Reform Pension Board

A Covenant of Trust – ברית אמונה

Quarterly Commentary – June 30, 2016

A Perspective on Persistent Low Interest Rates

In the past five years, there has been an unprecedented change in interest rates, not only in North America, but also around the world. As a result of actions by central banks, most developed world governments, and major corporations, interest rates have fallen to record lows. Today, the U.S. government can borrow money for about 1.35% for ten years. In Europe, the Swiss will *charge* you money for making bank deposits, and 30-year Swiss government bonds pay interest of 0.1% per year. About $13 trillion of sovereign debt pays negative interest rates. Although hyper-low interest rates have been wonderful for home-buyers and consumers, they pose challenges for savers.

Gone are the days when the bank on the corner would sell a five-year Certificate of Deposit paying 5%. Today that same bank will offer you 1%, or maybe 1.5%. Bond funds strain to produce returns over 2%. With consumer inflation running around 1.5%, savers and bond buyers are getting a real return—*the return of an investment after factoring in inflation*—close to zero, without even taking taxation into consideration**.**

Investing in CDs, bonds and money market funds had long been the sweet spot for older investors and those worried about stock market volatility. Returns might not have been wonderful, but at least knowing the interest rate that would be paid provided a sense of security and made planning easier. Now, however, those who need a certain return from their portfolio to maintain their lifestyles are finding it harder to get it from the fixed income market without also eating into capital or curtailing their spending—both unpalatable choices. What was sweet has turned sour, and old ideas about investment, risk and return simply do not work as well in this environment.

Recent pronouncements from central banks in the U.S., Britain and Europe have made it clear that interest rates will rise slowly, if at all, over the next few years. In today's world, risk adverse investors should consider expanding their horizons. Stock market volatility can be scary, but even with the inevitable market crashes and crises along the way, it is a fact that stocks tend to rise over time. Even the disaster of 2008/09, the worst stock market crash since the 1930's and during which the S&P 500 fell 50%, took only about two or three years to repair. Most market events are much less dramatic and over the long haul, amount to mere blips on an upward sloping line.

In a world of low economic growth and low interest rates, it is likely that dividends will command a level of attention and importance that they last saw in the early part of the last century. Stocks will be held not only because they may increase in value, but also because they are expected to pay dividends, which should provide a better return than bonds. The best stocks to own will be the ones which are the most reliable dividend payers and dividend growers, and investors will pay a hefty premium to own these kind of securities. In fact, over the past forty years, dividends have provided 1/3rd of the total return for investors in the S&P 500.

To enhance the potential yield of the RPB's Income Focused Fund over what bonds alone might deliver in this low rate environment, we've been maintaining allocations to managers that invest in dividend paying stocks as well as MLP's (Master Limited Partnerships). We also maintain an allocation to our unconstrained bond manager, who can position their portfolios with more or less sensitivity to interest rates, which can be helpful during periods where interest rates move quickly in either direction.

The RPB consistently seeks out managers and investments with the potential to enhance the yield of all of our funds, and we continually monitor allocations and make adjustments as needed. Likewise, for you, we recommend you seek help from advisors who are not only knowledgeable about investments, but who are also knowledgeable about your unique financial needs and tolerance for risk. If you don't have an advisor, you can always contact Ceridian Lifeworks free of charge and schedule an appointment with a financial counselor.

Other Announcements - Domestic Large Cap Portion of Capital Appreciation Fund Moves to Passive Management

The RPB has determined that passive management - an investment style that mirrors a market index and is most appropriate for highly efficient asset classes – will be used for the large cap portion of the Capital Appreciation Funds. As a result, we will be shifting these investments to the Vanguard S&P 500 Index Fund from Brown (U.S. large cap growth), Eagle Capital (U.S. large cap value), and Northern Trust Quality Dividend Focus (U.S. large cap dividend). As a reminder, the Appreciation & Income Fund will reflect these changes based on its respective 60%/40% allocation to the Capital Appreciation and Income Focused Funds. Click here to view the updated Fund Descriptions.

For many years, the RPB used both active and passive management within domestic large cap equities in an effort to outperform the domestic market while controlling costs. Active managers attempt to add value by constructing a portfolio of securities they believe are undervalued by the market and poised to appreciate due to an unknown or misunderstood catalyst (revenue, profitability, new products). The ability to uncover these underappreciated stocks becomes more difficult when there is so much information available to investors. For example, there are thirty-seven Wall Street analysts covering Apple, making it nearly impossible for an investor to identify a catalyst for growth not already known by the market. This is known as an efficient market.

The efficiency of the domestic large cap market has reached a point in which only the very best managers have a decent probability of consistently beating the benchmark. And even then, many of them experience periods of 1 to 3 years in which they may significantly trail the market.

There are, however, many asset classes that are still relatively inefficient and provide an environment conducive to active management. The RPB will continue to monitor the performance of its managers in these asset classes to ensure there is value for the fees paid through higher returns, lower risk, or both, and will make changes as appropriate.

L' Shalom,

Michael Kimmel	G. Leonard Teitelbaum	David P. Baskin
Executive Director	Chair of the Board	Investment Committee Chair