RETIREMENT PLAN

FOR

CHICAGO TRANSIT AUTHORITY EMPLOYEES

The 378th Meeting of the Retirement Allowance Committee was held on Monday, June 16, 1980, at the Continental Illinois National Bank and Trust Company, 30 North LaSalle Street, 10th Floor, Conference Room "A", Chicago, Illinois. The following were in attendance:

Mr. W. Ashley	Mr. R. Kren
Mr. S. Bianchi	Mr. E. Langosch
Mr. R. Goldman	Mr. T. O'Mahony
Mr. P. Kole	Mr. J. Weatherspoon

Mr. H. Hegarty, alternate for Mr. W. Spears, and Mr. C. Heatter, alternate for Mr. J. Gallagher, were also present. Messrs. Hall, Kasmer and Morris were also present. Mr. R. Burke, the Retirement Plan Attorney, was present. Mr. R. Harrell of Lowry, Raclin, Harrell and Howerdd was present.

Messrs. E. Hamilton and W. Leszinske of Continental Bank were also present.

The Chairman called the meeting to order at 10:34 A.M.

The Chairman asked for approval of the Minutes of the 377th Meeting held May 19, 1980.

On a motion by Mr. Kren, seconded by Mr. Weatherspoon, the Committee unanimously approved the Minutes of the 377th Meeting held May 19, 1980.

The Secretary made the announcements of deaths reported since the last meeting, as per the attached list.

The Secretary presented six (6) Survivorship Options for approval. On a motion by Mr. Bianchi, seconded by Mr. Weatherspoon, the Committee unanimously approved the Survivorship Options, as per the attached list.

The Secretary presented nine (9) Pre-Retirement Surviving Spouse Options.

On a motion by Mr. Langosch, seconded by Mr. Weatherspoon, the Committee unanimously approved the Pre-Retirement Surviving Spouse Options, as per the attached list.

The Secretary presented twenty-one (21) Applications for Retirement.

The Secretary indicated that among the twenty-one (21) applications was a disability retirement for Mr. Hans Foit. The Secretary indicated that this employee was injured on duty January 9, 1980 and was found fit to return to duty on two occasions; the last examination being April 22, 1980 and, consequently, his Worker's Compensation Benefits were discontinued.

The Secretary indicated that under Section 12 of the Retirement Plan, an employee with the required service would be eligible for disability retirement benefits after receiving benefits for the particular disability for 26 weeks. Inasmuch as Mr. Foit did not receive benefits for 26 weeks, he does not qualify under Section 12 of the Plan and his application for retirement is withdrawn.

The Secretary indicated his office will follow up on this employee to ascertain employability. If the employee is disabled because of a medical condition, a Weekly Disability Claim will be started for him.

Mr. O'Mahony asked if there was a dispute between Mr. Foit and Gallagher Bassett relative to this matter. The Secretary indicated that he did not believe that there was.

The Secretary also advised the Committee that among the applications to be approved was a disability retirement retroactive to June 1, 1980 for Mr. Hurley Thomas. The Transportation Department indicated that Mr. Thomas indicated that he did not know that he had to file his disability retirement application by May 14, 1980.

On a motion by Mr. Bianchi, seconded by Mr. O'Mahony, the Committee unanimously approved twenty (20) Applications for Retirement, withdrawing Mr. Hans Foit's application and approving a retroactive June 1, 1980 disability retirement for Mr. Hurley Thomas.

The Secretary reported that eight (8) employees receiving Disability Retirement Benefits had been examined or their records reviewed.

The Secretary presented twenty-three (23) refunds totaling $138,442.52 for approval.

On a motion by Mr. Bianchi, seconded by Mr. Weatherspoon, the Committee unanimously approved the Refund of Contributions to be paid on June 30, 1980.

The Secretary directed the Committee's attention to the book titled "Trustee Summary" prepared by Compensation and Capital, Inc. indicating the Total Book Value of Cash and Investments as of May 31, 1980 was $342,093,680.75.

The Secretary submitted for approval one (1) bill from the Authority totaling $25,691.67 and two (2) operating bills totaling $3,029.65 and four (4) remittances totaling $169,593.30.

Mr. Hegarty asked about the bill for air fare. The Secretary responded that it was for a member of his office to attend the Annual Client Conference sponsored by the Retirement Fund's Financial Consultant, Lowry, Raclin, Harrell and Howerdd.

On a motion by Mr. O'Mahony, seconded by Mr. Weatherspoon, the Committee unanimously approved payment of the bills and remittances on June 30, 1980, as per the attached list.

The Secretary presented twenty (20) Death Benefits totaling $52,000.00 for payment on June 30, 1980. On a motion by Mr. Langosch, seconded by Mr. Kole, the Committee unanimously approved payment of the Death Benefits, as per the attached list.

The Secretary asked Mr. Richard Burke, the Retirement Plan Attorney to update the Committee on the litigation against the Continental Bank relative to the Penn Central Stock.

Mr. Burke responded by indicating that Mr. James S. Gordon, the attorney for the plaintiffs in the Penn Central Case, has indicated that Judge James B. Moran, on April 21, 1980, ruled to sustain Mr. Gordon's position that the litigation may proceed as a class action suit. Mr. Burke indicated that he will keep the Committee advised of further developments in regard to the possibility of settlement of the action and further if the matter proceeds to trial in absence of a settlement.

The Secretary called the Committee's attention to the copy of the 1979 Condensed Financial Statements which was in the pass out material and indicated that it will be circulated to all employees in their upcoming paycheck.

The Secretary distributed copies of a proposed amended Rule No. 2, which reads as follows:

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RULE NO. 2

(AMENDED JUNE 16, 1980)

No vacation, holiday or other benefits accrued on the employee's normal or early retirement date shall be used in the formula determining the actual pension to be paid, nor shall there be any contributions deducted or made on such benefits.

Mr. Ashley explained that Amended Rule No. 2 was presented to clarify an administrative practice that has been in existence since the inception of the Plan. The Rule as written in the Plan only referred to employees, who retired on a normal retirement (age 65), but in practice this rule has applied to individuals taking early retirement as well as normal retirement. The Amended Rule No. 2 covers both early and normal retirements.

A discussion ensued between Mr. Hegarty, Mr. Kole, Mr. Burke, Mr. O'Mahony and Mr. Ashley relative to this rule.

On a motion by Mr. Kole, seconded by Mr. Hegarty, the Committee unanimously approved the Amended No. 2 Rule.

The Secretary advised that it will be necessary to appoint an Actuary and Auditor for the Plan Year 1980. The Secretary recommended that The Wyatt Company be named Actuary and the

Arthur Young Company be named Auditor for the Plan Year.

On a motion by Mr. Kole, seconded by Mr. Langosch, the Committee unanimously approved the appointment of the Actuary and Auditor for the 1980 Plan Year.

The Secretary referred the Committee to the letters, in the pass out material, that were being sent to the retired employees relative to the changes in the Retirement Plan as a result of the Arbitration Award between the Authority and Locals 241 and 308 of the Amalgamated Transit Union. The letters are attached to the Minutes.

Mr. L. Morris asked if the Secretary's Office has reviewed the Arbitration Award as to the impact on the funding of paying the hospitalization premiums out of the fund and to the legality of doing so.

The Secretary indicated that the Actuary was advised of the changes as a result of the Arbitration Award and is presently reviewing.

The Secretary asked Mr. Burke to respond relative to the legal implications of the Award on the Plan.

Mr. Burke indicated that the Arbitration Award was binding on all parties. He further indicated that his office is in the process of researching the provisions of the Award from a legal standpoint. He indicated that as soon as this is finalized he will present the findings to the Committee.

Mr. Hegarty asked whether the Plan of Major Medical Benefits Complementary to Medicare had coordination of benefits. The Secretary responded in the affirmative, pointing out that there is only coordination of benefits between group plans, but there is none between a group plan and an individual plan.

Mr. Kole asked if the Secretary's Office would provide the Committee with the numbers of individuals receiving additional benefits as a result of the Arbitration Award broken down by each new benefit.

The Secretary advised the Committee that Mr. Louis Wade returned to the Disability Retirement Rolls, effective June 1, 1980.

The Secretary reported that Mr. Emmanuel Bolarinwa was reinstated from a Military Leave of Absence on March 5, 1980 and failed to reimburse the Retirement Fund as provided under Rule 21, in the amount of $966.57. Mr. Bolarinwa's new pension service date is March 5, 1980.

Mr. Leszinske referred the Committee to a letter, dated June 11, 1980, titled "May Market Summary" which described the economic conditions as well as changes in the Bond Portfolio.

A discussion ensued between Mr. Leszinske, Mr. Kasmer, Mr. Hall and Mr. Heatter relative to the purchases and sales of securities.

Mr. Leszinske presented a chart which gave the Committee an indication on how volatile short term securities have been.

Mr. Heatter asked if Continental has ever made a performance comparison between a Bond Portfolio and a short term portfolio where securities are constantly turned over. Mr. Leszinske indicated that they have not. Mr. Heatter asked if a study could be conducted for the last 18 years and a comparison be made between a short term portfolio and the CTA Fixed Income Portfolio.

Mr. Robert Harrell of Lowry, Raclin, Harrell and Howerdd made a presentation.

Mr. Harrell explained his role with the Retirement Allowance Committee. He explained that his organization has no vested interest in setting the debt/equity ratio or who manages the Retirement Fund money. His company is a resource of information that is used by the Committee in order to make intelligent and informed decisions with regard to how the funds are invested. He explained that his organization works for 3 of the Bell Systems, Monsanto, Emerson Electric, Black and Decker and also for large Municipal Funds such as the City of Dallas. Mr. Harrell explained that his organization works for the largest Taft Hartley Fund, the Central

States Teamsters Fund for the last 2-1/2 years. He indicated his organization works for about 50 corporate and public corporations. Mr. Harrell indicated that an important function was to assist the Authority in reviewing various investment schemes as proposed to the Authority from outside sources. Mr. Harrell continued his presentation by reviewing slides on actuarial interest and salary assumption rates and relating the assumption to contributions. He suggested that The Wyatt Company set up a security/benefit ratio in order to ascertain the amount of money that would be required to pay off all its obligations to its participants if the Fund was terminated. Mr. Harrell indicated that the obligation to pay benefits fluctuate as the interest rates go up and down. If the interest rates go up, the Fund needs less money to pay obligations; if the interest rates go down, the Fund needs more money to pay obligations. The reason being that if the Fund was terminated, the Fund could buy annuities at the going interest rate to meet its obligation to the participants. Mr. Harrell indicated the Committee has structured an investment policy that would obtain a real rate of return at 6.5% over a 25 year period. If the Fund realizes the 6.5% over a long period of time and benefits do not change then the cost of funding the Plan will go down but, typically, what happens is benefits are improved.

Mr. Harrell continued his presentation by reviewing a chart on the Dow Jones Industrials over the last 55 years. This was presented to give the Committee an indication on how the Fund expects to earn a 6.5% real rate of return. If the Dow was purchased in 1925 at book value (original equity and retained earnings) and spent all dividends, the rate of return would have been 4.8% compounded annually with inflation, if inflation was taken out, which averaged 3%, the return would be approximately a 2% real rate of return. He stated companies grow at a 2% real rate of return without dividend. He indicated that this 2% real rate of return directly relates to how much companies have reinvested in their companies for new plant and equipment, increasing the productivity rate. He also indicated that 2% real represents the real increase in salaries over the last 200 years. He indicated that by reinvesting dividends, which the Retirement Fund does, the compound annual rate of return would be 9.5%. He pointed out that the majority of return from the stock market is through the reinvestment of dividends more than capital gains. He reviewed a chart on the historical prices of stocks and their relationship to book value. He pointed out that in 1925 the market was twice book and in 1929 the market was 3.4 times book - its highest valuation in the last 200 years, so during the depression the market went from this high valuation back to below book value.

During the depression, investors were overevaluating these future returns delivered by market. He reviewed the historical price to book ratios indicating that in 1932, 1933 and 1941 (outbreak of World War I) the market went below book value, and in the 1950s and 1960s the market stayed above book value when wall street took over and tried to convince people they would become kings by investing in the stock market, which pushed the market value to relatively high levels relative to book. He pointed out that in 1974 during the recession the market value dropped below book value and has dropped below book value at the present time.

Mr. Harrell indicated that there has been four opportunities in the last 55 years to buy stock at or below book value.

He indicated that this was an important consideration because investors must be able to perceive that they can earn a rate of return more than a Treasury Bill, otherwise there is no investment incentive. This is known as Capital Formation Theory, it's what the investor demands for the use of risk capital and if one does not get it the capital will not form. Thus, the concern about the equity market and its volatility can always be measured from time to time and that's what we do every ninety (90) days, measuring the rate of return in market and what the Fund has to pay for it. The rate of return achieved is the growth of book value plus the dividend reinvestment rate, where does that money come from, it comes from the money that is earned by the companies in the portfolio, so what we want to measure is the return on equity, how much companies are earning on their book value and is there a correlation between that number and the inflation rate, is there always a risk premium over and above the inflation rate available in the equity market. Mr. Harrell reviewed certain securities between 1960 and 1979. In 1960, the AAA Corporate Bond average yield to maturity was 4-1/2%, inflation rates were much lower at that time, the average company in the S & P 400 was 11%. He indicated that the important point is to realize there has been a parallel relationship between return on book value and the inflation rate which was represented by the AAA Corporate Bonds. Bonds return a rate of return of inflation plus 1%, according to the Ibbotson and Sinquefield Studies, whereas, the common stocks rate of return is from 6% to 7% and, as a result, that is why the portfolio is 70% invested in equities instead of 70% in bonds. We are trying to earn incremental rates of returns in order to increase benefits and/or reduce costs.

Mr. Harrell reviewed a chart of the S & P 500 Stock Market Index with dividends reinvested which indicated the total return on market value since 1926. He indicated that for the 5-year period ensuing in 1926, the total return was 1.6% compounded annually, for the 5-year period ending 1979 - the compounded annual rate of return was 11.3%, the point was made that the returns are totally non-predictable, no one can predict changes in the inflation rate as witnessed by the most recent 5 month period in which everyone thought inflation rate would go to 25% and it immediately turned around and went down. He indicated that we were not going to try to predict the inflation rate or interest rates, this is what most money managers attempt to do. The position the Retirement Fund will take is to measure the rate of return on shareholders equity and what we have to pay for it, it is a no win situation to predict what the stock market is going to do, as well as what interest rates are going to do. He indicated that there is a wide range of return we can expect from the stock market for any 5 year period, but over longer periods there is a narrow range of return that can be expected and this is what the Retirement Fund is interested in, as we are investing for the long run. Mr. Harrell reviewed the Bond Securities over the recent short term period indicating that there is little or no real return received in the bond market. The only reason for bonds is to do 2 things, reduce amount of fluctuation and give the Fund an option of moving the debt/equity ratio based on price to book. One recommendation Mr. Harrell made to the Committee was to amend the Statement of Policy to set up a variable Debt/Equity Ratio, that is, there are times when we might change the Ratio based on the rate of return on shareholders equity and the Price to Book of that equity. The alternative which was used prior was to let the investment advisors set the debt/equity ratio based on their perception of changes in interest rates which is typically how they adjust amount in stocks and in bonds. Mr. Harrell reviewed a chart on judgments made by money managers relative to debt/equity decisions which indicated that the advisors funded the wrong type of security at the wrong time. The advisors put money into equity securities when price to book was at all time highs and put money into debt securities when price to book was at low levels. So the Committee set up a passive equity/debt ratio of 70/30 to realize a 6.5% real rate of return. Mr. Harrell reviewed a chart on returns realized at various debt/equity combinations for the last 25 year period. He indicated that by having 100% invested in equities a portfolio would realize an investment real return between 2.3% and 12.5%, pointing out that there is a lot of volatility in the market for the last 25 years. This was the reason to put money in debt type securities in order to reduce volatility in returns. Mr. Harrell pointed out guaranteed contracts are just like bonds as they give you a real return plus 1%. If the Committee decided to invest 100% in a guaranteed contract and not worry about the volatility of the stock market, the portfolio will only realize a 1% real rate of return over the last 25 years and he didn't believe that the Committee would be satisfied with that as it will not give the Plan competitive benefits at current costs. He indicated that as the equity exposure is increased the expected return is increased. Mr. Harrell indicated that the problem with a passive equity/debt ratio of 70/30 means that the portfolio will be at 70/30 even though the securities go way over book value. Looking at the Dow over a period of time at price/book ratios, he sighted that in 1966 the Dow was at 995 at 2.2 times book, which was a very high valuation and the investors will discount at different rates the future of earnings and dividends, so the market went from 2.2 times book to 1.6 times book, then in 1968 - 2 times book and up and down to our present situation of 1.2 times book. He indicated that the average was 1.5 times book. Mr. Harrell recommended that the Committee, as a result of this study, use a mechanical decision rule that automatically adjusts debt/equity ratio based on price to book ratio of the market. As a result at twice book, we may have 30% of the Fund in the equity market; at 8/10 of book we may have 70% to 80% in the equity market. Mr. Harrell proposed a scale that will automatically adjust the equity/debt ratio based on return on shareholders equity and the price to book ratio of the market. He indicated that this will not increase the rate of return but it will reduce the fluctuations in the portfolio. Mr. Harrell indicated that adjustments in equity/debt ratio will be adjusted through new contributions using the two index funds managed by Continental Bank.

Mr. Harrell reviewed how we selected our present investment advisors. He reviewed a chart which indicated the higher quality stocks have lower volatility; the lower the quality the more volatility. This came from the study presented by Sharpe and Cooper. Mr. Harrell reviewed a chart which depicted investment advisors according to quality of stocks managed, the advisors' stated investment objective and the price earning ratios of stocks managed by the advisors. Mr. Harrell indicated that when we selected our money managers, we chose those who manage higher than average quality stocks and achieve higher than average rates of return. These managers have been selected based on a moving average who will add incremental gains between 250 to 300 basis points better than the market itself. If money can earn 200 basis points over that of the market, in 25 years we will have eight (8) times more money than if we randomly performed 200 basis points below the market.

We further diversified the risk by hiring managers with different investment styles - Putnam buys high quality growth stocks - Delaware buys income producing cyclical stocks - T. Rowe Price New Horizons buys aggressive growth stocks and emerging growth stocks. Within that scenario it doesn't make sense to compare these managers to S & P 500 because it has a risk index of its own, therefore, we compare to managers with similar risk indices.

Mr. Harrell reviewed how some consultants compare investment advisors, indicating that they use point-to-point measurements ranking one against the other without regard to investment styles resulting in outstanding long term investment advisors to be fired. Mr. Harrell indicated that investment styles go in and out of favor and when managers are compared against one another in a point-to-point measurement without regard to investment characteristics, a superior long term investment may be ranked at the bottom of a databank.

Mr. Harrell indicated that his firm does not work for any firm that manages money, so any information given to the Committee has no bias, the only way his organization stays in business is providing valuable information to committees like CTA's. Mr. Harrell asked that each Committee Member pick up a copy of the report for the quarter ending March 31, 1980.

The Secretary asked if Mr. Harrell would put the amendment to the Statement of Policy in writing and forward it to the Committee. Mr. Harrell indicated that he would do so.

Mr. Heatter indicated his concern over the long term performance of the T. Rowe Price Growth Stock Fund indicating that it is performing below average over the long, intermediate and short term basis. Mr. Harrell indicated that there has been a squeeze in the amount of spread between the average of the peer group and the T. Rowe Price Growth Stock Fund, but there has been expansion in the T. Rowe Price New Horizons Fund, remembering they were put together as an index portfolio consisting of two-thirds (2/3) of money in Growth Stock Fund and one-third (1/3) in the New Horizons Fund. Mr. Harrell indicated that his firm was not concerned about erosion and indicated based on the intrinsic value of T. Rowe Price Growth Stock Fund will outperform the New Horizons Fund in the second quarter of this year.

Mr. Hall asked if Mr. Harrell reviewed the Guaranteed Contract proposed as submitted by Union Labor Life. and the Equitable Company. Mr. Harrell indicated that he did and again found that the guaranteed contracts give the same return as the CTA Bond Portfolio. Mr. Harrell indicated he reviewed the proposal submitted by Union Labor Life relative to their "T" Account and found that they give identical rates of return to that of short term investments of the Continental Bank.

Mr. Hamilton announced the Committee was invited upstairs for a luncheon at which time T. Rowe Price Associates, Inc., Investment Advisor, would give a report.

On a motion by Mr. Langosch, seconded by Mr. Kole, the Committee unanimously agreed to adjourn at 12:40 P.M.

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SECRETARY
RETIREMENT ALLOWANCE COMMITTEE

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CHAIRMAN
RETIREMENT ALLOWANCE COMMITTEE

DATED_________________________

NOTE: A copy of the report presented by T. Rowe Price Associates, Inc. is attached.