CITY OF OWOSSO
EMPLOYEES' RETIREMENT SYSTEM BOARD OF TRUSTEES
REGULAR MEETING
OWOSSO CITY HALL COUNCIL CHAMBER

APRIL 18, 2018 **7:15 AM**

CALL MEETING TO ORDER:

Chairperson Farrell called the meeting to order at 7:20 a.m.

ROLL CALL:

PRESENT: Trustees Richard Brewbaker, Elaine Greenway, Douglas Morrice, Andrew Reed, Vice Chairperson Mark Mitchell, and Chairperson Wilfred Farrell.

ABSENT: Trustee Burton Fox.

ALSO PRESENT: Graystone Consultant Brian Brice; Graystone Analyst Erik Burger; City Attorney Scott J. Gould; and City Clerk Amy K. Kirkland.

CITIZEN COMMENTS:

There were no citizen comments.

NEW BUSINESS:

Graystone Consultant Brian Brice prepped the Board prior to the first interview reminding the Board that MLPs are an alternative investment, likening them to being part of the third leg of a stool. He said he had comparisons between the two firms up for interview as well as a comparison with an MLP index fund. He noted that Graystone has the ability to lower the minimum investment and fees for both firms. They would be looking at targeting 5% of the portfolio but no commitment was necessary today.

MLP MONEY MANAGER INTERVIEWS

CUSHING ASSET MANAGEMENT (7:30 am)
Presenters: Tim Scanlan, Managing Director of Institutional Distribution
Libby Toudouze, Portfolio Manager

Tim Scanlan introduced the firm saying they are 100% employee owned and most of their institutional clients are public entities. They specialize in mid-stream investments in the energy supply chain. He indicated he would be the Board's main contact with the firm and introduced Portfolio Manager Libby Toudouze.

Ms. Toudouze explained that MLPs came about 20 years ago from changes in the tax law that incentivized investment in energy infrastructure, and the asset class is still evolving. She said the energy sector is coming off a 3-year downcycle with new energy supply sources and $600 billion in infrastructure needs. The current market environment has caused these stocks to languish making them particularly attractive from a price to value standpoint, while still maintaining a strong cash flow. She said she feels that institutional investors will start moving into the class because of this and she expects prices to rise as a result.

Ms. Toudouze went on to detail the recent decision of the Federal Energy Regulatory Commission (FERC) that has delivered another blow to this investment class. While the decision affects only a handful of MLPs the market has fallen 10% in response. She went on to explain that the FERC's decision requires all affected MLPs to file a rate case before the Commission and each case will be determined on an individual basis, effectively extending the volatility into the foreseeable future. That being said, she indicated the firm (Cushing) will be factoring this volatility into their calculations for the portfolio.

After giving the Trustees a briefing on the MLP market Ms. Toudouze delivered an overview of the Cushing firm, its philosophy, experience, and approach to research. The firm was founded in 2003, has 35 employees, and is 100% employee owned. The portfolio has two managers supported by 16 other investment team members possessing a wide range of backgrounds. She said the team has a very disciplined framework for the portfolio and they recognize that clients want consistent returns with managed risk. Their philosophy is to maximize growth while still preserving assets, equating risk with the permanent loss of capital. The portfolio typically contains 25 to 35 mid-stream holdings and has a turnover ranging from 10% to 40% per year.

Their process involves analysis of the 135 firms in their universe from both quantitative and qualitative standpoints. The qualitative analysis is done entirely in-house and compared with those of outside industry consultants to verify their findings. The team also maintains constant analysis of all three segments of the MLP sector, believing that understanding the entire energy business is key to being successful in their chosen market.

Vice Chairperson Mitchell inquired about which portion of the midstream class the firm tends to focus on. Ms. Toudouze said the firm does not focus on one particular class but wants the ability to move to the side that is producing returns. Mr. Mitchell went on to ask if she was anticipating more regulation of the asset class. She said the industry is already highly regulated but she sees a majority of the projects out there moving forward because the demand is there.

SALIENT PARTNERS (8:00 am)
Presenters: Nevin Woodside, Midwest Region Divisional Director
Scott Fogleman, Portfolio Strategist

Nevin Woodside started by giving a short synopsis of the asset class. MLPs were created in the mid-1980's. At that time the government felt it was in our national interest to build a solid energy infrastructure within the country and MLPs were created as a means to incentivize energy infrastructure investment. MLP companies do not pay federal income taxes and investment in MLPs is tax deferred. The development of MLPs has succeeded in helping to build a significant amount of energy infrastructure; such projects are very capital intensive up front and the ability to avoid federal taxes allows firms to reinvest the money saved into other projects.

Mr. Woodside then briefly introduced the firm, saying the firm is headquartered in Houston, Texas and was founded in 2002. They have $13.3 billion in assets under management with the largest component being MLPs at $4.8 billion. Within the MLP strategy approximately 80% of their clientele are institutional investors. Mr. Woodside then handed the presentation over to Scott Fogleman, Portfolio Strategist.

Mr. Fogleman noted that the MLP team consists of 14 professionals dedicated to MLP and energy investments. The team thinks that US production of energy will increase in the coming years, though demand in the US will not rise by that amount, ultimately the resulting product will be exported. Because of this they are taking a more downstream approach to the midstream sector. They want to own the companies that own pipeline leading to docks or refineries.

Their investment universe consists of about 85 companies focused entirely on North America, of which they choose the best 20-30 stocks for the portfolio. Each analyst on the team will cover about 25 names in the universe, becoming acquainted with those firms inside and out. They rank all the companies in their universe using a wide range of measurements and prefer companies without direct commodity exposure. Within the portfolio they mix firms that are rapidly growing with those that are considered “blue chip”. Stocks are added to the portfolio if they increase return without increasing risk. They are sensitive to the tax ramifications of selling off a stock so they don’t necessarily remove a stock entirely if they bring a new one in, they might reduce their holding instead.

Addressing the recent FERC ruling Mr. Fogleman said it had really spooked investors leading to a drop in the overall MLP market. He expressed his opinion that the Commission did not think their decision through, ruling as if no taxes are ever paid when taxes get paid at the time an investor sells. He said he felt the ruling may be overturned entirely or the companies subject to the ruling will petition to charge their users more as no pipeline operator will accept a 20% hit to their revenues because these types of assets don’t provide high return margins.

Mr. Fogleman concluded by saying the strategy’s yield is currently 6.75% and they expect it to grow over the coming years despite its underperformance in 2017. He said the valuation of MLPs is currently low and now is the time to buy.

Vice Chairperson Mitchell asked if the strategy focuses entirely on pipelines. Mr. Fogleman indicated that approximately 80% of their investments are pipeline focused.

Vice Chairperson Mitchell inquired whether Mr. Fogleman felt their universe would be increasing or decreasing in the coming years. Mr. Fogleman said there is some consolidation taking place and some companies have gone public. In light of the FERC ruling there is less of an incentive to structure as an MLP, but he felt that the overall effect would be a wash.

Consultant Brice asked Mr. Fogleman to briefly explain the strategy’s focus on growth and distribution rats. Mr. Fogleman said that their portfolio will almost always yield a little less than the benchmark but they look for firms that pay higher dividends.

Trustee Brewbaker inquired about the firm’s management structure. It was noted that the firm is mostly employee owned with 3-4 people holding 45% of the company.

DISCUSSION

Initial comments from Trustees Brewbaker and Greenway indicated they preferred Cushing slightly over Salient.

Vice Chairperson Mitchell asked whether MLPs are struggling looking for cash. Consultant Brice indicated that they hadn’t approached Morgan Stanley to find investors for them. He said he saw his purpose as helping clients make smart investment decisions. He brought this asset class to the Board now because it is becoming more attractive to institutional investors and timing is important with this class.

Chairperson Farrell inquired about Mr. Brice’s convictions on the asset class and how well it would mix with the System’s current portfolio. Mr. Brice suggested the Board may want to hold off on a decision to allow time to review the asset allocation study that will be a part of next week’s regular meeting. He said he was not backing off from MLPs and encouraged the Board to explore the opportunity costs of MLPs.

As to his recommendation, Mr. Brice indicated he felt that Cushing would be a more appropriate manager for the System. Chairperson Farrell agreed.

Chairperson Farrell asked if anyone else had anything they would like to discuss regarding the asset class or managers. There was not.

NEXT BOARD MEETING:

The next board meeting is scheduled for April 25, 2018 at 7:15am

ADJOURNMENT:

The meeting adjourned at 9:21 p.m.

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Amy K. Kirkland, City Clerk