WALL & ASSOCIATES

An Independent Investment Advisory Group

To: Rosemary Ryba

From: Dave Wall

Re: Police Pension

Date: October 17, 2014

The pension plan achieved a return of 7.20% for calendar year 2013. On average, the plan held a weight in equities of about 30% for the entire year. Each quarter, the board met and reviewed the plan asset allocation and chose a very conservative approach to the investment portfolio. Clearly a greater allocation to equities could have added additional return, possibly as much as 2.5% to 3%. Beginning this year, greater allocations have been made to equities. $400,000 was added in the first quarter, bringing the equity allocations to 37%, $200,000 was added in the second quarter bringing equity allocations to 40% and $375,000 in the third quarter bringing the equity allocation to 43%, which is close to the statutory limit of 45%.

The approach to the management of the equity portfolio has been evolving over the years as it relates to equity weights in the portfolio and instruments utilized. This has largely been driven by state statute. Plans with less than $2.5 million in assets are only allowed to invest 10% of plan assets in equities and must use mutual funds or separate accounts of life insurance companies.

The plan surpassed the $2.5 million threshold in December 2008, at which time, up to 45% of plan assets could have been invested in equities. Over the following years, equity allocations were slowly increased from 10% to 30%. State statute required that plans with assets greater than $2.5 and up to $5.0 million invest in mutual funds or separate accounts.

Plan assets exceeded $5.0 million in December 2012. The Barrington Hills plan had utilized mutual funds until the plan asset exceeded $5.0 million. By statute, plans greater than $5.0 million are allowed to invest in single issue stocks. When plan assets reached $5.0 million, the investment policy was updated to allow for the use of Exchange Traded Funds (ETF's) in an effort to reduce internal expenses ratios. ETF's are currently utilized in the equity investment portfolio.

On the fixed income side, Government securities, largely agencies, have been held in the plan. It was not until January 2011 that state statute allowed plans to invest in investment grade corporate bonds. Prior to January 2011, an effort was made to gain exposure to this asset class subset utilizing a mutual fund, which according to the Department of Insurance, is considered an equity. In April of this year, the investment policy was amended to allow for investment in investment grade corporate bonds as plan size now exceeded $7.0 million. The bond funds have since been sold and positions in investment grade corporate bonds have added to the portfolio.

Evaluating returns in comparison to other state plans is very difficult for a number of reasons. The single greatest driver is each plans' appetite for risk, and their willingness to hold greater allocations to equities. Secondly, state statute is a driver as they allow plans with assets greater than $10.0 million to invest up to 65% in equities, however, those with assets greater than $2.5 million and less than $10.0 million are only allowed a maximum allocation in equities of 45%. Obliviously, those plans with equity allocations greater than 45%, many as much as 55% to 65%, have experienced greater returns. Finally, any comparison to large state plans is meaningless, as police pension plans have several restrictions, such as the inability to invest in greater equity allocations, private equity, asset backed securities, lower quality or global bonds, or hedge funds, that the large state plans do not have to adhere to when making investment decisions.

Our approach to the management of the equity portfolio is dynamic in nature and very broadly diversified. Passive instruments (ETF's) are largely utilized to gain exposure to various parts of domestic, international and emerging markets. Broad market world or region ETF's are considered in order to gain international exposure. Specific country ETF's are not considered. Broad domestic sector and sub-industry ETF's are utilized to gain exposure in the domestic equity portion of the portfolio. The mix between domestic and international capital markets is dynamically managed. By policy, international exposure can range from 0% to 50% of the equity portfolio. However, a more typical range is 10% to 30%. Currently, about 17% of the equity portfolio is invested in broad market international ETF's with some modest exposure to emerging markets. The domestic equity portion of

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the portfolio is also dynamically managed. The equity portfolio is invested in broad sector and sub-industry ETF's. All sectors of the S&P 500, and each respective sector weight is the starting point for constructing the domestic equity portion of the portfolio. Decisions are then made to overweight or underweight each sector relative to the S&P 500. Sector overweight and underweight tilts range from 10% to 20%. Sub-industry tilts are also made from time to time. Currently, the discretionary, industrial, technology, materials, telecom and utilities sectors are market weight to the benchmark. The energy sector is underweighted and the staples, healthcare and financial sectors are modestly over weighted. Sub-industry positions are held in aerospace and defense, and transports within the industrials sector. Within the discretionary sector, an actively managed ETF is held.

Our approach to management of the fixed income portfolio is generally duration neutral to Barclays Intermediate Aggregate Index. Duration may be 10% long or short of the benchmark. A greater emphasis is placed on current income and owning a high quality portfolio. US Government securities are generally securities with fixed coupon's and not callable. Corporate debt issues are rated "A" or better.