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Quarter Ended 3/31/10 Performance Meetings
 May 27, 2010
 Retirement Fund Conference Room

Board of Trustees Present:

Joe T. San Agustin, Chairman, Board of Trustees
 Wilfred P. Leon Guerrero, Ed.D, Chairman, Investment Committee
 Gerard A. Cruz, Member
 Wilfred Aflague, Member
 Antolina S. Leon Guerrero, Member
 Katherine T.E. Taitano, Member

Staff Present:

Paula M. Blas, Director
 Diana Bernardo, Controller
 Rosalia Bordallo, General Accounting Supervisor

Other Present:

Terry Dennison, Mercer Investment Consulting
 Mike Perez, Great West
 Doris Flores-Brooks, Office of the Public Auditor

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9:00am-9:45am Economic & Capital Market Development

Terry Dennison: Good morning everyone. We're going to start on the agenda, the first item is the Economic & Capital Market Environment and as often is the case, we're going to talk about a world that changed dramatically. We will do some updating which will be almost universally negative. If you go to page 4 in your book,

the quarter end review, the markets continued to do well basically based on considerable improvement in the economic picture in the United States. The S&P was up 5.4% and we're going to look at a lot of data trailing 12 months, basically from April 1, through June 30, or March 31st and the numbers are going to look sensational. The S&P Index from March and March is significant because pretty much that's when the market turned around, the S&P is up 50%, which has recovered about half of the losses, because we lost about 50% and the problem with the mathematics is if you're down 50%, you need 100% return to get back to where you started from. So, while a 50% return is certainly good, we're still struggling with a return to the market levels we saw before the economic crisis started in 2007.

The Federal Reserve continues to be very accommodating with the Fed funds rate remaining very, very low. The interest rates continue to rise at the long end, because the concern about inflation down the road, either commodity driven inflation or inflation because of money supply continues to be a concern. Inflation expectations in the short term remain moderate despite the fact that we have all of the deficit spending, the tremendous increase in money supply, plus when we get upward pressure on the commodities, I'm on page 4, under tab 1. Inflation expectations are still modest, in fact they decreased 7 basis points, they're a little bit above the 5 year average, but certainly the sense is, whatever inflation we have is out there but it keeps getting pushed out about the same rate the calendar moves. (Periodically throughout this, I'm going to jump in with a couple of updates) The sense at this point is the economy might be slipping back into a double dip recession. Basically the concern being that we're just not seeing as robust a rebound as we would have expected. Typically the strengths of the rebound is very strongly related to the steepness of the decline, that you have very rigorous rebounds when you have very steep declines and somewhat slower rebounds or more difficult rebounds when you have slower levels of decline or more gradual decline. We certainly had the sharp drop in 2007 and 2008 and the expectation we have more of a V-shaped recovery and this recovery has been very muted. 3.2% GDP growth 3 quarters into a rebound is not very strong. Typically in post World War II, recessions of this shape, we would be expecting numbers in the 5 or 6 percentage and because these are real, they're adjusted for inflation, but with inflation as low as it is, the nominal rebound is very low. Typically in rebounds who tend to have an increase in inflation as demand for credit picks up, as interest rates rise, well interest rates are being held artificially low, so a 3.2% real GDP is not much more than that in nominal terms which is very low. There have been a number of developments since March 31st, clearly what's going on in Europe will be more into Greece and what's going on in the Euro. Those are very deflationary events and you're already seeing it with the headline numbers for inflation, which have actually dropped almost to zero, there's basically no inflation. I asked our economist on our Monday call, what would be the trigger point where you have a Japanese style descent into a deflationary spiral and a deflationary spiral is triggered when prices are falling and demand drops off because why buy today when you could buy tomorrow at cheaper prices and it's extremely difficult to get out of a deflationary spiral, which has been the issue with the Japanese economy. The usual approach to getting out of a slowing economy is to cut interest rates. Well interest rates are now virtually zero or you could be extremely accommodating in terms of fiscal policy where you just spend a lot. We're beginning to run into a Greek European style limit on the amount the U.S. Government can effectively borrow. This is going to sound a little bleak, but the reality is, if we did slip, and it's our economist view that you would need a couple of

quarters of minus 1 to 1.5% inflation of that range in order to actually sort of, the tipping point where you start to get into a high risk of a deflation or a deflationary spiral. We're not there yet, but inflation has fallen off dramatically. The unemployment rate has dipped and has rebounded and a good reason for that rebound, at least initially was with the seemingly improving economy, which may have stalled, we're starting to see some of the long term unemployed re-enter the labor force. The way the unemployment statistic works is its basically measuring people looking for jobs now and if you stop looking for work, because you have been unemployed for a long time and have seen no prospects, you literally fall off the radar screen. There is another unemployment statistic that's captured by the Department of Labor that's called U6 and the U6 number has been getting a lot of attention, it's the percentage of people who have been unemployed for 6 months or more and that number is about 17%. It hasn't moved much. So what you're going to see is a very difficult time reducing the headline rate of unemployment because as soon as jobs are created, people come out of this long term unemployed no longer looking, re-enter the labor force and that's why you see typically, a very slow and if you look at it, historically, the economy has to improve a great deal before you really get a significant decrease in unemployment. You need about 2.2% GDP growth to maintain stability in the unemployment rate, because of labor force growth. As people enter the labor force, if there's no growth, the unemployment rate would actually increase. The GDP number we have is only modestly above the level you would need in order to actually begin to push unemployment down significantly.

One of the statistics that has gotten a lot of attention lately is new claims for unemployment and that number unexpectedly spiked up last week, which very much unsettled the market, which explains a lot of why you see the pretty steep declines we've had in the last several weeks. Basically the S&P 500 is now in negative territory for 2010 and all of these effects become accumulative.

Consumer confidence while it bumps around a little bit and we'll see a chart of this, has basically rebounded some, but we still don't see a lot of spending in the retail area, people are still very cautious with their money, they are concerned about their jobs or concerned about the economy and of course one of the things that could reduce that deflationary spiral is people looking at unemployment popping back up, the headlines about weekly claims being much larger than we're expecting, they were expected to decline 20-30,000, they actually grew by about 25,000, that they've become even more reluctant to spend.

The Purchasing Managers Index, which is a closely watched measure of whether or not purchasing managers are seeing orders, basically has strengthened substantially. The rebound in the economy has largely been in the manufacturing area, part of this for export with the declining until very recently, the value of the dollar. Our exports have been much more competitive around the world. The dollar has strengthened dramatically, not because the U.S. economy is doing well, but because it's doing less badly than everyone else. So, we're probably going to start to see a bit of a decline in manufacturing. The surge that we saw to refill the inventory pipeline has largely been finished. Companies and end users or end buyers basically allowed inventories to fall dramatically because they weren't sure that the final sales would be there. As the economy picked up, everybody started to refill that pipeline and that pipeline is pretty

much largely filled. Unless there are final sales, that's going to slow manufacturing back down again.

Doris Flores-Brooks: Today because of the market dropping and because of the Euro, I've been hearing discussions pro and con, we're no where near, the U.S. is no where near like Greece and there are others who say, yes we are and that's continued to be conflicting and I'm just wondering what your colleagues are saying. Terry Dennison: Well at the present, we aren't there, but we're heading there very fast. There are several problems with Greece and with the other countries particularly in Southern Europe, Portugal, Spain, Italy and also Ireland and if you move out a little bit further, you start to pick up Belgium and Austria, it's basically the level of sovereign debt that they have. They have been living beyond their means for a long time by issuing debt and they were able to issue debt because as part of the Euro for a long time they were able to borrow at the Euro interest rate which is effectively the German interest rate. Well, the Germans run their economy very well. So basically they were insulated from what the markets perception of the real risk of what their debt was until the scale fell from everybody's eyes and the reality was that basically Greece is broke, they're bankrupt, that there's no way out of where they are. Their labor markets are very inflexible, they have too much public spending, their pension system is too rich. What's happened is there's been a growing recognition in the market that basically Greece would not be able to repay their debts, they would have defaulted this month had they not gotten some kind of bail out. The problem is as we've discovered in the U.S., you can bail out this and you can bail out that, but the debt keeps building. The key statistics are the debt to GDP and until the financial crisis of 2007 and 2008, ours was probably 60% of the GDP that was growing. So basically because the GDP was growing that we could add more debt and maintain that proportion up to a reasonable level. With the debt from the financial bail outs and all of these others, that number is now growing to a very dangerous level where you could see it getting to 100. If you recognize the off balance sheet debt, the unfunded social security, the unfunded Medicare, the number is already well above 100%.

The other number that is significant is current year deficit as a percent of GDP. The Austria Treaty in the Growth and Stabilization Pact in Europe basically said, in order to remain in the Euro you had to have a no more current year deficit than 3% of GDP. Well now every single Europe country has violated that. Greece is somewhere in the vicinity of 11 or 12, but you can't trust the numbers because they just make them up, so they're grotesquely over that limit. Our deficits which are just utterly astronomical, I mean in the trillion dollar range, also put us, because our GDP is only about \$14 trillion dollars, so if you have \$1 trillion deficit, you're at 7.5% of GDP, so you're already in a very much danger zone. Coming down the pipe are other promises that have been made that basically can't be kept. There's an article that I saw today, there's been a lot of interest in the mainland about public sector debt. Our version of Greece, or California, Illinois, New Jersey, New York... The pension debt is the significant pieces. There's a chart in here that basically shows how bad the deficit situation is at the state level. Pretty soon you just look at it and you get drunk, that's really the actual answer here, you just get drunk, but having to deal with this, unfortunately we can't do that.

Right now the current crisis is, or the next crisis is going to be the roughly trillion dollars unfunded public sector pension and medical care promises. There's been a lot

of discussion, both in a financial and public press about the issue with public pension plans and I think the reality is that frankly the Federal Government couldn't bail out the states, they don't have the money really. At some point here, nobody's going to want our money and if you think about, nobody wants dollars anymore because they're worthless, you're going to have gas at \$50 a gallon because nobody is going to want to, nobody with oil is going to take silly paper, worthless dollars for their oil, they're going to want things that are worth something. So even if they wanted to which they don't, because politically it would be very unpopular. If you look at the beneficiaries of this debt, it's a small percentage of the population, about 15% and I don't think you're going to get too many politicians who are going to want to bail out foolish promises that were made to 15% of the population by significantly increasing taxes on the other 85%, they would be un-electible. You're just going to default on that debt; the public debt is probably just going to be defaulted upon. So you're looking at, we're not Greece now, but it wouldn't take very far, they're going to run out of money in the pension plan in Illinois in 2015. Doris Flores-Brooks: How soon? Terry Dennison: Soon. Today is yesterday's tomorrow and that's our problem. Everyone is saying we need a bail out; well California is tens of billions of dollars behind in their current budget deficits. There's a discussion here about state level deficits and the U.S. is in better shape than other countries because we are growing. The problem with Greece and most of Europe is they're not growing, they're economies are stagnant and basically it doesn't work instantaneously, but if you're GDP is less than the interest rates you pay on your debt, you're dead, you may not be dead this minute, but you will be dead very soon. If your economy isn't growing at least at the rate that you're paying on your public debt, you'll ultimately not be able to service it. It's the same thing with an individual, if you're debt is growing faster than your income. You may be able to borrow or sell everything you own on EBay, but eventually, you're dead, you can't survive that. That's why if we start to see countries where the interest rate is growing very rapidly, much faster than their GDP growth, growth right now in Europe is probably in the vicinity of 1% and they are slipping back into recession. So this issue will eventually become an insolvable problem in Europe and eventually in the U.S. The debt crisis, the problem with too many promises will soon be very visible.

Doris Flores-Brooks: If you don't mind if we can just take a few minutes, because I'm struggling with our own General Fund audit and the concern I have, we don't have GDP, so what would be an equivalent number that we could use to see what our debt is? Terry Dennison: Basically the technical definition is, it would be the total value of goods and services produced on the island. Doris Flores-Brooks: We have not yet developed the sophistication, Mr. Perez at Bureau of Planning is trying to do that, get grants to try to help Guam, but we don't have a number like that yet. Terry Dennison: It would be approximately, if you went to the Department of Revenue, you could start with, what is the income of all of the taxpaying entities on Guam, the individuals and companies on Guam would be a first approximation. Gerry Cruz: I think it's 3.7 billion. Doris Flores-Brooks: Where did you get that? Gerry Cruz: Revenue and Tax, Bank of Hawaii publishes it and I think the Interior recently published it. Terry Dennison: You could go to the Department of Commerce's website for the U.S. and look to see exactly what the definition is and do the best number you can. Clearly if the Department of Revenue would know what the gross incomes were reported and that's a fair start. Now there is an adjustment in the GDP number for exports and imports, which might be the harder thing to do. Exports add dollar for

dollar to GDP, imports reduce dollar for dollar, so it's net exports. This isn't either a particular import or export driven economy so again at some point on the first approximation basis that may not be worth knowing or worth the cost of finding out. Doris Flores-Brooks: Last year GovGuam issued a \$271 million bond to pay off the COLA as well as tax refunds, but the sad news is we still have on the books another \$28 million because of the interest on the COLA and tax refunds even though we spent over \$112 million, we still owe about \$200 million, so it didn't remove those obligations. Terry Dennison: Fundamentally you can't cure a debt crisis by issuing debt.

Gerry Cruz: I have a side question since we're on the issue of debt, has the S&P or Moody's one of the rating agencies changed the way in which they rate municipals or counties, Governments so that they used the measure that they rate corporate bonds the same way they use now to rate municipalities and in some instances it has brought up the credit ratings on some of the municipals. Terry Dennison: Well I'm certainly not an expert on it, but I can remember years ago looking at something like this. Basically municipals look and if you're looking at general obligation as opposed to revenue, basically it is a question of how much have you expanded your ability to tax. If you have reached the limit of your ability to tax, that is obviously a very negative position, so it's basically a measure of what is the bonded indebtedness versus the taxable base. Often there will be legislative or constitutional limits on the amount of taxes that can be extracted and basically if you have a level of bonded indebtedness that is approaching the maximum level of tax revenue that you could extract including whatever growth calculations and you wouldn't be able to service anymore, that's probably going to start to push you down into the lower categories.

The way they rate corporates obviously is to do with cash flow and earnings and the ability to, which is not unrelated, earnings and cash flow are related to taxes, states, territories, cities have business models too, people say, it's a public fund, it's not, it's business, there's business modeling, they extract taxes, that's a revenue, they have expenses, they spend things, they have assets often pledge for revenue bonds, they have liabilities such as pension plans and bonded indebtedness. So basically the model is the same, can you pay it back and the words change because in one cases you are looking at concern that has got a certain level of short term and long term liabilities. One of the reasons why the UK is not in as bad shape today as say Greece or Ireland or Spain or Portugal is they're in as bad a shape in the debt front, but they're maturities are much further out, they don't have the near term refinancing.

The other issue is, what is the schedule of bond payments and you have maturities that you should have to roll over. If you have a lot of near term maturities, that's a very negative sign, that's what basically tipped Greece over is not just that they had a lot of debt, because the UK has a lot of debt, but the UK's debt is 4 and 5 years out in terms of significant near term maturities. Greece had maturities in May that they couldn't pay. Gerry Cruz: And refinancing was an issue? The reason why I ask that is I think we're use to from the meetings from the Government side, we're use to seeing tinkering with the formula when you reach the debt caps, you raise the ceiling. Doris Flores-Brooks: We did do that and we're already almost maxed out at our debt capacity limit as far as GL and that's around \$870 million and that's not counting all those other debt like for the schools that is not GO obligation, that is debt is only GO. Gerry Cruz: We're used to seeing that side of the equation tweaked. We look at the

rating agencies as the objective greater of the credit and so if they're beginning to tinker with the formula, what does that do to our, as an investor, our knowledge that there is an actual objective mechanism for us to make an investment decision. Terry Dennison: Well obviously they are trying to refine their processes. They have been identified as one of the major villains of the piece, particularly with their rating of sub prime mortgages and various derivatives that were based on sub prime mortgages and they clearly had conflicts, they rated things Triple A based on ludicrous formulas. I saw a table probably 2 months ago in the economist magazine that had the estimates of default percentage rates that they were using, the rating agencies were using for various credit qualities and they had like Triple A is one tenth of 1%, Single A is like 2%, 25% of the Single A defaulted, they didn't miss it, they missed it by a mile and they've been trying to clean that up, they're under a lot of pressure. So I would say any changes that they're making would actually be more conservative from an investor perspective. They may have positive or negative effect on the Government, because if they're looking at through different glasses or different formulas or different approaches, it could be positive or negative and I think from an investor perspective, they're trying to be more conservative. There's nobody as righteous as the reform center. The reality is I think it is going to have the effect of tightening it up. Their failings were so gross; a hundred times as many bonds defaulted than they expected would default with the sub prime and the sub prime derivatives. The changes are going to be --- , but I would assume they would have the effect of making their assessments of the investments more conservative, but burned badly.

As far as the debt, I can't see which one of these charts is the funding ratio. Gerry Cruz: I think we're in the 50's. Terry Dennison: Yes, so basically you could add about a \$1.2 billion to GovGuam effective debt. Gerry Cruz: I think we do, it's on the books, it's in the footnotes. Doris Flores-Brooks: The total amount was never really on the books, implemental portions were on the autonomous entities and not all the autonomous entities, like the Retirement Fund. Paula Blas: It was not material. Doris Flores Brooks: It may not be material, but from an accounting perspective, but you should have been calculated and put it on.

Terry Dennison: There was an interesting note, I get a lot of public fund and accounting blogs and there was one for NASRA, National Association State Retirement Administrators today that Gatsby is now getting close to being much stricter about the treatment of post retirement medical programs. Were previously they allowed you to go on a pay as you go basis, this may not effect Guam. Gerry Cruz: It does. Terry Dennison: It definitely affects significantly, states in the U.S. Gerry Cruz: It could affect Guam depending on... Doris Flores-Brooks: Lou did a study on what that was going to cost and that was over a billion. Gerry Cruz: It was huge. Terry Dennison: When I was growing up and working in my early years in Illinois, we had a senator, a favorite, famous senator Everett Dirksen and he coined the very popular phrase, "a billion here and a billion there and pretty soon you're talking real money," you would have to translate that to trillion now a days, but that's going to have a very significant effect on Governments, their credit rating, their ability to raise deficit spending, so it's getting interesting.

Gerry Cruz: So these reports are as of March, has there been a world of change? Terry Dennison: Yes, that's what we've been talking about. The world has changed dramatically. Gerry Cruz: So the VIX is now at 35? Terry Dennison: It's crossed 40

(today), the last couple of days it's been in the 40's. (The VIX is on page 6) Ted Spreads widened a little bit, but the VIX, which is basically a measure of volatility, it's basically a fear gage. It is the best fear gage and the thing that's interesting about the VIX is you could buy and sell it. So if you believe that things are getting worse and fear is growing, you can actually buy the VIX, it is actually an investible index. It's derived from the implied volatility using the Black Scholes model of option valuations from the Chicago Board's Option Exchange. You can back out mathematically what is the implied level of volatility. You think about an option for a security, the part of the reason that you will pay something for an option that has got a value less than zero, is if the markets are volatile enough there's a chance it will rise above zero during the life of the option. There's an option valuation methodology called the Black Scholes Model names for Fisher Black and Myron Scholes, which basically incorporated volatility into the valuation of options and what the CBOE did is actually look at all the options that are available out there and looking at the pricing of those options and basically determine what is the implied volatility that the pricing indicates and that's what VIX is. You can see that during the peak of the crisis, remember Lehman failed in September of 2008, you can see there were several peaks there where the number became completely astronomical and then it settled back to not exactly the old range that usually was between 10 and 20 and this is simply a unit-less value, it has no units, it's just a measure and now has been grading back as the economy began to improve with the sense that world wasn't going to come to an end and the banking system wasn't going to fail and now we've had this spike back up again because of concerns about the situation in Europe. I think it's important to understand that when the European community, the European Commission, technically, which is the executive body of the European union, basically put up this nearly trillion dollar support program, they weren't bailing out Greece, they were bailing out the French and German banks, because who do you think had all that debt. If you look at the proportion of the Greek Government debt, which is, who owns it. About 30% of it is owned by French banks and about 20% is owned by German banks, so basically what they're doing is they're bailing out their banking system, because if it would have defaulted, S&P believes that in any default situation, the bond holders are likely to get about 50% of their money back. If you're a bank and you have leveraged your capital base and part of your investment portfolio are these bonds and you lose half the money on the bonds, you're probably bust. So really what the issue is and why the VIX has increased and of course our banks make loans to banks in Europe, but there's some exposure to European sovereign debt, mostly not in Greece, but in some other countries amongst the U.S. banking so is often the case, the issue here is not bailing out the notional beneficiaries, but rather bailing out the people who loaned money to the notional beneficiaries in order to protect the system.

So that's why the VIX has spiked up again. Doris Flores-Brooks: Where is it now? Terry Dennison: It's about 49-0-45, it varies day to day. It's a very volatile number, there's probably some mathematician somewhere fooling around with the second derivative to find out what it is and can you actually invest in the rate of change because that of course is very sensitive. If you look at the rate of change of something, that sends an even better message than what the value of it is. Gerry Cruz: That is what they were talking about quite a few years ago, about a year and a half ago, the second derivative, the rate of which we're no longer falling. Terry Dennison: Well you definitely saw that with measures like the Case Shiller Index of house prices. What was perceived as good news was house prices were falling at a rate slower than before.

They were still falling, but looking for what they call in the UK, that first young shoots of spring coming out of the snow, the fact that house prices were falling at a slower rate was seen as positive. Of course if they're going to reverse, that second derivative has to become positive.

Let's look at page 8, the GDP you can see how steep that decline was. If you look at the area under that curve, on the downside to get back to where we were in terms of national wealth, we have to fill in that hole, the area under that curve and you can see with the very weak rebound we've had, the area under that curve is probably at best only been recovered by half of the subsequent 3 quarters. Gerry Cruz: So last month was the 10 year anniversary for the S&P, the S&P's peak and over that 10 year period, it's gotten zero. Terry Dennison: Negative, not zero. We've had our lost decade, you've gotten basically nothing investing in equities in 10 years. The thing about equities is the primary component of this pension fund and most other pension funds that's part of the reason we're in the big hole we're in is the principle earning asset that people expected would actually create wealth, has created no wealth at all. In fact we had, the markets are cyclical, we've had 2 downturns and 1 upturn or 1 and a half upturns, so it's not too surprising mathematically that we're sort of in the hole, because we haven't had 2 complete cycles yet. It's possible that the rebound we had starting in March of 2009 may have been a false rebound, but it might be heading back down again. If we look at inflation expectations, they're still out there, but the reality is that this is a 10 year expectation and again I don't think inflation is likely to rise significantly given where we are in the economic environment.

Turn to page 9. You can see the unemployment rate and we've indicated the recessions by the gray bars and you can see among other things, unemployment rises significantly after the technical recession is over with, it is very much of a lagging indicator. If you look at the recession in 2001 that was triggered by the dotcom crash and burn and securities bubble instead of house price bubble, you can see that the unemployment started to rise at the beginning of the recession, but continued to significantly after the recession was over. While we show the March number here 9.7, it could easily rise again into the tens even in the face of a moderately increasing economy.

On the upper right hand panel we have got retail sales and consumer confidence and sales have risen back above the zero or the percent change is now positive, but it's still very weak for where we are in this recovery and you can see the consumer confidence has barely recovered, it's actually recovered to a number below the normal value. It's up from the very bottom but it's no where near the level of confidence that justifies a significant increase in retail spending. The retail spending issue is not only a psychological issue where people are very careful with their money, it's an ability to spend issue, because credit card limits have been cut back and in many cases, credit cards have been cancelled as credit card companies looking at the new regulations say, we can't afford the level of credit losses we had before, they're protecting their profits by simply taking a lot of credit card risk off the table.

The most interesting number is down at the bottom right, the Institution of ISM, Purchasing Managers index, Institute of Supply Management. There's 2 break even lines there, the one at 41.2 is break even for the economy and you can see we're now well above that. This measure, which of course has got a component to it of not only

real final sales, but also exports, which are probably going to start to struggle with the dollar strengthening as much as it has as well as this inventory pipeline filling has been very strong and it's now even above the break even line for manufacturing. So manufacturing is actually expanding and that's the one area of the economy other than Government, which is actually growing. Most of the private sector at best has ceased to contract or is now contracting more slowly.

The next page is kind of interesting, page 10. With respect to the TARP Program, which is one of the early efforts to deal with the economic slowdown, particularly the damage that was done from the sub prime securities to the banking system and if you remember it was talked about as a \$750 billion program to bail out the banks, the Treasury right now expects the final costs to be about \$120 billion and in fact about two thirds of the money that was given to the banks to help them out of their crisis has been paid back and they actually made \$17 billion in income in the program. This particular part of the stimulus program as opposed to the big spending increases, all of the infrastructure spending, which is money just debt, just gone. This is actually turned out to be a relatively minor cost that the "bail out of the banks" could actually end up being a profit making enterprise for the Government. They have also got other bail outs, GM, AIG, Fannie and Freddie, but outside the strict banking system, I suspect the cost of bailouts are substantially larger.

Page 11 looks at credit conditions. One of the things that has happened, in the lower right hand corner, corporate bond spreads are a measure of the markets assessment of the risk of various quality sectors. Credit spreads have narrowed dramatically, there was a period at the very bottom when high yield bonds were yielding over 20%. When we look at the performance, we will see they equity like returns, in fact high yield bonds outperformed the S&P 500 in the recovery. You do not participate in that because of your regulatory structure, but you could have made a lot of money. One of the things that I think worries people, is usually the case, the pendulum swung too far, that basically credit spreads are now too narrow, that the reality is there's too little differentiation in the market and the amount of risk in these securities and if there's a perception of rising risk, spreads will rise and produce very negative returns again for bonds. So because the spread factor here, if we do see a slump, second slump in the economy, not only are equities going to be hurt, but bonds are going to be hurt, because spreads have gotten too narrow. You're going to start to see default rates rise and the perception of risk drive the bond prices down because of spread widening.

Page 12 was a page that I referred to earlier about state budget shortfalls. You could see the states in red, the shortfalls exceeds 20% of the general fund expenditures (so the current year deficit is greater than the general fund expenditures). Of course the poster children for this page in terms of absolute magnitude are California and Illinois. Just to remind people, in most of the mainland there is a constitutional requirement for a balanced budget and that's why you end up with these silly escapades and you have the reality TV in California is they try to pace together a balanced budget by making all sorts of ludicrous assumptions of what's going to happen. One of the things that's worrisome at both the Federal and State level and the tax receipts in April, which were personal, the big tax receipts are in March, corporate, although much of that spread throughout the year and in April for individuals, those tax receipts are disappointing. Doris Flores-Brooks: Same on

Guam, our revenues to date are only 600,000 less than last year, but 34 million shortfall against estimate for the year.

Terry Dennison: The second bullet there, I make notes to myself, the note I have for the second bullet is a nightmare, continued high unemployment rates, an increase in demand for Medicaid, ---, depressed property in sales tax revenue resulting in a decrease consumption in lower property values who can contribute to more dramatic budget shortfalls in 2011. The budget gap for 2011 fiscal year is estimated to be a total of \$103 billion for the 42 states that have provided us estimates and it may balloon to \$180 billion, this is current deficit. Doris Flores-Brooks: Didn't a lot of these states like the so called sweet 16, they got a lot of stimulus money. Terry Dennison: Yes and that stimulus money will be over at the end of the year. The stimulus program was 2009 and 2011. Doris Flores-Brooks: 2011 is when it was suppose to end. Terry Dennison: The 3rd bullet for 2010 and 2011 combined budget shortfall is \$375 billion. Gerry Cruz: What are cities like? Terry Dennison: Los Angeles has a deficit of about \$600 million. In the little part of Los Angeles, if you think about it, Los Angeles is like Guam, it's made up of little villages and I live in a village called Palisades, we call it that, we have 2 fire stations, one of them is closed half the days of the week. Doris Flores-Brooks: There was one community I read, the cost of running the fire department was too great. They said it was cheaper to let the house burn, they closed the fire department. When you think about what we're paying for our fire department, our fire costs us more than police now. Terry Dennison: If you want to avoid this, you can move to Montana or North Dakota, they don't have a budget for shortfalls, but they do have winters just to remind you. Doris Flores-Brooks: South Dakota was listed as a good place to go if you like winter, because it's very cheap, just in the recent Time Magazine. How bad will it get? Terry Dennison: It will get bad. Doris Flores-Brooks: How do we account for the fact that it's the sector of the economy that is growing is the public sector? Terry Dennison: Because they're living on borrowed money. These budget deficits are implied debts. They have spent the money and they come up with some imaginative story and the debts roll over. You can see why these deficits are basically accumulating and that the 2010 deficit is relatively smaller than the 2011 and basically there has to be a shrinkage of these costs. I think you're going to start to see a lot of cities and counties file for bankruptcy to get out of pension and other contractual responsibilities. California supposedly looked into whether or not a state can declare bankruptcy and it's not clear that it can. Doris Flores-Brooks: Because of it's pension? Terry Dennison: Yes. Gerry Cruz: Just it's overall obligations. Terry Dennison: Just its overall obligations and they have a particularly difficult situation in terms of laws requiring a super majority to pass budgets and the super majority basically produces the irresistible force and immovable object scenario, so part of this is the inability to govern, the Government can't function. In Illinois which their pension funds are less than 50% funded and several of them are going to run out of money as early as 2015, they passed a state budget with imaginary revenue and no contributions to the pension funds. You do start to run into the situation, it's going to blow up, so why plow money into it, just let it blow up and we'll deal with it after it blows up. In fact there are a lot of people who really suggest that's what Europe should do. Basically the money they're putting into Greece is just good money after bad. Gerry Cruz: Who is funding the bail out in Greece, isn't it also the IMF? Terry Dennison: The IMF is in for a piece and of course we're about 17% of the IMF so we're bailing them out. Gerry Cruz: But putting the IMF in charge of a country, that brings about a whole set of restrictions, debt

restructuring, Greece will no longer become a sovereign nation. Terry Dennison: Pretty much. Doris Flores-Brooks: Guam is already that way with the receiver and we're getting another receiver with Mental Health and another receiver even though it's with DOE. I mean, we're already there. Rosalie Bordallo: Not completely and maybe that's what we should be. Doris Flores-Brooks: I want to just interject here, what is your unfunded liability for 2008, what is your report right now, is it still \$1.2 billion? Paula Blas: It's still \$1.2 billion. Doris Flores-Brooks: So the good news is it hasn't grown, that's the good news, but it's still \$1.2 billion. Terry Dennison: It's not incorporated into your last evaluation because they always lag, but your return for last year, not the fiscal year, but the last 12 months was almost 40%. You have a total fund return of 38.6%, that's 5 years worth of assumed earnings or almost 6 years of assumed earnings with your actuarial assumption. Now the problem of course is you had huge losses like everybody. Doris Flores-Brooks: And don't forget, what is the current rate we're paying right now, 26%? Paula Blas: 26.04%. Doris Flores-Brooks: And if that number continues to go, sooner or later it's going to bust the bank and with health premiums and everything, I calculate 30% of payroll just as a fixed cost. When you have a million dollar budget of payroll, then you add 30%, that's \$1.3 million and that's the incremental growth of that. The good news it's reducing the unfunded liability, the bad news is we haven't done anything else to cut back. We're going to have a record deficit this year, this biggest in the last 8 years.

Let's go to page 14. Part of the reason that we had a relatively and again it wasn't anywhere near what we needed or should have had rebound was export growth. The export growth was in part because the dollar had been slipping and became relatively cheap versus our major trading partners. The graph on the bottom of page 8 shows the trade weighted value of the U.S. dollars and what they do is they look at all of the countries which the U.S. exports and produces a trade weighted average of their currency versus the dollar. Obviously in part again because the Europeans and the British have recognized where they are on the debt front, those currencies, the Euro, the Sterling have fallen dramatically versus the dollar and that has benefited the dollar in terms of strength, it's caused oil prices to go down, but the reality is with the dollar strengthening, that's going to reduce the ability of the U.S. to export and probably knock a couple of tenths off the future GDP. Rosalie Bordallo: Why is the Yen strengthening against the dollar, why is that occurring? Terry Dennison: I don't know the answer to that. Japan actually has the largest amount of Government debt in the world. Their debt is 200% of GDP, but it's almost all held by Japanese and that's part of the reason why the Italian debt is as dangerous as some of the other European debt. Italy is very indebted, but it largely owes its own citizens, so you don't have this external debt roll over issue. The Greek problem finally reached a peak when it was pretty obvious they weren't going to be able to refinance the next --- of maturities, because it was largely owned to banks and other institutional investors. Basically --- the postal savings program and directly, the Japanese population has been a big consumer of Japanese sovereign debt. While the debt level is astronomical, they have not had the pressure that other countries have had. If I had to guess and remember I said all of this is relative, the dollar is stronger than Euro, Pounds, Sterling, but it's on a relative basis. The dollar is certainly weaker and you can see that in part with energy prices, gold, anything that has got a value that isn't dependent on the currency has tended to rise. Oil has risen, gold has risen, most commodities have risen in dollars and that basically means, mathematically that the dollar is worthless. A thousand dollars used to buy an ounce of gold, now it takes

\$1,200 to buy an ounce of gold. If you assume (and we can get into all sorts of philosophical arguments) you can make an argument that the dollar has lost 20% of its value, in terms of something that is not whose value is not determined by the value of a currency. Gold has an intrinsic value, either it's a store of wealth, it's industrial value is not very significant, but it's a store of wealth and basically that's indicating to me that the dollar has lost 20% of its value. My guess is you're looking at a relative valuation and the Japanese look a little less bad than the U.S. and that's why the Yen has improved. I think the Japanese, obviously in Asia, the declines due to the global economic crisis were less and the rebound was faster and I think they may also be benefiting some by intra-Asia trade, which has held up better than the trade elsewhere in the world. It used to be you see these container ships lined up in LA or Long Beach or San Pedro with 1,200 or 2,000 containers and you'd see these 3 mile long trains out of Los Angeles toward the East, you don't see much of that anymore. Basically there hasn't been the tremendous import from Asia, but I suspect Japan has probably benefited some from that.

Just quickly on the home prices on page 15. Stories improving some, we're now actually beginning to see year over year increase, but realistically they're still very depressed from the peaks. Gerry Cruz: And there's no more stimulus, no Treasury buy backs. Terry Dennison: There's no stimulus, there's no buy backs, although interestingly, I think there was a lot of concern when the Treasury purchases of mortgage backed securities program ended at the end of March, the sharp spike in mortgage rates, it hasn't happened. Gerry Cruz: No, but you still had the first time homeowners credit through April so I think the real number is probably by the end of this month. Terry Dennison: But we are seeing some improvement. The area that's still flat on it's back is construction, both commercial and residential construction, not just actual physical new properties, being built, but even like land purchases have picked up a little bit which is a little like first step. Building permits, they're still kind of flat. You're beginning to see a little bit of people looking at potentially getting back into construction, but you're seeing nothing like the insane construction we had obviously financed by the mortgages that were just laughable. That's it for the economy, not terribly good news. Doris Flores-Brooks: It's not optimistic. Terry Dennison: Optimistic, not to be terribly pedantic, is more forward looking. The recent past has been really good. If you look on page 17 at the one year return, those are really handsome numbers. Basically just about every asset class was up at least 50% with mid value up 72%. The thing that's depressing as Gerry suggested, if you look at the 3 year numbers. Even with this sensational growth that we've had and of course the one year is imbedded in the 3 years, so it gives you a sense of how bad the prior 2 years were, we're still basically in negative territory.

So looking back through the years, the recovery of the market has not fully recovered the losses and of course these 3 year returns are annualized. If you look for example at mid value which is down 5.2, that's 5.2% per year, un-annualize that, it's about 18%, so we're still 18% behind in that particular spot. One of the things that's interesting because we do recognize both style, growth and value and cap size, large cap and small cap in our portfolio, that basically we're no longer seeing any real distinct pattern between large and small. If you look on page 17 on the lower left, basically there's no real direction, large and small are about the same. You can see that in a typical market environment, where there's some direction to it, it's very clear which is the better performing. It was a long period through the dotcom era where the

large caps outperformed, then we have the small caps outperform, in their case, outperforming in a sense of losing less, but also during the rebound we saw the middle years of the last decade, small cap stocks did much better. If you look over to the right we are seeing, and again it's a little unusual historically, a continuation of growth outperforming value. It's not common, again you can look at the area under those curves if you sort of in your mind integrate in a calculus sense, the area below those curves, you can see there's a much larger for value than growth, so typically value outperforms so we are in a contrary period.

Page 18 you can see across the market the returns were just utterly astronomical, although mostly achieved in the first 3 quarters of the trailing one year. The one quarter numbers are all positive, but they're not gigantically positive. If we did this on a quarter to date for 2nd quarter, that all of course would be negative. Gerry Cruz: You know these numbers, a lot of these, let's say the large cap growth stocks have managers in there that currently are beating their benchmarks, but for a long period of time they were trailing it. I'm just wondering if it's just the mandate that instead of, maybe we should be looking at using now an ETF to just go after low cost beta if these guys aren't able to find alpha. Terry Dennison: When we get into the performance, we'll talk about, I'm going to talk about some things that, we've been giving a lot of thought to how equity portfolios should be structured, where you should use passive and where you should use active and how much international and how much emerging market and how much small cap you want and we'll talk a little bit about that, but clearly there's been a lot of focus. We're going to see with the DB Plan and the DC Plan where you had managers that did relatively well during the decline and by relatively well, I mean lost less money, but struggled with the rebound and other managers did particularly poorly during the decline, but have rebounded dramatically. It would be wonderful if all your managers did great all the time, that can't happen. In fact if you had it happen even for a little while, I'd be very worried, because what that means is all your managers are doing the same thing, so when the market psychology changes, they will all be doing very badly. So in one sense, it's never good to have managers that are bad, but in reality you probably want some of them to be, not bad, but less good in order to provide a diversity of style. Gerry Cruz: Well you want them to be good within their mandate. On page 18, in any one of these mandates, you take the Russell 1000 Value for example and you have a good manager in that space and if he returns consistently above the benchmark in up and down markets and then a manager in the Russell 2000 Growth and he consistently does well against his benchmark, they won't be returning the same numbers quarter after quarter, but relative to what we hired them to do, they're beating their benchmark. Terry Dennison: Let me just do a slightly deeper dive. There's not really much you can do about it because it's not just a matter of money, but it's a matter of the number of managers you could live with. The problem with these styles is they are themselves. If you look at growth for example, growth comprehends everything from all out momentum, growth at any price, through traditional growth, to relative growth, down to growth at a reasonable price and similarly with value, these categories are very broad. There are managers you don't have them except probably Security Capital might be close to the ultra deep value, even the so called road kill managers, they don't buy anything that looks half dead, because the rebound potential is just so high, all the way through deep value, traditional value, relative value, actually back to growth at a reasonable price. So it's a continuum and the managers tend to have a particular style that's pretty consistent, because their whole process for making

investment decisions is focused around an intense, for example, focus on valuation. Basically they will focus primarily on growth or primarily on risk. They look at risk on relative terms, relative to the benchmark or on absolute terms, we don't want to lose money. You can't have your cake and eat it too, why don't we have all managers that don't want to lose money, well the problem is they also don't make any money. Unfortunately in your financial position, you need managers who are taking risks. Your situation has improved significantly in part because we've actually increased the risk in the portfolio, but we've blended that risk so we don't have everybody taking the same kind of risk at the same time, we have a diversity of styles. So, it becomes a little bit more nuanced how you do this, because you can't with 2 or 3 managers cover all of these bases and for example right now we're seeing low quality growth continue to lead the market. Low quality growth is looking at companies with balance sheets, they're much more leveraged, they tend to have less strong management, the really turn around cases. Other cycles in the market will be growth or more quality where basically the junky stocks all get clobbered and we might now be at one of those inflection points. If everything is going great and anybody is making money, you might as well buy them as cheap as you can, but if all of a sudden we're heading into more difficult economical times, now quality matters, strong balance sheets matter, loan debt matters, strong brands, good management, diverse sources of funding, perhaps less concentration on domestic sales. So if we're at an inflection point we're going to see some managers who are lagging and didn't rebound as strongly all of a sudden they get the outperform and people who were fishing in the stinky end of the pond, all of a sudden get their head handed to them, because all of a sudden not just credit spreads, the bond sector will rise, meaning that people will want to get paid a lot more taking risks than they use to. But there's an equity risk premium, there's something that's a little harder to see because there's no benchmark really to measure it against the treasury yield curve, but you start to see people demand a higher return for taking risk, which in equity sense, the prices go down, people want to buy more stock for less money and the way you buy more stock for less money is the price goes down, so the equity risk premium rises, the cost of low quality stocks has to fall. So we might be at one of these inflection points where the market psychology changes. The managers are pretty consistent, people don't change their spots. One of the things we try to do when we construct portfolios is to cover a lot of bases, we're getting a little bit more thoughtful about how we do that, much more polished about how we do that and looking at some fundamental economic factors, looking at the portfolio, what kinds of stocks do they buy, we've got a tool that you don't see, but it's underlying a lot of our thinking about who we recommend. It's called style research which looks at the underlying style down to the security level, what kinds of stocks do they buy and it looks at about 40 different factors. So we can take a look at this portfolio from this manager and that portfolio from that manager and begin to get a sense of what kind of stocks do they actually buy, not growth and value, not large and small, but much deeper level of stock. We also then can look at the market and say well what kind of stocks in favor and where we might come down on a manager, which might surprise you, is where the market is much more in tuned, where the manager is much more in tuned with the market where we're not seeing striking out performance. I'll give you an example of a manager you don't use, Hotchkis and Wiley in Los Angeles, it's a value manager, very volatile, probably inappropriate for a lot of funds, in the mid 2000's they had quarters where they were 1,100 basis points ahead of the benchmark and they said, please don't think we can keep doing this, they tried to moderate people's expectations. Market decline, they were 2,000 points under the

benchmark. With the rebound, they were 1,500 basis points ahead of the benchmark. So because we understand what they're doing and we can say, ok this in an unfavorable market for them, we understand bad performance and that's why this gets very nuanced, you can't look at this and we can bring this to you, but plan on spending a week looking at... You don't pay us to bring stacks of paper like this, you pay us to think about this back in the office and say, we're edgy about this manager, they're doing great, but they should be doing better, or we're not worried about this manager because they're doing badly, but we understand why they're doing badly. In fact if they were doing well now, we'd be worried about the stability of their process. They're trying to change their spots, you can't change their spots. If you built an entire process to identify particular companies that had particular characteristics and you say, our strategy isn't working, let's think about doing something else, that's almost sure to fail, because your people are thinking in one terms, your system is built to identify companies, it's the people who change their styles that alarm consultants and consultants become very worried when all of a sudden we don't know how they're running the money when they change their spots.

So I agree with you sometimes we look at it nominally when we look at it as just this growth and value or large mid small breakdown. We're actually looking at it on a much deeper level than that. Gerry Cruz: So have our managers remained consistent in their process? Terry Dennison: Yes. Some of them doing well, some of them not because again if you look at the deep style, the style beyond just growth and value, because growth and value by itself, it comprehends a huge range even within that spectra, but then there's 40 other spectrums, how do they view risk, how do they view valuation, how they view quality. You can think of this like a 40 dimensional picture. Gerry did I answer your question? Gerry Cruz: Yes. I think we'll talk about it a little more on the strategic allocation side, because I think we've come to the point where there's a little more flexibility in our way of picking stocks, so we can tilt on certain occasions, I know we did on the emerging markets.

Terry Dennison: If we go to page 22 looking at the international markets, now these numbers, there's a little clue here to the future, the first bullet on page 22. EAFE was up 9 tenths of 1%, 90 basis points in dollar terms. In local currency terms, they were up 4.4%, so they lost about 3.5% because of the strengthening in the dollar. These numbers are not going to look good for 2nd quarter, because the dollar has really strengthened, particularly versus the Euro and the Pound. If you look at where our trading partners now, principle trading partners terms our currency, Euro, Pound, and the Yen. The Yen is moving in the other direction. The Yuan which of course is a huge trading partner is largely pegged to the dollar. You got kind of a dirty float with a minor trend of devaluation, which they're not very happy about so the reality is the Yen's kind of out of the picture that's because of the dirty float, but you're going to see particularly amongst the Euro countries, big declines not only because their markets had declined significantly, but we've lost a lot of currency translation.

If you look at some of these numbers like Pacific ex. Japan, part of this is Australia. Basically the Australians are selling their country in ship loads to China and pretty soon they'll run out of country and they'll all be standing knee deep in the water, but as long as China does well, Australia does well.

Some of the emerging markets on page 23, now China is down 20% for the year. You can see just for the 1st quarter they're down 1.6%. For some of the other countries, these numbers are kind of eye popping. The India market is actually relatively small, it's not an easy place to invest, while the BRICK countries as economies are doing well, the Indian stock market and it's interesting, all of a sudden we're seeing a lot of managers, both indigenous, there's the bank in India, the initials are ICICI, they're now beating on our doors, they're coming to Los Angeles to meet with me and others in the U.S. about an India fund. That's about the 3rd India fund that I've seen launched and wanting to talk to us, but it's still a fairly small market. Brazil is a deep market, but you could see that basically the emerging markets, as strong as the rebound has been in the U.S. against big losses, these are huge gains against small losses.

Go to the fixed income side, page 24. We've probably seen the big bang with bonds, because spreads as you saw are now back down to kind of historical levels. The next move on bonds is probably negative, either because of rising interest rates or spreads widening as the economy might be slowing down some. The eye popping number obviously is the Barclays High Capital yield number which is up almost 60% for the year. That was the poster child of spread narrowing. If you go from 22% spreads down to 4% spreads, you're going to have gigantic capital gains. That is a return literally higher than the S&P 500. Gerry Cruz: That's once in a lifetime. Terry Dennison: It's once in a while. Gerry Cruz: Has it ever gotten that big, because we thought the sky was falling on all corporate debt, we got no bids on Treasuries for a little while. Terry Dennison: It's obvious that the time to buy is when everybody else is selling and the time to sell is when everybody else is buying. Right now one of the hottest, people in the institutional business sort of smirk at retail investors, they're always late, they're always trend followers, they basically do dumb things, well, one of the hottest segments right now in the retail mutual fund market is high yield funds. If you look at where the economy is, if you look at where spreads are, if you look at past performance and this is one of those cases where it's absolutely positively not indicative of future performance unless you want to put a minus sign in the front, run like hell.

Let's go to REITs on page 29, some of this stuff is interesting, but I want to be sensitive to the time. REITs as we know are somewhat volatile, we sat out a little bit of the market, the last year the REITs index was up modest 106%. You're more aggressive REIT manager, Security Capital was up 122%. The REITs are actually in pretty strong shape, both financially and in an opportunistic sense. If you read that 3rd bullet, a lot of them raise capital because that period capital was pretty cheap so they're sitting on a lot of money. They have a lot of what we call dry powder and there's a lot of really distressed real estate out there, commercial real estate is very depressed. What I think you're going to see is I think REITs are pretty well positioned, because they have a lot of money, the kinds of things they invest in are still depressed and if they invest this money wisely, they could have another couple of years of pretty solid performance. 100% is not likely to happen, but they're pretty well placed right now, because real estate is a huge bargain, particularly commercial real estate.

Let's talk a little bit about, on page 31, in terms of alternatives. As Gerry indicated, we seemed to have moved into a world where we have a little bit more flexibility to invest and we'll look at a chart when we get to the DB Plan, it just shows how this fund has

evolved in terms of asset allocation, where we were in 2003, which is basically 40% stocks and 60% bonds to a much more sophisticated asset allocation. We'll see in an attribution chart, how that asset allocation has benefited, we have gotten huge returns. It's not we have brilliant managers, it's basically asset allocation and I'll show you on a chart when we have attributed the performance to asset allocation managers performance. The managers overall have actually done well, but it's the asset allocation that's done us all well. One of the places that people are going are commodities and commodities are all the things that you think of, the principle that everyone thinks of as energy, but it's also industrial metals and copper, lithium and led, most of it's bad for you, the precious metals, gold, platinum. Agricultural commodities, obviously corn has benefited dramatically from Congressional mandate to produce a percentage of our, the U.S. energy consumption, the gas consumption, using ethanol, livestock, and clearly it has been a good time for commodities.

We issued a paper that you should have gotten, house view on commodities. A lot of the consulting firms are saying commodities are the place to go, we're running out of everything. It's an inflation hedge, it's a bet on China. China is consuming literally stupendous, they consume half the cement in the world. Their consumption of whatever it is you can think of is just absolutely astronomical. The sense is commodities other than agriculture, are basically wasting assets, there's only so much oil, there's only so much gas, there's only so much copper, there's only so much gold. All the gold that has been mined in history is a cube about 50 feet in size. If you put all the gold in the world that has ever been mined in one place, it's a cube about 50 feet, that's all the gold there is in the world. So that's the argument, that it's a hedge against inflation, it's a growth asset, they're not making it anymore. Our sense is that it is very cyclical. Energy goes up and down, gold goes up and down and if you can call the turns in the cycle, you can make lots of money. If you look at it over the long term, there's no real trend to the return. Copper is \$5 a pound, then it's 80 cents a pound, then it's \$5 a pound, then it's 80 cents a pound and we're a little skeptical that, it's a guarantee sure win investment. If you go for the scarce of the argument, over the long term, there's only so much, but if you look for example at energy, forget about the problem they're having in the Gulf right now, but if you look at oil, you can find in the press articles as early as the 1940's saying that we're running out of oil, we found all the oil and we're bust, there's no more oil. If you look right now at shale, there are more gas shale formations in North America, not at some place where they all hate us. In North America it's never been burned, there's an enormous amount of these and if the prices go high enough, you find replacements. So, we're not as keen on commodities as some other organizations are, because the investment case for them is largely cyclical. If you can find people who can call the turns, you can make a lot of money.

There are a lot of people who suggest that you invest in currencies, that you can make money by considering currency an asset class. Right now you'd be long dollars and short Euro. If you get it right it's terrific, the problem is you tend to get it right, right terribly wrong. Somebody once characterized it as picking up nickels and dimes in front of a steam roller. We always want to be open minded, but maybe there is a place for commodities. We need to be open minded and I agree with Gerry, partly it's seizing the moment and if the moment is a little bit more flexibility about being able to invest... Rosalie Bordallo: I think one of the problems is and I see this problem with this Board is, with commodities what you're saying it's really a game where, look,

you're going up, up, up, you need to sell when, you can't get greedy, you have to sell. These guys don't know how to not be greedy and like you're saying, it's going to crash and when it crashes, it crashes big. Instead of going for what is a bird in hand... it's more like, if you set your target return at 10%, you hit the 10% but you know that... Gerry Cruz: In order to do something as Terry has... Rosalie Bordallo: I think what Terry has said all the time is sell high and buy low, you guys never want to sell high. When we have to basically rebalance and take away from a manager, why take it from the guy that's a winner, because most of his stocks are selling at the highest point. Doris Flores-Brooks: That's the psychology overall. People will hold on longer to the losers and won't sell the winners. Gerry Cruz: The Board doesn't and neither does the Investment Committee, play a role in the trading of the portfolio. All we do is set up a strategic allocation and determine the managers, hire the managers to specific mandates, whether they hold or sell at any one particular time, we don't see those trades, we just don't do it. Paula Blas: You don't play an active part. Gerry Cruz: The only time we ever get involved and it's been very limited and it may sound like a lot, because we have gone through the manager change, is through the transition process and since we've hired the ETFs as an option, even that would have been to a lesser degree than we use to. So as it relates to this mandate in commodities, there are a couple of ways to go at it, we could hold physical assets where we can do it through an ETF or we can hire producers and just hire a manager who buys, for example, those minors, mine gold as to only gold directly. So, there's a couple of different options and in any of those scenarios, we wouldn't be making trades. I think what we would need in this case is the flexibility have either through a manager, through discretion, through a consultant, say, ok it's time we get out and move quickly to get out, if we wanted to be in this space at all, but we don't. Terry Dennison: Let me rephrase what Gerry is saying a little bit. Clearly you're not in a position to decide, we're going to buy this or sell that, but historically we suggested, in part because of the Government's model and the limitations we had of investing, of basically taking a strategic position, finding a good strategic position, that's what the asset allocation projects do, find a good strategic position and hold it. There is a middle ground where basically you more actively manage the asset allocation. We've done that already, we've held off funding the REITs when our model said REITs are over valued and I think we preserved some wealth there, we were there when they did well. The Committee said, let's up the emerging markets and yes they've been winning, but there's also as we strongly believe, a strategic reason why you want to over weight emerging markets relative to say a market weighted index. If you look at a market weighted index, it really represents the decisions of the past. The market capitalization index says, the total market value of the U.S. is this, the total market value of Europe is that, the total market value of emerging markets is this. That really represents the past. If you look at the future and for example if you look at what a GDP weighted fund would look like, you're not looking at the past value of the markets, but basically where is the wealth being created in the world, you would increase your assets in emerging markets probably twice, because a very significant, well not majority of course, the rise of the developed world, the emerging markets in terms of GDP creation has been huge. It's not yet reflected in the market as well as emerging markets have done. They've still not actually matched their share of GDP of the world. So our view strategically is that you should over weight emerging markets versus a global index. If we lead up to the global index what's called ACC, All Country World, so basically you'll be able to get the whole world, the investable world is about 45% U.S. and about 12% emerging markets. Even emerging markets are kind of a

funny definition, is China really an emerging market? Let's just use the simplistic definition of an emerging market. Realistically if you looked at China and the other emerging market share of GDP, it is much harder, much larger than its share of a global index that's capitalization weighted. So that's not only a timely tactical decision, look at the returns, but also a timely strategic decision, because we think the emerging markets are where the wealth is. The developed world is on a decline. If you look frankly at how emerging markets run their economies, they do a much better job running their economies than the U.S. and Europe does, they tend not to be deficit spender, they tend to invest in long term wealth creating projects, not distribution projects. Gerry Cruz: I'm sorry to interrupt, but if you think about taking it a step further, think about the index on emerging markets, 8 of the 24 countries are in Asia who have a case model of an in floating crisis economically back in 1998, so where they can pull an actual case study on how to evolve through an economic crisis, the U.S. can't and neither can developed worlds. They have put in the measures and increasing ratios in their banking system and they have gone through what we are currently going through some ten years ago and have developed a stronger economy to prevent those same things from happening in the future. Doris Flores-Brooks: I recall when Forbes had their billionaires, the top value manager was from South America, no longer... several other countries aside the U.S., that appeared to come from out of nowhere. Terry Dennison: If you look actually at the long term 10 year returns in the emerging world, emerging Latin America has done even better than emerging Asia. Now in terms of percentage, it was a smaller base to begin with, but it grew faster than Asia. There's a lot of emerging markets out there that you don't think, you tend to think of China, when you say emerging markets, the first thing in your mind is China. Gerry Cruz: But there's India, Indonesia, Thailand... Terry Dennison: Brazil, Ecuador, Chile...

If we wanted to move to the next level, the next level is a more active and a more structured and a more active movement between asset classes. As Gerry has said several times, with the ETF option now, it is relatively quick to do it, we don't have to, if we want to go into an option or reduce the allocation to an option, it's not a lengthy process to acquire a relevant manager or a difficult process of taking money from a manager. It may not be difficult to you, you could just call up and say, we want money, but it is disruptive to the manager's investment process. It requires a more governance model or some other mechanism for doing it, but realistically that is something that is doable. The managers do it to managers too and if you can think of them as kind of a species, if you have a dog and a cat and you have 50 dogs and 50 cats and cats are in favor, maybe we had decided we're going to have 70 cats and 30 dogs, you would be improvident to go to 100% cats, because the market psychology changes. We do a lot with what we call dynamic asset allocation, we're looking at valuation so we actually have measures and you can say markets don't always move based on valuations. Valuations are kind of what a rational person would do, the problem is the markets un-rational, if the market gets into an emotional roller coaster about an economic crisis or a political crisis or a military crisis, who knows what's going on with our friends in Korea right now, the reality is, it doesn't always work, but if you had a lot of money, it was exposed because of prior success. Maybe taking some of the money off the table wouldn't be a bad thing, but you just can't do it without some kind of compass, some kind of calculator that says, not just on an emotional basis or who read which headline or who speaks the loudest or pounds the table the hardest or some kind of rational process that said, we're probably over exposed to this

risk or this market or this asset class or this style, let's dial it back some, that might be the next phase. Doris Flores-Brooks: Is that different from the ranges that we currently have? Terry Dennison: That's a good question, because the range is more of a risk control measure. The range guarantees that in the event of a run away market in one direction or the other that it doesn't become a void where you own nothing or it's all become something. Let me give you a perfect example, back in 1999, there was one segment of the stock market that was doing well, it was large cap momentum growth stocks, the dotcoms and if you didn't have some kind of rebalancing process that took money from the simple ways, took money from growth and gave it to value, when the market psychology changes, you would have an enormous amount of money now declining and very little money participating on the upside. (Remember we look a lot at percentages, we made 38% last year.) Well if the Fund was fully funded, we would have made twice as much money, because that 38% was applied to \$2.4 billion and not 1.2 billion. Similarly if the market declines, we want to minimize, we can't eliminate because if we get it wrong, we could be giving money to the future losers and taking money from the future winners, but it's a little bit more active where you start to say, it's still within the bound, but it's really getting kind of ---, it's kind of bubbly, it's kind of over valued and we no longer can see the justification for the valuations, whether its price earnings ratio or some other measure of risk, it looks like it's gone kind of far, maybe we ought to just cut it back a little bit.

There's was an article talking about the old aphorism attributed to Benjamin Franklin, a penny saved is a penny earned. Well, actually that's not right, a penny saved is worth more than a penny earned, not just because of taxes, but because of risk. If you invest to make a penny, there's a chance of losing money. If you save the penny, you have the penny. (The rest of this I think we can skip. I'd be happy to address any of it, but I think we probably ought to, in the interest of time, get to the Fund.)
(End of Economic & Capital Market Environment presentation)

Defined Benefit Plan

10:00am-10:45am DB Plan – Quarterly Performance

Let's go to page 41 under the Executive Summary. I'm going to refer to this a couple of times because it bears repeating. You are ranked in the top quintile, which is the top 20% of public funds universe for all periods in the quarter, 3 years and 5 years, you are at or above the 9th percentile, which you did better than 91% of the other public funds. Doris Flores-Brooks: Is this all funds regardless of size or is it relative to our size? Terry Dennison: It's a total universe of public funds. It's not all, it's a statistically large number to get. It's a sufficiently large sample for this to be a significantly true statement. We're going to make no recommendations to replace any managers beyond the ones that have already been terminated for which searches are under way. We are going to talk a little about what is going on and what has been discovered with AXA since the termination. (It's certainly going to produce litigation and what it reflects is a level of hardly unprecedented, intellectual or corporate stupidity.)

In terms of the asset allocation of page 42, you're within your targets and the targets are relatively broad, you're not really getting close to any kind of limit. In terms of and I said I would talk a little bit and we have already, our thoughts about portfolio

structuring and you've already done a lot of what we suggest, which is, increased allocation to emerging markets, significantly above the capitalization weighted portion, inclusion of small cap as a strategic asset allocation and we're really looking not just at domestic small cap, but global small cap and you're actually ahead of the curve there, with an allocation, it's a little under weighted, an allocation to international small cap and the argument there is simply opportunity. It is a lot easier for a small company to grow than it is for a large company to grow. They also tend to be relatively less covered by researchers and other managers and therefore there really is an opportunity to add value. Gerry raised the question of, do we have managers or is it possible to find managers who can consistently add value ahead of the benchmark, above the benchmark. I think that's certainly an open issue in some asset classes like large cap, domestic where it's proven difficult for managers to add value consistently and remember, adding value is not just making more money when the market is up, but losing less money when the market is down. Often the real value added to active management is not that they outperformed the benchmark on the upside, because the benchmark has certain advantages, such as the fact that it's capitalization weighted, so the winners become a larger proportion of the benchmark, making the benchmark difficult to match because it's been accelerated away from you, but really adding value on the downside. On the downside I think managers add value not necessarily by picking winners but avoiding losers, because particularly where there's a short change in the market psychology what tends to happen is the formerly outperforming stocks which are now significantly large portions of the index, I think 1999-2001, these large stocks that have become significant portions of the index, when they fall, they fall steeper than the rest of the index. So, simply avoiding the over weighted stocks adds value in the sense of losing less money.

The other asset class that we think you should think of and it's not actually an asset class, it's an investment strategy, it's called low volatility. We're doing a lot of work and there will be a paper that we'll talk about at the next meeting about low volatility strategies and a lot of these were actually developed in Asia and a lot of the work we've been doing is actually in Australia, but they're available everywhere. It really comes in several flavors, some of which would be not only achievable with your present guidelines, but actually pleasing to certain parties. Two of those strategies are high quality stocks. Again the objective here is low volatility, the objective is not winning, the objective is moderating volatility. You can think of volatility as a kind of currency you spend or save, but if you go into emerging markets and small cap, those are relatively volatile, they go up and down a lot and by large amounts. If you want to maintain the same level of portfolio risk, from a total fund perspective, we need to reduce the volatility of the portfolio, because we've increased it, we're over weighting high volatility things like international small cap, total small cap and emerging markets. To counter balance that, we're looking at strategies with lower volatility, strategies that fall less in down markets. A couple of these strategies are high quality stocks, high quality dividend paying stocks tend not to go up as much as low quality non-dividend paying momentum growth stocks in up markets, but they tend to fall less in down markets because dividend provides, assuming the dividend is secure, provides a floor and you've already got a couple of percent of positive return simply because of the dividend yield. The other is strategies that aren't always invested in equities, that basically say, we might be 80% invested in equities and 20% invested in bonds or in cash or other low volatility strategy. You can say, we've gone back to the 1950's and re-invented balanced funds, but the objective here is really to find low

volatility. The other low volatility strategy, there are low volatility hedge funds and aren't trying to beat an index, they're trying to add value relative to a cash or zero benchmark. The objective is to not be isolated from the market. We're not trying to beat the market on the upside and lose less on the downside, we're trying to produce a constant 4, 5, 6 or 8% return regardless of what the market does. The advantage of the market neutral and they can either be a long short hedge fund or a hedge fund that's constructed to be, to have a very low beta which means it isn't very responsive to what happens to the market. Basically you have an absolute level of return and that's appealing for a Defined Benefit pension fund, because your actuarial assumption will beat the S&P by 2%, it's 7% so you have an absolute return, ultimate target. If you make above 7% in the fullness of time, you will actually fill in the hole with the under funding. If you don't make 7%, the hole gets bigger, because what they're doing is they're discounting your liabilities at 7%, if you don't make the 7% you'll fall in the hole and if you exceed the 7%, you fill in the hole. So an absolute return strategy, one that isn't coupled to the market, what that means is, when the S&P is up 49%, your total fund, you might be up 38%, that part of the portfolio might be up 6, but that's ok because if your total fund return is down 20, it's up 6.

Gerry Cruz: With the hedge funds, does the new financial reform clean it up a little bit? Terry Dennison: I think it does, it cleans it up. It's a little less than the Wild West because it's a lot more difficult to tell lies if you're registered with the FCC when the penalty for telling lies is a lot higher. Second of all, while the FCC is not exactly the most diligent watch dog in the world, sometimes you can knock on the dog house and all you hear are snores, as we saw with the high yield bonds, we have plenty of instances here and it's not a party political thing, all parties manage to screw it up. I think it's a lot better. At some point you just can't have an anathema against a particular way of investing without really thinking of what that way of investing is intended to do, how it works, what the risk control that are built into it do. It's fun to ride with the market when you're winning, it's no fun to ride with the market when you're losing and maybe a strategy or portfolio, we're not talking about all the portfolios, but a segment of the portfolio that is in a low volatility absolute return or market neutral strategy that basically has a beta and let me remind everybody that beta is the degree to which a portion of the portfolio tracks the market. (A beta of one looks like this, a beta of 2 looks like that, a beta of zero is that.) In reality, people suggest that you can find hedge funds with a beta of zero, hedge funds are not made out of photons, they're not made out of some cosmic particle, they're made out of bonds and stocks invested in a way to minimize the beta. Often you'll find betas at .2 or .1. So that basically if the market is up a lot, the hedge fund is getting a small benefit from the market a lot of hedge funds hurt a little bit, but you don't see the volatility that you have. One of the things that have come out, (I talk to the press a lot) one of the things we get a lot of pressing queries about is, what did people learn from the market decline in 2007 and 2008. One of them is, you have to pay attention to risk management and you pay attention to risk management when everything is going great, so when everything isn't going great, the risk management is in place. It makes no sense buying insurance after the house has burned down, you buy insurance before the house burns down.

Gerry Cruz: These little volatility strategies, how much of our portfolio would you...what are we talking about in terms of dollars? Terry Dennison: You have to put in enough to move the needle, putting in 2% is pointless, 10% I would say, 5%

minimum. Gerry Cruz: That's about \$120 million. Terry Dennison: Yes and it wouldn't necessarily be a single manager or a single strategy, it's basically a set of managers and the thing about it, it's a style of investing, there's no ETF for it, it's a way of thinking about it, it's a way of structuring portfolios to minimize this factor called volatility. Gerry Cruz: We cut away dollar amounts, \$120 million and almost manage that separately, give it its own strategic allocation to minimize any volatility, so within that \$120 million, we may have 60% bonds and 40% stocks. Do you go to that level of detail or do you just hire a fund manager who just manages that \$120 million? Terry Dennison: You want to have a diversity of style too. In a perfect world, in a world where we didn't have the constraints, I would probably have 2 low volatility traditional asset class styles, strategies and a couple of more hedge fund strategies, probably a market neutral and a long short hedge fund. More absolute return where basically we're not trying to beat an index by trying to add value with zero or cash... Gerry Cruz: And that strategy for the full \$120 million, so we track them separately from... Terry Dennison: It becomes in a sense, it's an asset class... Doris Flores-Brooks: You're going to have to take away from something to give it... Gerry Cruz: I guess what I'm saying is to determine, let's say, we use the 6% absolute return as a requirement, so in order to determine whether they've hit that, you have to peel away every one of those managers of that \$120 million to determine collectively whether they've hit the 6%... Terry Dennison: Well, if you did what I suggested, you'd actually have 2 sub asset classes, one you are looking for market like returns with less than market risk, so one group, the people who are investing in traditional bonds and stocks, the objective would be to produce returns similar to the market with less standard deviation, so actually low volatility. The other 2 would probably be benchmarks, they're more absolute returns, they benchmark would actually be zero or cash, which right now is zero. So their objective is absolute level of return, plus a very low level of volatility. Basically you'd be looking at the absolute return portion, you'd expect to get a small positive number almost all the time and the other you'd be looking for, some of the ones we looked at have got actual long history and this is kind of a new idea, it's not something that everybody in the world does and I just haven't told you about it yet, it's all kind of new. Gerry Cruz: I'm just wondering how we can integrate it into our existing strategic allocation. Terry Dennison: It would just be a new asset class with 2 sub asset classes. There's such a thing called alternative investments because they no longer have the same kind of objective as the other managers do. Gerry Cruz: But then just logistically, you'd have to peel away assets from other... Terry Dennison: Yes, you would have to do a re-allocation, the money has to come... Gerry Cruz: We'd have to determine if we'd have to reduce our exposure to the emerging market for example, what the impact of the re-distribution... Terry Dennison: You would have to do, it doesn't have to be included in a full asset allocation exercise. Realistically, the objective here is to allow an excess allocation, an increased allocation to emerging markets and small cap by providing a counter veiling force, a force with less risk, so where you're taking the money are your other risk assets like domestic equity and developed world equity. The objective here is we're trying to get the same level of return with less overall risk. Gerry Cruz: Risk is measured by volatility. Terry Dennison: Risk is measured by volatility.

If you go to page 73, I've mentioned this chart a couple of times and I think it reflects well on the Board and on the Committee, we're looking here at 7 years worth of history. This is how the asset allocation has evolved over time. You can see back in the beginning of 2003, it was very, very simple. Importantly, we're not really showing

all of the nuances of it, because back then because of the then in place dividend requirements and other things, basically the domestic equity was mostly value, because growth managers had to buy stocks with the predominate value characteristic of having a dividend yield and over time, in stages you can see that it goes and then it splits and then it splits again and then it splits again, over time we have evolved a much more articulated asset allocation.

Now go to page 76, I've mentioned the performance attribution. This is for a quarter, but the reality is when you're looking at being in the top 9% for 5 years, something like this has been working for a long time. What we're doing here is we're decomposing the total return into that portion of the return that's attributed to asset allocation, where we put our money in the asset allocation and then where we put it, how well the managers are doing in terms of value. What we find are the green bars which are hugely positive, is the asset allocation effect. The grey bars are the manager's effect, which is generally positive. There is something called an interaction effect, it's just a combination of the 2 things working together, you can't decompose. The dotted is the total effect. What you find is, the total effect is extremely positive, often because of the additive of the green and the grey bars. That's how you got to be as good as you are.

Let's go to page 79 and as I've said if you look at the very top line there, the total fund return for one year you're up 38.4%. It would have been nice if that 38.4% was applied to more money. If you look at for 5 years, is this a flash in the pan, this 5 years is an interesting 5 years. Going back, these 5 years, including the down market, those 5 years we didn't make our 7%, but we did better than 91% of the other funds. We did 90 basis points better than our blended index and our blended index is a passive implementation of our strategic asset allocation at the time. So the managers added 90 basis points which are not insignificant. For the quarter we were in the 6th percentile. To show you the effect of the managers, the blended index which is in the 66th percentile, if you would have been all passive, you would have only earned 3.4% where the public fund median was 3.7% and you would have been in the 66th percentile. Gerry Cruz: The managers added that additional amount. Terry Dennison: That and the fact that we permit in the interest of just giving some latitude, some difference in the asset allocation. This is looking at a passive of implementation of target, not passive implementation of actual, so the fact that we let some of the --- run a little has benefited us. We're going to see very outsized numbers for REITs and we've let the REITs run, so we've gotten gain on gain. If we look at some of the individual managers and there's a lot of numbers here, Atalanta was one of those managers that did well in the down market. If you look at them for 3 years and 5 years, for 3 years they were actually positive where the index was negative, put them in the 8th percentile. For 5 years they were up 6.3 where the index was up 1.9, 6th percentile. They've struggled in the rebound, for the last year they were up only 46%, with the market up 49.8. Two thirds of the managers did better than they did, but that's not too shabby. Fiscal year to date they were 10.8, with the market up 11.8, 73rd percentile. So they pretty much participated on the upside, they captured 90% of the upside return, lagged other managers but other managers did hideously on the downside. If you are in the 8th percentile for 3 years, what that meant was 92% of the managers did worse than you did, so overall they did pretty good.

Winslow is relatively new, we only have a year of history with them and they lagged a little bit too. In this report, this is actual data, we don't have any on them on a longer period, but their performance in the down market, because that was the period we were looking at when we hired them, was pretty strong. So again we have got a combination of managers which was the intention, the reason we have multiple managers is to avoid having all the assets dependent on the good will or sanity of one investment process, but we also have a bit of diversity in style. What we're working on now is being able to dive deeper, what I mentioned was called deep style, we're magnifying style instead of having one variable into 10 or 15 variables so that we can look at it more precisely.

Doris Flores-Brooks: Can I ask this question. Atalanta as well as Metropolitan West seems to have done, as far as their ranking, who determines, or how do you set the formula like within the group, Winslow has 7%, Intech has 6.9%, how do you allocate within your... Terry Dennison: I think it's largely equal weighted or some round number and then unless they become out sized and we took some money from Fisher because that asset class has gotten large and because of the success in the market place. Paula Blas: Just like the U.S. Domestic Equity, it's broken into growth, value, core... Gerry Cruz: The 5 managers, so they're basically equal weighted except that you'll see the differences because some have outperformed others. Doris Flores-Brooks: That's kind of like when you initially started. Gerry Cruz: Right.

Terry Dennison: One thing that's gratifying is Intech which had been struggling a bit, has started to come around to the point where for one year, if you look at the since inception, the return is still lagging all the way over to the right, they're still about 500 basis points behind, but they've certainly rebounded. This is a quantitative manager and quantitative managers have struggled in this market environment, it hasn't lent itself to reliance on past relationships between economic and accounting variables and future performance as much as the past did, but it's certainly gratifying to see them rebound. They're 50 basis points ahead of the benchmark and beat about two thirds ahead of the other managers and just 200 basis points behind a huge return for the year and above the median.

Robeco doing ok and a bit of an improvement where they are under for fiscal year or one year, they're only under by a tiny amount. They're capturing 98% of the return.

The one uncanny and it sort of defeats Terry's view of let's have managers do well in down markets and up markets, Metropolitan West, they just seem to do great all the time. They're creepy good. Gerry Cruz: It is a little concerning. Terry Dennison: Well it's not concerning, it doesn't concern me, it's puzzling because they're not changing their style, they're not a style rotator, they're not a drifter, they just seem to have that rare gift. But if you look at them for 5 years and 5 years is the last 2 years of the silly, adrenaline fueled market driven by huge consumer spending because of home mortgage withdrawals, 2 years of hideously, ghastly, worst sense of depression performance, they beat their rebound mark, the fact they beat it by 610 basis points is not as impressive as the fact that they beat it by 600%, they're 600 times as good, 4th percentile. Metropolitan West is just a jewel for you, their performance has been fantastic.

Switching to the international, we took some money off the table with both the asset class and largely through Fisher. The reality is they had a bit of a difficult quarter, they lost 20 basis points benchmark, 75th percentile, but long term while they bounced around a lot, they've basically done a half way decent job.

AXA, there's a lengthy discussion here about our conversation with AXA which has been very highly covered in the press, it's simply because of the prominence of the firm and the kind of luridness of the situation. AXA is also a quantitative strategy, basically what they do is they collect an enormous amount of data on the economy and the statistics about an enormous amount of companies and they run through a proprietary computer system that basically looks at what factors have led to future good performance and try to construct a portfolio that maximizes those factors and minimizes factors that were found to be negative. These models evolved over time to become more complicated and there's a separate team within AXA that basically manages the model, they do the research, they determine what changes would be appropriate and then implement the changes. I use to run data centers, my background among other things is, in IT management and programming and in a well managed organization you have a very formalized change process. Somebody says, ok this is what we need to do, this is why, this is what the change is going to be, what the testing was to prove that the change is efficacious, it had no negative implications. Well last summer, somebody just went in on like a weekend and said, this isn't working as good as it could have, I'm just going to go in and make a little change to the model without any documentation at all, they just went in and fiddled with it and no proper procedures were followed, they actually hired a firm to find out what impact it had. So the issue is not that the model broke and vast sums were lost, it was the process and this is simply from an internal control perspective and best practices in the programming operations and again I've run them for 40 years. It gets worse, the problem was discovered last fall, the change was discovered last fall and acknowledgement went all the way up to Bar Rosenberg who is the Rosenberg in AXA Rosenberg and they decided rather than revealing it, they would hide it. It went all the way to the beginning of April really and they said nothing about this, they just basically kept it quiet. Well, finally it started to leak out and they basically just clammed up, they have not followed the Johnson & Johnson, Tylenol strategy, they basically just clammed up. They did put Bar Rosenberg on leave while they hired a firm to try to go in and figure out what implications this had and they more or less fired the head of the research, although he basically retired, he's going to retire in 12 months, which is a little different than, you get out the door. The thing that people reacted to is the fact that it wasn't disclosed, it's just like Watergate, it was a 3rd rate burglary that was kept a secret and it has cost them an enormous amount of business and it could end up destroying the firm. Their reputation is in the toilet, they're losing just about every, P&I daily and all the news blogs I get, somebody else has fired them, somebody's got them on probation or something like that. The sense of loss of confidence, how can you trust them, the model is some complex black box and the presumption is the --- that manages the black box follows best practices for making changes and doesn't go in on some Saturday and just change the production code and I'm sure the change was minor, but they're still trying to figure out what it actually meant (and who did it, some junior person on their staff.) Where it got really ugly, the senior people in the organization knew about it and said, let's just keep it quiet. The end result is, the firm's reputation is in shambles, their business is in shambles.

Dimensional continues to do well. Dimensional has obviously got the vast majority of the international small cap money. They lag the benchmark for one year by 20 basis points, they were only up 68% with the benchmark up 70%.

Emerging markets have done very well, Cap Guardian hasn't done spectacularly well. Since inception which actually goes back to August 2006, for 3 years they look great, for nearer term, their absolute returns are great, but their returns relative to the market and relative to other emerging markets aren't terrific. At some point coming down the road, we might think either of splitting that or replacing them. I think we could probably do better, the reason I'm a little bit reluctant is they almost, I would say they would probably be tied with 2 or 3 other firms for having invented emerging market investments. The point is their research depth and spread is huge. There's issues with how they run the portfolio because remember, these are these multi manager structures, where basically it's not one portfolio manager, it's not a team, it's a group of people, each one of them do a slice, the research group has a slice and 6 or 7 portfolio managers have slices, which is good in the sense that they're probably not all going to get the same stupid idea at the same time, which is important, if they all get the same stupid idea at the same time, they can cost you a lot of money particularly in this asset class. I just wonder if longer term there isn't people who are a little bit more nimble because they have a lot of money. One negative of being first is you tend to accumulate the most money which makes them a little less able to move rapidly. At this point, no real change.

If we look at fixed income there's an important story here. The managers have generally done well, the asset class has done horribly and there are 2 words to describe why this asset class has done horribly, particularly relative to other funds, other managers, high yield. You can't they can, they were up 60% and you got nothing. High yield are junk bonds. It's the fact that other people had, I mean, they didn't have 50% of their fixed income allocation in high yield, but if you remember, the bonds in the, tend to perform a lot alike, bonds are bonds, so it doesn't take a lot for you to do really well, the spreads of performance is pretty narrow, so even 5 or 10% in high yield is enough to keep you sort of struggling.

I've saved the best for last, at least in terms of returns. The conservative REIT...the less aggressive fund was up only 115% and that put them in the 14th percentile. The more aggressive was up 122.3%. Gerry Cruz: More aggressive, Security Capital, these guys just invest in listed? Terry Dennison: Right, the issue here is concentration, they have 25 securities. If you read the notes, everything is in here, the notes basically say that this would be too risky as a stand alone manager, but combined with another REIT manager, it's a good portfolio. We're trying to build portfolios here, we're not trying to buy this manager and that manager just because they have good numbers, we're building portfolios of managers who play well together and these 2 play well together. So that's the logic.
(End of DB Plan Quarterly Performance)

Defined Contribution Plan

11:00am-11:45am DC Plan – Quarterly Performance

Terry Dennison: If you go to page 7 and again the only comment here is for the benefit of the minutes, that we have examined the array of investment options that we've made available to the participants to allow them to build portfolios to suit their unique risk requirements. We don't have any recommendations to add or delete any asset classes. There is a discussion on page 8 talking about the changes, looking at some forthcoming changes, we're adding the TIPS Fund and the Black Rock Target Date Funds. If we turn to page 8, there was a 6.5% increase both contributions of course and market change. In the 401(a) Plan, the top funds you've got very high allocations compared with most funds in the life style funds, these of course are being changed to the target date funds. The 457 Plan was up 7%, \$2.2 million. If you go to page 9 and then look at page 20, I mentioned earlier and we're talking about the Dodge & Cox Balanced Fund, that we find in this case it's going to be a lot of funds where the performance has been very different in the up markets versus the down markets. Remember the balanced fund is a blend of bonds and stocks, the notional sort of neutral mix is 60/40, Dodge & Cox has historically had a higher allocation to equities. If we look at page 20, you can see for the down market period their performance was not terrific. On a relative basis versus other balanced funds, their performance is relatively poor, but look at the comeback in the last year. For one year they were up 51.2%, which is nearly 2000 basis points ahead of the benchmark and put them in the 5th percentile.

(Recording ended at this point)

It's hard to criticize performance, basically 1st decile for one year and 5 years up 55%, there's no way we're taking this away, it's just something to watch. American Funds is the retail arm of Cap Guardian, Capital Research and Management (the emerging markets on the DB side).

Franklin Templeton is fine and the Baron Fund, the next one the Champlain has got exactly the same pattern of doing well in the down markets, poorer in the up markets. The reality is if you have to take your pick, that's the pattern you want, you want them to lose less money in the downside even if we sacrifice some of the upside. Basically if you look at the longer term performance for both of them, obviously Champlain has been fantastic for 3 and 5 years, Baron is ok for 3 and 5 years. Thornburg again has had a bit of a weak period in the one year and one quarter, but long term performance has been outstanding even with their high expense ratio and perhaps with \$11 million we can see if we can get a better share class. The Pioneer frankly here is a stinker and I think at some point here we have to decide what to do with this. We were hoping for a rebound when the market psychology changed, they were up 72% for the year, but they were only in the 84th percentile, the index was up 81.6%, so they only captured about 80% of the gain and that's not so good. We could let that slide one more quarter to see if, because we're now in yet another evolution of the market or we could make a change. This is another one I suspect where people didn't wander in accidentally, people who went here explicitly went here. Rosalie Bordallo: And I would hope to not remove the mandate. Terry Dennison: No, I would not take emerging markets out; that would fly in the face of everything we have said about where we

think investments ought to be. Gerry Cruz: Did you want to move to do that? We can go through the search, we can just go through the process of choosing a fund, because the next time we see you will be in the fall. Terry Dennison: It will be in August. Gerry Cruz: We could do the search based on 331 data and have the book to you in a couple of weeks. This conversion, I don't think you have to do RFPs, you could actually do this 6/30/10, if you wanted to have a phone call to talk about what to do, I'm going to be in the UK about the time the report would be in your hands to past the 4th of July for some company meetings so I don't know how easy it would be to call you from there, but I could send you, here's what we think you ought to do. Gerry Cruz: That might not be a bad idea then we can decide what to do, it's not a lot, it's only a million. Terry Dennison: Ok. And again, I don't think people are just there by accident. It's one thing to pay high fees and get good results, but paying high fees and not getting good results raises fiduciary issues that I want to keep you away from. Doris Flores-Brooks: As always it's very informative and I appreciate the opportunity to come to this.
(End of discussion for DC Plan Quarterly Performance)

1:15pm-2:00pm Franklin Templeton
Responses to Michael Materasso's Questions re: PL 30-120

Terry Dennison: We need to do the issue with Franklin before the managers come because there is a disclosure. Gerry Cruz: I'd like to talk about that because we're coming up to it. Terry Dennison: We asked the Legislature and they approved as Public Law 30-120, what it did was it said that any type of security that was in the Lehman Barclays Aggregate Index would be permitted. The problem we're running into is the index contains securities that represent large portions of the bond market because the intention of the index was to represent the bond market. The Legislation was written a long time ago before these bonds existed and it was unclear or clearly prohibited for managers to invest in certain of the securities that evolved since the Legislation was created. Rather than try to enumerate the types of securities that could be included, we said, if it's in the index, not the individual securities, but they type of security was in the index, it would be permitted, because that meant we wouldn't have to be constantly be fiddling with the rules. The rules would be derived from the constituents of this large, which is the principle of fixed income benchmark in the U.S., the Barclays Aggregate Index and it's in the book, under tab 1, Franklin Templeton, it's an email to Diana (Bernardo), we were asked a number of questions. Of course what's happened now is the compliance department of these managers, obviously they're trying to avoid the litigation risk of investing on approved securities. Compliance departments have gotten a great deal more fussy than they were before and before they were sleeping in the dog house too, they're now in your face, they're really running the places now. They basically said what about this, what about that and some of these questions when Joanne Grimes and I were working on the response that some of these questions produced gales of laughter because some of them are just preposterous, because, this is one of the questions, because this particular issuer has a type of security that's in the index, does that allow us to buy anything that the issuer issues regardless of whether or not it's in the index and we said, no. Some of these are a little bit sophisticated. Question number 4, may we continue to invest in Rule 144A securities --- in the index and FCC registered. Under rule 144A which is a rule of the FCC, so obviously that's kind of a redundant statement. The problem is

subtly here, because some of these have tranches that are and tranches that aren't, so the letter that Joanne (Grimes) and I put together that basically said, you have to look at this in a nuanced fashion. Gerry Cruz: So if it is registered... Terry Dennison: If it is registered, yes, if it's not registered, no. So we think we have dealt with and again this is a joint effort, you can see the letter which were written independently, but as Joanne (Grimes) says in her cover memo, this surface the issue that he identifies as number 7, what is the maximum allowed percentage we're permitted to invest in Federal agencies such as Fannie Mae or Freddie Mac, should we continue to combine straight debt with mortgage passes securities for that percentage. When we read the question, we started a little bit of free association and let me give a little background here. Your rules allow effectively unlimited use of U.S. Government securities, so that raises a question, what's a U.S. Government security, clearly treasuries are, they are debts of the U.S. Government. There are some agencies of the U.S. Government that are simply arms of the Government, they're instrumentalities of the Government and they have what is called, the technical term is, the explicit guarantee of timely payment of principle and interest and that is provided by the full faith in credit of the United States. It is synonymous with the Treasury, that's as strong a guarantee as you can get. Then you have Fannie Mae and Freddie Mac which are, because everything in the investment business has an acronym or a catch phrase, this is a Federal National Mortgage Association. These are funny, they are what are called Government sponsored enterprises which do not have the explicit guarantee as to timely payment of principle and interest by the full faith in credit of the United States of America. Their sister entity, GNMA or Government National Mortgage Association has. So GNMA is the same as the Treasurer, Fannie and Freddie and different. Fannie and Freddie are actually private companies, you can buy stock in both of them. It turned out to be a crappy stock, one particular preferred stock, Series B of Fannie Mae which was yielding 21% and yours truly thought this would be a hell of a yield, so I bought a pile of it at 14 and it's now selling for a buck and a half because they suspended payment of the dividend. So the question is, the market assumed that these were a moral obligation of the Government, but it was not an explicit guarantee, now having said it was a moral obligation, no explicit guarantee, when push came to shove and both of these were on the rocks, the Government bailed them out, they took them over. So the Government made good the bond holders, both the direct debt, because they issued debt in their own name, plus they issued mortgage backed securities, the question is, the interpretation of 8150 and we can read chapter and verse of 8150 in which at least one interpretation says, this is Treasury and Agency. Well this isn't actually Treasury and Agency, it's a Government sponsored enterprise. This has kind of freaky implications because both the direct debt and mortgage backed securities issued by these 2 agencies are significant portions of the index. (We have \$60 million invested in these.) The interesting thing is you have 2 other bond managers who have been blissfully investing in these, actually you have 3 who have been blissfully investing in these for years. Gerry Cruz: What is the cap on corporates? Terry Dennison: 5%. Gerry Cruz: Of the total fund, so if you add up the total concentration and assume that the Freddie's and Fannies are corporates, what would be our... Terry Dennison: You'd probably be ok because the 60 is total of Fannie and Freddie, 5% of total fund is \$60 million. Now the practice has been that we would limit each managers allocation to these limited securities to the statutory limit for total fund, because that mathematically ensures you can never break the law. Now it's surfaced that, depending on how you want to look at 8150 and 8150 was written before these became big. The securitization of mortgages despite the fact that I

believe these organizations restored in the 1930's they just sort of sat quietly, sat on the sidelines until... literally 8150 it goes back to a Government code section that predates the revised code annotated, it's ancient. So the question arose, what exactly do we do and what do we tell the managers. Gerry Cruz: Since they have been conserved, are they now... Terry Dennison: We still don't have the guarantee. The Government stepped up on one instance when they were in trouble and said, we're ok, we'll take care of you. They still don't have the explicit guarantee. Now it's insignificant, the market traded a tiny spread, they maybe traded 20 over treasuries or if GNMA was at 4, they maybe traded 420. So they had a tiny spread because moral guarantee isn't the same as explicit guarantee, so they traded 15, 20 over and when push came to shove, they got conserved, they got bailed out. Gerry Cruz: What's the risk, if every manager, let's go ahead and assume for a minute that they're regular corporates then, every manager took out 5%, which is the limit under another section.... Rosalie Bordallo: 8154 it would fall under this category now. Gerry Cruz: So it would be 5%, they'd still be ok right? My question is, are any of them exposed greater than 5%? Rosalie Bordallo: It's 5% in total, but when you look at each different manager, they have different percentages, one is 30, one is 16, one is... Doris Flores-Brooks: What I don't really hear you saying is whether or not we should even be invested with Fannie and Freddie. Terry Dennison: I'm just looking at the legalities. The reality is to not do that would produce an extremely unbalanced fixed income portfolio. When or if we write our written testimony in support of a potential bill, we would say strongly you would want to invest in these things. The problem is if you don't invest in these, the money has to go some place, so what you've done is you're over concentrated in treasuries which have got the lowest yield and actually the highest risk of a revaluation of the credit quality of the U.S. Right now, the issue about, what do we say to the 3 fixed income managers is if we cast out about the legality of their positions, their compliance department is going to say, out they go. The problem is if we don't invest in this, we're hugely over weighting in asset backed, corporates, treasuries and the other agencies, which you don't want to do. This the argument we've used in a lot of Legislation you have asked for, not that what we're proposing to do is really terrific, it's just that if we don't have it, we're over weighted in something else. Paula Blas: And for some reason I think the reason that they're over weighted like that, the only reason I think they're holding so much Freddie... Gerry Cruz: They're holding it because in the universe of fixed income mandate, I think they're thinking 5% of the universe of the allocation that we move into fixed income. Paula Blas: But that's what I wanted to clarify with the managers today, if they're viewing it, if it fell under 8150 as opposed to...and because they might be viewing it as an 8150, their compliance department is probably saying, because it's unlimited under 8150. Gerry Cruz: Right and we clarified that because I said no, it's not unlimited. They are a separate legal entity. At one point you could buy on the market independently rated from the Government, so it's not a political agency like the SBA or GNMA or even Sallie Mae which guarantees principle and interest. So they got that but I think they were thinking that in trying to come up with a calculation to determine concentration, they were only looking at the fixed income mandate, which at one point, 60% of the portfolio and now 38%. That was the denominator that they were using rather than the 1.2 billion, because if you think about the 1.2 billion, the number goes up to 60 million and 60 million, if you look at the concentration, or if you look at the component, 60 million, what is the component of Freddie and Fannie in the index, is that equal to 60 million, is that the same percentage? Terry Dennison: I bet at least 35% of the index. Freddie and Fannie are the principle debt issuing agencies,

sot the others are side shows and partly because of the huge growth in securitized home mortgages. So they've become a huge component, that's why this was an issue, it's become an issue because they've become a huge component of the index. Gerry Cruz: So let's say the 35% of the index, which means... our bond portfolio is 40% of 1.2 billion, which is 480 million, so 480 million and 35% of that is... Rosalie Bordallo: It's down to 30%. Gerry Cruz: So let's do 30%, 1.2 billion and 30% of that is the fixed income portfolio. I'm just trying to get the number to see if we're coming up against that or not. Terry Dennison: On page 150 of the big book there's a break down, mortgage backed securities at this point, virtually all the mortgage backed securities are agency, they're very few private non-agency mortgage backed anymore, because of the recent unpleasantness, are 38.% of the index. This is the mortgage backed piece, there's also straight debt of the agencies and the interesting question is that U.S. Treasury in agency or corporate and I'll bet it's a component of the U.S Treasury and Agency. So you could be looking at something in the vicinity of 50% the index as attributed to these entities. Gerry Cruz: So let's use the 50% as that figure, that is assuming that the bond managers were just going to match the index, they would have to have 50% of their assets invested in agencies. So the question is, if they did that, would that dollar amount be in excess of 5% of the total fund, 30% of 1.2 is 360 million and 50% of that is 180 million. Rosalie Bordallo: Did the law change here because this is saying it's not 5%, it's 2%, right here, "no more than 2% of the fund at cost shall be invested in the obligations of any one domestic corporation or other single domestic entity described in this section." So if you consider Fannie Mae as a corporation, not more than 2% of the fund at cost could be invested in it. Paula Blas: It's 5% of any one issuer. Rosalie Bordallo: It could be in the stock area, every percentage varies... Paula Blas: What section are you reading? Rosalie Bordallo: Corporate bonds, 8154. Only 2% not 5% per company, so if you say it's a company, then it can only be 2%. Gerry Cruz: And we're saying that we need to look at pass thrus and straight debt as the same. Doris Flores-Brooks: How much do you have right now? (\$60 million) Paula Blas: That's why we're saying the reason we're probably at that and I can't say that they're not in compliance because prior to us even clarifying this, many of us thought Fannie and Freddie fell under 8150 and there's no limitation under that so what we're recommending that is we amend 8150 to define it further so that without, just being in a general sense, clarifying what that really is intended to mean. Terry Dennison: What Joanne (Grimes) talked about with me is we don't want to write something that makes it look like we were in violation in the past. So what we want to do is we want to clarify the intentions of the (ancients) who wrote 8150 to comprehend that these were intended to be included. The reality is, when push came to shove, the Government said, yes we're taking over. Gerry Cruz: I think now more than ever, Freddie and Fannie are really it. Terry Dennison: They have clearly become the Government's vehicle for secondary home mortgages and facilitating home ownership in America. We're talking about a historical problem, not a current problem. The object is, let's clarify both retrospectively and prospectively regardless of the technical moral obligation or full faith in credit obligation. Paula (Blas) suggested that, we just been to the Legislature to fix 8154, the concern being the --- perceived is just an incremental, let's fiddle every 6 months or an over sight that we could have fixed it at the other time too. Gerry Cruz: I agree to that argument that we do keep fiddling with it, we need to... but the thing is, that's a tougher pill to.... Paula Blas: That's why I say we really wanted to sweep investments... Doris Flores-Brooks: That's harder to do because, we were just having this discussion on procurement where tinkering here and tinkering here as opposed to taking a more

comprehensive view and a more comprehensive view is much harder. Paula Blas: In this case all we're doing is, we're not clarifying, because when it was written, it was written in such a general term that back then when it was written in the 1950's... Doris Flores-Brooks: I don't really view this as a non-compliance issue, the perception had always been, it's just the market has changed and I think that the laws do need to be updated. Now that you know about it, the Fund should initiate a clarification on a going forward basis, that's just my observation, because who would have thought... Gerry Cruz: No one because there's no way you could have for-seen something like this. Terry Dennison: During the crash Fannie and Freddie traded big wides for Treasuries, all of a sudden the fact that it's not guaranteed, became a market reality that the 20 basis point spread got to be 100 basis points. Paula Blas: The clarification of 8150 I think is the direction. Gerry Cruz: That's the direction, but as far as the instructions to the managers, what do we tell them, because they're probably over weight. Terry Dennison: They're usually over weight. Gerry Cruz: That's just to clarify, the understanding is the same. Paula Blas: What Gerry is saying is, once we clarify it, given where they are right now, then they're going to be over. Terry Dennison: Right now they don't know they're over, because they have the markets interpretation rather than a legal interpretation. Gerry Cruz: There is also a conflict because we're saying we can invest in anything within the index... Terry Dennison: No, the index is not a type of security, this is not a type of security, it is an issuer issue. So the 8154 was to change to say that you could own, for example, when asset backed were added to the index, when they became significant with securitization of auto loans, credit card balances, that was something that was never contemplated when the language, when the 8154 was written, it simply didn't exist. We wanted to make this kind of evergreen by not saying what's in the index is ---, we're saying what's in the index as a type of security. So what we did with 8154 only really made this visible, it didn't make or change or produce the problem, it just focused the spotlight on the fact that now that you could invest in any type of security, somebody went back and said, well let's just make sure our interpretations about what is an allowable securities correct. In an ideal world and I don't know if we can pull this off, in an ideal world we can say, we're going to go for a clarification of what 8150 means, don't do anything yet, wait for the clarification. Paula Blas: We'll go ahead and present it at tomorrow's Board Meeting you'll go ahead and instruct us to move forward, but the proper language to... Gerry Cruz: Do you think it will be had to get... Paula Blas: Probably not. The way it reads right now, it doesn't say, it leaves the implication that it's full faith and credit, Federally backed. Gerry Cruz: The experience, the actual practice has been that the Federal Government has stepped in with full faith in credit. So it's not as thought it's an assumption and a possibility of it happening, it's actually happened. Doris Flores-Brooks: But again that's something that you can't guarantee for the future... Gerry Cruz: Right now they're an entity, right now they're basically there is no share holder value. The owner of the bonds now is the Federal Government. Terry Dennison: The Federal Government has basically said, these bonds are good, because if they didn't, you would have a gigantic crisis, you would have mortgage rates go to 10% and home sales would go to zero and the economy would be in worse shape. They didn't do it because they love the bonds, they did it in order to provide a viable source for the whole real estate financing. It's a hybrid. Basically I think the Government didn't want their debt on their balance sheet. This is an off balance sheet entity because if you put their debt on the Federal balance sheet, you're seeing a huge ballooning of liabilities of treasuries. They have to be sensitive to what the U.S. Government looks like as a credit entity. So you bring

them onto their balance sheets, these guys have to hold trillions of dollars worth of debt, so all of a sudden taking them on board has damaged the credit worthiness of the U.S. Government. This is not something they did whimsically, the reason they kept it off in the first place is just like they never recognized the Social Security liability. Gerry Cruz: So going forward, I guess the order will be... I understand we're going to seek clarification through Legislation, but in the meantime, we need to watch that number right, because you can't not be invested in agencies. Terry Dennison: Well you are so far over, you might as well just close your eyes. The problem is if you make an issue of this, the managers are going to say, sell it and now you've got... Rosalie Bordallo: First of all you need to get a clarification of exactly what's the status of Fannie Mae and Freddie Mac given the current change in their ownership position. Terry Dennison: Conservator ship is a temporary thing, they intend to re-float it. Rosalie Bordallo: Ok, but at this point in time, at this moment in time, are they Government owned, would they temporarily fall under this section of the law. Doris Flores-Brooks: She raises a good point, are they or aren't they, they either are or they are not, or are they a hybrid and if they're a hybrid, is the law can be amended to be reflected as a hybrid. Gerry Cruz: As of this point, the Federal Government has conserved them, they stepped in and have taken effective ownership of the organization and have agreed to back their mortgages. Terry Dennison: We maybe need a legal opinion to exactly what their status is. It's not in a place that's contemplated by that, it's in some very unusual place, technically. Paula Blas: So why don't we move with that too, to determine the status of these 2 entities. Gerry Cruz: I think it doesn't hurt to seek Legislative clarification, but as far as managers go... Antolina Leon Guerrero: Well you really can't give them instruction, because you don't know. Terry Dennison: From an investor perspective, it would be very easy to say, they trade like they're Treasuries, they trade with a tiny spread over Treasuries. Lot's of people have looked at this over years and until we focused the spotlight on 8154, nobody every thought about this, including me. The Custodian doesn't want to look into this, because they don't want to be responsible for looking into it. They don't want to volunteer anything, because as soon as you volunteer something, the next time you don't do it, you've implicitly said we're looking, so nobody ever wants to look at anything, because the litigation risk of then failing to identify something. Paula Blas: We'll still move forward with the clarification, but at the same time... George Santos: One is the legal and the second is the Legislation clarification.
(End of Discussion)

Brian Kahley: We have a full house here today, actually I think a couple of the Trustees are out, but we have Gerry Cruz, we have George Santos, Paula Blas is with us, Terry Dennison, Diana Bernardo and Rosalie Bordallo. (I guess we have about 30-45 minutes?) What Mike and I wanted to do was, I'll start and just give a brief update of the firm and the fixed income group and then Mike will to portfolio itself and performance and the outlook and so forth. We appreciate you letting Mike call in, Mike had a previous engagement (his daughter is getting married) and we appreciate the flexibility and allowing us to do this set up.

Why don't I just get started on page 3, page 3 is the firm overview. Your portfolio falls under our Franklin Templeton Fixed Income group, which is the 4th from the left. We manage roughly \$215 billion in fixed income assets. Right above that you can see our total is \$587 billion as of the end of March. I just want to point out that is a well diversified asset base, we have roughly 46% in equities, 35% including fixed income in

our money funds and the remainder in hybrid which would be fixed income and equity funds. Majority of that are managed assets in the U.S. but we do have roughly 26% exposure of clients outside the U.S. As far as the firm goes, we have a healthy balance sheet, plenty of cash, low debt equity ratio, so we made it through the down turn pretty good. Moodys and S&P both give us an equivalent rating of A.

Just one notable change within the organization that we announced last year was the formation of our alternatives division. The alternative division consists of the last 2 sleeves on the right, which would be the real estate advisors team as well as Darby, our emerging markets private equity group. The alternatives group also consists of our local asset managers in Brazil, Korea, India, Vietnam and so forth.

On page 4 this is just good representation of our local presence, we have over 100 investment professionals in the fixed income group spread across the globe and majority of that is based in San Mateo and the --- office in New York, London and all over the different continents with our local asset management teams which provide on the ground research and give us a local perspective for our research activity.

On page 5 is a chart for our fixed income group with a multi-sector functional chart and I think this is good because it also shows the depth and the --- of our fixed income team, particularly the core strategy there that you see in the middle, the core and the core plus and then the resources that Mike has at his disposal. Mike as you can see is the lead strategist of the U.S. multi-sector institutional strategies, in addition to lead strategist he is also Co-Chair of our Fixed Income Policy Committee with Chris Molumphy who is the Chief Investment Officer of our Fixed Income Group. So Mike has dual responsibilities in addition to managing portfolios. Notable changes in the group, we added some research professionals in our Corporate Credit Group to the left and additionally our Global Sovereign and Emerging Markets Group we've seen a lot of activity flows into that specific strategy that we've added resources where necessary.

The last page I'm going to cover here is page 6. Page 6 is just a portfolio overview from the top down. Your benchmark here we have listed as the custom Government of Guam fund benchmark, just to clarify, the benchmark we use is the Barclays Capital U.S. Aggregate and we call it a custom benchmark because for performance purposes, we link the original index to the U.S. Aggregate in order to present the full history of performance back on inception. The original benchmark was Barclays Capital U.S. Government Credit Intermediate Index up until October 2005.

Other notable here would be the inception date is March 31, 1986 so we just surpassed our 24th year of managing money for the Government of Guam Retirement Fund and I'd just like to acknowledge that we appreciate the business and the long term relationship and Mike and I both want to say thanks and hopefully continue the relationship far into the future.

As of April 30th, the total assets we manage for the portfolio are \$121.2 million. From here unless you have any questions, I'm going to turn it over to Mike to get into the --- presentation. Rosalie Bordallo: We have standard housekeeping questions that need to be asked of you. The first one would be, is there any current litigation or Security SEC items that we should be made aware of? Brian Kahley: There have not been any in the last year. Rosalie Bordallo: Any major organizational changes? Brian Kahley:

Just what I went through with the alternative strategies. Rosalie Bordallo: Or changes in the ownership or structure? Brian Kahley: No. Rosalie Bordallo: That's it.

Mike Materasso: Thanks Brian and thank you everyone for your consideration and for allowing us to do via conference call rather in person.

To begin the presentation, on page 7, you've asked us to cover several time periods, I guess one of them would be --- ending September 30th 2009, the 4th quarter of 2009, the 1st quarter of 2010 and then the year to date. So to accomplish that on page 7 just to give you more of a --- overview of the U.S. Fixed Income Market. It's been probably now 14 months since the U.S. economy has began to recover and it has had a significant impact on the pricing of risk in the fixed income markets as well as an impact of the Treasury yield curve. During this period in time we've seen --- in treasuries rise to the --- of 2008, --- treasuries were about where they are, about 70 basis points, but 10 year treasuries were closer to 2 and a quarter percent and today, even with the --- that we've seen, the 10 year treasury is close to around 3 and a quarter percent and earlier this year it was as high as 4%. In addition to that when we move away from treasuries and look at the corporate bond market and the mortgage market including mortgage backed securities, we've seen a tremendous improvement in those sectors. A year ago, especially 15 months ago ---, corporates looked as though they were more like high yield rather than actually being corporate, but as both --- fiscal policies that were put into place at the end of 2008 and the first half of 2009 started to take hold, they started to restore liquidity to the capital markets, both in the primary and secondary markets, which is extremely important in terms of helping our economy and in addition to that as we met last year in late March, it seems as though at the point the economy wasn't ---, it wasn't as though we've seen a recovery, but many were expecting the U.S. economy in 2009 to contract fairly significantly for most of the year and instead by the 3rd quarter, we were a positive territory and the market started to anticipate that by not seeing a worsening of the economy in the late Winter, early Spring. At that point in time when the equity rally began, recovery began as well as the beginning of spread tightening in investment grade corporate bonds, high yields, commercial mortgage backed securities and emerging market debt and that took place pretty much steadily through the end of 1st quarter of this year and so as a result of that. If you look at the table on the right hand of the page and the lower table, which is labeled "Relative Returns vs. U.S. Treasuries" you'll see that for the full year of 2009 when you compare the sectors of the fixed income market versus treasuries, you'll see tremendous out performance and if I didn't give you what the sectors were and you saw returns relative to, almost 30% for CMBS, 25% for asset backed, 23% for corporate bonds, those look more like equity returns rather than bond returns. Those sectors had performed so poorly in 2007 and 2008, with the recovery that we saw both in the capital markets and the economy, we averaged tremendous performance.

The positive performance continues in the first quarter of 2010. If you look at that column, you'll see pretty much positives all the way down before you get to non-dollar bonds, which were negative and that was because the --- in the U.S. dollar. During this period of time it's been very good time for taking risk with corporate bonds as well as corporate securities and we were paid very nicely for taking that risk.

If you turn to the following page on page 8, I'll go over the performance of the Retirement Fund for the time period. The top of the page, the table shows the total returns as of April 30, 2010. The column which is labeled 9/30/08-9/30/09 you'll see for that fiscal year the return for the portfolio was a little bit over 13% as compared to the 10.5% for the Aggregate Index. For the 4th quarter it was pretty much flat to the index, so 18 basis points versus 20 basis points. For the 1st quarter of this year, slightly under performed 170 basis points versus 178 and on a year to date basis, that is through April 30th, returns of 273 versus 284. Because of the very good performance for that fiscal year ending September 30th, 2009, it had a positive impact on our one year, 3 year and 5 year numbers, all those out performing the benchmark.

Down at the bottom of the page, the tables break out the attribution. If you start with the 3rd column, which would be the fiscal year ending September 30, 2009, we're showing you the various components of the portfolio and their attribution versus the benchmark from a sector perspective and from issue selection from within sectors.

So, interestingly enough for this calendar year, there were some ways almost a round trip in terms of spreads, so from September 30, 2008 through February 28, 2009, there were very, these sectors typically under performed treasuries, the spreads were widening and treasury yields were declining, but from the end of February through the end of September 2009, there was a major reversal of that. You'll see that investment grade corporate, where we were over weight in that sector and we continued to gain corporates in the 1st and 2nd quarters of 2009 to almost about 250 basis points of out performance that was coming from the over weight in the --- corporate bonds as well as the issue selection in specific corporate bonds that we had in the portfolio and comparing that to the benchmark.

Interestingly, we talked a lot over the years about not being permitted to purchase CMBS, which are commercial mortgage backed securities, although not having that weight in the portfolio for that fiscal year period which what I mentioned was sort of round trip, ---- virtually have no impact on the portfolio, because for the first 5 months commercial mortgage backed securities significantly under performed treasuries and then for the remaining 7 months for the fiscal year, the spreads tightened tremendously for that 7 months period, but putting it together is basically zero in terms of the relative return, by not having any weight in CMBS. But, obviously in terms of the driver performance, it was coming from the investment grade corporate sector. With the other components, neither duration yield curve of the various sectors having very little impact on the portfolio.

For the 3rd quarter, once again investment grade corporate over weight was a positive, CMBS was doing well, so by not owning CMBS, that subtracted 12 basis points and we had been under weight in agency mortgage backed securities in the portfolio since November of last year. Our concern is as the Feds started to exist their purchase program, we felt that the spreads widened and in anticipation of that, we under weighted the sector and in fact, we have not purchase mortgage securities now for about a month and a half and it really has had very little impact on the portfolio. We continue to be under weight in the sector, with about a 20% weighting in the portfolio versus 35% for the benchmark.

In the 1st quarter of this year if you look at the first table, you'll see once again investment grade corporate bonds did well with the over weight as well with the issue selection that was a positive. Not only CMBS was a negative, with minus 25 basis points, but basically when you had the plusses and minuses for the quarter, it resulted in slightly under performance at 8 or 9 basis points.

In April when the guidelines changed, --- the new guideline instructions --- we began to move the portfolio, restructure the portfolio a bit, not a heck of a lot, we did buy about 3% of the portfolio in Triple A rated CMBS securities and we just purchased one non-corporate bond, Namora Corp., the Japanese brokerage firm, --- to the extent that the portfolio has changed, as a result of the change in the guidelines. So this has been a surprisingly good period for U.S. fixed income, it's been a result of, we started the period with very wide yield spreads and with the U.S. economic recovery as well as a restoration of liquidity in the fixed income market, which is also significant spread tightening, which is more than offset the increase in yields in our treasuries pretty much across the yield curve.

That concludes my review of the performance of the Fund. Are there any questions? If not I'll start to talk about our outlook and strategy.

--- possibly if we had this meeting 2 months ago, we really would --- first of my comments about the U.S economy and the U.S. fixed income markets, but given some of the problems that exist in Europe as well as to the lesser extent in Asia, we have to sort of talk about 2 outlooks.

As far as the U.S. is concerned, we are solidly in a recovery. We began with a cyclical recovery which is --- take place and by cyclical recovery we mean it's a combination of the --- of the U.S. economy that we're not really --- but --- contracted along the rest of the economy that was especially in the 4th quarter of 2008 and the first quarter of 2009. So far as the economy started to recover, there's been sort of a normalization - -- industries that really did not ---, but we're cautious given the uncertainty that surrounded the U.S. economy and capital markets in 2008 and early 2009. That recovery continues to grow now and surprisingly the consumer is participating in this recovery, the spending in the most recent quarter was historically strong and while some of that has to do with the --- programs that helped the consumer, nonetheless, the consumer started to spend again.

In the U.S. economy we have a low interest rate environment, we have concern that the Fed has put so much liquidity on the U.S. economy and at some point they have to start taking it away and that has given a lot of concerns with --- that U.S. interest rates are too low and they should rise and rise significantly. --- they're concerned that with all of this liquidity, at some point it's going to result in inflation. Having said that, interest rates on treasuries remain low even before this most recent rally and inflation if anything is declining at the core level, over the last 5 or 6 months, the core rated inflation annualized only about 3 tenths to 5 tenths of 1%, pretty close to zero. So concerns about inflation seems to be over blown and in fact with a very high unemployment rate, even with job growth, you'll continue to see individuals enter the work force, but partly on the sidelines, so we expect the job growth in the U.S. this year, but because of individuals re-entering the job force we expect the unemployment rate to remain relatively high, that is above 9%. With that --- waiver continuing to be

there, we feel that wage cost inflation would really be non-existent for the foreseeable future. So as a result of that, in all likelihood the Fed will remain on hold for most of this year, if not for all of 2010. If you can recall in terms of our first quarter review and outlook, our view has been that while in near term we thought that because of the growth that we expect from the U.S. economy that it could --- in that interest rates could rise and possibly rise above 4% on 10 year treasuries that it would be short --- the economy continues to grow but at a non-inflationary rate and because of sub prime global growth, the competition for capital is not there and the Treasury would continue to be able to issue debt at relatively low levels of interest and that has been the case so you should expect that to be the case going forward for the balance of 2010.

So it's been our view that for the most part, 10 year treasuries will trade in the range between 3 and 4%. We're kind of surprised that they're in the lower end of the range right now because we didn't expect the problems in Europe to have a significant impact on the U.S. market as it has, but obviously it has done so, which we'll move over now to Europe. The problems that began with Greece, I'll point out the shortcomings of the European Union and that it is a union of, a marketary union but not officially unlike the U.S. and that is causing problems because in the case of Greece, typically when a country has as much debt as they have and they're not really capable of servicing it and will continue to pile on debt, typically what a country like that does is de-value their currency to make their goods more --- but because they're part of the Euro, they can't do that, the only thing that they can do is have fiscal constraints and that is cutting Government workers wages, retirement benefits and cutting back on services. That will the --- economy at the same time they're --- make it for a very unpleasant environment for many years to come for Greece. So the problem that Greece faces is and the concern the market has is that it's reached now -- it's --- over to Spain and Portugal. Our view is that we do not see a domino effect; we feel at some point, Greece has to be restructured, that they need significant --- on their balance sheet. Most likely they will be a restructuring somewhere down the road. We believe that the problems with Greece which are significant, really are not the same as Portugal and Spain, so our view is that while the markets are making this extension, we believe that is not the case and when the dust settles, we will find that the problem is Greece and ---. What we do expect is the fiscal constraints across Europe in 2010 and 2011 and that will resolve --- in Europe. --- in Europe to some extent has a negative effect on the U.S. to the extent that they sell goods to the European region.

So our view is that there is a de-leveraging that is going on and both the business and consumer and this is a cycle that will last a few years and inflationary pressure should not arise as a result of that. Our view is that if we don't start looking at treasury rates, we don't expect a market rise in rate to the extent that treasury rates are significantly above 4, 4.5% over the next few years.

Moving over to other sectors of the market, our view is that despite the --- that was seen as credit spreads have widened pretty significantly especially for corporate bonds, our view is that the U.S. economy's economic recovery is in tact, we do not expect a double dip and that U.S. companies will soon be able to grow and their balance sheets --- and as a result of that, we feel that the widening of spreads that we've seen in May --- temporary.

So in terms of our portfolio strategy, the portfolio is mutual in duration, we are over weight in investment grade corporate bonds, we have a zero weight in agencies, because their spreads are very tight, we are under weight in mortgage, agency mortgage backed securities as I mentioned that earlier and we currently have a mutual weighting in commercial mortgage backed securities --- in the portfolio, which is very similar to the benchmark. We are over weight in treasuries and that will help us this month as treasuries are out performing all those other sectors in the market --- spreads widening --- corporate bonds --- out perform the benchmark for the month of May. So despite the volatility that we're currently seeing, we continue to have a positive outlook on the U.S. Fixed Income market over the next 6-12 months.

If you turn to page 13, you've asked to look at the risk of the volatility of the portfolio and on page 13, we're showing that in terms of tracking error, we're tracking, showing you the mismatch of the portfolio versus the Aggregate Index. The tracking error of the portfolio since September 30, 2008 has been fairly constant, between 170 and 190 basis points.

That tracking error is expressed as of April 30th on page 14. Of that risk of 489 basis points, a small amount, almost 40 basis points is coming from duration of yield curve positioning. The portfolio is over weight in the 3 to 5 year yield curve as well as the long end of the curve, it's pretty much mutual in duration. In terms of sector positioning, that's the lion's share of the risk that's in the portfolio with the under weight in --- as well as the over weight in investment grade corporates and the under weight in agencies. The reason why the numbers don't add up, 489 basis points is that the --- diversify the portfolio --- isolated tracking error --- marginal contribution because of the --- aspect of the positions in the portfolio.

Finally on page 15 is a break down of the portfolio by sector, yield curve and quality and we're showing --- as of the end of September 30th 2008, September 30th 2009, the end of the first quarter of this year and once again as of the end of this month, to the end of April and comparing that to the index --- as of the end of April. So you'll see that for April 30th, we were 3.3% in CMBS, which is really --- the portfolio and about 3% of the portfolio was in cash and you'll see from a credit quality perspective while we don't own any agencies, we own treasuries so we have a slight over weight in U.S. Government versus the benchmark. We're under weight in Triple A --- under weight in Triple A corporate bonds, but that --- Triple A and we're under weight in agency mortgage pass thrus and we are over weight in --- and Triple B rated --- versus the benchmark. That concludes our review of the portfolio as far as out outlook. Are there any questions? Gerry Cruz: No, we're pretty much in line with what Terry (Dennison) mentioned as far as the outlook, so no questions.

Michael Materasso: Just one other question that I had and that's on page 15, we're well aware of the guidelines have been expanded so that fixed income managers can add to the portfolio in a more consistent way with the benchmark, but there's one issue that I needed to get clarification of and that is with regards to the maximum amount of weighting that we can have in the agency securities, specifically Fannie Mae and Freddie Mac. The reason why I'm pointing this out is, of the agency mortgage pass thru sector, which is about 35% of the index, probably about 28-30% would be securities of Fannie Mae and Freddie Mac. The agency --- is about 12% of the index

and about 8% of that is Fannie Mae and Freddie Mac. So putting those 2 sectors together and the index exposure to the issuer both on a straight debt and agency pass thru perspective, it's probably any where between 35-38% of the portfolio. When I look at the guidelines and this is where I need clarification, the question is, how much can we own in the portfolio of the securities. I'm looking at the guidelines, I'm looking at item number 8146 and it says that we can own 5% of the Fund at cost and also a question, there's also a response, I'm looking at 8154, which says, pertaining to corporate bonds, but saying no more than 2% of the Fund at cost. So, the question is, 2% of 5% of the total Fund at cost to give us an idea, if it's 5%, it would mean that, given that fixed income is only about 3/8 of the total Fund and I'm assuming that we have only 1/8, 1/3 of that, so if the maximum Fund exposure is 5%, it would mean that the portfolio level that we can own is a little over 13% of the portfolio, let's say in Fannie Mae or Freddie Mac securities. If it's 2%, using that same math, it would mean at the portfolio level we could own about 5-5.5% in any one of those names. In each case it would be an under weight, but it would be significantly better than just say 2% of the fixed income that we manage. So that's one area that I need clarification. Other than that, I thank you for the work that went into changing the law and expanding on the guidelines, because I think they are significantly a better match between the investment guidelines and the benchmark and the investment goals as well for the fixed income section of the Retirement Fund. Gerry Cruz: Ok, let me answer that question (Mike, this is Gerry.) That's a good question and not necessarily contemplated, so what we're going to do is we're going to get a legal interpretation so that we can be explicitly clear on the direction and we'll be able to get back to you. Michael Materasso: That's great, I appreciate that. Are there any other questions? Gerry Cruz: Our laws as you know have been written a long time ago and so we understand the spirit, but we just need to be clear that the letter matches what we think too and as we've made changes, sometimes getting legal interpretation is also necessary so that we don't trip over ourselves, but that's what we'll do and I don't think we have any questions. (Thank you for staying up late and congratulations on your daughters wedding and thank you for you hospitality.)

Brian Kahley: I just want to point out that we included a couple of handouts in the back of the book, Mike (Materasso) briefly touched on it, our outlook in Europe and the current --- over there, just something to provide more detail and then I also included a profile for our non-U.S. strategy, I know it's probably under review right now and there might be a black out process as far as the RFP goes, I just thought I'd include an update because we did respond to that RFP.
(End of presentation by Franklin Templeton)

2:15pm-3:00pm Income Research Management
Request to Extend Guideline Waiver

Stephen Weiss: Thanks for having me out, I appreciate it. You can interrupt me as we go along and ask me any questions. There are some market charts up front and then we can dive into performance and the portfolios and everything else.

Jump right to page 3 and we'll start talking about the corporate markets. The upper left hand chart shows what spreads have done over the past 20 years, despite in 2008 and to rapid recovery and to where we are now. Our thought is, when you look at the

lower left hand side, you can see the leverage of non-financial companies, the leverage on the whole is decreasing, so there are some positive sides. On the upper left hand side is the upgrade and downgrade chart, ratio chart, you can see in 2009 as the rating agencies were catching up, if they were late, where were they in 2008, in 2009 they decided to downgrade everything and now that has changed recently where that section was more upgrades than downgrades. So, there are some positives in the corporate space, positives both on the fundamental side and the technical side, so a lot of 2008 blowout was a technical sort of experience where there were just more sellers and buyers --- quality and some of the technicals are improving as well. Issuance is going to be down a little bit I think, so there's still some pretty strong demand for corporate bonds. So our thought process is, you'll see this reflect in the portfolio, is our we out of the woods yet, no, we're still taking to very high quality buyers, having upgraded the portfolio throughout the end of 2009 and the beginning of 2010, because we think there is, we don't know if there is, we don't have macro economist on staff who are going tell you that we're going through a double dip scenario here, but we want to make sure that we're protected against it if it happens.

Page 4, I think you've seen this chart before, all of the holdings in the Barclays Capital Credit Index were spread on the left and rated by a credit quality from highest to lowest. The blue squares is kind of where our emphasis is, so you can see that we're not buying every bond that offers tremendous amounts of yield, we're keeping a higher quality focus on the Triple B side, there are no Triple B minus bonds, so we're staying away from the stuff that could potentially fall into junk, especially if there's a double dip, even though junk has done well, falling off into it now wouldn't be too bad, but if there was a pull back, falling off into junk could be not a good thing. Now Triple B's in your portfolio are only 1.7%, we have more Triple B's in our other portfolios. We'll talk about this later, but because of the guidelines, if you take into consideration all of the bonds in the holding tank in a transition portfolio, you're over 20% in bonds rated below A, so we're sort of keeping our Triple B's lower in the core portfolio until we eventually finish selling all of that transition and then eventually there will be more Triple B's in your portfolio, in the core portfolio.

Page 5 talks about the mortgage backed market. The Barclays Aggregate Index is 35% in fixed rate pass thrus, so the agency mortgage backed securities, we own just about zero. The Government has purchased over 2009, basically over a trillion and a quarter of fixed rate pass thrus with Freddie and Fannie and we think at some point, we don't actually think they're going to sell it, but they stopped buying, so at some point there could be some pressure in that markets. We've been avoiding fixed rate pass thrus all together, our focus has been on the Hybrid ARMs and we're decreasing our holdings there because I think that overall we're worried about a back up... Gerry Cruz: Are Freddie and Fannie Hybrid ARMs? Stephen Weiss: Yes, non-agencies, agency backed Hybrid ARMs. We like them better because we think they have less extension risk, if rates do start to back up and there's unwind of trade, you've got extension risk just selling and from upward rate pressure and so the Hybrid ARMs will hold their value.

Page 6 talks about CMBS and our focus hasn't changed, we've reduced our exposure to CMBS in the core portfolio as spreads have come in and our focus is still on the highest quality so the ones who have 30% credit enhancement behind them. In the chart there on the bottom left shows, really basically you could have 100% defaults and 60% recovery, or 70% recovery and your principle isn't going to be touched. So

we still like and I would even dare, I would say love, the CMBS that we own, it is not our blessing of our commercial real estate market in the United States which is still messy. It is a belief in the structures that we're owning and we own very diversified pools. So we like the bonds, but we reduced the exposure as spreads have come in because we expect some volatility in that sector.

If you look on page 7, this a new version of this chart, I don't think you've seen this one yet, this is the same sort of concept that we use for the corporate bonds, but on the CMBS, so these are all the CMBS holdings from the 30% down to the lower tranches. Our focus is on the blue squares in 2005 and 2006, you can see we own no 2007 and no 2008 because of the underwriting standards were horrific. In 2006 they started to deteriorate a bit, but the 2006 bonds that we own are some of the front paid tranches, so if there are tranche losses in the underlying securities, your bonds will be paid off first. So they're a little farther up the food chain in the shorter duration. But again, CMBS we like, but we have reduced our exposure overall. There's still a little bit remaining in the transition portfolio. What we've done, is we've sold a ton, we're down to really just a million and change in CMBS. Gerry Cruz: What has been your average price for selling those? Stephen Weiss: For the super seniors, probably in the 90's and I'll double check to make sure. The junior tranches or sub tranches, those are actually going to be less than that, but it's been pretty solid.

(Page 8 and 9, we're not going to bore you with, they're macro economic charts, they tell you what you already know, which is it's still up in the air).

So, maybe jump to the core portfolio and I have it in here for a couple of different time periods, data based on what you were asking for, I have a couple of different snapshots. On page 13, we compare the portfolio at the end of 2009 through the first quarter of 2010, I don't know if you want us to focus on just the quarter or where we are.

Flip to the next page, I'd like to focus on the current since things change so rapidly these days. On this page what you're looking at is a snapshot of the portfolio from 1/31/09, so basically right when we got fully invested, from when we first inherited the portfolio and got it sort of invested to where we are today. So dramatically changes obviously in the market place, in the upper left hand side you can see the yield, as rates have come down as spreads have tightened, have gone from 6.85 to a 3.14. We're at a slight yield disadvantage to the index right now, so your portfolio is yielding 3.14 and the index is yielding 3.35, that's a result of being slightly higher quality, reducing the CMBS. I think if you compared this portfolio to other core portfolios, the yields are about equal, so we're giving up a little bit of yield in this portfolio to keep it a little on the conservative side, given we still have \$22 million roughly of not very conservative stuff still left in the transition portfolio. This was going well for us in May as rates, as spreads have widened as a result of Greece, financial reform and what have you. So I think the other thing to focus on is on the right hand side, some notable sort of differences, so if you look at the 2 far right hand columns, your portfolio as of 4/30 versus the index, the things that jump out at me are under weight in treasuries, the index has 30% and you still have 12, which is up so we've increased our treasury allocations, but we're still no where near the index is and that reflects our belief, that spread products are still the thing you want to own, there's still some room for corporate spreads to grind tighter, for CMBS spreads to

grind tighter in both those for quite a nice cushion if rates rise. So 70% of the time corporates outperform treasuries in rising rate environments, so having an over weight in corporates, again it's not really our view necessarily that the rates are going to rise, but there certainly feels like there is some pressure that might happen.

The other things that jump off the page are, like I said in the bottom part of the securitized box you could see traditional mortgage backed securities, in excess 34%, we just have 1%, so very little. CMBS if you go to the top of that box, you could see we basically have the CMBS holdings since the wides back in 2009, but still an overweight relative to the index and corporates were about a 2 times weight relative to the index. Not much of a change in our allocation, but I think the weight of a nominal basis, but I think on the credit quality side, we believe the names we were holding are --- up quality. There's been a bit of an increase in municipal... Gerry Cruz: The FNMA DUS, what's DUS? Stephen Weiss: Delegated Underwriting Servicing, so FNMA, these are multi-family deals, so they're still mortgage pass thrus in a sense, the multi-family gives back to the FNMA, so they don't have nearly the extension risk or the sensitivity to interest rates and they are pretty solid. One thing you may see pop in here, are GNMA... Gerry Cruz: So these are like 2-4 family units? Stephen Weiss: No, they could be more, apartment buildings. Gerry Cruz: I didn't know that they bought or securitized apartment buildings. Stephen Weiss: Yes, bigger apartment buildings, it's sort of like commercial real estate, but backed by FNMA, they're not commercial, but just multi-family stuff. I'll get you a write up. Gerry Cruz: That would be helpful. Stephen Weiss: GNMA has a similar program, I don't know about similar, but they're called GNMA Project Loans and there's nursing homes and multi-family deals in their pools and they're GNMA so they're fully backed, they're supposed to be backed by the Government and we're finding some newer deals that don't have much construction loan risk, they're sort of 3 year durations and they're picking up 50,60 over treasuries with not a lot of extension risk, so it's another way to sort of play the high quality gamble.

I don't know if this is the time to raise that point, but the new Legislation that has focused on the Barclays Aggregate holdings; I don't know if, I could tell you right now, we'll have to figure out what to do with this. SBA's which is one of our best ideas aren't with you guys. Gerry Cruz: But those would be agencies right? Stephen Weiss: Yes, they are agencies. Gerry Cruz: So maybe this is where we need to clarify that issue. Terry Dennison: Is it a full faith in credit agency? Stephen Weiss: SBA's are full faith in credit. Terry Dennison: Then that's not an issue. Gerry Cruz: It's not the specific issue, meaning the specific security, it's the type. Terry Dennison: The Legislation talks about types of securities, not issuers. So, if this is a full faith in credit, it's like a GNMA, it's basically 8150, so no issue. Stephen Weiss: Ok, makes sense to me.

The other increase has been taxable municipals, from 0% we're up to about 1.6%. Most of them are 30 years, this is the new Buy America Bond program, it's been about \$100 billion in issuance and it's a neat way for us to go up quality, which sounds weird because municipals are certainly having their issues as well, but if you can focus on bigger GO's and --- service revenue bonds, it's a nice way to add extra yield and really sort of remain up quality, you can see that potentially increasing over time.

Gerry Cruz: You do have a Lehman Brothers and you don't have a yield on it.
Stephen Weiss: Right and this is a Lehman that we inherited. Gerry Cruz: So what would you take for it? Stephen Weiss: It's priced at 22 and if you went to sell, it probably wouldn't be too far away from it, probably in the 20's maybe high teens and the thought process is right now that we're still going to hold and sort of let things play out and see, get your arms around recovery, there's some estimates in the mid 30's and there's now that fraudulent charges against them which could... Gerry Cruz: We're in litigation now, just curious, if someone came to you and offered you 30, is that a good price? Stephen Weiss: I think 30 would raise some eyebrows. Rosalie Bordallo: So what would you sell it at? Stephen Weiss: I think if someone came to us and they bid around 30, we would do that. Terry Dennison: There have been a lot of vulture funds around that are trying to get, are they paying fair prices or are they just people wanting to get their name off the books. Stephen Weiss: I think they're people wanting to get their name off the books. We have another client who has them, they got the notice sent to them and said, should we do this, it's up to you, we haven't heard what the price was and theirs was the preferred, so their price couldn't be very big at all, but it will be interesting to see. There is a traded market from security to security, I don't know if the bids are coming in, I assume the bids will be below the quotes just to try and mass something.

Terry Dennison: On these Buy America Bonds, there is a nuance of what's allowed and what is not and I'm actually looking at the Barclay's fact sheet on the index and this is what it says, "Buy America Bonds with tax credit issued to the issuer are eligible, those with tax credits issued to investors are considered exempt and therefore would not be allowed as an investment." Stephen Weiss: Right, we're doing the prior.

Performance is on page 19. Since inception, we're out performing almost 5%, which is big, but don't get use to those numbers, our target is not to out perform, I don't think you would want us targeting 5% out performance on a yearly basis. Just to give you an idea of how we're holding up, the 3rd column from the right, is the year to date through April, so we're out performed by 56 basis points, if you take in the first, basically through May 24th, we are out performing by 32 basis points, so we've lost about 24 basis points of performance as a result of some of the spread widening that has gone on from Greece and it's holding in, given how horrible the market's have been, I think it's holding up fairly well given our over weights to spread products and our under weights to treasuries.

The transition portfolio, this is a summary I have been carrying on since we started talking about it and hopefully at some point we'll be able to go all the way back to the beginning, but I do want to go back to the beginning one more time just so you can remember how we started, because you started in probably the most interesting time the bond market has ever seen. On October 15, 2008, there was about \$51 million in the core portfolio and about \$60 million in the transition portfolio according to pricing by the pricing service and as we all know, the pricing service on all those transition portfolios or holdings was wrong. They hadn't caught up yet and stuff wasn't worth anywhere near what they were saying it was worth and you could sort of see that correction in pricing at the 12/31 number, so a dramatic reduction in the holding tank portfolio. We started out with what everyone thought was 111, but not really based on reality, so if you look at where we are at today, a couple of things, we reduced the holding tank portfolio to about \$22 million, total value of both portfolios is

\$116 million. If you remember there was that one movement of bonds on January 15, we took CMBS from the core portfolio over the transition portfolio, because CMBS probably should have been there from the get go, so if you skip that line, but you add up everything that transferred, so everything that we sold and transferred, we moved over about \$57 million from the transition portfolio over to the core portfolio. About \$47 million of that were sales, so market value of sales and another \$9 million was cash flow, so pre-payments and coupons and the like. The other thing I wanted to add is that you've taken out about \$6 million, \$7 million dollars, that number if you didn't take it out would be closer to \$123 million, so I think it's been, these aren't performance numbers, but I think it shows you, really I don't want to say how good of a job we've done, but I think being patient in not hitting the bid in all that transition holding stuff when it was trading ridiculously low was definitely the right thing to do and holding on for better pricing, better exit points has really paid off.

So let's focus on what's left, that's probably the next question. If you go to page 22, you can see the progress we've made. We started with 86 holding, (back in the upper right hand side), we started with 86 in the beginning of 2009 and we're down to 30 now and those 30 holdings, the bulk of them are in the securitized base, the bulk of that are non-agency backed securities. If you look at the bottom right hand side, you'll see the current holdings, non-agency and these are straight non-agencies, represent \$19 million. The bulk of those are Alt-A, so not prime, about 80% of the total is Alt-A and about 10% is prime. Gerry Cruz: Those are still paying right? Stephen Weiss: Yes, everything, when we think about it, one sort of metric that we're looking at here is coverage, so your ---- coverage ratio, it talks about the payment, default, that kind of stuff. Only 18% of your holdings are below one-right now and only 10% of the holdings are priced below 50 and the pricing services are now caught on, so they're much more close to reality, you're not left with the drags, it's not like we sold all of the stuff that was sellable and now you're left with the stuff, this \$22 million is going to go to zero because everything is total junk. It's still not great stuff, but 50% has a coverage ratio between 1 and 3 and 30% has a coverage ratio above 3. So there's some good stuff in here and roughly 10% is priced below 50, 50% roughly is priced between 50 and 80 and about 40% is priced above 80. What we're doing, our process just so you know, we are constantly I don't know if I went through this process before, but we download the holdings from the --- so every bond in the non-agency space, home equity, all the stuff that you own, it's out there, we download it every day and we compare them to our holdings across all the portfolios, when a matcher comes up, that's when we get into action and say, let's see what we can tag on the piece you own, to their piece. If you put the bonds out for the bid, you're going to get a bid 10 points below the pricing service, but if you work it and tag it along, you can get closer to actual market value and that's been our process.

The holdings here on pages 23 and 24 are as of the beginning of 2009 and all the bonds in yellow are the ones that are left. There should be 30 of them and those alone are all stacked nice and neat for you on page 25.

The other thing, jump back to 22 for a second, we'll talk about the big guideline waiver which I hate asking for guideline waivers. If you look at the holding tank portfolio, 70% of this is rated below Triple B. When we inherited the portfolio, they were all rated AA, AAA and A. If you add up both portfolios, the amount we're allowed to have in the guidelines that's rated below A is 20% and I think we're 23%, but that includes

all these holding tank bonds, actually we're at 25%, 17% of that is in the transition portfolio and only 8% is in the core portfolio. We can go ahead and get in compliance by selling all the Triple B's and Triple A's in our core portfolio, but I would say that's not the way to go, there's value to those bonds and you don't want to force the sale of those bonds in the holding tank, so if we get the guideline waiver, hopefully just one more 6 month period, that would be great, don't hold me to it, I'm hoping. Gerry Cruz: When we're done with this, could we get a report on the impact of having held them versus having sold them on all the transitions that way we know that we did the right thing? It doesn't need to be as big as any of these. Stephen Weiss: I'll figure out a way.

Any questions on the portfolio? I can give you a quick firm update. Gerry Cruz: Any major changes? Stephen Weiss: We added 4 employee share holders at the beginning of the year, one of which is me, so we're up to 18. We're up to about 99 employees, so we've grown. We grew assets fairly nicely over the course of 2009 and the beginning of 2010. Gerry Cruz: New money, how much? Stephen Weiss: We brought in the course of 2009, probably about \$5.5 billion, \$6 billion new money and part of it was massive reallocation of fixed income, we sort of benefited from everyone with fixed income. We benefited from taking on a lot of portfolios like yours, the holding tank business was been good for us. A lot of managers away from Aberdeen, some recent entries into that mix has helped us as well. We've seen a lot of interest in our long, our long duration as a lot of pensions who are closer to fully funded had us our rolling ---- duration ----, we're getting a lot of attention in our long duration and customized long duration solutions as well. We've seen growth in TIPs, the Aggregate, everything, it's been interesting, if you look at the pie chart on page 27, the growth has been pretty much across the board, as has the client type, it hasn't been one sort of thing that has dominated the group. We have been hiring some junior folks on the investment team, some analysts to sort of beef up and bulk up the staff there, but we've been hiring across the board, the firm to compliance, technology, everything. It's a nice time for hiring, because there are a lot of people looking for jobs.

Rosalie Bordallo: Are you involved in any litigation or SEC compliance at this time?
Stephen Weiss: No we are not. Our last SEC audit was March 31, 2008.
(End of presentation by Income Research & Management)

3:15pm-4:00pm Davis Hamilton
Letter RE: Name Change & Change in Control

Daniel Kallus: I guess I'll just jump right in and if you have any questions, please jump in and throw them at me. Gerry Cruz: Ok, we're interested in the performance. Daniel Kallus: I'll touch on that in the beginning and what I have here is 3 pages on performance, one for each of the periods listed in it, so we start off with the fiscal year ending September of last year (2009). You can see there for the since inception, one thing I'll point out, this is a fiscal year to date, the middle column where it says one year, that was a calendar year to date whereas the annualized since inception would happen to work out to exactly the fiscal year since it was a 9/30/08 inception. Obviously you could see for the quarter end in that period, the calendar year to date and the annualized one year number since the inception, the performance was very strong relative to the benchmark. If you move forward to the next page which are

these periods ending December 31, 2009, again 4th quarter of 2009 was also a very favorable quarter so the one year number looks even better since inception, still very strong and again updating for the first quarter of the 2010 calendar year, once again it was a good relative quarter fiscal year to date since September 30, 2008 off to a very good start and the since inception numbers looking very good. Again, over the time period since we started managing the fixed income, it's been a pretty consistent track record so far, we're happy not so much that we've outperformed by the magnitude that we have, but it's also been consistent, not just where we had one or 2 good quarters, it's been consistent.

The un-numbered page on the back of the performance, we're a little bit long now since we've been in the relationship, but since I wasn't here since last March, I just want to give one final update in terms of, you kind of want to look at it as the completion of the restructuring or the portfolio when we took over and one of the things I'll point out if you look at the top, obviously we've had a dramatic consolidation of the portfolio from 109 securities at the time we took it over to 26 currently at the end of March. Again, that's probably over time, that's probably about as low as we would go, we typically have 26-40's. Why it's so low right now is again where we have our corporate exposure, we really have larger positions in the highest quality corporates that we find out there in the universe instead of trying to spread it out and obtaining anything we don't feel as good about from a quality perspective. Obviously we've upgraded since the time we took it over, upgraded the credit quality, the portfolio, we've reduced the Triple B exposure within the corporates and other than that, sold off a lot of the other agencies and agency guaranteed mortgages that came in with... Gerry Cruz: You sold those off? Daniel Kallus: Yes. The only thing that's left in there is we basically have 1.3% of Triple B's that are very near maturity so we've just decided to let those roll off instead of selling them at this point. In terms of the portfolio and convexity, the one thing we did do is we sold the 30 year mortgages that came into the portfolio and put them into 15 year mortgages. As a matter of practice, typically when we build our mortgage exposure within our portfolio, we typically will buy 15 years, that's the longest that we will go out.

Managed duration, obviously we've moved from being 40% longer than the benchmark to being a more neutral position and our game plan we're envisioning, we're bar bell the portfolio in anticipation of interest rates moving up primarily in the short end and we're also moving towards a slightly shorter duration than the benchmark and all touch on this a bit more. Obviously improved liquidity by selling out the illiquid positions that were in CMO's, CMBS and some municipals, that's all gone, that would have all been sold off in the first few months that we had it under management, so I probably would have told much the same story when I was here in March of last year. One of the other key things we did is we increased the average coupon in the portfolio, increased it by about 38 basis points, which is consistent with our approach. Again, if you look at our philosophy, we want to preserve capital, maintain liquidity in the portfolios and we think that over a full investment cycle, one of the keys to outperforming the benchmark is to have a higher level of yield in the portfolio and obviously we've achieved that through spread product.

I'll point out why we were able to do as well as we did. Going back to 2008, especially in the fall of 2008, around the events around Lehman Brothers, there was a dramatic flight out of all risk assets into U.S. Treasuries. At that point in time we saw U.S.

Treasuries as being dramatically over priced and we didn't see a lot of opportunity from that point of view. The only place for them to go would be down in price. Opposite of that we found tremendous opportunity in spread products, primarily mortgaged backs and asset backs, in terms of Fannie Mae, Freddie type pools. What we've done over that time frame, we were very light spread product going into the fall of 2008, so when prices got this extreme as they were, we saw yields approach at almost 600 basis points above comparable treasuries, we went out and aggressively added exposure in other spread products, moved to under weight treasuries and that's where we're continuing to be positioned. What I'll say is what we've been doing over the most recent 4 months, is the AS corporates have tightened in, which they have meaningfully and you can see this from this chart, as they've been tightening in and as individual corporate positions have tightened in where we no longer see a fair value opportunity for the risk that you're taking in corporates relative to the Treasury, we've been selling off those corporate positions that have tightened in. Our first --- right now is to try to look for other attractive corporates that we think there's still room to tighten in. Secondary to that, we've been adding other spread products, so be it mortgage or the agency. Gerry Cruz: So you've been buying agencies lately? Daniel Kallus: I think in this portfolio, we did not own any at the end of March. In certain other portfolios we might have had agency exposure, but the primarily, it's either a combination of; in this case, what we've been adding is more mortgage exposure to the portfolio. Again, the plain vanilla, 15 year type mortgages we typically own as we see the spreads attractive. Gerry Cruz: Who would be the owners of those mortgages? Daniel Kallus: They're all Fannie or Freddie, so they're just the big plain vanilla mortgage. Regardless of where we're at in exposure, it's our goal to stick to the highest quality security within that asset class. We will be active with our sector allocation and again that's where you can see where we've been positioned in spread product relative to treasuries, but within those sector bets, we have to keep it in the highest quality spectrums.

The thing I'll point out, as I mentioned, we've been trimming back the corporate exposure. Our game plan like I mentioned is we envisioned moving to a shorter duration than the benchmark going to a barbell portfolio over the coming months of the year as we things unfolding and rates eventually increasing. As we look into trimming down our corporate exposure, because of the fact that corporate spreads have widened out over the last month a bit, we actually are now seeing some opportunities that some of the corporates that we have sold to add them back in the short term. We think the way that it will play out as these tighten again, we will sell them again when they get back to those levels, but in certain cases, if they've lightened out 30, 40, up to 50 basis points, JP Morgan is an example, we've sold that security, we've now bought it back because we see it as being very attractive in the short term, but it doesn't change our intermediate goal of trimming back the corporate exposure. So again it's been a very profitable trade and we're not looking to over stay our welcome. Part of that, again we talked about the interest rate thesis, going into the year we thought yield curve would start to flatten, so far that really hasn't been the case, it has in fact widened out a little bit further with rates staying extremely low in the short end, they've gone even lower obviously with the events going on in Europe and kind of the flight back to U.S. Treasuries as a safer instrument. We think again it's still --- for the same trade because at some point because of inflationary pressures, and the improving overall economy, that we will start to see short rates move in up higher. Gerry Cruz: When do you think in your forecast we'll see enough... Daniel

Kallus: We're expecting to see them start to move up by the end of the year. We're not calling for 100 basis points Fed Fund rates at the end of the year, but we think that there will be Fed Funds activity by the end of the year so whether or not the first one is just 25 or 50, at that time we think it will start and honestly our opinion is, once they start raising rates, we think they will be raising them pretty aggressively. This is very extreme, no other time in U.S. history have we maintained zero percent Fed Fund rates for going on for almost a year and a half period. We think that even if they raise them back 1.5-2%, we're still at historically low levels and so we think that once they start raising them they'll move pretty quickly to get them back to that level.

As far as fixed income market factors, it also kind of play into where we're positioned and we think that because there's been a lot of concern over rates rising that the sentiment, also with the improving economy, the sentiment has been favorable in the short term for bonds. Again the way we kind of look at this is the inverse of the way you would look at these same measures for the equities. Right now economic, because we are looking for improvement, usually means higher interest rates, higher interest rates mean lower bond prices, so we see economic as being a negative because it is improving. Inflation, this might have been neutral, because we would have had higher inflation expectations, but given the low level of the most recent CPI readings and the fact that overall we just really aren't seeing any initial signs of inflation, if anything there's an equal change of near term deflation and we don't see this as being a meaningful factor on bond prices, so we think this maybe gives us a little bit of a further lift or support to bond prices over the coming months.

Page 10 as far as where we're positioned in the portfolio, again at the end of the quarter we were 54% corporates, 38% mortgages, only 8% treasuries. So obviously a meaningful bet in favor of spread product relative to treasuries and that's really where we've been over the last year. Going back to the March, I know for sure, March 2009 is probably where we really started to get to the tail end of driving of driving up the corporate exposure, since then we've just been kind of maintaining it. Our next step is we think that will work lower, I mean this number right now is actually lower, this 54% at the end of March is closer to low 40's now. Gerry Cruz: What did you replace it with? Daniel Kallus: Mortgages. The treasuries have probably gone from about 2 or 3% up to 8%, so we have bought some treasury to maintain our overall duration exposure on the portfolio as some longer dated treasuries, but overall it's gone into more shorter term mortgage instruments, because we can still see the more attractive spread characteristics there that they can't tighten in even further. Gerry Cruz: So your mortgage exposure is higher, it's up from 38%? Daniel Kallus: Ok, yes if you were to look at it not meaningfully, but the combination of the treasuries maybe at this point in time will be a little bit higher than the 8 and maybe the mortgages are a little bit higher than the 38. What we've done more recently is we've sold a few percent of treasuries to add back to some of this corporate exposure. I mentioned the JP Morgan, we added about 2% back to our JP Morgan and that came from treasuries. But again as this unfolds, in the year that interest rate scenario plays out the way we think it will, you would expect to see a higher weighted in treasuries, possibly a higher weighted in mortgages, but not necessarily. What you should probably see is a lower corporate exposure. At this point I don't see ourselves going below index weight in that next say, three quarter time frame, but if they tighten in quick enough, we will, but again, we're not going to overstay our welcome on the trade and it's been a very favorable trade, up to now we still see opportunity, but we're staying on top of that.

On page 11 it's just some of the risk control measures. Just given where we are in our corporate mortgage exposure, we just want to point out that day in and day out we run reports in all of our portfolios versus the benchmark to see where our duration and yield curve exposure is coming from to make sure we are not taking an unquantified bet. Gerry Cruz: You're a little long on the duration. Daniel Kallus: We were at the end of March, I don't know the exact number, I believe it's closer, I think we're still slightly longer than the duration, we were longer at the end of March.

One of the things again, from duration contribution you see the biggest difference and I'll point this out, because of our corporate exposure, we have a bigger chunk of our duration exposure coming from corporates versus the benchmark and up on the top where it says duration contribution on page 11, 3% of our overall duration of that 4.9, if you look at it that, is coming from our corporate position, whereas only 1.3 of that comes from aggregate benchmark. Offsetting that is our mortgages because our mortgages positions are much shorter in maturity, then the benchmark is only 0.9. So again it's showing the offsets of where we're taking the risk exposure to where it all is balancing out to a duration that's slightly longer, but we're aware of what we're taking in the corporates and it's offset by shorter duration and mortgages kind of keep that all into control.

Another thing I'll point out is again, of this 23% of corporates that are in the benchmark, I think about and I may say this wrong, I think about 10% of that are Triple B's. We do not own any Triple B's in our portfolio, except for the one position that's an inherited position that we're rolling off. That's another thing, you see our higher exposure versus the benchmark, but one of the elements that are a little bit less risky exposure within that is that we do not own any of the Triple B's. Same thing on the yield coverage exposure, the only thing to talk about there is we're moving to a barbell portfolio, you can see that almost 39% of our portfolio is in securities under 2 year and obviously much bigger in the benchmark, or smaller in the benchmark and then the offset is the 6-8 year. We're under weight in the middle part of the curve there and then we're over weight 6-8, we really don't own anything in the 8-10 and right now we just kind of have an end line exposure to the greater 10 year and that's where you'd see a lot of our treasury exposure would be in that longer term, we don't usually try to go out the yield curve to the long, long dated maturities to try to get our spread exposure, we usually have that more intermediate to short term.

I'll give you an update organizationally, what's going on with the firm. I think I've talked about this when I've been here in the past, we've had affiliated managers group as an outside investor and remember Bob Davis and Jack Hamilton entered the relationship with them back in 1998 and one of the primary reasons being to eventually facilitate a way of transitioning ownership to the next generation of the firm, because back when they were looking to set that in motion, none of us in the next generation had the capital to be able to buy back in 1998 and so they were able to sell some of their position, majority of their position, I think at the time, 60% to AMG. AMG over time bought back a little bit more of Bob and Jack's stock to where they got their ownership up to 75 and then over the last 4 years starting in 2006, we've been buying back that ownership internally to the new generation of partners and they're currently 6 internal partners in the firm and this will be the only 6 partners at the moment. What we're going to do as of June 30th, we're going to buy back the

final 25% from AMG that we don't currently own, so we'll be 100% employee owned and the way it shakes out with the make up of our 6 partners, we will be at that time, about 70% owned by minority in women partners, so for us it opens up a new opportunity within that market space where we'll be an emerging manager, we're kind of in a unique place as an emerging manager with a track record that goes back to 1988 and with a track record in all of our products and obviously more than \$2 billion in assets, so we're strong standing, so we're really excited about that opportunity.

Part of that, as we're buying back the remainder of the stock, we will and I believe everyone received the letter, we're going to be officially changing the name of the firm as of January 1, 2011 to Garcia Hamilton & Associates. Garcia is Gilbert Garcia who is our managing partner and runs the fixed income portfolio and has been with the firm running the fixed income since 2002 and stepped up as a managing director at the firm back in 2006 as we were really going through this transition of leadership. The Hamilton is not Jack Hamilton, it is Janna Hamilton who is previously Janna Woods, but Janna and Jack have actually been married for quite a long time, she just never used the last name to kind of avoid the confusion and everything else, but I'll be honest, we wanted to preserve some of the continuity of the name, so it's the same name in it, but it's not Jack Hamilton who it was before, it's Janna Hamilton who is our senior marketing person in client service and she owns the 2nd largest amount of equity in the firm other than Gilbert (Garcia). Janna (Hamilton) has been with the firm since 1995, so again it's very long standing members of the firm. I know some clients that are new clients, they were confused a bit wondering if this was some type of merger taking place because we're now changing the name, so just so everyone understands, it's the same management team that's been in place for sure since we started this transition back in 2006 and everyone who's on board has been involved with that. I've been with the firm since 1997, Janna (Hamilton) since 1995, Gilbert (Garcia) since 2002, Curt Rohrman is one of the other partners, he joined us in 2006 as an equity portfolio manager, Kevin Lunday is our Comptroller, he joined us about 3 years ago and then Beth McWilliams is our Chief Compliance Officer and she's been with the firm since at least 1995 I think, maybe 1993. So again, a lot of long terms player are the 6 current partners and we just feel that the name change is appropriate given the current composition of the owners and that's really what's driving that. Gerry Cruz: So Bob Davis is no longer? Daniel Kallus: We basically over the last 12 months, the last piece of ownership that Bob had with the firm, we've bought out internally and Bob (Davis) is still a friend of the firm, he still has money invested, a sizeable amount of money in the mutual fund that we sub-advise and I saw him 3 weeks and he's involved with the Child Advocates in Houston and there was a big fundraiser and I spent the evening with him there and things are all still going good in that area. I'll be honest, if I was Bob (Davis) would I rather still see my name in the firm, yes, if you founded the firm, you would love to see your name maintained in that, but I think from the angle, he and Jack (Hamilton) are both retired now and trying to move the firm forward, it makes sense if we're buying back the remainder of the stock now to kind of do all this at one time instead of letting it move on and possibly create some confusion down the road.

Rosalie Bordallo: Do you have to legally change the name? Daniel Kallus: No we don't have to. Nothing is causing to have to, it's just more of a reflection of, if Bob (Davis) and Jack (Hamilton) no longer own any of the firm, it doesn't make sense to have the name, Davis Hamilton Jackson, it creates the confusion that they're still...

Rosalie Bordallo: But a name is a brand... Daniel Kallus: Within the market place, the consulting community and everything, we've met with, they've actually, even before we did this, they asked us a couple of years ago if we're going to be changing the name, because again, it's creating confusion for us because when you talk about going through the transition and everything else and we're still seeing Bob (Davis) and Jack (Hamilton) name all over everything, it creates the confusion to people that they're still involved with the firm and at some point you get down the line and if Bob (Davis) retired in March 2008, we don't want any of our existing clients or basically any else to look at it in 2013... Rosalie Bordallo: I'm sorry, I just have a different opinion. I know that these guys have nothing to do with my account anymore, but it's just a company. Daniel Kallus: The other things we thought about doing, we typically, most people have never called us Davis Hamilton Jackson, they just call us DHJA and we thought about just maintaining that and just officially changing it to that abbreviation, but it was mainly Gilbert (Garcia) and Janna's (Hamilton) decision on it and they consulted with Jack (Hamilton) and Bob (Davis) is aware of it.

One message we want to get out to everyone is, we're 100% employee owned and we have transitioned over the last 4 years and we have a new management team that is very eager and enthused and motivated and we kind of want to reflect that new energy and everything else with the name change. Gilbert (Garcia) is the largest and primary shareholder, when it's done, we'll buy back and he'll own close to 40% of the firm, Janna (Hamilton) will own 20 something and I'm the 3rd largest shareholder, but in combination of Gilbert (Garcia) Janna (Hamilton) and Beth (McWilliams), the 3 of them will own close to 70% so that's where the women in minority status comes from. I'll be honest, part of that name change as well is we see an enormous opportunity, because there are a lot of mandates out there right now where the public playing space especially, they are a lot of looking to hire women in minority in firms, as part of that name change, we were thinking, do we just stick with DHJA or is there a bit of an opportunity that would be in our best interest to make sure the current ownership is reflected, so that was kind of a factor in that. I mean, I'm with you on that, my first response was, that was the easy thing, that's what our clients know us as and the easiest thing is just to leave it alone, but I can see both sides of the argument and hopefully our existing clients judge us by the quality of the work we're doing and the performance that we're putting out and they see that the name may have changed, but nothing we're doing has changed or the people involved. The people involved haven't changed, we think there's more chance of a confusion if they see that Davis Hamilton in there and then there's a new prospect and they read something and say, your name is Davis Hamilton and I don't see a Davis or a Hamilton or a Jack (Hamilton) on your partner's list. Jack (Hamilton) isn't mentioned all that much, because he officially left the firm in 2005, he was the first to go of the original partners.

Rosalie Bordallo: We have a couple of questions, I think we know about the first one, which were organizational changes. The second thing is the usual question, is there any litigation being proposed against you or any regulatory issues that have come up? Daniel Kallus: No, no litigation, no regulatory issues. Rosalie Bordallo: That's about it. Daniel Kallus: Thank you very much, I appreciate the opportunity to manage money for you.


(End of presentation by Davis Hamilton Jackson & Associates)

4:15pm - Other

The following items were deferred for discussion during the Regular Board Meeting on May 28, 2010.

1. Asset Allocation
2. Offer by Contrarian to Purchase Lehman Holdings
3. Mercer's Research Notes on Security Capital and AXA Rosenberg
4. Securities Lending Update

Respectfully submitted,



STEPHANIE A. HERRERA
Recording Secretary

Affirmed:

Gerald A. Cruz,
Acting Investment Committee Chairman