

# Town of Hampton



## TRUSTEES OF THE TRUST FUNDS

OCTOBER 18, 2010 3:00 p.m.

TRUSTEES: David Hamilton, Chairman  
Edward (Sandy) Buck, Vice Chair  
Warren J. Mackensen, Bookkeeper  
Norman Silberdick  
William A. Hartley

ADVISOR: Robert Magan, TD Wealth Management, Private Client Services,  
Vice President & Senior Portfolio Manager

PUBLIC: Michael Pierce  
Mary Louise Woolsey  
Selectman Richard Nichols  
Stephen Demarais  
Shir Haberman, Hampton Union

The meeting was called to order at 3:00 p.m. by Chairman Hamilton, followed by the Pledge of Allegiance.

---

### **Real Estate Trust Fund**

The Trustees reviewed the written Market & Economic Review provided by Mr. Robert Magan of TD Wealth Management (TD WM).

#### Third Quarter 2010:

Over the past year, stimulus programs from the public sector have attempted to revive the economy. With pressure building to reduce these programs and contain expanding government debt, the economy will need to rely on the private sector. Unfortunately, at this time, the private sector does not appear willing or able to rise to the occasion.

While corporate balance sheets may be in their best condition in years, there is little incentive for corporate America to re-invest. Unknown new regulatory hurdles and health care costs continue to cause various businesses to delay their hiring practices and expansion plans in the short term. This is leading to sluggish jobs growth and continued diminished consumer confidence.

With poor employment prospects, consumers remain on the sidelines. As neither the public nor private sector is willing to pick up demand, we are concerned about the overall economy and the impact on profit margins. As a result, we do not anticipate any significant increases in interest rates. Potential central bank tightening has been delayed. On the equity front, while valuations have improved, we are concerned that future earnings estimates are too high.

### Economy

The final tally showed the U.S. economy grew at a 1.7% annualized rate in the second quarter, slightly better than the 1.6% previously estimated. The upward revision reflects larger increases in consumer spending and inventories. Economic growth has slowed from 3.7% in the first three months of the year and 5.0% in the final quarter of 2009.

Overall, the economy lost 54,000 jobs in August, but the private sector added 67,000 positions. The unemployment rate edged up to 9.6% from 9.5%. U.S. manufacturing expanded in September for the fourteenth straight month, though at a slower pace than in August.

Headline inflation rose 0.3% in August, the second straight increase. The annual rate came in at 1.1% versus 1.2% the month before. Core inflation was unchanged in August, with the annual core rate holding at 0.9%, the lowest since 1966.

Mr. Magan provided ten pages of slides for the Trustees. He commented that the recovery is gradual at best. There has been anemic 2-1/2% growth year-over-year for 2010.

Manufacturing is leading the way, but it has been driven mostly by inventory rebuilding. The consumer is not driving much of the demand. The consumer is stabilizing the economy somewhat, but is not providing a significant improvement in the economic recovery rate.

Credit conditions are improving as banks ease up somewhat, but lending is still not robust. Credit standards remain tight as banks increase their willingness to lend to consumers. There is modest improvement, but not highly significant.

The federal stimulus programs are a drag on growth. The housing market has fallen back into the doldrums. The decreased federal revenues are a long-term issue.

Interest rates may rise around the end of 2012. U.S. inflation is very much under control and TD does not see deflation occurring.

The equity markets are struggling to make any headway in 2010. There is a lot of extreme volatility.

#### Hampton Real Estate Trust Portfolio Review

The Real Estate Trust Fund remains invested in accordance with the Real Estate Trust Fund Investment Policy. The portfolio's asset allocation is approximately 38.4% in Equities and 61.6% in Fixed Income and Cash. The estimated portfolio yield is 3.46%.

The portfolio's total return for the 12-month period ending September 30, 2010, was 11.34% versus the performance benchmarks, which returned 9.26% for the same period.

#### Hampton Real Estate Trust Discussion:

Mr. Mackensen noted that the three-year average annual total return for the portfolio managed by TD Wealth Management, after fees, was 2.15%. This means that the portfolio effectively returned 2.15% per year for three years in a row after fees.

Mr. Hamilton asked how the portfolio performed in light of the change to the investment policy statement in March of 2010. Mr. Magan replied that there was some modest outperformance due to the total return approach.

Mr. Hamilton noted that TD Wealth Management sold Verizon and the yield was around 7%. Mr. Magan countered that the sale in August was just a trimming of the position to take some portfolio gains.

Mr. Silberdick asked how the Trustees could assess the fixed income performance from March to September. Mr. Magan said that TD Wealth Management can run a report to provide an accurate response.

Mr. Hartley commented that the average maturity of the fixed income portion of the portfolio moved out from 6.6 years to 7.3 years. The short-term bond percentage declined from 57% to 48%. The long-term bond percentage increased from 29% to 36%. This shows some of the changes made by TD Wealth Management.

Mr. Silberdick noted that there are some taxable Treasuries in the portfolio that have a low yield. He inquired as to why the portfolio was invested in these low-yielding (1-1/2 percent) Treasuries. Mr. Magan said that the portfolio would have to pay a premium to get higher coupon Treasuries, which would result in the same yield to maturity.

Mr. Silberdick further inquired about purchasing other corporate bonds. Mr. Magan said that the portfolio is managed to a fixed income index, and that TD over weights quality corporate bonds to provide the yield and purchases Treasuries to get the duration of the portfolio to match the fixed income index.

Mr. Silberdick further commented that almost 10% of the fixed income portfolio is tied up in low yielding investments. He inquired as to whether 3.5% is a good yield.

Mr. Hartley interjected that it depends on the quality and duration of the portfolio. By reducing the quality, the yield can be increased.

Chairman Hamilton opened floor to the public for questions.

Mr. Nichols asked about the average maturity of the fixed income portfolio. Mr. Magan replied that it is 7.2 years.

Mrs. Woolsey commented that the draft 2009 audit report from the town auditors, on page 16 to 17, talks about \$1,705,258 of the \$20 million was subject to custodial credit risk. She also said that the town audit report stated that there is no formal interest rate risk policy. It was not completely clear that these comments applied strictly to town funds or trust funds. Clarification was needed on this matter. The town auditors have not communicated any concerns to the trustees.

Mr. Nichols said that money on deposit used by the town to pay bills is 100% FDIC-insured because the account is not interest-bearing. He continued by saying that he was nevertheless concerned about the interest rate risk in the Real Estate Trust Fund.

Discussion ensued about the fact that TD Bank is a separate entity from TD Wealth Management, which has significant errors and omissions insurance. Mr. Magan said that he will produce a SAS 70 report to allay some of the risk concerns.

Mrs. Woolsey asked the Trustees how often the investment advisory contract is reviewed. Mr. Mackensen said that the investment advisory contract was put out to bid in August 2008. There were 15 RFPs sent out to bidders; there were 9 bids. The field was narrowed to 5 bidders who were subsequently given the opportunity to make presentations to the Trustees. After those five public presentations, the Trustees voted 3-2 to continue with TD Wealth Management.

Mr. Pierce reminded everyone that the banks are having serious problems with mortgages and wanted to know what the exposure is relative to mortgage backed securities. Mr. Magan replied that the portfolio does not contain Citibank stock, nor Bank of America stock. In fact, TD Wealth Management avoids all TARP-related banks.

Mr. Nichols pointed out that the fixed income portfolio comprises \$2.8 million of financial securities with significant mortgage-backed security exposure, expressing his concern about the potential liability that these companies may represent.

Mr. Silberdick said that the day of reckoning is coming. The banks have not written down the mortgage values to the point where the values are realistic.

Mr. Pierce continued that in view of the situation would it not be more prudent to look at short-term bonds? Mr. Magan replied that TD Wealth Management looks at the risk level versus the long-term goals of the portfolio. The fixed income managers at TD look at both the short-term and long-term nature of the portfolio.

Mr. Magan left meeting at 3:49 p.m.

---

### **Real Estate Trust Fund Trend Graphs**

The Trustees reviewed graphs showing the month-end market values of the Real Estate Trust Fund since late 2005.

---

### **Real Estate Trust Fund Disbursements Review**

The Trustees reviewed the 2010 Cash Basis Income, Fees & Distributions Summary spreadsheet provided by the Bookkeeper showing the accumulated income and distributions to the Town as of the end of last month.

---

### **Real Estate Trust Fund Fee Calculation**

The Bookkeeper informed the Trustees that the recent fees for the Real Estate Trust Fund were computed correctly by TD Wealth Management.

---

### **Investment Policy and Investment Management Change**

Chairman Hamilton turned the discussion towards the proposed mutual fund and exchange-traded fund portfolio that was discussed last month.

**MOVED** by Mr. Mackensen:

1. To adopt a revised Investment Policy for the Real Estate Trust Fund that will accommodate the implementation of a mutual fund and exchange-traded fund portfolio.
2. To commit the Trustees to performing the Investment Manager functions stated in the Investment Policy.

3. To adopt the proposed mutual fund and exchange-traded fund portfolio proposed and discussed at the September 20, 2010, Trustees meeting, in lieu of the current TD portfolio that lacks broad equity diversification (only about 35 stocks in the \$5,948,000 equity portfolio).
4. To engage the services of National Advisors Trust Company, Overland Park, Kansas, as custodian and Agent for Trustee for the purposes of providing principal and income trust accounting services at their posted Agent for Trustee fee schedule (nominally 6.6 basis points for a \$15,300,000 portfolio – about \$10,000 per year).
5. To direct TD Wealth Management to sell all security positions in the Real Estate Trust Fund immediately.
6. To direct TD Wealth Management to wire the Real Estate Trust Fund sales proceeds and all cash to National Advisors Trust Company.
7. To terminate the services of TD Wealth Management upon completion of the wire transfer.
8. To accept the offer of Mackensen & Company to execute trades as directed by the Trustees, and to provide quarterly portfolio performance reporting services to the Trustees at no cost to the Real Estate Trust Fund or the Town. This offer stands irrespective of Mr. Mackensen serving as a Trustee.
9. To direct Mackensen & Company to implement the proposed mutual fund and exchange-traded fund portfolio asset allocation (place the trades) once the wire transfer has been received at National Advisors Trust Company.

**SECONDED** by Mr. Buck.

Mr. Mackensen made the following points.

**Trust Reporting:** National Advisors Trust Company is recommended because they are a full-blown chartered trust company, as opposed to Schwab and Fidelity, which are fundamentally brokerage firms. Their brokerage statements have been revised to a purported “trust-style” statement, but these altered statements are far off the mark from National Advisors Trust Company statements. Samples of all three statements were provided to the Trustees.

It should be noted that Mackensen & Company uses all three of these custodians for various purposes, depending upon client needs. For the Hampton Real Estate Trust Fund, National Advisors Trust is the superior firm for the needs of the Town.

**Disclosure:** Mr. Mackensen is a Charter Shareholder of National Advisor Holdings, Inc., the parent company of National Advisors Trust Company, FSB. He owns 0.25% (one-quarter of one percent) of the stock of National Advisor Holdings, Inc. He has never received any dividends from National Advisor Holdings, Inc., nor does he ever expect to. Neither Mr. Mackensen nor Mackensen & Company has ever been compensated in any way by National Advisors Trust or any of the mutual fund companies that are used in portfolios.

**Background:** National Advisors Trust Company is an FDIC-insured federal savings bank chartered by the Office of Thrift Supervision in Washington, DC. National Advisors Trust Company is a “qualified custodian” under SEC definitions. The purpose of founding a national trust company in 2001 was to provide a service-oriented trust company that would serve the interests of clients, rather than the shareholders. There are about 120 shareholders of National Advisor Holdings, Inc., all of whom share this client service philosophy. Shareholders operate registered investment advisory businesses and are located in about 32 states. The National Advisors Trust Company headquarters is located in Overland Park (Kansas City), Kansas. This central U.S. location facilitates shareholder (and client) service by readily accommodating multiple time zones. There are over 30 employees at National Advisors Trust Company. The Trustees were provided with a National Advisors Trust Company brochure.

**Action:** Mr. Mackensen emphasized the importance of passing this motion now, as opposed to deferring the proposal to a future meeting. Mr. Mackensen apprised the Trustees about a similar mutual fund portfolio proposal that he presented to the Trustees three years ago. The proposal did not receive much traction with the then-sitting Trustees and was ultimately tabled.

A retrospective analysis of the proposal that was presented three years ago showed that the Town would now have over \$756,000 more in the Real Estate Trust Fund had that proposal been adopted three years ago. Mr. Mackensen pointed out that \$756,000 divided by 36 months means that the opportunity cost was about \$21,000 per month for the last three years.

Discussion ensued about the proposed portfolio. Mr. Silberdick commented that Mr. Mackensen had done a lot of analysis in preparing the motion. He was concerned what other people might say about the portfolio, i.e., is there a possible lower-cost option that would also provide a better rate of return.

Mr. Hartley commented that what Mr. Mackensen proposed is a better way to manage the Real Estate Trust Fund. However, he has not had the time to analyze it. He is favorable to a mutual fund portfolio. He felt that the fees may not be that much less. The advantage, though, is to get a better return.

Mr. Hartley continued that we could have other people come in, but other proposals will not improve the situation very much. He knows what the other bidders will come in with. Mr. Hartley is disenchanted with the concentrated

portfolio that we have now and said that a portfolio of only 35 concentrated equity securities is not desirable. He is in favor of waiting another month before voting in favor of the motion in order to give him time to analyze the proposal.

Mr. Nichols commented that he was happy that the Trustees are looking at other opportunities, but he reiterated his concern about the risk of the portfolio. A discussion about average maturity and duration of the portfolio ensued. Chairman Hamilton thanked Mr. Nichols for his input.

Mr. Pierce asked whether or not shifting from TD Wealth Management is good or not. He said that he felt there is a very serious conflict of interest where a trustee is proposing to provide investment advisory services at no charge to the town.

Mr. Mackensen replied that there is absolutely no conflict of interest because there is no compensation that will be paid to Mr. Mackensen or to Mackensen & Company. Mr. Mackensen has been a resident of Hampton for the last 28 years and is committed to supporting the community. Mr. Mackensen has been providing bookkeeping services for four years for the Trustees without compensation, using his firm's portfolio management software. Adding one more portfolio to the monthly portfolio reports is just fine. The Real Estate Trust Fund portfolio would be number 15, added to the bottom of the list of the 14 other funds that he has been managing for four years.

Mrs. Woolsey asked whether the Trustees can change funds every month. Mr. Hartley responded that they could, because the flexibility is there in the investment policy. Mr. Mackensen added that, despite the ability to make changes every month, the investment policy is designed to provide a diversified portfolio with well-established broad-based index-type mutual funds and exchange-traded funds where changing funds every month is not likely to be necessary. In fact, it runs counter to the idea of a well-designed diversified mutual fund portfolio. Further, the Trustees should avoid market timing.

Chairman Hamilton proceeded to ask some questions, especially relative to DHK Investment Advisors in Portsmouth. Specifically, he asked what their fee structure was two years ago when they provided their bid.

Mr. Mackensen replied that their fee was 37 basis points. Mr. Mackensen further stated that he received a phone call from DHK Investment Advisors this last week wherein Mr. Dempsey of DHK offered to provide investment advisory services to the Real Estate Trust Fund for 10 basis points.

Mr. Buck turned to the proposed 30-fund mutual fund proposal prepared by Mr. Mackensen that included about 13% non-investment grade bonds. Mr. Hamilton was concerned that the non-investment grade bonds would be acceptable by the State of NH. As well, he was concerned about this type of investment period.

Mr. Mackensen replied that high yield bonds are a separate asset class that is consistent with the prudent investor rule. He further stated that it is difficult to



completely avoid non-investment grade bonds because the various mutual funds sometimes have a minor portion of high-yield securities in their portfolios in order to improve yields. Mr. Mackensen said that, even if there are no high-yield bond funds in the portfolio per se, there still may be a certain percentage of non-investment grade bonds embedded in certain bond funds.

Chairman Hamilton indicated that he was not comfortable with serving in an investment manager role. He was also concerned that it may be difficult to fill future Trustee positions because they may not have the technical qualifications to run for Trustee. He added that if this motion passes, it must be publicized so future candidates fully understand the responsibility of becoming a Trustee.

Mr. Hartley responded that the Trustees really are picking the investment managers that run the mutual funds. Mr. Mackensen commented that it is the Trustees' primary role to ensure that the portfolio stays within the guidelines of the investment policy.

Mr. Silberdick said that he has never invested in mutual funds and that he would have to do research. Mr. Mackensen said that the mutual fund research statistics would be provided when the Trustees get closer to approving the final mutual fund portfolio. Mr. Mackensen's firm subscribes to Morningstar mutual fund research on a monthly basis and that the data would allay the concerns that were being expressed by Mr. Hamilton and Mr. Silberdick.

Mr. Buck felt that the Trustees needed to review the proposed investment policy changes before voting on the motion made by Mr. Mackensen. Chairman Hamilton said that he did not want to review the investment policy at this time because the motion may not necessarily pass and the investment policy review would be for naught.

Mr. Buck said that he supports diversification and the portfolio. Mr. Hartley said that he would like to wait a month before voting on the motion in order to do his own analysis. Mr. Silberdick said that he wanted to get other proposals before deciding. Mr. Hartley stated that other advisers would definitely charge more than 10 basis points.

There being no further discussion, Chairman Hamilton called for a vote on the motion.

**VOTE: 1-4-0**

**Motion Failed**

Mr. Hartley said that he will bring up the motion again at the next meeting. Mr. Silberdick said that he will obtain the names of the bidders from the 2008 bid proposals as well as the list of investment companies provided by the Attorney General's office. He will take the lead in contacting the various firms to get a sense of what other proposals might look like.

Chairman Hamilton tabled looking at the investment policy at this meeting.

### **Minutes of the Last Meeting**

The minutes from the meeting of September 20, 2010, were reviewed.

**MOVED** by Mr. Hartley to approve the minutes.

**SECONDED** by Mr. Silberdick.

**VOTE: 5-0-0**

**Motion Passed**

---

### **Smaller Trust Funds and Capital Reserve Funds**

The Trustees reviewed financial documentation on the smaller trust funds and capital reserve funds for the prior month. There were no comments.

---

Mr. Silberdick left the meeting at 4:45 p.m. due to another commitment.

### **School Trust Funds**

The Bookkeeper reported that three deposits into the Trustees' checking account were made on October 15, 2010, affecting the following trust funds:

Hampton School District, Article 6: Created a new Hampton Schools Special Education Expendable Trust Fund, with initial funding of \$50,000. Note: The Hampton Schools Special Education Expendable Trust Fund is different than the Winnacunnet School District Special Education Expendable Trust Fund.

Winnacunnet School District (WSD), Article 4: Add \$50,000 to the WSD Special Education Expendable Trust Fund.

Winnacunnet School District, Article 5: Add \$50,000 to the Winnacunnet High School Building Maintenance Expendable Trust Fund.

The trades to invest in the Vanguard GNMA Admiral Shares Fund were placed on October 18, 2010.

---

### **AED Trust Fund**

Chairman Hamilton reported that he communicated with Mr. Maury Friedman relative to the AED Expendable Trust Fund, and that the AED Trust Fund would be discussed at the meeting in November.

**Next Meeting**

The next meeting of the Trustees is scheduled for November 22, at 3:00 p.m.

**MOVED** by Mr. Hartley to adjourn.

**SECONDED** by Mr. Hamilton.

**VOTE: 4-0-0**

**Motion Passed**

The meeting adjourned at 5:06 p.m.

Respectfully submitted,

*Warren J. Mackensen*

Warren J. Mackensen, Bookkeeper