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

April 19, 2024

The Board of Trustees of the Kentucky Judicial Form Retirement System (JFRS), the Investment Committee for the Kentucky Judicial Retirement Plan (JRP), and the Investment Committee for the Kentucky Legislators Retirement Plan (LRP), convened at the Whitaker Bank Building, 302 Ann Street, Frankfort, Kentucky 40601 on Friday, April 19, 2024, at 10:00 a.m. All Board members, with the exception of Senator Jimmy Higdon, were present.

JFRS staff present included Bo Cracraft, Executive Director, and Rebecca Stephens, Retirement Programs Administrator. Guests attending the meeting included Don Asfahl and John Watkins of Baird Trust Company.

Chairman Venters called the meeting to order at 10:03 a.m.

The trustees considered the adoption of the previously distributed *Minutes* from the January 19, 2024 meeting. Upon motion by Mr. Stephen LeLaurin, seconded by Judge Doughlas George, the Board unanimously approved the *Minutes* of the January 19, 2024 meeting.

The next order of business was a review of the Lexington Investments Partners quarterly compliance report. Chairman Venters recognized Mr. Cracraft, who notified the board that Stan Kerrick, Lexington Investment Partners, was unable to attend the meeting. He noted for the record that *Lexington Investment's Compliance Report as of March 31, 2024* was included in board materials distributed to the Trustees in advance. Mr. Cracraft highlighted page one of the *Report*, which provided a summary of the portfolios investment policy statement compliance. He pointed out that both portfolios were within prescribed asset allocation guidelines and met duration and dividend requirements. He did highlight Progressive Insurance as an equity holding that had reached the 8% of the equity portfolio and suggested the trustees ask Baird to discuss the team's plan going forward. Next, Mr. Cracraft reviewed recent activity in the portfolios. He stated that no equity positions had been bought or sold, while five bonds matured from each portfolio during the quarter. Lastly, he reviewed cash flow in the portfolios and highlighted how staff had used some of the bond proceeds to meet retiree payroll obligations.

Chairman Venters welcomed Baird Trust Company, who arrived and joined the meeting at 10:15 a.m. Mr. Cracraft had previously distributed copies of Baird's *Investment Review for Kentucky Judicial Retirement Fund and Kentucky Legislators Retirement Fund* dated April 19, 2024. In accordance with Board policy, the System maintains a copy of the Investment Review.

Mr. John Watkins began with a review of Baird's most recent quarterly market commentary, titled "Combining Growth and Value." While many investment strategies are placed in a distinct growth or value bucket of style, the Baird team aims to incorporate strengths from both styles into their long term approach. While many believe the two styles are polar opposites, in reality they are not so different and should be used in combination. Growth can lead to compounding, while value serves as downside protection. Mr. Watkins noted the team sought to invest in companies who allocate capital well and continue to grow revenues, margins, or earnings per share. However, the team doesn't want to over pay for a growth opportunity, which is where value investing serves as a compliment. The team wants to invest within a margin of safety, or at a price point they believe is at a discount to the long term value of the business. Ultimately, Baird does not think of growth or value as a choice you have to make, but rather want both to play a role. And when combined correctly, can lead to strong, consistent results.

In response from a question from Mr. Allison regarding how the team measures the "margin of safety," Mr. Watkins stated the team attempts to value the business as if they were purchasing the entire company. Then they project future cash flows, but he acknowledged it was not an exact science or price. Rather, the team rates all new and existing ideas within three ranges or buckets of value; cheap, about right, or expensive. Existing holdings might move within those three buckets, but as it relates to new ideas, the team would want to find something more attractive than a current holding or something they believed was firmly priced in the cheap category.

In response from a question from Mr. LeLaurin regarding Berkshire Hathaway and the firm's level of comfort since the passing of Charlie Mungor, Mr. Watkins expressed confidence in the business. While he noted the allocation model might change, as expected with the transition, the processes and way they do business was well ingrained and established. In addition, Warren Buffett remains active and engaged, which will provide continuity as the business transitions.

In response to a question from Chairman Venters regarding the team sell discipline, Mr. Watkins highlighted three primary reasons a team might consider selling a current holding. Those three reasons were a deterioration of the business, management change or concern, and lastly, the price or value of the business. He noted some of these considerations, such as management's ability and or the current value, can be harder decisions. Historically, the team has been fairly patient, especially with long-term investments, as they do have a lot of confidence in the management teams and know that good companies often tend to outperform even the most optimistic expectations.

Mr. Asfahl reviewed several economic statistics and highlighted recent consumer activity. He noted that the Fed's plan to ease rates had gotten pushed out a little further than expectation, which had led market to correct some in March. Both the unemployment rate and CPI index had climbed slightly, while bond rates continued to provide attractive returns and provide reasons to hold bonds. Mr. Asfahl continued with a review of current asset allocations, annual estimated income, and the current yield on the portfolios. He discussed the fixed income portfolio and schedule of upcoming maturities.

Next, Mr. Watkins reviewed a snapshot of the portfolio, which included relative sector weightings, attribution, top performers and largest holdings. He reminded the trustees that the portfolio would look significantly different than the index they were trying to outperform but emphasized sector weightings were completely driven by stock selection and not a top-down decision. He drew attention to GE Aerospace and highlighted that the company had formally completed the spin-off of their energy business, now known as GE Vernova. He reminded the trustees this was the final phase of GE breaking up their healthcare, energy, and aerospace businesses into three independent companies. It began in January, when GE spun off GE Healthcare, however after receiving shares, the Baird team did not decide to hold on to the new company. With regard to GE Aerospace and GE Vernova, the team tentatively plans to hold both companies. The team believes both have significant tailwinds that have the companies set to profit for several years. Lastly, Mr. Watkins noted the team had decided to exit their position in Pfizer and had used those proceeds to add to GE Vernova. Pfizer was a company the trustees had discussed in prior quarters but continued to struggle in a post-covid environment.

In response to a question from Mr. LeLaurin regarding GE Vernova and any exposure to nuclear power, Mr. Watkins stated the company did have some exposure, but it was minimal at this time. He noted nuclear power was gaining traction within the industry but given the amount of regulation any significant impact was likely a decade or more out into the future.

In response to a question from Judge John Grise regarding the recent strong performance of NVDIA and if the Baird team had considered adding to the portfolio, Mr. Watkins stated the team would most likely not own the company in the near term. He pointed to the high levels of volatility generally experienced within the semiconductor space, driven by huge cycles or periods of under or out performance. He acknowledged that NVDIA had performed significantly and could be changing the game within the sector, but believed the team would have to have a lot more comfort before owning.

Mr. Asfahl also pointed out Progressive Insurance, which was bumping up against the portfolios' policy limit of holding no more than 8% of the equity portfolio in one name. In response to a question from Mr. Cracraft with regard to how any proceeds from trimming Progressive would be reallocated, Mr. Watkins stated the team wanted the portfolio to remain fully invested if possible.

In response to a question from Representative Brad Montell with regard to Apple and its relative performance recently, Mr. Watkins agreed that Apple had performed fairly sideways for the last year plus. He noted that so much of the company's performance was still tied to iPhone cycles, even though the company generated overwhelmingly more income from other sources. Longer term, the team still believed Apple was attractive and he pointed to their unique and highly demanded ecosystem that continues to grow. While it might not be as growth oriented as in the past, Apple was well positioned to generate attractive cash flows and had a tremendous history in allocated those cash flow well.

In response to a question from Judge Grise regarding Disney, their recent missteps, and his growing concern going forward, Mr. Watkins expressed some agreement with the concern and stated the team was watching closely. He referred to this situation as another example of the Baird team having a "business owner" mentality, which often leads to periods of patience. While not always, historically, the team had been rewarded for being patient and they still believed there were attractive aspects with regard to Disney. While the stock had underperformed, the fundamentals of the company were improving and several decisions from Bob Iger gave cause for some optimism.

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 are well-positioned, continue to produce strong risk adjusted results, and had outperformed the blended index over each measured period.

Lastly, Mr. Asfahl quickly reviewed allocation, returns, and holdings for the LRP legacy portfolio and two smaller Cash Balance portfolios. He referenced the Board's recent decision to diversify the portfolios and pointed to the most recent quarterly performance as evidence of how performance of the two portfolios had tightened.

The meeting recessed for lunch at 11:50.

The meeting reconvened at 12:15 p.m. Mr. Asfahl and Mr. Watkins left the meeting. Chairman Venters recognized Mr. Cracraft, who reported on several administrative matters. The trustees discussed the items and took action when noted.

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

> **January 22, 2024** – JFRS was not on the agenda. A handful of proposed legislative amendments were discussed that related to teacher sick leave and retiree health reimbursements. The only other agenda item was a short discussion related to TRS and unpaid days missed due to religious holidays.
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> **February 26, 2024** – JFRS was not on the agenda. Three legislative proposals, all unrelated to JFRS were presented. And the Kentucky League of Cities also presented a pension proposal related to CERS.
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> **March 2023** – The Oversight Board did not meet in March.
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> The **April Meeting** is set to meet on Monday, April 22. JFRS was on the agenda and had been asked to provide an update on investments and cash flow.

(B) 2024 General Session. Mr. Cracraft referenced the *2024 Regular Session – Legislative Update* memo from staff included in the Board materials. He discussed the recently adjourned regular session, which apart from the biennial budget bills, only included one piece of legislation that directly impacted JFRS.

Mr. Cracraft highlighted House Bill 635, sponsored by Representative Meade, as the only material pension related bill that was passed. However, Mr. Cracraft indicated the bill did not really impact JFRS as the stipulations outlined were already consistent with JFRS policy and procedures. The bill was related to actuarial analysis and required that actuaries provide more basis and documentation in the event they used assumptions or methods that were different from those used in a pension plan annual valuation. Mr. Cracraft could not recall an instance where JFRS actuaries had used different assumptions but noted that the PPOB approved Actuarial Analysis template utilized did include a specific section where actuaries were asked to outline any new or different assumptions utilized.

(C) 2024-2025 Personal Service Contracts.

1. **Investment Management.** Mr. Cracraft informed the Board that Baird Trust Company had agreed to a 2-year extension to their June 16, 2022 investment management contract. There were only two changes noted in the extension, both to make clarification with the recent passage of HB 236 from the 2023 Regular Session, related to proxy voting policies and fiduciary standards of investment.

2. **Audit Services.** Mr. Cracraft informed the Board that Staff had offered a two-year extension to Blue & Co, who countered with a proposed fee increase to $45,000 from $36,000. He expressed some frustration, but also reminded the Board that two prior RFPs had resulted in only one response. And Blue was currently conducting audits for all three pension administrators.

   Audit services for the Agency was reviewed and discussed. Judge John Grise made a motion, seconded by Representative Scott Brinkman, to agree with Blue & Company a 2-year extension of the August 9, 2022 investment management contract for the period of July 1, 2024 through June 30, 2026 under the terms and conditions as outlined in the August 2022 contract, except for the annual fee will increase to $45,000. The motion was unanimously adopted.

(D) Actuarial Request for Proposals (RFP). Mr. Cracraft drew attention to a staff memo, titled *Request for Proposal – Actuarial Services* memo, which was included in the Board materials. Mr. Cracraft reminded the Board that staff had issued an RFP in February for the purposes of seeking qualified firms to provide actuarial services to JRP and LRP. This RFP was required given the existing contract with USI, Inc (formerly known as Findley) was set to expire on June 30 and all available extensions had been exhausted.

Mr. Cracraft informed the Board that six firms responded to the RFP, including the incumbent. All respondents met the minimum qualifications and represented a good mix of both smaller, regional sized firms and those larger or more nationally recognized. After review of the responses, staff reduced the group down to three finalists, which included USI, Inc., Gabriel Roeder & Smith (GRS), and Milliman. Mr. Cracraft admitted that staff thought very highly of all three finalists and expressed confidence in each firm's ability to capably provide services to JFRS. He provided a summary of each finalist along with a few staff observations and considerations for each.

Actuarial services for both JRP and LRP were reviewed and discussed. Mr. Ben Allison made a motion on behalf of the Investment Committee for the Judicial Retirement Fund, which was seconded by Judge Doughlas George, and Representative Brad Montell made a motion on behalf of the Investment Committee for the Legislative Retirement Fund, which was seconded by Representative Steven Brinkman to extend an offer to Gabriel Roeder & Smith for actuarial services for both plans for the period of July 1, 2024 through June 30, 2026. The motion passed unanimously.

(E) Administrative, Budget, & Personnel. Lastly, Mr. Cracraft referenced the recently passed budget bills pass by the General Assembly. He informed the Board that all three branch budget bills included budgets included language that provides a three percent (3%) salary increase for each eligible employee effective July 1, 2024 and also July 1, 2025. He reviewed the impact on JFRS administrative cost if a similar raise was provided to the agency's three current employees.

Upon motion by Judge John Grise, seconded by Representative Scott Brinkman, the Board unanimously authorized providing staff with a 3% increase in salary or hourly rate of all three current JFRS staff members effective July 1, 2024.

There being no further business, the meeting adjourned at 1:38 p.m.

Justice Daniel Venters, Chairman
Board of Trustees

Mr. Ben Allison, Chairman
Judicial Retirement Fund Investment
Committee

Bo Cracraft, Executive Director

Representative Brad Montell, Chairman
Legislators Retirement Fund Investment
Committee