



Memorandum

To: City of Fort Pierce Pension Board
From: Cody Chapman and Weston Lewis
Date: January 12, 2018
Subject: Recommendation to Increase International Equity

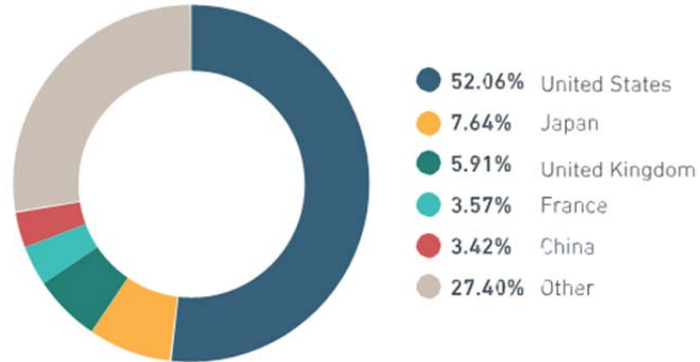
For the past several quarters, Callan has recommended increasing the weight to international equity as a percentage of the total equity in the Plan. This memo outlines the rationale for the increase, and provides a recommendation to increase international equity closer to the market weight.

Currently the Retirement Plan maintains the allocation targets in the table below. The overall equity allocation—domestic and international—is 63%. As a percentage of total equity, international equity represents approximately 24% while domestic equity represents 76%. Callan is not recommending an increase in total equity; rather, we are suggesting the Board reconsider the split between domestic and international.

Asset Class	\$000s Actual	Weight Actual	Target
Domestic Equity	95,683	49.6%	48.0%
International Equity	29,241	15.2%	15.0%
Domestic Fixed Income	46,291	24.0%	27.0%
Real Estate	21,671	11.2%	10.0%
Cash Account	45	0.0%	0.0%
Total	192,931	100.0%	100.0%

Relative to the global market weights the current Fort Pierce domestic equity allocation is very high. The starting point for equity allocations should begin with the question, how is the market invested? The pie chart on the following page shows how the global market is invested and shows that the United States as a percentage of the global equity pie at 52% as of September 30, 2017.

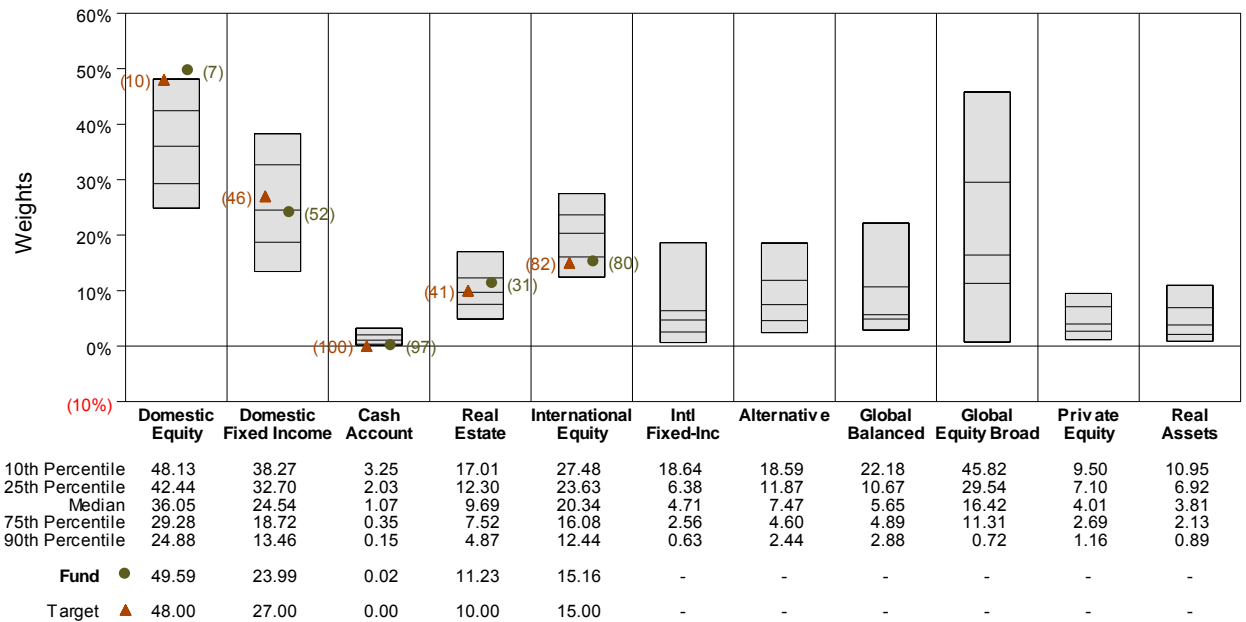
MSCI ACWI INDEX COUNTRY ALLOCATIONS



Source: MSCI

Relative to public fund peers, this difference also stands out. In the chart below, the 48% target allocation to domestic equity is a higher than 90% of the City's peers. Conversely, the target allocation of 15% to international equity is lower than 80% of peers.

Asset Class Weights vs Callan Public Fund Sponsor Database



The next question is whether the City wants to have a higher or lower allocation than how the broad market is invested. Stated differently, does the City want to have a home country bias? Callan does support a strategic overweight to U.S. equity largely due to the currency volatility inherent in non-US investing, but that overweight is much less pronounced than the City's current overweight to U.S. equity. Our recommendation for Fort Pierce is to move toward a 60% U.S equity / 40% non-US equity split.

As we have pointed out discussing performance for the Plan, the City's overweight to U.S. equity relative to the market and peers has driven some of the favorable peer rankings over the last five years. However, we have less reason to believe this will exist in perpetuity. Callan's long term capital markets expectations do not suggest either non-US or US maintaining a meaningful performance advantage over the next 10 years. However, we do believe that an optimal portfolio would include a larger allocation to non-US equity than your current allocation.

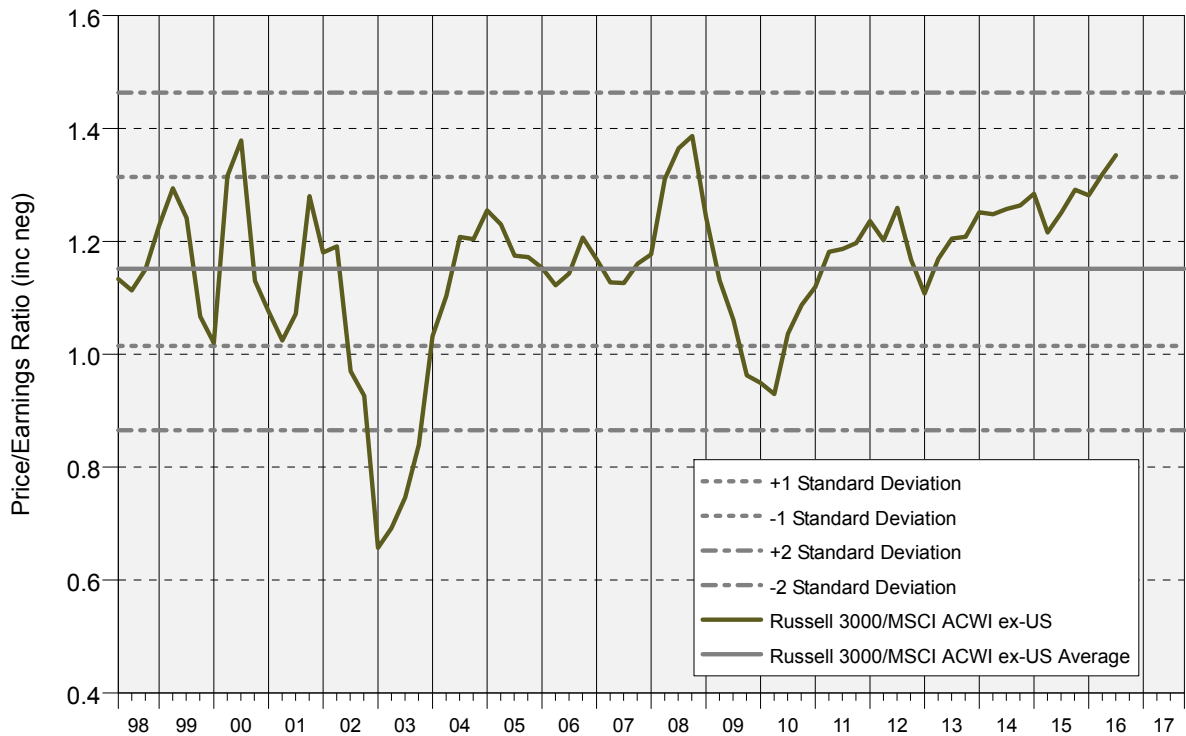
In addition the size and duration of the performance advantage that U.S. stocks have enjoyed over the last 5-years is something we witness less frequently in markets.

1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Europe	Japan	US Equity	Emerging Market Equity	Emerging Market Equity	China	Developed Mkt Small Cap	Emerging Market Equity	China	China	Japan	Emerging Market Equity	Developed Mkt Small Cap	US Equity	China	US Equity	US Equity	Developed Mkt Small Cap	US Equity	China
27.18%	61.53%	-7.46%	-2.61%	-6.17%	87.57%	30.78%	34.00%	82.87%	66.24%	-29.21%	78.51%	22.04%	1.03%	22.75%	33.55%	12.56%	9.59%	12.74%	54.07%
US Equity	Non-U.S. Equity	Developed Mkt Small Cap	Asia ex Japan	Developed Mkt Small Cap	Developed Mkt Small Cap	Emerging Market Equity	Developed Mkt Small Cap	Europe	Asia ex Japan	US Equity	Asia ex Japan	Asia ex Japan	Europe	Asia ex Japan	Developed Mkt Small Cap	China	Japan	Emerging Market Equity	Asia ex Japan
24.14%	27.92%	-7.56%	-4.03%	-7.82%	61.35%	25.55%	26.19%	34.43%	40.13%	-37.31%	72.07%	19.62%	-11.22%	22.36%	29.30%	7.96%	9.57%	11.19%	41.72%
Non-U.S. Equity	US Equity	Europe	US Equity	Asia ex Japan	Emerging Market Equity	Europe	Japan	Asia ex Japan	Emerging Market Equity	Non-U.S. Equity	China	Emerging Market Equity	Non-U.S. Equity	Europe	Japan	Asia ex Japan	US Equity	Asia ex Japan	Emerging Market Equity
18.77%	20.90%	-8.87%	-11.46%	-8.49%	55.82%	21.61%	25.52%	33.32%	39.39%	-43.56%	62.29%	18.88%	-12.21%	20.18%	27.16%	4.80%	0.48%	5.44%	37.28%
Japan	Developed Mkt Small Cap	Non-U.S. Equity	Developed Mkt Small Cap	Japan	Asia ex Japan	Non-U.S. Equity	Asia ex Japan	Emerging Market Equity	Europe	Developed Mkt Small Cap	Developed Mkt Small Cap	US Equity	Japan	Developed Mkt Small Cap	Europe	Emerging Market Equity	Europe	Non-U.S. Equity	Developed Mkt Small Cap
5.05%	19.73%	-13.37%	-12.52%	-10.28%	46.55%	20.38%	22.69%	32.17%	15.17%	-47.01%	46.78%	16.93%	-14.33%	20.00%	24.39%	-2.19%	-2.73%	2.75%	33.01%
	Europe	Japan	Europe	China	Europe	Asia ex Japan	China	Non-U.S. Equity	Non-U.S. Equity	Europe	Europe	Japan	Developed Mkt Small Cap	Emerging Market Equity	Non-U.S. Equity	Japan	Non-U.S. Equity	Japan	Europe
	17.35%	-28.16%	-19.49%	-14.04%	39.52%	17.35%	19.77%	25.71%	12.44%	-47.30%	38.50%	15.44%	-15.94%	18.23%	21.02%	-4.02%	-3.04%	2.38%	26.06%
	China	China	Non-U.S. Equity	Non-U.S. Equity	Non-U.S. Equity	Japan	Non-U.S. Equity	Developed Mkt Small Cap	US Equity	China	Non-U.S. Equity	Non-U.S. Equity	Asia ex Japan	US Equity	China	Non-U.S. Equity	China	Developed Mkt Small Cap	Non-U.S. Equity
	12.59%	-30.26%	-21.40%	-15.80%	39.42%	15.86%	14.47%	19.31%	5.14%	-50.83%	33.67%	8.95%	-17.31%	16.42%	3.64%	-4.32%	-7.82%	2.18%	24.21%
		China	Europe	Japan	US Equity	Europe	US Equity	Developed Mkt Small Cap	Asia ex Japan	US Equity	Europe	China	Non-U.S. Equity	Asia ex Japan	Developed Mkt Small Cap	Asia ex Japan	Europe	Japan	
		-24.71%	-17.85%	35.91%	11.95%	10.71%	15.72%	1.45%	-52.38%	28.34%	5.07%	-18.41%	16.41%	3.07%	-4.95%	-9.17%	1.00%		
		Japan	US Equity	US Equity	China	US Equity	Japan	Japan	Emerging Market Equity	Japan	China	Emerging Market Equity	Japan	Emerging Market Equity	Europe	Emerging Market Equity	China	US Equity	
		-29.40%	-21.54%	31.06%	1.89%	6.12%	6.24%	-4.23%	-53.33%	6.25%	4.63%	-18.42%	8.18%	-2.60%	-6.72%	-14.92%	0.90%		

Sources: ● MSCI Asia ex Japan ● MSCI Japan ● MSCI China Free ● MSCI EAFE Small Cap ● MSCI Europe ● MSCI EAFE ● MSCI Emerging Markets ● Russell 3000

While valuations do not precisely predict future performance, they can offer additional insight into markets that tend to revert back to historical means. Callan suggests that all markets currently appear expensive relative to their historical averages. However, as we observe the relative Price-to-Earnings for U.S. companies as represented by the Russell 3000, it appears far more expensive than the Price-to-Earnings for non-US companies as represented by the MSCI ACWI ex-US. In fact, by this metric a dollar of US earnings is more expensive than a dollar of earnings earned outside the U.S. in any time over the last two decades.

Price/Earnings Ratio (inc neg)
for 19 1/2 Years Ended September 30, 2017



Believing that markets are largely efficient, we remain humble in our approach to opinions about the future. We do not know with any certainty that international markets will outperform the U.S. markets in the future, or vice versa. Admitting we do not know the future, we support the need to diversify. We believe a reasonable step to gain additional diversification in the Fort Pierce Retirement Plan is to consider the following asset allocation:

Asset Class	Recommended Weight	Current Weight
Domestic Equity	38%	48%
International Equity	25%	15%
Fixed Income	27%	27%
Real Estate	10%	10%