

April 10, 2019

Keith Stephens
Chairman
City of Fort Pierce Retirement Board

Mr. Chairman,

At the City of Fort Pierce Retirement Board's March 21, 2019, meeting, the Board received the investment fund's annual actuarial report from Brad Armstrong of GRS. At the meeting, Mr. Armstrong recommended moving the fund's investment return assumption from 7.75% to 7.5%. You requested that Callan, as the Board's investment consultant, be prepared to provide our thoughts on this recommendation at the April Retirement Board meeting. The information below is provided in response to your request.

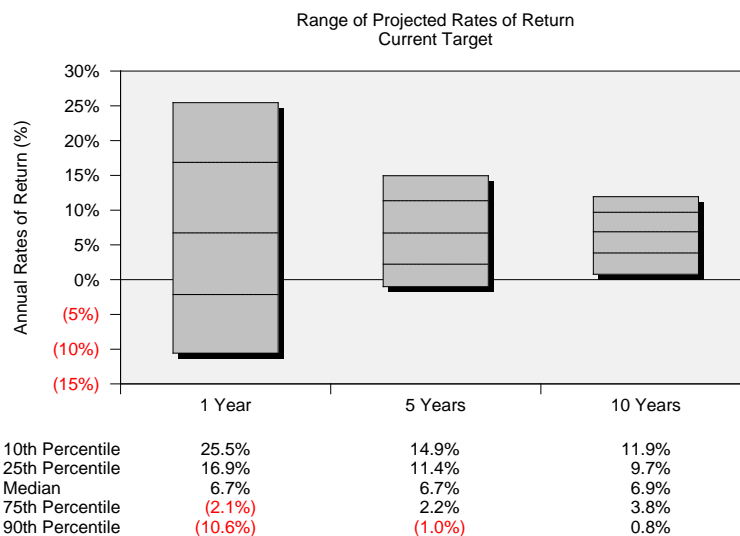
Callan's Capital Market Projections

Callan develops projections of capital market performance at the start of each year. These projections are a key component of asset allocation studies, incorporating the economic and financial environment in which asset owners, investment managers and Callan will operate. Callan integrates information on past capital market performance, key economic indicators and the market insights of Callan professionals to develop projections that are sound, defensible and consistent. Individual asset classes (equities, fixed income, cash, real estate and alternative investments) are analyzed as part of a larger system, acknowledging the interaction between asset classes and the influence of larger macroeconomic events on the entire structure of capital markets.

The capital market projections consist of projected returns and two measures of risk – standard deviation and correlation – for each major asset class and inflation, as represented in the index column in the following chart. The projections for returns, standard deviations and correlations are for the ten-year period from 2019 through 2028. A ten-year period is chosen to capture a full market cycle. The return and risk expectations are for the index returns alone (i.e. passively implemented), and do not assume any return premium that may be achieved through active management.

The table below illustrates the current asset allocation and Callan's ten year expected return for the fund, using the assumptions shown on the previous page. Over the next ten years, Callan projects a geometric mean return of 6.68%. The second chart illustrates the range of outcomes that are expected over various time periods.

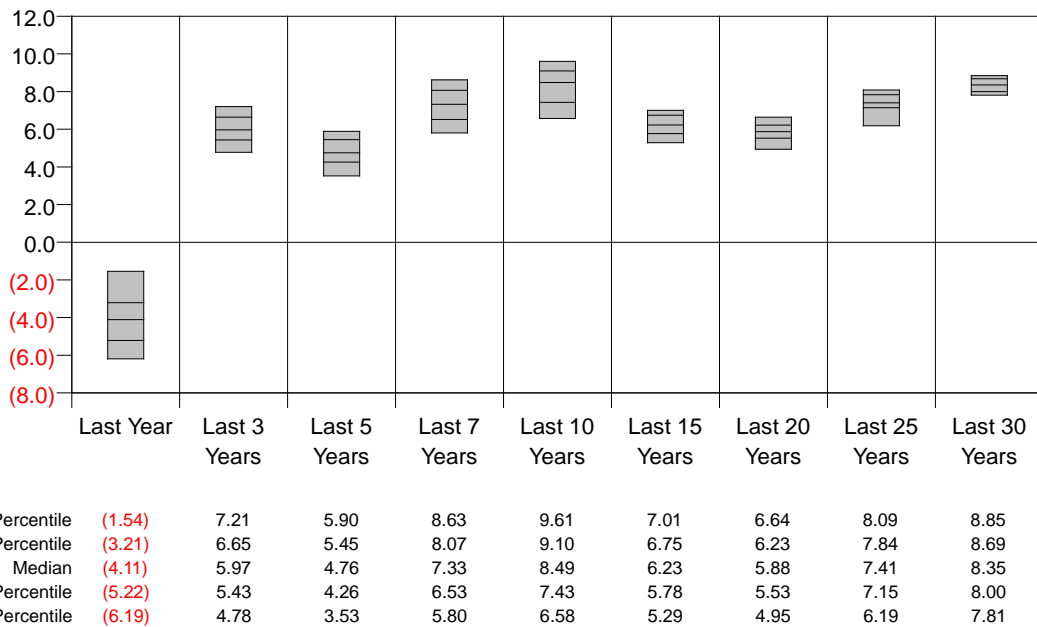
Investment Mix	
US Large Cap Equity	26%
US Small/Mid Cap Equity	12%
International Equity	25%
Domestic Fixed Income	27%
Real Estate	10%
Total	100%
10 Yr. Geometric Mean Return	6.68%
Projected Standard Deviation	13.01%



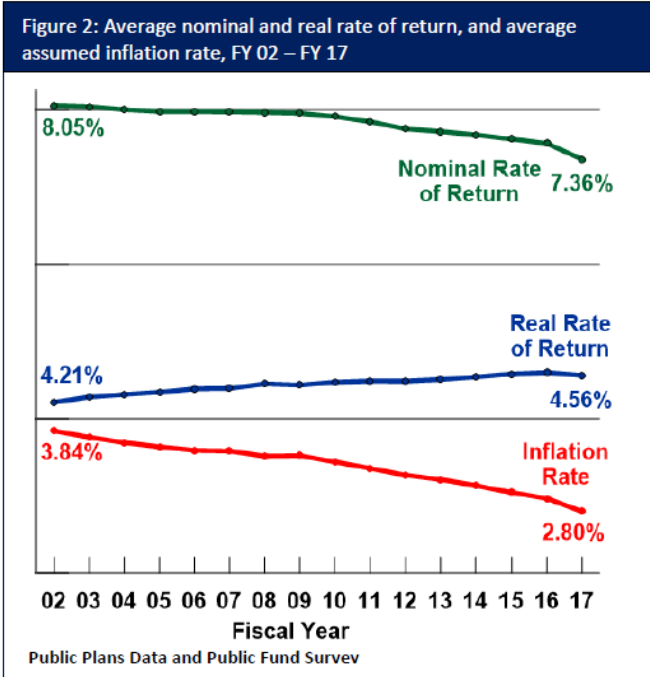
Another important consideration is the “real rate of return” or the return after adjusted for inflation. Currently, the investment policy statement contemplates this dynamic in the “Investment Objectives for the Total Fund.” The stated primary long-term objective is for the total fund “is to earn an annualized investment return which exceeds the CPI inflation rate by at least five percent (5%).” Callan’s CPI inflation expectation for the next 10 years is 2.25%. Adding the 5% real return expectation together with the inflation expectation of 2.25% further tilts toward a reduction from 7.75%. Since the investment policy statement is silent on the nominal rate of return—and by extension the discount rate—there are no immediate changes required to facilitate a change to the discount rate.

While the return expectations outlined on the previous page fails to meet either the current 7.75% return assumption or the 7.50% proposed return assumption, we would note that this range of return has been achievable for public funds similar to the City of Fort Pierce with a sufficiently long time horizon. As the chart on the following page illustrates, the median public fund in Callan’s database achieved a return over the last 10 years of 8.49%. Over the last 20 years, the median return was 5.88% and for the last 30 years, the median return was 8.35%. Investment returns will naturally fluctuate with time, as the chart below illustrates. However, we believe that plan sponsors with a sufficiently long time horizon, like the City of Fort Pierce, can justify a return expectation in the range of 7 to 8% over time.

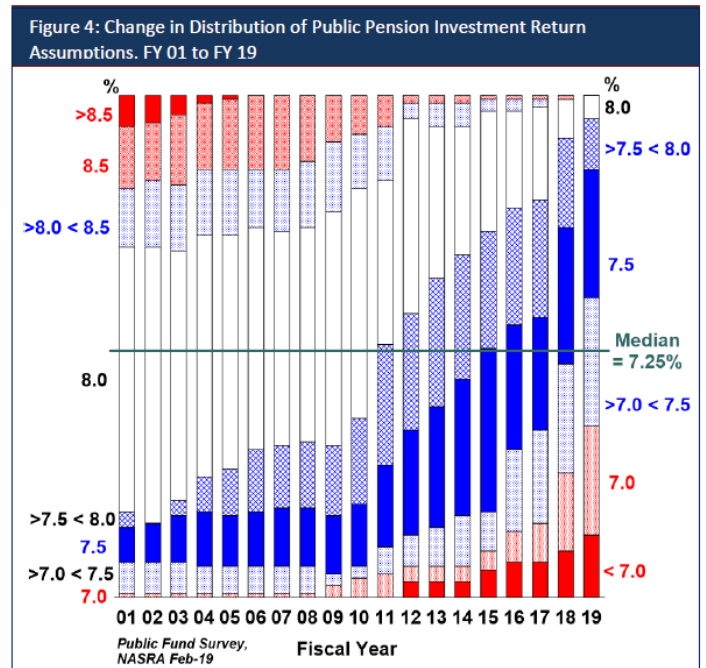
Experienced Returns
Callan Public Fund Sponsor Peer Group
Periods Ended December 31, 2018



Finally, we would note the contemplated reduction in return assumption is in line with the experience of other public plan sponsors. As the graphics on the following page illustrate, the average public fund return assumption has been declining over the last ten years and the median return expectation now sits at 7.25%. A large majority of the plans surveyed utilize return expectations between 7% and 8%.



Source: NASRA Issue Brief, February 2019



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We would note that the ultimate selection of an investment rate of return is a nuanced decision that must be made by the Retirement Board and the Board's actuary. However, based on the data above, we are supportive of the decision to move to a 7.5% return assumption. While the median of the range does not achieve a rate of return that meets the nominal 7.5% expectation over the next 10 years, there is the potential for active management to provide a modest 0.1%-0.25% return premium net of fees over time. Consistent with this expectation, the fund has outperformed the total fund benchmark by approximately 0.13% per year over the last 10 years and by approximately 0.25% per year over the last 20 years, after accounting for fees. As a result, we do believe that the 7.5% return assumption can be met over a long time horizon and is reasonable based on historical experience.