

MINUTES OF THE JOINT MEETING
OF THE BOARD OF TRUSTEES OF
THE KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM,
THE INVESTMENT COMMITTEE FOR THE
KENTUCKY JUDICIAL RETIREMENT FUND,
AND THE INVESTMENT COMMITTEE FOR THE
KENTUCKY LEGISLATORS RETIREMENT FUND

January 22, 2021

The Board of Trustees of the Kentucky Judicial Form Retirement System (JFRS), the Investment Committee for the Kentucky Judicial Retirement Fund, and the Investment Committee for the Kentucky Legislators Retirement Fund, convened at the Administrative Office of the Courts, 1001 Vandalay Drive, Frankfort, Kentucky 40601 and via Video-Conference utilizing Microsoft Teams on Friday, January 22, 2021, at 10:00 a.m. All Board members were in attendance with the exception of Judge Tom Jensen. Bo Cracraft, Executive Director, Rebecca Stephens, Assistant to the Director, and Stan Kerrick, Lexington Investments participated in person, while Mr. Don Asfahl, Mr. Tom Watkins, and Mr. Andy Means of Hilliard Lyons attended via video-conference.

Chairman Grise called the meeting to order at 10:06 a.m.

The trustees considered the adoption of the previously distributed *Minutes* of the October 23, November 2, November 13 and December 29, 2020 meetings. Upon motion by Representative Brad Montell, seconded by Mr. Stephen LeLaurin, the Board unanimously approved the *Minutes* of the October 23, November 2, November 13 and December 29, 2020 meetings.

The next order of business was the report of Lexington Investments LLC. Chairman Grise recognized Mr. Kerrick. Mr. Cracraft previously distributed electronic copies of *Lexington Investments' Kentucky Judicial & Legislators Retirement Funds* as of December 30, 2020. In accordance with Board policy, the System maintains a copy of the *Reports*.

Mr. Kerrick confirmed the Funds were in compliance with the Investment Policy Statement with equity allocations for the Judicial Fund at 77.9% and Legislators Fund at 77.8%. He advised that more than 50% of each Fund's equity positions have paid dividends for the last five consecutive years. He also advised that there were no individual equity market values exceeding 8% of total equity market values as of December 31, 2020. Any time an individual equity value exceeds 8% of the Funds' total equity market, Mr. Kerrick advises the Executive Director of JFRS.

Next, Mr. Kerrick examined the rates of return in the Performance Analysis for each fund, pointing out that we experienced excellent performance and outperformed the benchmarks as of December 31, 2020. He discussed performance from the S&P and noted how strong

returns had been for both the JFRS portfolios and index since a market low in late March. He reviewed the Portfolio Statement, Cash Reconciliation Reports and the Brokerage Fees Report for each fund. During this review, discussions ensued concerning the funds' various holdings, including a callable \$1.95M bond with Federal Home Loan for the Judicial Fund only that Mr. Kerrick advised would likely be called during the meeting. While reviewing the Legislators Fund, Mr. Kerrick advised that the Fund is nearly identical to the Judicial Retirement Fund.

In response to a question regarding cash withdrawals during the quarter, Mr. Kerrick discussed how he and staff work together to determine projected cash balances and when funds will be required to meet benefit and expense obligations. Cash withdrawal reported in his presentation represented cash transferred from the custodian to JP Morgan for the purpose of meeting monthly benefit obligations and paying administrative expenses.

In response to a question regarding inflation, Mr. Kerrick noted much money was floating around, but given current interest rates and the Federal Reserve's intent to maintain lower rates, rising inflation was probably not a short-term concern.

Lastly, Mr. Kerrick advised the Board of some recent transactions made in both portfolios by Hilliard Lyons to rebalance the portfolios. The equity allocations in both funds had grown very close to an 80% maximum allocation, so Hilliard Lyons reduced the equity allocations in both portfolios to approximately 75%. The activity resulted in approximately \$20 million raised in the Judicial portfolio and \$7 million in the Legislators portfolio, with those proceeds being placed in fixed income securities. Mr. Kerrick reminded the Board that the asset allocation information provided in his presentation only included cash held at the custodian. He noted that both funds had additional cash held at JP Morgan, which staff utilized to pay monthly benefits and expenses.

Mr. Kerrick departed the meeting at 10:46 a.m.

Chairman Grise recognized the representatives of Hilliard Lyons Trust Company, who joined the meeting virtually via Microsoft Teams. Mr. Cracraft previously distributed copies of Hilliard Lyons' *Investment Review for Kentucky Judicial Retirement Fund and Kentucky Legislators Retirement Fund* dated January 22, 2021. In accordance with Board policy, the System maintains a copy of the *Investment Review*.

Mr. Means began Hilliard's Market Commentary with a review of his quarterly article, "Know Who You Are as an Investor." He reflected on how the prior twelve months, which saw a global pandemic force government shutdowns, still result in strong investment results. He pointed to monetary and fiscal policy responses, which flooded the market with money and pushed interest rates to their lowest levels in history. These responses supported increases in almost all asset values, including the stock market. He cautioned against rising speculation, specifically within various sectors, and advised that Hilliard Lyons chooses not to participate in those type of opportunities. Lastly, he pointed to 2021 and anticipated there would be much continued change as vaccines are rolled out and a new presidential term leads to policy changes.

In a response to questions from Senator Joe Bowen regarding how Hilliard Lyons was mitigating risk with so much speculation, Mr. Means stated the portfolio had trimmed several large holdings to reduce single stock exposure, had introduced two new high quality stocks to the portfolio to improve the overall quality of the portfolio, and had increased the margin of safety on several current holdings by adding to the positions when the companies were trading at a discount to intrinsic value.

Mr. Asfahl discussed current valuations, which are elevated relative to averages, but noted that inflation, taxes, and interest rates are all at historical lows. He referenced the coordinated efforts of central banks to keep rates lower and how that had impact home prices and asset values. He reviewed recent investment activity of the portfolios, included a recent rebalancing event, for the Judicial Retirement Defined Benefit and Hybrid Cash Balance accounts and the Legislators Retirement Defined Benefit and Hybrid Cash Balance accounts through December 31, 2020.

In response to a question from Representative Brad Montell regarding current valuation and if Hilliard Lyons had any concern, Mr. Means stated that while current values appear high compared to long-term averages, when compared to times with similar market volatility, the valuations aren't quite as abnormal. He pointed to lower rates and how if Treasury rates remain low, valuations appear attractive. If inflation increases, P/E's would definitely have to come down.

In response to questions from Senator Joe Bowen regarding global markets and what appeared to be a disconnect between stock results and underlying fundamentals, Mr. Means pointed to importance of the Information Technology sector and how U.S. based market leaders had helped domestic markets outperform those outside the U.S. He advised that foreign markets would benefit if the dollar were to weaken, but emphasized that Hilliard Lyons was not going to try and predict. Mr. Watkins added that fundamentals of current holdings are very strong and cited a business like Microsoft, which was well positioned and scalable to a very large degree. He noted how many current market leaders are not as asset intensive businesses as market leaders a decade or two ago, and most do not require significant additional capital or resources to expand or continue to grow.

Mr. Watkins review the current equity allocations, top performers and largest holdings. He highlighted the portfolios current overweight to financials, which was growing close to a policy limit at just under 30% of the portfolio. He also noted an underweight to information technology, which was a bit unusual for the portfolio, but largely the result of the team capturing gains from Microsoft and Apple several times throughout the period. Mr. Watkins discussed several top performers during the year. Lastly, Mr. Watkins advised that turnover in the portfolio was elevated compared to prior years, but most of the activity was for rebalancing. He did reference one new addition to the portfolio, Charles Schwab, which he noted was also a top performer during the year.

Mr. Asfahl concluded the presentation with a short review of the fixed income portion of the portfolios, a summary of risk statistics, as well as trailing period performance of the portfolios. He advised that the portfolios were well positioned, continued to produce strong risk adjusted results, and had outperformed the blended index over each measured time period.

In response to questions from Mr. Stephen LeLaurin and Judge John Grise regarding why Hilliard Lyons might own the bond of a company such as Exxon, but not the stock, Mr. Means stated that with regards to bonds, the decision to own is based on the company's ability to repay, but when evaluating whether to hold a stock, the assessment is focused on future growth expectations of the company. With regards to Exxon, Mr. Asfahl noted the team had owned the stock in the past, knew the company well, and felt comfortable with a company's debt service ability, but growth and outlook expectations didn't make stock as attractive.

Mr. Don Asfahl, Mr. Andrew Means, and Mr. Tom Watkins departed the video-conference at 12:00.

The meeting recessed for lunch at 12:00 and reconvened at 12:20 p.m.

Chairman Grise recognized Mr. Cracraft, who reported on administrative matters. The trustees discussed the items and took action as noted.

(A) Public Pension Oversight Board (PPOB). Mr. Cracraft gave a summary of the PPOB meetings since the last JFRS meeting.

- **November 17, 2020.** LRC staff presented a Semi-Annual Investment Review. In addition, five legislative proposals were discussed, none of which impacted benefits or membership in JFRS.
- **December 14, 2020.** LRC staff presented PPOB's recommendations and annual report. In addition, Kentucky Retirement Systems and Teachers' Retirement System provided updates on recently completed actuarial valuations.

(B) 2021 Personal Service Contracts.

1. **Investment Management.** The May 10, 2019 Personal Service Contract with Hilliard Lyons Trust Company contained an option to extend the contract for two additional one-year periods beginning on July 1, 2020 under the same terms and conditions at a fee of eight (8) basis points. On June 6, 2020, a 1-year extension was agreed upon which is set to expire on June 30, 2021.

The investment counseling and management services for the assets of the two retirement plans were reviewed and discussed. Justice Daniel Venters made a motion on behalf of the Investment Committee for the Judicial Retirement Fund, which was seconded by Mr. Stephen LeLaurin, and Senator Joe Bowen made a motion on behalf of the Investment

Committee for the Legislative Retirement Fund, which was seconded by Mr. A.C. Donahue, to offer Hilliard Lyons a 1-year extension of the May 10, 2019 investment management contract for the period of July 1, 2021 through June 30, 2022 under the terms and conditions as outlined in a personal services contract extension dated June 6, 2020. Both Committees unanimously adopted.

2. **Audit Services.** An RFP was issued in early 2018 and resulted in JFRS contracting with MCM CPAs & Advisors for auditing services for the period July 1, 2018 through June 30, 2019, at the annual fee of \$17,750.00. The contract provided for two additional one-year extensions, which have both have been executed. Mr. Cracraft noted the final extension was set to expire on June 30, 2021.

Mr. Cracraft also advised that JFRS was likely due to have current fiscal year financial audit performed by the State's Auditor of Public Accounts (APA). By statute, the APA is required to perform the audit once every five years, and the last audit was conducted for FY2016. Mr. Cracraft advised that he was going to reach out to confirm the APA's plan.

Representative Brad Montell made a motion, seconded by Mr. A.C. Donahue, to issue a RFP for JFRS audit services in accordance with the Commonwealth's Model Procurement Code. The motion passed unanimously.

Mr. Cracraft noted that pending confirmation from the Auditor, staff would provide an update during the April quarterly meeting.

3. **Actuarial Consulting.** Both the Investment Committee for the Judicial and Legislators Retirement Funds entered into a contract with Findley, Inc. on June 26, 2018 for actuarial services which expired on June 30, 2020. Each contract provided that the contract, upon agreement by both parties, could be extended for two additional two-year periods.

Mr. Cracraft noted that both committees agreed to extend the original contract and on May 21, 2020, a two-year extension was agreed upon which will not expire until June 30, 2022.

4. **Custodian.** State Street remains the custodian of the Funds. The Commonwealth of Kentucky and State Street are the parties to the current contract, which was last extended for a 2-year period in 2019 and scheduled to expire June 30, 2021. The 2019 extension included services to JFRS as a named agency of the Commonwealth.

Mr. Cracraft noted the current extension was set to expire effective June 30, 2021. He advised that he was in process of trying to determine if another extension would be agreed upon and if so if JFRS could remain a named agency. Following discussion, it was the consensus of the trustees that JFRS continue to participate in the Commonwealth's custodian contract with State Street.

5. **Legal Services.** The Funds utilize the services of Alan Pauw and McBrayer PLLC and a revised Letter of Engagement was most recently executed on May 27, 2020. Mr. Cracraft advised the letter of engagement did not include specific term dates, which generally were required by the Model Procurement Code.

Following a discussion, Mr. Stephen LeLaurin made a motion, seconded by Representative Brad Montell, to enter into a Personal Service Contract with Mr. Alan D. Pauw and McBrayer PLLC, for legal services subject to successful negotiation and terms. The intent of the Board is to comply with Model Procurement Code policies by relying on the due diligence and RFP for Legal Services that was recently conducted by Teachers' Retirement System and resulted in a contract awarded to Mr. Pauw and McBrayer, PLLC. The motion passed unanimously.

(C) **2021 Regular Session of the General Assembly.** Mr. Cracraft reported on Part I of the 2021 session and reviewed the *2021 Legislative Update*. He stated that staff was tracking a handful of legislative proposals impacting JFRS, included one year budgets for both the legislative and judicial branches. Mr. Cracraft advised that an actuarial analysis had only been requested on one bill, which was **House Bill 121**.

(D) **JFRS Administration.** Mr. Cracraft provided the Board with a revised copy of a *Memorandum of Understanding between the Administrative Office of the Courts and the Kentucky Judicial Form Retirement System*. He referenced the Board's decision in July 2020 to authorize Chairman Grise to execute a Memorandum of Understanding between the Administrative Office of the Courts (AOC) and JFRS for the purpose of administrative, personnel, and technical support to ensure effective and efficient operation of the retirement system for the benefits of its members.

Mr. Cracraft reported that he had met with several members of AOC, the Personnel Cabinet, as well as Commonwealth Office of Technology (COT) since joining JFRS in December and did believe it was in the best interest of JFRS to follow through and execute the Memorandum of Understanding. He advised that the transition would likely begin during the final quarter of the fiscal year, with personnel, finance, and procurement support being the initial focus. Technology needs exist and changes will occur, but Mr. Cracraft indicated that transition would phase in over a period of time as long-term projects are tackled.

(E) **Financial Disclosure Statements.** Mr. Cracraft requested that each trustee complete a *Financial Disclosure Report* for calendar year 2020 on or before March 31, 2020 in order to comply with the annual mandated disclosure requirement. A copy was provided to those members attending in person and electronically to those joining the meeting virtually.

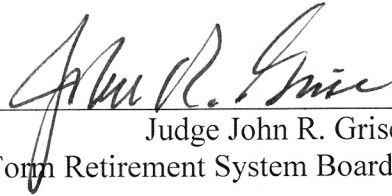
(F) **Actuarial and Audit Reports.** Mr. Cracraft noted that JFRS had filed actuarial and audit reports with the Legislative Research Commission and posted same on System's website in accordance with KRS 21.440(1) and (2).

A motion was made by Mr. A.C. Donahue and seconded by Mr. Stephen LeLaurin to enter into Executive Session for the purpose of discussing personnel and confidential member information of an employee. The motion passed unanimously.

A motion was made by Judge Douglas George and seconded by Mr. Stephen LeLaurin to return to open session. The motion passed unanimously. No action was taken during the closed session.

Mr. Stephen LeLaurin made a motion that was seconded by Justice Daniel Venters to increase the monthly salary of Ila Moody by \$1,000 per month for a six month period beginning January 1, 2021 and not to exceed June 30, 2021. The motion passed unanimously.

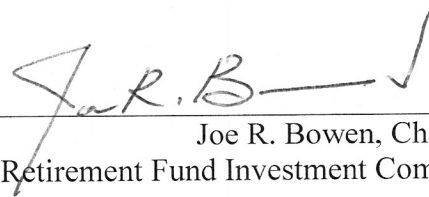
There being no further business, the meeting adjourned at 1:41 p.m.



Judge John R. Grise, Chairman
Judicial Form Retirement System Board of Trustees



Stephen F. LeLaurin, Chairman
Judicial Retirement Fund Investment Committee



Joe R. Bowen, Chairman
Legislators Retirement Fund Investment Committee



Bo Cracraft, Executive Director