CITY OF MERIDEN

Pension Fund Update August 12, 2014

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Meriden Retirement Board

Tuesday – August 12, 2014

Overview

Volatility has returned to US equity markets, with renewed signals of investor concern for inflationary pressures buried inside a widely celebrated report on employment. Wage inflation – the increasing cost of salaries and benefits – rose last month at the fastest rate since the third quarter of 2008, giving analysts concern that the Fed may raise interest rates more quickly than previously anticipated. The Employment Cost Index is believed to be the primary metric use by the Fed in setting its interest rate benchmarks.

The US economy continues to grow into the rising expectations of investors. Second quarter corporate earnings remain ahead of forecasts, monthly job growth of 200,000 is steady if unspectacular, and the most recent GDP report supports continued progress through the fall. Wharton's Jeremy Siegel anticipates just a mild market correction this fall with the Dow Jones Industrials reaching 18,000 by the end of the year. But Harvard economist Martin Feldstein warns that higher stock prices have been "artificially induced" by Fed policy, and aligns with Stifel's more cautious outlook on the inevitability of rising borrowing costs, expanded geopolitical risk, and the likelihood of more head-spinning trading days such as July 31, when the Dow dropped 317 points, wiping out a month's gains in a few short hours.

The recent selloff in smaller, high-growth stocks has turned attention from top-line revenues to bottom-line earnings. Our colleagues at Equity Compass provide this interesting observation that may illustrate the potential for a disruptive market: over the last 12 months, estimated corporate earnings have increased 7.7%, while the S&P 500 has gained 12.6%. While July's pullback brought the price-to-earnings ratio of the equity market closer to its historic multiple, anxious buyers may face a wall of inflationary caution, extended markets, and rising global tension.

Meriden Retirement Funds

Meriden's investment funds capitalized on favorable market trends in the past fiscal year, posting a gain of 14.6% in the composite City Employee and Police/Fire pensions and 18.3% in the OPEB Health Care Trust. Over the past five years, the annualized investment returns for the retirement plans have exceeded the actuarial goal established to support future benefits, with the City Employees' fund gaining 9.6% and the combined Police/Fire pension at 10.1%.

All the funds lost ground in July, however, as smaller-capitalization equities sold off sharply, and large-caps and bonds lost ground as well. The S&P fell 1.5%, the Russell 2000 index dropped more than 6.1%, and the international benchmark EAFE dropped 2.6%. The City Employees and Police/Fire funds each fell 2.2% in July, while the OPEB lost 1.9% in value. Overall, the Meriden funds have been positioned to capitalize on increasing volatility, with asset allocation now 62% equities, 18% in alternative investments, and 20% in traditional fixed income and cash equivalents.

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