and Benefit Committee, unless there are other issues you wanted to raise. All right, so...

Kevin:

I move that we adjourn as the Pension and Benefit and reconvene as the Authority, I'll move that if you'd like.

Suzanne:

Actually, I just have a question. Can you guys not hear me?

Catherine:

We can hear you now.

Suzanne:

Oh, okay. Sorry. I have a question before we leave the Committee. Did we leave it already?

Catherine:

No.

Suzanne:

Okay. So my question is, when are we going to follow up with our process of RFP, whatever process we were going to use for our financial services?

Rochelle:

We actually do have a follow up, we actually asked Angel to reach out to Morgan Stanley. They've actually reached out twice. They have come back with a proposal. I just recently shared it with Catherine to see if she was comfortable.

Catherine:

It is moving in a positive direction in terms of fees. And I'm happy to distribute this to the board members. We're not in executive session, so I really don't want to discuss it in detail.

Suzanne:

My question's more general. Are we going to go through a process, or no?

Catherine :

Angel did conduct a... They did go through the RFI process. Should we say that... This is a legitimate reason for an executive session. I would entertain a motion to go into the executive session to discuss...

Suzanne:

Catherine, if you want to discuss this at a future meeting, I'm okay. I just would like to follow up and make sure we have a conversation about it.

Catherine:

I think that's fine. I'm happy to have it now.

Suzanne:

Okay.

Catherine:

So, I'd like to entertain a motion to go into an executive session to discuss matters that are exempt under 1-206. I think that's correct, related to economic strategy and also under 1-210B-5, which are trade secrets.

Mario:

So moved.

David:

Second.

Catherine:

Okay.

Suzanne:

And you're inviting everybody on the meeting in?

Catherine:

Yes, I'm inviting the executive staff.

Jennifer:

Peter Betkoski is also present. Can he stay?

Catherine:

Yes, I don't have a problem for Peter.

Jennifer:

Okay.

Catherine:

So we'll go into executive session. Sorry. All in favor?

Committee members:

Aye.

[EXECUTIVE SESSION FROM 1:02 P.M. TO 1:23 P.M.]

Mario:

I motion that we adjourn as the Pension and Benefit Committee and meet as the Authority.

Mario:

Second.

Catherine:

Seconded to adjourn as the Pension Benefit Committee and reconvened as the Authority? All in favor?

Committee members:

Aye.

[PENSION & BENEFIT COMMITTEE MEETING ADJOURNS AT 1:23 P.M.]