

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

October 21, 2022

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 on Friday, October 21, 2022, at 10:30 a.m. All Board members were present. Senator Jimmy Higdon participated via Microsoft Teams video-conferencing.

JFRS staff present included Bo Cracraft, Executive Director, and Rebecca Stephens, Retirement Programs Administrator. Guests attending the meeting included Stan Kerrick, Lexington Investments, Don Asfahl and Andy Means of Baird Trust Company, and Wesley Wickenheiser of Findley, Inc. Mr. Matthew Widick of USI, Inc. also participated via Microsoft Teams video-conferencing.

Chairman Grise called the meeting to order at 10:31 a.m. The trustees considered the adoption of the previously distributed *Minutes* from the August 5, 2022 and August 19, 2022 meetings. Upon motion by Justice Daniel Venters, seconded by Mr. Ben Allison, the Board unanimously approved the *Minutes* of the August 5, 2022 and August 19, 2022 meetings.

The next order of business was the report from Lexington Investments LLC. Chairman Grise recognized Mr. Stan Kerrick. Mr. Kerrick distributed to the trustees Lexington Investments' *Compliance and Cash Flow Report of the Kentucky Judicial & Legislators Retirement Funds* as of September 30, 2022, dated October 21, 2022. In accordance with Board policy, the System maintains a copy of the *Report*.

Mr. Kerrick began with a compliance statement, which noted both plans were within their prescribed asset allocation guidelines. He also highlighted that neither plan currently had any individual equity positions that exceeded the 8% maximum weighting as of September 30, 2022. Since the close of the quarter, Mr. Kerrick noted the portfolios holding in Progressive Insurance had reached the 8% threshold for a day or two in October and was being monitored. Mr. Kerrick also reviewed the dividend yield of the equity portfolio and duration of fixed income allocation and stated both were in compliance with the investment policy. Lastly, Mr. Kerrick discuss recent transactions, which was limited to a few bond purchases, and projected cash flow in the portfolios.

Chairman Grise welcomed Baird Trust Company, who arrived and joined the meeting at 10:50 a.m. Mr. Cracraft had previously distributed copies of Hilliard Lyons' *Investment Review*

for Kentucky Judicial Retirement Fund and Kentucky Legislators Retirement Fund dated October 21, 2022. In accordance with Board policy, the System maintains a copy of the *Investment Review*. Mr. Kerrick departed the meeting.

Mr. Andy Means began the quarterly review with a few comments regarding Baird's most recent Market Commentary, titled "Focusing on What's Knowable." He began by reiterating comments from Baird's prior quarterly review highlighting just how disruptive and unpredictable the past two and half years had been. A complete shutdown of markets, flood of money, and supply chain issues had been further compounded by geo-political pressures from the war in Ukraine and a strained U.S. relationship with China. More recently, the Fed had aggressively tried to react to rising inflation, which had led to a pretty significant reset of markets as investors adjusted to a new reality where rates were rising and the cost of capital was no longer free.

While admitting he did not know what the future would bring, Mr. Means did express confidence in the underlying businesses held in the portfolio. He pointed to the large swings and volatility experienced in the stock market, but stated the underlying companies were much more stable. He also pointed to past performance of the portfolios during similar periods, where companies held in the portfolio were able to grab market share. He acknowledged this does required a longer-term view, but patience has been rewarded in the past.

In response to a question from Mr. Ben Allison related to current valuations, Mr. Means stated the portfolios were currently trading at approximately a twenty percent discount to what the team believes is intrinsic value. In response to a follow up question from Chairman Grise regarding if the team was looking to double down or reinvest, Mr. Means stated the team does not have any immediate plans, largely driven by comfort with where the portfolios current allocation between equity and fixed income.

In response to a question from Mr. Cracraft regarding if the team had any concerns with current holdings, Mr. Means stated they were happy and thought most companies were performing well given the circumstances. He pointed to a few industries that had been significantly influenced and time spent by the team to determine if the recent experience or new normal was going to overwhelm the underlying business models. As an example, he identified Carmax and the used car industry. Carmax was negatively impacted early during the pandemic by the market shutdown and lack of foot traffic visiting their physical, land-based dealerships. In addition, given the low cost of capital, it opened the door for new competitors, such as Carvana that tried to capitalize on a zero touch experience. In the midst of the pandemic, both companies saw tremendous growth as a lack of supply in used cars pushed prices to all-time highs. But more recently, with rising rates and the cost of capital going up, a company such as Carmax is looking stronger and better positioned going forward.

In response to a question from Representative Brinkman regarding harvesting returns, Mr. Means stated the team was definitely thinking about those types of decisions. He referenced multiple sells of Apple and Microsoft over the past 18 months and identified Progressive Insurance as a current company, which had performed very well.

In response to questions from Mr. Allison and Chairman Grise regarding rising rates and the Fed's reaction to inflation, Mr. Means agreed that rising rates were not the worst thing for all companies. He pointed to several financial holdings that would benefit, but also expressed some confidence that other companies in the portfolio had enough pricing power to weather the rise in inflation. Regarding the Fed's reaction, Mr. Means agreed the Fed waited too late to get started and worried they might overdo it. He pointed to a lag in response that makes handling inflation so difficult, not to mention, concerns of something else happening that would force them to react or provide liquidity.

Mr. Asfahl reviewed the current asset allocation, annual estimated income, and the current yield on the JRP legacy portfolio. He discussed the fixed income portfolio and schedule of maturities. Mr. Means reviewed a snapshot of the equity portfolio, which included relative sector weightings, top performers and largest holdings. He pointed out the financial sector was the largest industry weight and close to a policy limit. He also noted that roughly 60% of the equity portfolio were in the top 10 holdings. Mr. Means also reviewed performance attribution and noted that not holding energy stocks had been the primary detractor over the short term. Lastly, he reviewed top and bottom contributors over a one and five year trailing period.

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.

The meeting recessed for lunch at 12:05.

The meeting reconvened at 12:30 p.m. Mr. Wesley Wickenheiser of USI, Inc. joined the meeting in person, while Mr. Matthew Widick of USI, Inc. joined the meeting virtually via Microsoft TEAMS. Mr. Means and Mr. Asfahl departed the meeting.

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

(B) 2021 Actuarial Valuations. Mr. Cracraft recognized Mr. Wesley Wickenheiser and Mr. Matthew Widick of USI, Inc., who had joined the meeting to present results of the System's July 1, 2022 GASB actuarial valuations.

Mr. Wickenheiser began with a broad review of the valuation process followed and reminded the trustees that full funding valuations, used to determine funding requirements, were completed every 2 years leading up to budget years. In the interim, odd years, only a roll forward valuation is conducted to produce GASB reports used for the states accounting reports. In these roll forward valuations, data and assumptions from the prior year are rolled forward and compared to actual market value of assets.

Next, Mr. Wickenheiser reviewed recent activity, which included the actuarial audit being conducted by the PPOB; numerous recent benefit determination tied to year-end retirements, as well as the recent change to the plans amortization method that passed during the

2022 Regular Session. In addition, he provided a review of several assumptions used, specifically pointing out the plans long-term interest rate, mortality, retirements, and asset smoothing.

Next, Mr. Matt Widick reviewed a summary of GASB results for the 2021 and 2022 valuations. He pointed out that as expected, total liabilities only grew marginally given the roll forward methodology, but total assets declined considerably given investment returns. As a result, the funded ratio for both the pension and medical plans, while still fully funded, had declined from the prior year for JRP and LRP. Next, Mr. Widick provided a summary of the liability split between legacy and cash balance members, calling attention to reality that the cash balance portfolios, while growing in number, still had very little impact on the underlying dynamic of the plan's total liability. Lastly, he reviewed current membership counts for both plans and pointed out how cash balance members were continuing to grow, especially the LRP plan.

In closing, Mr. Wickenheiser noted both plans continued to see strong funding levels and that future projections showed continued improvement. Given the funding position of both plans, he suggested the board may consider modest changes to asset allocation and targeted asset returns to remove some risk from each plan. Alternatively, the plans could also shift some of the risk through an annuity market or potentially seek liability driven investment strategies.

Mr. Wesley Wickenheiser and Mr. Matt Widick departed the meeting at 1:15 p.m.

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

August 22, 2022 – Each state-administered retirement system was on the agenda and provided an investment update TRS also testified with regards to sick leave and temporary re-employment after retirement provisions.

September 27, 2022 – JFRS was not on the agenda. The Kentucky Deferred Compensation Authority provided an annual update and both TRS and KPPA provided a Retiree Health Update.

Mr. Cracraft indicated the PPOB was scheduled to meet on October 25th and JFRS had been asked to attend and provide a short quarterly updated on investment performance for the first quarter of the new fiscal year.

(C) 2022 General Session. Mr. Cracraft referenced the *2023 Regular Session – Proposed Legislative Plan* memo from staff included in the materials. He noted the shorter, 30 day, session was expected to begin on the first Tuesday in January.

Given the shorter timeline along with the fact that the General Assembly was going to welcome several new faces, Mr. Cracraft indicated that staff did not have any plans to introduce potential legislation, but rather planned to cultivate new relationships and look to have legislative discussions with regards to future housekeeping legislation. He did quickly discuss a couple

legislative topics, included the annual interest credit process for member with reciprocal service and potential health insurance benefit considerations for cash balance members in the future. He suggested there was some time to have discussions and expressed a desire to reach out to KPPA staff and gauge interest in working together on the items.

(D) APA Fiscal Year 2022 Audit. Mr. Cracraft provided a brief update of the audit, which he stated should be completed by the middle of November. He was hopeful there would be no material or significant findings in the final report, but advised the Trustees they would receive a copy via email as soon as it was received.

(E) Open Records Rules and Procedures. Mr. Cracraft referenced the *Open Records Policy* memo from staff included in the materials.

Following a discussion, Representative Scott Brinkman made a motion, which was seconded by Representative Brad Montell to adopt the revised JFRS Open Records policy. The motion passed unanimously.

(C) Pension Administration Software. Mr. Cracraft provided a quick verbal update on the Pension Administration Software project. Since the August meetings, the team had largely focused on design and data cleansing. In addition, the team was redesigning all the agency's forms and documents, which would give their web, print, and other communications a very similar look. Milliman plans to provide a beta version as soon as November 15 and by the end of January the plan is to have MARC programed to begin reviewing calculations and reporting.

There being no further business, the meeting adjourned at 2:13 p.m.



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



Stephen F. LeLaurin, Chairman
Judicial Retirement Fund Investment Committee



Representative Brad Montell, Chairman
Legislators Retirement Fund Investment Committee



Bo Cracraft, Executive Director

