

GOVERNMENT OF GUAM
RETIREMENT FUND
STABILITY · SECURITY · REWARDS

Eddie Baza Calvo
Governor

Ray Tenorio
Lieutenant Governor

Paula M. Blas
Director

Trustees:

Joe T. San Agustin
Chairman

Wilfred P. Leon Guerrero, Ed.D.
Vice-Chairman
Investment Committee, Chairman

Antolina S. Leon Guerrero
Secretary

Gerard A. Cruz
Treasurer
Audit & Operations Committee,
Chairman

George A. Santos
Members' & Benefits Committee,
Chairman

Katherine T.E. Taitano
Trustee

Wilfred G. Aflague
Trustee

**Quarter Ended 3/31/11 Performance Meetings
& Annual Manager Reviews**

July 28, 2011

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
George A. Santos, Member

Staff Present:

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

Other Present:

Maggie Ralbovsky, Wilshire
Howard Yata, Wilshire

Franklin Templeton

Income Research & Management:

Garcia Hamilton:

Other:

Review of Current Asset Allocation

pages 1-12
pages 12-21
pages 21-29

pages 29-45

9:00am-9:45am Franklin Templeton

Wilfred Leon Guerrero: Good Morning. I'm going to try to introduce everyone. The Chairman is Joe T. San Agustin, our Director is Paula Blas, Trustee George Santos, Trustee Antolina Leon Guerrero, Trustee Wilfred Aflague, Diana Bernardo is our Controller, I'm the Chairman of the Investment Committee Wilfred Leon Guerrero, this is Rosalie Bordallo (General Accounting Supervisor) and to your left we have Maggie (Ralbovsky) and Howard (Yata).

The agenda is we're going to allow you to lead us in a discussion about your portfolio and we've allotted 45 minutes. You can say anything you want to but for our part in addition to your performance we would like to know, we want to meet our fiduciary responsibilities so we would like to know whether there are any changes in your organization and whether any of the regulatory agencies have any issues with your firm.

Brian Kahley: For the benefit of the new consultants we'll just start off introducing ourselves, my name is Brian Kahley and I'm the relationship manager for the Government of Guam Retirement Fund's portfolio with Franklin Templeton and I'm based in our San Mateo, California office. With me today is Mike Materasso and he is the lead portfolio manager for the strategy and has been working managing the portfolio since 1997 and Mike is based in our New York office.

Just to get started let's turn to page 3, which is an overview of our investment platform. Franklin Templeton investments is a firm fairly large, as of 6/30 we have about \$734 billion dollars in assets, about a quarter of that is our institutional business roughly around \$180 billion dollars. To answer your question about any SEC regulations or litigations against us, we don't have anything pending so we're okay on that front. Our business has been growing, a couple of factors supporting that market, appreciation, acquisition and strong flows in our fixed income group particularly our global bond strategy, but some notable acquisitions throughout the last year we've been building out our specialized strategies division which is the 4 columns on the right, pretty much building out our alternatives divisions, we acquired ---? Capital which is managed future commodity, long short hedge fund type strategies and we've been building out our local asset management groups via acquisitions with a firm in the UK ---? Fund Management and a firm in Australia, Balanced Equity Management and we're just trying to build up our local presence throughout the world in addition to our existing strategies on the equity and fixed income sides.

Following up on that on page 4, this illustrates our global presence in the fixed income group. We have offices throughout the world, our 2 largest offices are in San Mateo which is our global headquarters and also in New York where Mike (Materasso) is based, but we also have offices in London, Asia and South America. Some of these are part of our local asset management group and some are strictly the fixed income groups that Mike (Materasso) works with.

On page 5 is kind of an overview of our multi-sector functional chart. In the middle you can see the core/core plus strategies that we manage for you, Mike (Materasso) is the lead strategist. Whether it's the different sectors within the fixed income group, whether it's credit, municipals or bank loans, we have over 100 dedicated fixed income

investment professionals within the fixed income group. There have been a couple of additions and departures within the separate sector groups but that's more on the analyst front as opposed to the senior leadership for portfolio management professionals and all these groups are overseen by fixed income policy committee which Mike (Materasso) is also the Co-Chair of. The fixed income policy committee meets once a week to go through the different issues in the markets and how different economies are performing throughout the world and Mike (Materasso) leverages all this information when building a portfolio and maintaining the portfolio asset allocation.

On page 6 before I turn it over to Mike (Materasso), just a snapshot of the portfolio as of June 30th. The benchmark we have here is what we call the Government of Guam Retirement Fund benchmark, but basically what it is the Barclays Capital U.S. Aggregate and you guys had a different index going back historically so for performance purposes we linked the 2 in order to show performance historically which we'll see on another page, but right now the primary index is the Barclays Capital U.S. Aggregate.

I just want to acknowledge that we just passed our 25th anniversary with you guys, the portfolio incepted March 31, 1986 so we would like to say thank you for your continued support and we do value the relationship. As of June 30th the total assets in the portfolio were about \$124 million dollars.

Mike Materasso: Good morning everyone. I guess over the next 20 minutes to half an hour I would like to talk about the Government of Guam portfolio, how it has performed over the time periods that you have asked me to talk about, that is for the year ending September 30th, 2010 and for the first 3 quarters of presumably your fiscal year, 4th quarter of last year calendar year and 1st and 2nd quarters of this year. In addition to that I'll talk about the drivers of performance and then from there I'll talk about our outlook for the economy and our outlook for interest rates and portfolio structure.

If everybody would turn to page 7 and what I would like to do is sort of walk you through these performance time frames in terms of how the market has performed. We'll start back with September 30th, 2009, if you think back then at least looking back the U.S. economy was in the first quarter of its recovery and at that point in time a lot of forecasters were talking about the fact that interest rates were so low and that the economy had previously performed so poorly that we would have a strong recovery and probably sometime in 2010 the Fed would start to raise short term interest rates because we'd start to see inflationary pressures build up especially if the economy performed very strongly. Obviously since then the economy has performed very differently, we're in a recovery probably starting into an expansion meaning that the economy has retraced, it's gotten back much of the losses that occurred during the recession so we're probably at the very early stages of an expansion but the economy on many fronts has performed sub par in terms of growth, in terms of job growth and just in terms especially on the consumer side, in terms of the lack of strength of the consumer. Being a bond portfolio manager there's a part of me that says that's a good thing because I think also if you think back in September 30th of 2009 and we went around the room and said where do you think the 10 year treasury would be on July 27 or 28 of 2011, we wouldn't say it was 3%, we wouldn't think the 2 year treasury

would be at 45 basis points, we would assume that it would be significantly higher on the 2 year probably 1.5-2% and probably the 10 year 4% or 4.5% and that's not the case.

So it really is different this time in terms of how the economy is performing, how it has performed to date and how we expect it to perform in the future over the next several quarters or couple of years. Once again as a fixed income manager, that's sort of a good thing for fixed income portfolios, interest rates rise it means you get a negative return on your bonds because interest rates rise, prices go down, well that largely hasn't happened. On the other hand the economy has grown enough that the risk premium on other sectors of the market compared to treasuries have done well. Think back in 2009 especially the 1st quarter of 2009, spreads were at their widest versus treasuries especially on a sector such as commercial mortgage backed securities, but even investment grade corporate bonds as well as the low investment grade corporate bonds yield spreads were significantly wide and because the economy is recovering corporations are in pretty good shape, they have a tremendous amount of cash on their balance sheets, they've been able to turn out their short term debt so from a fixed income perspective they're a lot less risky today than they were a couple of years ago, investors are not demanding as much of a premium to own these securities as they did a couple of years ago and that results in good performance. So you've had relatively stable interest rates and you've had risk premiums tighten and it has resulted in good performance.

So if you look on this page and you look on the table, the right hand side, the lower table on the right hand side which is labeled "Relative Returns vs. U.S. Treasuries" there are 4 columns. If you look at the second column, September 30th of 2009 through September 30th of 2010 you'll see how these sectors have performed versus treasuries and you'll see very positive returns from a little over 1% for agencies and mortgage backed securities, that would be FNMA, FREDDIE and GNMA, but commercial mortgage backed securities which have performed terribly in 2007, 2008 and part of 2009 had excellent performance. If I didn't tell you that this is a table for fixed income you might have thought that was an equity return because it's so good, a return of over 16%, but even asset backed securities and investment grade corporates had a return better than treasuries of almost 4%.

So this time frame, that fiscal year was a good time to be in fixed income securities, treasuries pretty good, but away from treasuries, very good. Since then we've had pretty good performance with some speed bumps along the way. So we continue to see spreads growing tighter, that was the case in the 4th quarter of 2010 as well as in the 1st quarter of 2011, but in the 2nd quarter of 2011 because of the slowdown in the U.S. economy, as well as concerns about what's going on in Europe, as well as the Middle East, as well as in Japan, risk premiums rose a bit, so spreads on corporate bonds widened out a bit, spreads on commercial mortgage backed securities widened out a bit as well. As a result of that their performance was slightly negative versus treasuries, but when you look at the 3 quarter performance, being invested in those sectors was definitely a positive factor, being over weighted in those sectors would have been a positive factor, investing in investment grade fixed income portfolio with U.S. dollar assets.

Let's turn to the next page and talk about specifically performance for the Government of Guam Retirement Fund portfolio that we manage. The performance that we're showing you is gross of fees, it shows you performance from its inception date, which is March 31st of 1986 and then the time frames that you asked us to talk about, the 1st and 2nd quarters of 2011, the 4th quarter of 2010, the period of October 1st of 2009 to September 30th of 2010 and then 1, 3 and 5 years. You'll see we've had mixed performance, in some cases we've done a little bit better than the benchmark and in other cases we have not done as well as the benchmark.

Let me stop for a second and talk about the investment guidelines because there have been significant changes in the investment guidelines over the last year. Previous I guess from my perspective, let's say previous to June 30th of last year the portfolio was highly restrictive. We had a benchmark that included corporate bonds, both U.S. and foreign issuers, commercial mortgage backed securities, agency mortgage backed securities and yet the investment guidelines said if you're buying corporate bonds they can only be U.S. corporations. We can't buy commercial backed securities, buying agency mortgage backed securities if you're buying FNMA or FREDDIE, it can only be 5% of the portfolio, GNMA's because they're Government guaranteed you could buy a lot more. So these were significant restrictive elements in the guidelines which basically when we come annually to talk to you we spend a lot of time in terms of talking about the mismatch and why we either out performed as we did in the previous period because of the spread widening occurred in some of those sectors or the under performance because they did well and we were under weight because of the investment guideline changes.

If you look at the bottom of the page you'll see these 4 tables and if you start off on the right hand side this one year period of October of 2009 through September of 2010 you'll see for that one year period that we under performed the benchmark by 58 basis points. That 58 basis points of under performance came from our duration yield curve positioning, we thought that the yield curve would flatten and we were over weight the long end of the curve and it didn't flatten it steepened so that was an active decision on our part that didn't work. On the other hand 2 other sectors the mortgage backed sector weighting which was very under weight as well as the CMBS sector weighting which was a zero weight, both of those sectors did very well for the one year period and either being under weight or having no securities at all resulted in negative performance of about 56 basis points. So that's sort of reconciling that one period.

When you look at the 3 quarters in the current fiscal year you'll see in the 4th quarter we out performed the benchmark by 18 basis points even though the benchmark, the guidelines didn't allow us to have as much weighting as we had in other portfolios. In MBS you could see that resulted in -31 basis points, but other than that we had some other good calls which resulted in overall positive performance. We get to this calendar year and no more excuses, the guidelines basically allow us to invest in at least what's in the benchmark, so as a result of that now it's a fair apples to apples comparison. In the 1st quarter we out performed by 12 basis points and a good portion of that came from our exposure to investment grade corporate bonds. We did believe and continue to believe that we are in a positive credit cycle and by being over weight to investment grade corporates over several quarters should result in out performance versus the benchmark because we do believe that over time that risk premiums will continue to tighten versus treasuries by investing in investment grade

corporate bonds and that was largely the biggest driver of performance in the 1st quarter.

In the 2nd quarter we under performed by 21 basis points, we expected in the 2nd quarter for the economy to rebound. In the 1st quarter the economy was impacted negatively by very bad weather, we had a very cold winter and also a lot of rain which had an impact in flooding areas in the Mid West and we felt that a lot of that would be behind us and we'd see a snap back in the economy in terms of weather, also the payroll tax cut of 2% for individuals we felt that would have an impact in the 2nd quarter as people started to spend that money and also gasoline prices had risen in the 1st quarter and we thought that was largely behind us. As it turned out that wasn't the case, consumers continued to be very restrictive in their purchases, bad weather continued to be a problem, the Japanese tsunami, earthquake resulted in larger supply disruptions than we anticipated for U.S. manufacturers and all of this resulted in slow growth in the U.S., a slowdown in growth and as a result of that a decline in interest rates. We had been short duration versus the benchmark during this period of time and that's the reason why we under performed with our duration decision by 38 basis points. On the positive side our security selection within the agency mortgage backed securities sector was positive and helped us a bit to bring the overall net under performance to 21 basis points.

So that sort of gives you a profile of the performance during these time periods and the attribution, the positive decisions and the negative decisions that we made which resulted in the relative performance between the two.

Are there any questions or comments? Antolina Leon Guerrero: Just one question, gross of fees, is that typical in your report, when do we ask for net of fees? Paula Blas: Yes. Sometimes they put it in here. Mike Materasso: We could if you like. Antolina Leon Guerrero: I just heard the reference, we always talk about net of fees that's why I asked. Howard Yata: Actually when we calculate performance we always calculate net of fees so it probably makes sense for you to show the net of fees going forward because then the Board will see both numbers and when we see our report is reconciled with your report. Mike Materasso: We'll definitely get that added in.

Maggie Ralbovsky: How much of your process is top down by duration positioning? Mike Materasso: I would say we'll go over the risk decomposition of the portfolio, but typically looking at duration itself I would say typically duration is about 20% or less in our process, so a lot of our macro work goes into our view on risk, our view on how sectors are going to perform, our monetary policy and direction of interest rates, but in terms of making large duration bets within the portfolio, they're typically relatively small, a quarter to a half year is usually the under weights or over weights that you will see. Maggie Ralbovsky: What's the current position on duration? Mike Materasso: Right now we're about 30 basis points short versus the benchmark and this year we had been anywhere between 15 and 50 basis points short duration.

Howard Yata: Being the new kids on the block here and hearing that there's been a change in the guidelines, presumably there was quite a bit of discussion last year about modifying the guidelines to bring them inline with the Barclays Aggregate, can we assume that there are no other suggestions that you would have for the guidelines in this portfolio going forward? Mike Materasso: Considering that this is a core U.S.

portfolio, I think that the guideline restrictions, not relative to the benchmark but relative to our style are very, very small, we can't buy 144A securities that are 144A for life, only those that have registration rights, that's small. So yes, we do feel comfortable and we really do appreciate the work that went in to, this is not just a matter of, as you know of this group sitting down and saying let's do that, it's Legislative changes and I really appreciate the amount of time and effort that went into this, thank you.

Joe T. San Agustin: I assume now it's because of the guidelines, we always hear the guidelines are very restrictive, but now that the guidelines are relaxed in a sense, you can't use that in a future presentation. I'm just trying to make sure that we don't go back to that again because I hear that so many times so we modified the guidelines but at the same time now that guidelines have been removed, show me now. Mike Materasso: That's right, I agree. Joe T. San Agustin: We're going to look for much better improvement, you can't use that as a protective shield, I just want to be sure of that. Mike Materasso: That's how I started off talking about calendar year performance, there aren't any excuses.

Why don't I spend a few minutes in terms of how we see the economy, how going forward it's implications for interest rates and portfolio positioning. As I mentioned earlier the economic cycle we're in currently, it really is different this time, we have never experienced a recession the way we did in 2008 and 2009, in our history at least our history the last time --- with the exception of the great depression and this was a recession that really hurt the consumer and not only in terms of losing jobs, but also in terms of the consumer's credit quality and in many ways going forward it's an economy now where leverage is going to play a much smaller role. Leverage has gotten a bad name because a lot of times people misuse leverage, but on the other hand if leverage is used properly, that is borrowing, what it does is it allows you to get through some soft patches as an individual running a household and if you borrow in that fashion and otherwise live within your means and when consumers are prevented from doing that, because they have negative equity in their home, because their credit rating has fallen so their credit cards have been taken away from them or their credit line has been reduced it means that when expenses rise unexpectedly, you spend less on something else.

So one question that always raises everybody's concern about inflation, well interest rates are so low monetary stimulus has been so great, fiscal stimulus has been so great, we're running a trillion and a half dollar deficit that inflation is going to be a problem at some point in the future, maybe it will but not in the near to intermediate term future. We have an unemployment rate that's above 9% and will come down, but will come down very slowly, I say that because the jobs that were created from 2005 through the first half of 2008 were jobs that are not going to be replaced, our housing --- are not going back to levels that we have seen during that period of time. The financial leverage that was existing within the financial community in terms of banks, brokerage firms and insurance companies, consumer by regulation that's not coming back or if it does it's going to be a very long period of time. A lot of that employment growth is going to come through normal population growth and that's going to be a heck of a lot slower.

So you have a situation where the unemployment growth stays at a relatively high level, you have a situation where workers really don't have a lot of leverage in terms of asking for higher wages. When you have problems like we had earlier this year in terms of rising food prices, but especially rising energy prices and gasoline prices, the consumer doesn't have that leverage. As I was coming from the airport and I could see that gasoline prices are close to \$5 dollars a gallon here, well you can't use that as an excuse anymore to get a raise because we're constrained as well. Inflation becomes a tax rather than a reason for it to filter through to wages and other parts and when it's a tax it means that you spend less on something else and that's what we've seen in the first half of this year, when the consumer doesn't have the financial flexibility to get through hopefully what is a temporary increase in prices in terms of running a household and we think that's going to stay in place for a longer period of time than many expect.

So the economy is growing around 2%, a little bit less, a little bit more, probably the natural growth rate is 2.5-3.75%. We're expecting the second half of this year as the supply disruptions from Japan have gone through the system and the auto companies are producing more cars as hopefully weather does not have an impact as it did in the first 4 or 5 months of the year as energy prices, gasoline prices seem to be coming down a bit helps out the consumer a bit. These should be factors that help the economy in the second half of the year to grow at 3%, 3.5%.

Strictly looking at what I told you so far when we look at interest rates on treasuries in an environment where the economy is growing at 3, 3.5%, when the unemployment rate is starting to come down a bit, where jobless claims aren't above 400,00 but are below 400,00 we believe that 10 year treasury rates are 3%, we believe they should be more in the 3.5-4% area rather than 2.85-3.20 area, this where they've been in the last couple of months and that's the reason why we're short duration versus the benchmark. Not that we think that interest rates are going to go up tremendously, so because if they do they're going to slow the economy down so it's sort of a self correcting mechanism there because we just don't see that long lasting strong growth coming out of the U.S. economy over the next couple of years.

There are other factors as well that are having an impact on the economy and probably reasons why the economy is growing slowly. What's going on in Europe is definitely an uncertainty, what was just Greece a year ago is now Greece, Portugal, possibly Spain, Italy their bond market was under pressure a couple of weeks ago. It's very difficult for the European community to act as one because they don't have full control over the process and as a result of that things are getting worse in terms of concerns about risk rather than better and that's having an overall impact on the European economy and also to some extent the U.S. economy.

What's going on in terms of regulation in the U.S., the uncertainty with regulation is also having an impact on corporations in terms of hiring costs, deductibility of certain expenses and that applies to individuals as well. A lot of these factors right now are having an impact on consumer confidence as well as spending habits and employment habits of corporations and hopefully we'll see some type of resolution to this that will be credible and be positive for the economy. So those are some of the things that are impacting the economy currently.

Wilfred Leon Guerrero: What are you going to do if the U.S. Government defaults?
Mike Materasso: That is exactly what I was going to say. First of all the U.S. we believe that the U.S. Government will not default, that it won't default. Is it possible that the U.S. Government gets a credit down grade because they increased the debt ceiling with very little more meat to it other than that and it results in a down grade, that is possible. What will be the fall out from that, probably not very much because despite the double A rating it's still considered to be a very high quality credit. Keep in mind Japan has a double A rating and their interest rates are even lower than ours. I think that what's more important is that if we don't correct these problems in terms of running very large deficits over the near term and correct them in very credible way that it's possible that at some point in time that investors could lose confidence in the United States.

We have a very large amount of debt outstanding, we continue to have a deficit so that debt continues to pile up, we've shortened the average maturity of our debt which means it comes due more often and right now we're in a very low interest rate environment, so if the Treasury is selling 3 or 6 month bills, they're paying one or 2 basis points, that's their cost to issue that debt, if they sell a 5 year bond it's 1.5%, 3% for a 10 year bond. Over the last 20 years interest rates for the U.S. Treasury were about 5.5%. If interest rates normalized a bit it means that our debt service is going to go up higher, if it were to go back to that average, it's going to go up significantly higher. The last thing we want to do discourage investors from buying our debt and one way to discourage them would be to say this is a country that really can't get its financial house in order and that could be a problem. Hopefully what we're witnessing right now is just the usual political jaw boning, brinkmanship that goes on in the process, even though it appears ugly and it appears very indecisive and with ulterior motives it is what it is and hopefully there will be an 11th hour resolve. If they do and it's a big if, but if they do get it right in terms of trying to get entitlement programs more realistic over a long period of time, simplifying the tax code so that they are less exemptions and loop holes for both corporations as well as individuals, lowering tax rates a bit that it could end up being very positive in that it could end up allowing the economy to grow at a faster rate and at the same time keep interest rates low.

It's quite possible as well that if there is a decent amount of fiscal constraint from the Government, Federal Government over the next several years it gives the Federal Reserve Bank more of a reason to keep short term interest rates low because if you think about it for a second, if we're going to have deficit reduction, meaning less fiscal spending, it means that the Government portion of GDP will be in negative territory and if we're looking for the economy to add jobs and to grow at a decent rate it means that the private sector has to really carry the baton, has to carry the economy with exports being sort of more at the peripheral area. One way to do that, to add jobs and for the consumer to spend and the last thing you want are higher interest rates because that would be counter productive. So we could be in a situation where interest rates, monetary policy remain at these low rates for a longer period of time than expected and at the same time without inflationary pressures, but it would require the fiscal programs to be one that was significant and credible.

Joe T. San Agustin: The original thought that the stimulus package was suppose to provide that, but obviously that failed, it's no longer curing the disease, so are we stuck in this slippery slope, slow it down?
Mike Materasso: I would tend to agree with

you in terms of the fiscal stimulus not necessarily helping but I guess the question and I think it's a valid question, it's not answering the question, but it's a valid question nonetheless is that what if we didn't, what if we didn't provide that stimulus? Joe T. San Agustin: It was an effort, twice in fact they pumped in so much money and then money becomes so cheap. We didn't provide the stimulus to provide the jobs or the manufacturing or the housing structure, all that. Mike Materasso: Well putting the housing I think is a special situation because quite honestly as much as I'd like construction workers to be working, what we don't need right now is more houses, we have a tremendous housing supply and it's the existing homes that have to be sold, so we don't need new houses, but I think that it's quite possible that consumer confidence would have been lower which would result in less spending, it's quite possible that the unemployment rate would be even higher or stayed at a higher level and we don't know that, we can't really point to that, but I think that if the Federal Government did not spend and just let things work themselves out, we would be in worse shape. Unlike previous recessions, typically employment is a lagging indicator, it's reactionary, my business slowed therefore I cut, this time around it was simultaneous or even anticipatory that companies were cutting jobs believing things were going to get worse, not even to stay bad, but getting worse. As result of that there were more jobs that were cut and then what happens, we cut jobs and we found out we could run our companies with 10% less people, so there was less of a need to hire people so productivity went up and other expenses were cut. It is a bit different, it's one of the reasons why especially Germany snapped back much faster than the U.S. Why, because they're not allowed to cut jobs the way we did, so if you don't fire people, they have jobs, they have income, they're spending money. In many respects this was different.

What I'm trying to say is that we could be in a period of time where for fixed income, we're in a relatively low interest rate environment in the United States, where inflation remains low. Keep in mind with all of the leverage that we talked about especially from 2004-2008 people borrowing over half a trillion dollars a year from their homes, not to put on an extension, but to go on vacations, to buy cars, to go to restaurants, all of this stuff. All of those things and the core inflation rate with all of that, only hit 2.8 or 2.9% and for a very short period of time. Now we have a situation that's very different and I think it will take a long time for core inflation to move up and to move up significantly. So our view is that while we're not a bear on interest rates in the U.S. we just think that with an improving economy we'll find that these interest rates will do well and so will short duration.

In terms of the sectors, we feel that investment grade corporates is a good place to be, we feel that municipal bonds, that's also a sector that should do well, we think that municipal credit quality is improving, those are 2 areas that we are over weight. We think that Federal agency bonds, the straight debt of FNMA and FREDDIE as well as other agencies, as well as agency mortgage backed securities, we think that they're fair value at best, so we're under weight in those sectors and as a result of that we have a slight over weight in treasuries. It's not that we're being defensive by treasuries, we just think that there's very little protection owning agencies at 5 or 10 basis points over treasuries or mortgage backed securities where their --- and spreads are pretty tight, so that's the reason we're under weight there, as a result of that under weight is going into treasuries. We think that it's a relatively positive environment despite low

interest rates, we think that credit spreads can come in further and we think that you can see returns will be better than expected from a fixed income portfolio.

Just 2 other pages and one I think for our consultant friends on page 12, this shows how the portfolio was mismatched versus the benchmark, so in other words, under weights and over weights versus sectors, credit quality, duration, yield curve positioning and specific securities. You'll see the first date September 30th of 2009 that this mismatch total tracking error was 182 basis points which is pretty high for a core fixed investment grade portfolio. A good portion of it was because of securities that we couldn't own, that the index owned as well as volatility was higher back in 2009 which also increases risk. You'll see more recently though it's under 100 basis points, it's a combination of 2 factors, we now have a mutual weighting in CMBS and also volatility has dropped from those levels and that's resulted in this slower tracking error versus the benchmark.

Finally on page 13 in a more traditional way, we're showing you the portfolio in terms of its yield curve exposure versus the benchmark, quality as well as sectors and you'll see the under weights and over weights for all of those components.

Just one other thing we didn't include in the portfolio but we're required to report to you on and that's the Lehman Brothers holding bond that we own, the bank receipt proceedings continue to surprise us on the positive side. This was a very unusual bankruptcy in that they were not forced to liquidate their real estate holdings, in some cases they restructured them, they added some infusion of cash and as a result of that they're selling off properties at higher values than they anticipated. The bonds which had been as low as 9 cents on the dollar back in 2008 I think began last year at 20 and closed the year at 24 and right now they're about 27.5, so they continue to go up. Obviously we're talking about 27.5 cents on the dollar for a bond we bought at par, but we recommended that when the bankruptcy occurred not to sell, at least that recommendation so far has been a good thing. Our view is that the ultimate liquidation value can be as high as 40 cents on the dollar which was one of our original estimates and we think we'll continue to be on that path. Joe T. San Agustin: You haven't had any recover yet? Mike Materasso: No, the only recovery you're seeing is the quote on the bonds, there has been no payout. The assets continue to surprise on the upside. Joe T. San Agustin: So you're still hanging on to it, do you think you're going to maintain that 40 or it will go a little higher? Mike Materasso: Our analysts when they're looking at recoveries on securities like this they look at alternatives and one of the things we have going for us right now is that interest on cash is zero, so as a result of that even though this doesn't pay, this is not paying us interest obviously it's in default, but we feel the total return profile looks very attractive not only versus cash but versus investment grade corporates. Joe T. San Agustin: You're not able to do any swaps? Mike Materasso: No we can't, the 40 cents isn't there, we feel that's the ultimate liquidation, it's 27 cents right now.

Wilfred Leon Guerrero: What is your percentage in U.S. treasuries? Mike Materasso: 40%.

Wilfred Aflague: Are there any changes in management or key employees? Mike Materasso: No, no turnovers as far as the executive ranks, nothing on the horizon, pretty much status quo on that.

One last housekeeping item, I sent the invitation to Paula (Blas) and Diana (Bernardo) we're having our conference in Orlando, it's more of an investment forum, educational session and our key note speaker this year is Condoleeza Rice so we're pretty excited about that and everybody is more than welcome to attend and I'll be able to answer any questions about it if there are any. We'd love to see you there if you can make it.
(End of presentation by Franklin Templeton)

10:00am-10:45am Income Research & Management

Wilfred Leon Guerrero: You have the allocated time of 45 minutes for you to lead us in a discussion on your portfolio. Stephen Weiss: Alright I'll jump right in. Thank you very much for having me today. Obviously interrupt me with questions as I go through. On page 2 we'll start with the investment results and then I thought I would go through some charts to talk about the markets and outlook and then we can jump into the portfolio and go from there.

For performance we put the performance based on the email we got from you requesting all the different time periods, but I'm looking for the purpose of today focusing on year to date, it's kind of an easy thing to think about which is kind of in the middle there. We're up about 3% year to date, beating the benchmark by about 27 basis points. It's been an interesting year in the fixed income markets, I'm sure you know that. Am I the first fixed income manager you're talking to today? Antolina Leon Guerrero: No. Stephen Weiss: So you already heard a lot of the stuff so I'm not going to repeat all the stuff that's going on in the markets. Our strategy throughout really the past couple of years given kind of the bumpiness in the market has been to run a little bias towards higher quality. You'll see in a little bit that we're under weight in treasuries and over weight in some of the different spread products so corporate bonds and securitized paper and that has really helped us out perform really since the inception when we've been running money for you because spreads have on the whole been tightening and all those bonds, corporates and other various versions of securitized paper has been outperforming.

This year it's been a little tougher, it's been a little bumpier so corporate spreads as you know came in a little bit then widened back out with all the problems that are going on internationally and obviously with the continued mix outlook here in the United States. We out performed, the bulk of that I think really has been securities selection. It's interesting, since you hired us our out performance has been driven somewhat by security selection but a lot by our overall sector allocations, so owning corporates in general, owning CMBS, owning some of these different sectors just out right helped us because for a while there in owning in 2009, basically if you owned anything other than treasuries you out performed, it was pretty easy. Our strength is really the bottom up security selection so when you get into a market like we're in right now where it's sort of trading water, that's really where we're going to earn our striped and we can sort of see what we're doing by out performing so far year to date. It's really not owning the over weight in corporates that's helped, it's what corporates we are owning.

You'll see in a little bit we're over weight in financials, financials were rocky but the ones we owned actually out performed and you'll see that sort of theme as we go through here.

Maggie Ralbovsky: Could you comment on your philosophy for duration positioning?
Stephen Weiss: We are duration neutral so we are really not going to try to make a bet on the direction of interest rates. I'm sure everyone has an opinion on which way they think interest rates are going to go, the market has been telling you that rates are going higher and they've been telling you that for the past 2 or 3 years and rates have done nothing but go lower. That's a tough game to play and it's a game we don't want to play. So we're duration neutral but we're very duration aware, so we want to think about the bonds that we have in the portfolio and think about how they're going to perform in different interest rate environments and a way to add an advantage there is to focus on convexity and convexity is how bonds, you want to have positive convexity because that will help your bond out perform no matter what rates do. So we're trying to build that bias in the portfolio so that if rates move higher or lower we're going to try to out perform the benchmark. I'll show you if you want some details of how we're doing that a little later as we get into the portfolio.

The next bunch of pages there's chart after chart after chart and we're not going to go through everyone but I want to focus on some of the highlights. The first couple of pages here are macro environment and I think the chart on the upper right hand side really paints the picture. What you're looking at is the change in peak, basically the peak from unemployment throughout every recession that we've had since 1970 and basically the orange line is showing that the recession has gone on for a very long time since 2007 and employment has not recovered so basically employment is taking a lot longer to improve this time than any previous recession and that definitely is a big drag on the economy and definitely a big drag on the overall outlook and why we are maintaining this high quality bias because it doesn't feel like it's, while there are a bunch of positives, there's this big negative overhang that's keeping us concerned with the overall macro economic picture.

On page 5 you can see on the upper left hand side these are consensus estimates for 2011 and 2012, they're actual results from 2010 and in consensus estimates and you can see there when you look at the bottom for example the 10 year treasury again the market and people are predicting that rates are going to move higher so we ended 2010 at 3.30 the market thinks the 10 year treasury is going to go to 3.62 and ultimately to a 4.21 over 2012 and we're now sitting at about a 3%. So we have a ways to go to get to what the market is saying and they're also predicting that the Fed will hike rates to 3.75% with the first hike occurring in September 2012. So higher rates are out there somewhere but it doesn't feel like they're coming anytime soon.

On page 6 on the positive side is the corporations, they are definitely feeling better, they performed well on the upper left hand side you can see year to date these are returns for various corporate sectors, how they compare to treasuries. So year to date corporates have out performed through June with financials leading the way.

I like the chart on page 7 on the upper left hand side and this is really the positive what's really going on. Two things you're looking at is leverage for corporations and cash positions for corporations. Leverage as you can see from the peak in mid 2008

has come down so that's a positive, corporates have reduced their overall leverage. The cash position really is at all time highs, corporations are flushed with cash and their balance sheets look good and earnings have been pretty decent as well. Corporate America feels pretty good, now the cash can be a 2 handed sort of double edge sword from a bond holders perspective if corporations decide to use that cash to buy back stock, that's not really great for us as bond holders. To date they haven't really done too much of that. If you look at the chart just back on page 6, you can see that we're kind of approaching the average of common stock purchases compared to earnings. So they're doing it a little bit, but I think we're in the sweet spot where they can continue to do that for a while and cash will still remain high so as bond holders we're not all that concerned, we're pretty constructive on the corporate bond market and supply in corporates has decreased a bit so there was a big rush in 2009 when the markets backed up in 2010 and it's come down a little so the technicals corporate bond market feels pretty good, the fundamentals are good and technicals are good because a lot of demand and also I think what you'll see is if rates do back up, there's a lot of demand for corporate bonds at higher yields. So corporate pensions that are slowing moving more and more towards LDI type of approaches are really looking for any opportunity for rates to go higher to buy more fixed income especially high grade corporates so I think you'll see a lid maybe on how high interest rates can go on longer term corporates as well.

Jumping over to the securitized side of things on the upper right hand side we have a pretty decent allocation to CMBS, we have about 13% of your portfolio in commercial mortgage backed securities and again we'll talk about that in a second but our focus is definitely on the higher quality tier. Delinquency, 60 day delinquencies in CMBS are high, there's definitely, they're approaching 9% as the economy has been struggling that's been a problem, the rate in which their increasing however has slowed and stabilized a bit and the CMBS that we own there's been a lot of, the special --- have been in doing a lot of restructuring so rather than miss payments, they're figuring out ways to modify the loans and a lot of times they're extending the loans and making them a little longer which is what we're really focusing on it's not a question of whether or not they're going to repay, it's a question of when. Since we own a lot of the older vintage CMBS that have done well, ours traded higher dollar prices so if they extend the maturity a little bit, that's actually a good thing for us because it will give us more time to amortize that premium. We're pretty positive on the CMBS that we own, we still think that there's a lot of wood to chop obviously in the commercial real estate market in the United States and that's why we're not delving into anything beyond the top tranches of the whole market.

An issue in CMBS has finally started to get going again so I think one of the big concerns in the CMBS world is this sort of rolling wave of refinancing, so basically a lot of these loans need to be refinanced over the few coming years and with the market previously being shut people were worried about whether they could get these deals done and now we're starting to see this CMBS the sort of new market emerging CMBS basically allowing these companies refinance so that wallow of worry that people were worried about is starting to see some positives coming along.

The final couple of pages and we're not going to dwell on this we can talk a little bit more in a second is the municipal bond market in the United States. We own some and have increased our exposure to municipal bonds and if you remember I think we

talked about it last year, the Build American Bond Program, which was the program that was created coming out of the crisis in 2008 to allow municipal issuers to have access to the market because it really shut down for them. If you remember the tax free municipal bond market kind of led the way in terms of the crisis with all the insurance companies blowing up and it really hurt the municipal issuers access to the market and they created this Build American Bond Program to allow them to issue taxable bonds, increase their overall base and the Government would subsidize them and basically pay them back 35% of their interest. That program was very successful, got the markets going again, they shut the program off at the beginning of this year so the bonds that we own did well and was kind of a scarcity factor. The municipal bond market, I think of it in sort of 2 tiers, so when you read the newspapers you're going to hear about Illinois general obligation bonds, you're going to hear about California general obligation bonds and those are big states that are having big problems, big budget deficits. In our hear of hearts, we think that California is definitely going to be fine, but we don't want to take that kind of volatility risk so we're staying away from California general obligation, Illinois general obligation I'm not so sure, but we're really focused on the higher quality part of municipal bond market and you'll see in a second the different types of bonds we own, we own a lot of the universities, MIT, Harvard, they issue bonds in this market as well and they're pretty strong credits, a lot of cash, big endowments, expenses under control, those are real solid credits and those are the kind of things we want to own as opposed to a lot of general obligation bonds especially in the states with the United States having its issues. In fact 5 of the triple A states were actually put on negative watch given the fact that the United States Government is now on negative watch as well, so we're really trying to focus on the higher quality, really essential revenue service bonds if we can find them.

Maggie Ralbovsky: Since you mentioned, do you want to comment on the United States credit? Stephen Weiss: The debt ceiling and the debt crisis and the ratings outlook, we are watching this carefully, we haven't really done anything in our portfolios in reaction to this. In some of our shorter Government only portfolios, we're running portfolios for some clients for cash needs, we actually rolled out of the August basically the treasury bills that mature next week and the week after just in case there's a disruption, rolled them out to September. We're pretty confident that a debt deal is going to get done and the United States is not going to default on their debt. With that said, we think the likelihood of S&P down grading the U.S. to something below triple A is getting more and more likely. What is that going to do to the market, I can put someone on that side and I can put someone on that side and they're going to tell you 2 different things, some people will say that the down grade would cause and overall flight to quality still again and this will be a pretty big bid for treasuries and rates can go lower, I hear people saying that rates can go higher, I think there's more people saying rates will go higher as a result of this, maybe 30 or 40 basis points. There's talk about what it will do to the commercial paper market and a whole bunch of sort of different things that will flow from that, so you have one of the big worries is fore selling so some people who have triple A requirements for their Government bonds will now potentially have to sell.

We as you'll see in a second, we're under weight in treasuries and we think that will help us should anything happen negatively towards treasuries and we think that ultimately, it's hard to say whether we think a down grade is going to happen or not, the way our portfolio is positioned we think it will weather the storm pretty well again

the higher quality focus so if they decide to hurt corporates as a result there is a overall sell off of fear, another fear trade, we think owning the higher quality corporates will help us. We saw a little of this back, I think it was last year during the first sort of sovereign crisis where when there was a flight to quality we saw high grade corporates do very, very well so we think that there's another chance that could happen again. This is my very circular sort of way of saying we obviously don't know what's going to happen and we're pretty much sticking to our guns on our portfolio right now, we're not making any sort of major reallocations to the portfolio and we think the under weights to treasuries and really Government paper in general will probably help us through this period.

Wilfred Leon Guerrero: How much U.S. treasuries are you carrying? Stephen Weiss: Turn to page 13 and then we can dive into the portfolio here. I put 3 columns and the first column is what the portfolio looked like the last time I was here back at the end of April, the middle column looks like at the end of June and then the index at the end of June, so let's just focus on the middle column on the upper right hand side. So treasuries, the index is about 30% in treasuries, we are 6.9%, it's a pretty dramatic under weighting. We are over weight in agencies, so the agencies if you look at the agencies that we own, the bulk of that and we've talked about this before, is in SBAs, so these are the small business administration certificates that carry the full faith in credit of the United States. If the U.S. Treasury is down graded these will be down graded too, so basically if S&P takes the Treasury to double A+ or double A or whatever, everything in your portfolio that's treasuries, agencies and if you go down a little further into the securitized section, agencies ARMs, FNMA DUS and traditional mortgage backed securities, those will all be down graded as well, so the Government sponsored entities, everything we think will probably follow with the Treasury down grade.

There's a lot of talk about what's going to happen to the benchmark, if they default, if they miss their payment, they might have to take them out of the benchmark which is crazy, the benchmark suddenly will now, 33% will go away, so I think Barclays hasn't commented on exactly what they're going to do yet, I think that might be drastic, I don't necessarily think that, but if they do down grade the treasuries then 38% between treasuries and agencies will go down and really 32% if you can see if you look at the securitized column, you look at traditional MBS, that last line in the securitized section, 32% of the index is in fixed rate mortgage pass thrus and that will be down graded, so two thirds of the index is invested in bonds that will be down graded and bonds we think ultimately are over valued, even away from what's going on with the Government, probably 2 of the most over valued sectors out there, so treasuries are trading at ridiculously low yields and traditional mortgage backed securities have been bolstered by the Government buying a trillion and a quarter of them and a lot of demand for them. So two thirds of the index is there and if you look at our portfolio, we own very little in treasuries and we own virtually no fixed rate pass thrus.

Those fixed rate pass thrus while we're talking about that, those are the bonds that are very negatively ---, so a fixed rate mortgage pass thru, a bond backed by your traditional 30 year mortgages. If rates decline people refinance, those bonds get called away from you, they shorten up when you don't want them to and then if rates rise and people don't refinance, then the bonds get longer when you don't want them to. For us the way they act, we don't want to own them. If you go back to the upper left

hand side of the page and you go to the convexity line, our convexity currently is about .49 and the index is negative .01. We have a convexity advantage and it's basically our under weight to those fixed rate pass thrus.

So let's just jump through a couple of more columns and sort of see how the portfolio is positioned. We currently have yield advantage, so the portfolio yield is just over 3% where the index is 2.83 and that's primarily due to our under weight in treasuries and our over weight in credit. You can see from a duration point of view we're 4.95, the index is .19, so slightly short but nothing dramatic. Our average credit quality is double A2/AA, versus the index which is double A1/AA+ and you can see that our average credit quality is actually down a little bit from last year. The reason for that, there's a couple things going on, if you remember the transition portfolio, the holding portfolio, we made some decent progress over the last year, we sold probably another 12 million or so of that and moved the cash over to the core portfolio and by doing that we freed up the restrictions, we're limited no more than 20% of the portfolio can be rated below A2, but by getting rid of some of those junkier bonds in that holding tank, it freed us up to go ahead and buy some more of the higher quality triple B's that we like to own. You can see the triple B's jumped somewhat dramatically because compared to all of our other portfolios, you were under weight in triple B's. When we talk about triple B's, the rating agencies aren't perfect as we all know and not all triple B's were created equal. When you look at defense bonds, utilities, cable companies, they're all triple B and they're triple B because they're a little bit leveraged, but they're really strong cash flow, so they're not the triple B's that are sort of hanging on to their investment grading, we don't want to own those, especially in this environment, so we're really focusing on the higher quality triple B's.

So basically we did take your average credit quality down, but now it's more inline with what we're running with our other portfolios. I know we're suppose to talk about compliance in a second, but we no longer need any of the waivers we were getting from you for a while there especially on the quality and another thing that we were able to do given how much we sold out of the transition portfolio is to increase our CMBS position, so we were running your portfolio a little light on CMBS because we have a 40% maximum allocation to securitized paper and because we own so much of it in that holding tank we couldn't buy everything we wanted to buy in the core portfolio and now we can and we're totally in compliance with the guidelines.

Wilfred Leon Guerrero: Remind me again, you took over a portfolio and were just kind of holding on to it, did you just say you're at that point where you're almost... Stephen Weiss: Yes, let's jump there for a second and we can come back to this if you want. Maybe jump to page 19, this is the transitional portfolio. On the upper right hand side is the current holdings, so if you go to the bottom of that the market value at the end of June we were down to about \$8 million dollars where our holding tank, we call it holding tank or transitional portfolio, was down by \$8 million dollars and 17 bonds. We actually just sold another one a couple of weeks ago so now we're down to \$7.9 million of holding tank bonds and 16 line items. Gerard Cruz: You started at 61? Stephen Weiss: Yes we started at 61, actually we started at, we sold a total of 61, I think we started at 70ish. There's a long history with this and we can recount it if you want, but we put about \$60 million initially in there and if you remember correctly we started back in October at the end of 2008 which is in the middle of the crisis. When first did our allocation we put some of the CMBS bonds that we inherited

in our core portfolio and then quickly realized that the CMB market was kind of a disaster and weren't sure how that was going to move so we talked to you and moved them out of the core back into the holding tank. So 70 is million is where we started, we're down to 6.9 million, I think we're doing a really good job. The other thing is a lot of these bonds have been cash flowing, if you look at the bottom left what you're looking at here is sale proceeds, if you go to the 12 month total which is the second line from the bottom, over the past year we basically sold about \$12.2 million dollars worth, actually closer to 13 if you count the bond we just sold, but there has been about 2 and a half out of cash flow of these bonds because again these bonds are paying down and they're both principal and coupon payments, so we've transferred a total of about 15.7 million of them over the past 12 months from the holding tank over and the total since the beginning of about 80 million.

We're really getting towards the end of this process, the struggle as you know, the market has improved, pricing has improved. When you look at the prices of the portfolio according to the pricing service, they're using round lot prices. If you turn the page for a second and let's just pick one, let's just talk about the one we just sold, if you go to the 7th one up from the bottom, it's the WAMU2006 AR18 2A2, that was priced at a round lot of 75.649, what that's basically saying is for a big block a million or 2 million more, that's what the pricing services are saying you can get and this was pretty close to a round lot, it was almost a million dollars and we sold this bond for you guys for 75 so really close to the IDC price which was great, it was a reflection of us finding someone who owned it, negotiating a good price and it's a slightly bigger position.

The problem is if you go up a bond that's a 600,000 bond piece priced at 77, that's an odd lot, so now you're into the odd lot market and if we went and put that bond out for a bid right now, who knows what we'd get, it wouldn't be 77. We put some bonds out last week in your portfolio and the bid was 25 points below the price. So could we go ahead and put these all out and sell them, yes but if we did that the 6.9 million that it's worth right now would probably be closer to 5 and change. So what we're doing and I think we talked about this before, what we're doing is all the inventory from the street downloaded into our system so every day we come in and we see all the bonds that are out there on the street and our system automatically pulls up the matchers. If a new one pops up and there's 3 million out there and we own 400,000 of it, we're going to call that dealer and say, what would you pay us for 400,000 and they might say nothing until we sell it and we'll say, okay when you sell it tack our 400 on and tell us the price you're getting and that's what we're trying to do right now is really blocking and tackling and trying to get good executions.

So we think with patience, which you guys have shown a tremendous amount of over the past few years we can continue to whittle this down and get closer to the market value, but again it's probably not going to be realized so the pricing service is saying it's worth 6.9, if we do our best to, hopefully 6 and a half-ish is what we would get over the course of the next 6 months or so.

Maggie Ralbovsky: Did you say they're all cash flowings? Stephen Weiss: At this point they are all cash flowing. Maggie Ralbovsky: So if their coupon is 5.9%, their market price is 50 cents on the dollar, that means the yield is over 10%. Stephen Weiss: Yes. Maggie Ralbovsky: So why not just hold it at 10% yield, that's pretty

good? Stephen Weiss: Yes, but the problem is that's sort of the yield based on that, the problem is there's cash flows, there's assumptions as to whether or not there's going to be losses, so what we do is we run scenarios based on loss projections and the loss projections change constantly because as these deals age you could be getting into more and more of the distressed folks who may not make their payments, so the yields are a lot less than that. The yields when you do loss adjusted yields you're probably getting closer to the 6 percentage assuming a certain amount of loss and things like that. The best we can do is we've been holding on and just trying to get better execution to get out of these, but again the profile of these is still pretty rough, these are all rated triple C, single B.

The countrywides, there's 3 countrywides, I don't know how close you're following this, there's a Bank of America settlement that's coming on some of these countrywide bonds, it's really not all that material so the actual money that's going to flow through some of these securities is really not all that much, but our hope is that when that finally gets settled a market will come back up for these bonds and they'll be a lot of trading and then we can get out of them as the trading increases. I don't think it's going to be a big home run from a settlement point of view. Gerard Cruz: What was that law suit about? Stephen Weiss: It was some fraudulent stuff, it's similar to other law suits that we're seeing out there, but they settled and I think it would wind up, I think it depends on how these things go, it's very complex, multiple tranches, multiple deals, where the cash is going to flow, I think the prediction overall is it might be a 7% sort of flow through to each bond so you're not talking about recovery at all. For our hope is that it just sort of settles the market down at least for these 3 get the trading going. I think if you put the bid out right now the bid will be even lower because there's so much uncertainty, but once you get the uncertainty fixed the prices will come back up. Gerard Cruz: That law suit includes these series, these bonds here? Stephen Weiss: 3 of them, the '06's, not the '07.

Joe T. San Agustin: Do you have any statistical records of the original price and what price you're selling it now? Stephen Weiss: We can do that, we were talking about that as we get towards the end of this we could sort of wrap that up, I could put together a report. What will happen is and if you remember correctly, our records, in 2008 when we inherited these bonds that's the other issue that we talked about, we inherited them when there was not a lot of clarity and the pricing services were all wrong and we inherited them right here price wise and then the market got realistic and the values came down to here. So I'll put together a report that shows basically the history of the prices and what we sold. The original cost, I don't know if I'll have that, that is from the old manager, the prices from when we inherited.

I think it's been good progress and we're pretty happy we got another 12 million out over the last 12 months and we're just working through the rest.

Let me jump back to page 13 so I can cover a couple more things. When you look at securitized we're a little under weight relative to the index because we don't own as much in the traditional fixed rate pass thrus, but CMBS have doubled in allocation since the last time we were here. CMBS is definitely going to be the most volatile part of your portfolio, it trades very much on the headline risk and it's the first one to kind of move when there was kind of a blow off trade as to some sort of adverse market news. Our focus on the higher quality has actually done well, so our focus is mainly

in '05 and '06 vintage securities, highest tranche with 30% credit enhancement. Again it's not a question of, we think they're very solid against losses, it's more a question of when we're going to get paid and we think it's probably the most attractive sector out there, but again the most volatile, but they have definitely helped out performance well over the past 6 months.

Our credit we brought it down over the last year as a result of increasing CMBS so changing risk around based on what we're allowed to buy. You can see we own about 4.5% of put bonds, again one of the things we've talked about in the past is our being a smaller manager we can focus on some of the smaller sub-sectors and really find neat ways to add value and one of those is buying puttable bonds another is century bonds, 100 year securities, bonds that mature in 100 years as opposed to buying a 30 year, they offer a lot more yield and a lot more convexity, but not much more in terms of interest rate volatility so the duration which is the measure of how a bonds price is going to move with changes in interest rates, when you compare a 100 bond with a 30 year bond, it's really only another year of duration, so it's not that much more volatile with changes in interest rates and you can pick up an extra 50, 75, maybe even 100 basis points. One of the recent ones we bought for you was from MIT, Massachusetts Institute of Technology and they didn't have a 30 year to compare to, but we compared it to a 30 year Harvard bond and we were able to pick up another 50 basis points or so of yield above where the Harvard bond was trading for the MIT 100 year bond without really picking up that much more in terms of duration and really a similar credit quality. It's a neat way to add more yield and better convexity to the portfolio.

Bottom right hand page you can see we are over weight in finance relative to the index, we decreased it a little bit since last year but we're still over weight, our focus again is on the bigger banks, we're staying away from the smaller banks, the bigger banks and bigger insurance companies and as we talked before, the U.S. banks have done a lot to improve their balance sheet. I don't know if I want to be a stock holder of some of these banks, but from a bond holder point of view they have definitely firmed up their balance sheets a lot and there's a lot more capital on the balance sheets to weather through storms so we're feeling pretty good about the bigger banks.

From a firm point of view maybe jump to page 22, we continue to see some pretty nice asset growth. We're up to about \$29 billion in assets under management, the bulk of that over the past year has probably come in the long space, again as corporate pensions are focusing on LDI and those types of strategies, we're seeing interest there, we're seeing interest on the short end as folks are trying to figure out more ways to get more yield out of their cash positions and we continue to see interest in our core space, our aggregate as well.

The only change is Jennifer Lindenmayer left the firm and I think you met her, she was working out of her home in St. Louis and decided to, with all the travel and she has a 10 year old daughter back at home and decided that she wanted to basically change gears and spend more time at home, I think the travel was becoming a problem with her and her family. So she's back there but knowing her she will probably jump back in and start working again at some point, but I wouldn't be surprised if it's not in financial services. We're definitely sad to see her go, but we built the team up pretty well before she left so there's basically 6 of me types at the firm now. With her leaving we were able to prepare for that and it really wasn't that

much of an effect on the firm and there has been no change at the senior investment level. No senior investment person has ever left the firm and we're still independent and we're not looking to sell or anything like that, we think we're in a pretty good shape, we continue to grow at this pace, we don't want to become a Pimco or a BlackRock or any of those big, big firms, we don't have a target in mind, we continue to increase the employee shareholder base so there are 21 of us now and we'll probably add a few more at the end of this year and continue to look for ways to fully enhance people's experience at the firm. We're up to about 100 employees total so 1 in 5 is a shareholder which is pretty neat in the shareholders spread across the firm so everywhere you look, be it in operations, be it in compliance, be it in technology, there's a shareholder and we feel it's our job to look over the firm and make sure we're all making the right decisions for the benefit of the firm.

I don't know if you noticed but we definitely changed our look, that happened at the beginning of the year, basically our old logo was kind of blue-ish and it looked like a stock chart because bonds can't do that but it was time for a refreshed look and we didn't go out and spend a ton of money on it but I think it's kind of neat. That's the only thing that has changed, the firm itself is exactly the same.

Wilfred Leon Guerrero: No problem with regulatory agencies? Stephen Weiss: No. the SEC came in March of 2008 and we haven't seen them since, I'll assume they'll knock on the door at some point and come in but there's been nothing going on.
(End of presentation by Income Research & Management)

11:00am-11:45am Garcia Hamilton

Wilfred Leon Guerrero: We have allotted 45 minutes for your discussion of our portfolio, you're going to lead us on this and we're interested in your performance and what you think it's going to do next year, we would also like to hear about whether there are any major changes in your organization, whether any of the regulatory agencies have issues with you and we will interrupt anytime we feel like.

Jeffrey Detwiler: Let me first say thank you so much for having me here, this is my first trip to Guam, I've had a great time and also I am involved in the APAC Conference so if any of you are going out to Manila I will be there, I am one of the speakers.

I'm going to go ahead and jump into the presentation, I'm going to go over organization first then get into performance then get into some of the market type stuff. I know one of the questions that came up are there any types of regulatory or investigation or anything along those lines, there has not been anything along those lines so I just wanted to get that out of the way first.

If we get in the presentation, page 1, organizational background, we're based in Houston, Texas founded in 1988. You may recall at one point we were an affiliate of AMG which is Affiliated Managers Group, as of the summer of last year we bought back that ownership interest in our firm, Gilbert Garcia is the largest shareholder of the firm and also the director of fixed income, the second largest is Janna Hamilton who is our lead marketing person and so we have renamed the firm Garcia Hamilton and that is something we're very proud of today to be 100% employee owned.

On our investment team we have 10 individuals, we average 16 years of investment experience with approximately 9 years on average with the firm, so very seasoned people who have been working for a very good amount of time together.

We manage about \$2.6 billion dollars in assets so we're a relatively small firm. Of that 2.6 billion approximately \$2 billion is in fixed income, the remaining 500 plus million is in equity. Whether it is equity or fixed income, we are a high quality firm, we want to avoid any type of negative surprises.

At the bottom of the page we have a breakdown of pie charts, our largest strategy which is the strategy we manage for you is the aggregate strategy makes up 37% of our assets. By client type public funds are our primary client.

On page 2 is our representative client list. There are a couple of things I wanted to highlight on this page, we are now managing money for many of your neighbors in the area such as Palau, under the corporate non-ERISA group we manage money for Century Insurance both in Saipan and in Guam and under the endowments and foundations we manage money for UOG. Certainly I want to say thanks because the fact that you have been our client for 10+ years certainly speaks to the other individuals in this area and so we appreciate that. The clients who are highlighted in green are clients who have been with our firm for over 10 years and that's something that we're very proud of the fact that even with all the stress and turmoil in the markets we've had this many clients stick with us due to our consistent investment performance.

On page 3 we highlight our goal and philosophy, this has not changed since day 1 of the firms founding and that is that our investment goal is to out perform our benchmark net of fees using a high quality low risk strategy. That's all we're trying to do, we just want to out perform, we don't want to take on a ton of risk, we're not trying to hit homeruns, because there's no such thing as a free lunch, taking on all this extra risk to get a little bit extra return so our goal, out perform, high quality, less risk. That stems from our investment philosophy on fixed income which is we want your fixed income portfolio to be there in times of stress, you take your risk in other areas, in equity, in small cap, in emerging markets, wherever it might be, but the fixed income needs to be there.

On page 4 I thought I'd just take a minute to go over some of the things that we've done in your portfolio since we inherited it a few years ago. When we first received the portfolio there were a lot of positions that were very small relatively illiquid, we've managed the portfolio to more meaningful positions, we've consolidated, we've upgraded the credit quality of the portfolio so we're reducing the credit risk, we've sold triple B positions, there's only one remaining triple B position left in the portfolio and that is set to mature this year. Our firm philosophy on fixed income is that we only buy A or better rated corporate bonds. We've improved convexity, convexity is a statistical term in fixed income that talks about the change and rate of change. Duration is a straight line, the reality is bond prices don't move in a straight line, improving the convexity improves the return characteristics of the portfolio so we've upped it from .22 to .59 increasing your return characteristic. The duration when we first got the portfolio was very long, we manage our durations within a band of plus or minus 10% because we don't want to take on a ton of risk. If you do anything more

than 10% you are taking on a lot of interest rate risk and we don't think that's necessary in your portfolio. Gerard Cruz: Plus or minus 10% of the benchmark? Jeffrey Detwiler: That's correct. Today the benchmark duration is about 5.2 so the shortest we would go would be something like 4.7 and the longest we would go would be something like 5.7.

We've also improved the liquidity in the portfolio, we sold the CMO's the CMBS's the taxable muni's, those types of bonds don't trade very well so we did in a very thoughtful meaningful way moved out of those positions and moved into more large liquid issues that way in case you guys need to take money we need to sell a position we're able to do so without impacting the market and being able to get a good price.

Lastly we increased the average coupon in the portfolio from 5.6 to 6.51%, having a higher average coupon means that you're getting more income and the great thing about income is if things generally stay the same but you're getting extra income, that will help you out perform. So these are the types of things we've done in your portfolio in the past couple of years.

Before I move on to performance does anyone have any questions on anything I've touched so far? (no)

If we move into the next tab we have performance over the time periods that you requested, we have the last 3 quarters, the one year fiscal period for you through September 2010 and the average annual return since inception. Even though we improved the quality, improved the liquidity in your portfolio we did not do it by sacrificing performance. You can see since inception your portfolio has returned 10.6% versus the index average of about 7.3%. The one year period again about 10.6 versus 8.2% and year to date performance has been very strong as well.

On page 6 I put performance for more traditional time periods, year to date, one year, 2 year average and since inception. I do check your performance on a daily basis and through this week in July your year to date performance is about 3.6% versus the index at 3.5%. So we're very happy and pleased with the performance results and I think the key take away is that we're able to achieve our objective of out performing on a consistent basis without taking on a ton of risk.

On tab 2, page 7, we'll get into some of the economic environment. This model here is our liquidity model, we have an independent quantitative strategist at our firm, his name is John Lohman, he's been with the firm for 15 years and this model here, this liquidity model has good predictive power with manufacturing the ISM Index. It's not going to specifically tell us where things are going to be, but it does give us a sense of whether manufacturing is expanding or contracting. If you can make some intuition about what manufacturing is going to do you can have some intuition about what the economy as a whole is going to do. This model was extremely helpful in late 2008, you see where the red line came down to about negative 35%, that was really the nadir of the economy, of the financial crisis. At that time John's (Lohman) model was pointing as you can see straight up the blue line, it was here at the top while manufacturing was at the bottom. The question at that time that everyone had to make a decision on was, are we going into a depression or is the liquidity that's in the system and all the different programs that the Federal Reserve was enacting, was that going to help save

us from being in a depression. The answer was it did and we saw that ahead of time and we were able to invest accordingly and take advantage of the recovery. You can see that manufacturing rebounded significantly and even stronger than most people would have expected.

Maggie Ralbovsky: What is in that model? He has different things such as money supply, growth, --- yield curve and 3 or 4 other factors that are proprietary, but generally there are things that combined have a good predictability power with what manufacturing is going to do. Howard Yata: So both lines are headed straight down now? Jeffrey Detwiler: Yes, manufacturing and the liquidity model have rolled over. They're still in expansionary territory, over 50% is expansionary, this is something that we're monitoring closely. With the model rolling over earlier this year we increased the duration on our portfolio because this said to us that the economy is still fragile and that means that rates are not going to rise significantly. So at the beginning of this year the yield on the 10 year was about 3.5% and today the yield on the 10 year is just below 3%, so using this model we had our duration longer than the benchmark and so when rates fell, we were able to have higher prices.

Maggie Ralbovsky: How much of your process relies on duration based on this model? Jeffrey Detwiler: Based on this model helps us with not only duration but with also sector weightings, so for example this model helped us make a decision that we wanted to be invested in spread products and in particular corporate bonds during a period when it was pointed upwards and corporate bond spreads were extremely wide. This model also helps us with duration, now again we're not big duration players just plus or minus 10% and we'll only take that position maybe once or twice a year when the economy or the market presents and opportunity to us. So this model is one of the tools that we have. Again, we're not a black box type of firm, we're not just only looking at models, we do our own fundamental research, this model is a nice check and balance with the fundamental research that we do.

On page 8 we highlighted corporate bond spreads since the mid 90's and I just wanted to highlight a couple of key points here. You can see in the mid 90's we were sort of in a steady state period and then in the late 90's we had the Asian/Russian crisis and you can see we hit this kind of crisis point where corporate bond spreads widened out. Then we had 9/11, dot.com bubble and all the different accounting scandals with Enron and Worldcom at that time we thought this is as bad as it's going to get and obviously that was a peak right around 2.5%. Again for those of you who don't know, spreads are the additional yield you receive on corporate bonds over treasuries, so the wider the spread the cheaper the corporate bond and so during these times of stress, that's the opportunity in corporate bonds.

After the economy rebounded, the stock market rebounded, this was during the '03, '04, '05, '06 period, we were sort of in the steady state environment which was below 1% additional yield in corporate bonds and then we had the economic slow down, we had Bear Stearns and we thought this is as bad as it's going to get because this peak was above the accounting scandals peak and the Asian/Russian financial crisis. Then we had one of the greatest policy failure mistakes in the past 20 years and that was letting Lehman Brothers fail and it wasn't a failure because they let them fail, it was because they already set the precedent that Bear Stearns was bailed out and then they let Lehman fail and so that was what signaled the markets that anything could

happen. At that point I think the Fed and the Treasury quickly learned their lesson, they bailed out AIG, the Fed enacted several other programs to return liquidity and confidence to the system.

Again going back to the previous page, at that point the liquidity model is pointing straight up, manufacturing is pointing straight down. We felt at that point with all the different programs in the system that we were not going to go into a depression and this right here was the opportunity, this crisis point right here. If I could take this chart as far back as I could, the last time we were at this level was the great depression. So we made the decision that we weren't going into the great depression type area and this is where the opportunity was and obviously spreads have come down and corporate bonds have been a wonderful trade for us and that's where a lot of the excess return has come from.

Today corporate bond spreads have widened out a little bit on global economic fears, you can see they're at the 1.5% area, that's still wider than a nice steady state environment so we still think that there is still room to go, we think that corporate bond spreads will continue to grind in tighter and that's why we're still over weight in corporate bonds.

Maggie Ralbvosky: During the crisis time period a lot of bonds were down graded in the corporate sector, there were fewer and fewer A and above, if you just focus on A and above do you feel you're constrained by the opportunities because bonds are so scarce in this area? Jeffrey Detwiler: Bonds are scarce but we were constrained because at that point everything was cheap, WalMart, Target, Disney, IBM all of these, AT&T, McDonalds, all of these companies that typically trade at very tight levels, very tight spreads meaning higher prices, they were even themselves cheap even though they weren't really involved in a financial crisis and we were buying all of these different companies. Maggie Ralbvosky: How about today? Jeffrey Detwiler: Today what we've done as those types of companies their spreads have come in, we've reduced those positions, where the opportunity is today is still in financials. All the financials that we own are A rated or better, many financials aren't A rated, so we own the big names the big issuers such as Bank of America, Goldman Sachs, JP Morgan and those types of companies and the reason why we own those companies is on page 9, the breakeven analysis. The breakeven analysis is away to tell you how much cushion you have, what you want to know before purchasing a corporate bond is, I can either buy a corporate bond or I can buy a treasury, I can buy a spread or I can buy a treasury. Why would I want to buy this, what is the breakeven, what is the downside protection, how much can spreads widen before that additional yield you're receiving gets eaten up in the total return and the return of the 2 items are equal? We've listed 3 corporates that we own in your portfolio, the Citigroup 5.50, February 17, Morgan Stanley 7.30, May 19 and AFLAC 8.50, May 19. I'll just focus on the Citigroup, the spread today above a comparable treasury is 2.4%, so you're getting .4% additional yield above a similar treasury. Over a one year time period that spread would have to widen 69 basis points for the return of that corporate bond to equal the return of the treasury, so if we're talking 69 basis points on top of a spread of 240, we're talking about a spread above 300. Now that type of spread goes back to Bear Stearns environment and we don't think that we're heading to that environment. Today corporate bonds in particular in the financial area are very attractive and financials can't help but make money due to the steepness of the yield curve, front end

rates are very low so their cost of funds is very low and they're able to lend money at much higher rates. The spread between their cost and their revenue is generally around 4 or 5% just based on the yield curve, so we think that they can't help but get healthy in this environment.

Joe T. San Agustin: Is 4% spread a respectable spread? Jeffrey Detwiler: Yes, especially compared to where it was because in the summer of '07 the difference between short end rates and long end rates was somewhere around 20 basis points. So today that difference just looking at the yield curve, just looking at treasuries is 4.3%. Joe T. San Agustin: That's why they call it obscene rate, the rates are so low it's cheap money. Jeffrey Detwiler: That's right, it's cheap money, they can't help but get healthy. Additionally I just want to say on top of the yield curve and the ability to make money in a very easy way, there's been additional regulation on financials and beyond that many banks sort of have that once bitten twice shy mentality which is they've increased their lending standards.

Maggie Ralbovsky: Will these banks have any exposure to European sovereign, could they experience write downs? Jeffrey Detwiler: Yes, it's very possible. As a diversified financial institution there's going to be exposure to European sovereign debt. Maggie Ralbovsky: Is that one of the reasons the market priced them the way they did, just the uncertainty of possible capital erosion because of the write up due to the sovereign issues? Jeffrey Detwiler: That's part of it. I would say one good example is, not Europe but AFLAC in particular has many policy holders in Japan and we saw spreads widen on that corporate bond after the disaster that took place in Japan and we took that opportunity to add to our AFLAC position because we thought that it was extremely cheap and AFLAC would recover from that. I think the key things with these corporate bonds is that you have to be able to delineate between what is a media event and what is the actual risk to the corporate bond. What we're concerned about is can this company make its interest and principal payments and in all these cases we think we are very confident that the bonds we own that are all A rated or better will be able to make those payments. In the short term there is a lot of concern about Europe, there's concerns about regulation, we're going to take that opportunity to invest in these bonds because we think that offers extra yield, we know it offers extra yield and because the break evens are so compelling that's because of the downside risk protection versus treasuries.

One of the great things with the steep yield curve that we've been able to do is extend corporate bonds that we own. On page 10 we've highlighted some corporate extension trades. I mentioned that we've moved into corporate bonds in a meaningful way in 2008 when spreads were extremely wide. Those bonds were 2016, 2017, 2018 maturities, back then they were 7, 8 9 year maturities, now they're 6, 7, 8 year maturities so we're pushing the maturity out a year or 2 years and picking up additional yield. Let me give you a couple of examples, the Citigroup we use to own the 5% of September 2014, we bought the 5.5% of February 2017 so pushing up the maturity just under 2 and a half years, the duration extension only 1.8 years in duration extension, but picking up tremendous yield 1.15%, this is only available because of the steepness in the yield curve. On the shorter end of the spectrum we have moves like JP Morgan where we push up the duration close to a half year but picking up 33 basis points. We're continually looking for these opportunities to add

income to your portfolio and these trades are not always available but due to the market environment they are today.

On page 11 we're highlighting the duration move that we made this year, I mentioned that we were over weight duration at the beginning of the year and the main reason was because there was an overwhelming consensus in the market place that rates were going to rise. We often find that when everyone thinks one thing, the market goes in the opposite direction so we use sentiment as a contrary indicator. We saw that the Government was going to reduce hiring and even actually lay off some people, we saw struggling housing market which has continued and higher oil prices which is going to pinch the consumer so we didn't buy into this fact that rates were going to rise. The chart below shows what the 10 year yield has done this year, it's gone from about 3.5% down to about 3% today. We think going forward for the next 6 months rates are generally going to trade in this range from a 3-3.5% and so because we're at the low end of this range we've taken off that duration over weight and we think that the bias from this point is sideways to higher. Maggie Ralbovsky: So now you're neutral? Jeffrey Detwiler: Now we're neutral to short, correct and here are the key stats. On page 12 we have a breakdown by sectors, at the top on the left hand side we have the index, on the right hand side the pie chart is your portfolio. A couple of key things to highlight as I mentioned we favor corporate bonds right now so we have an over weight, again the corporate bonds we own are A rated or better and 10 years or shorter in maturity. The corporate bonds in the index, there are about a third of those are triple B's and also they have 30 year corporate bonds. As a rule we will not buy any spread product and spread product is anything other than treasuries longer than 10 years in duration.

Our treasury under weight 7% versus 33%, we do not own any asset backed or CMO's in your portfolio or CMBS's. Our mortgage position is roughly neutral on a percentage basis, however we only own high coupon 15 year mortgages whereas the index typically for the majority owns 30 year mortgages, 15 years have much better convexity characteristics, again risk return characteristics than 30 years, 30 years have the ability to extend during rising rate environments.

At the bottom of the page we have some key stats, the average yield in your portfolio is 3.8% versus the index at 2.8%. What that means is that if things generally stay stable you will out perform the benchmark by a percent, so out yielding is a great place to be. Average coupon is higher as well as I mentioned earlier, average maturity and average duration are marginally shorter.

On page 13 we have some risk controls. These are controls we looked at on a daily basis for your portfolio to make sure things aren't getting out of whack. We have duration contribution, duration contribution is where your interest rate sensitivity is coming from, where the exposure is coming from. It's not enough to know that we have an over weight in a particular sector on percentage, you want to know if you have long corporates or short corporates. The time periods here are actually year end and through June 30 so I apologize for the typo there but at the top you can see our duration that's the sum total 5.4 versus the index 4.98 and today the duration is 5.0 versus 5.2. We reduced our treasury exposure, you can see we're at 1.5 in duration contribution in treasuries, today about 1.09. By reducing the treasury exposure is how we reduce the duration of the overall portfolio.

On page 14 another set of risk controls again year end through June 30. This is our yield curve exposure, yield curve being where are you in durations from short, intermediate to long. You can see at the beginning of the year in the long end let's focus on the 8-10 and over 10 group, we were marginally longer than the index in the over 10 group and the reason was that's where our treasury duration contribution was coming from. Because we reduced our exposure to long treasuries, we're now significantly under weight to long end of the yield curve.

Last item I just wanted to highlight some new additions, I know there was a question about whether there's been any change in employment and anything along those lines. As we continue to grow we're going to continue to bring on new people and we added a new compliance person to help out Beth McWilliams who is our chief compliance officer and has been with the firm 15+ years, Yvonne Lewis, she has a lot of great experience, she's joined us earlier this year and has hit the ground running. On the right hand side Ben Monkiewicz he was an intern with us last year over the summer and after graduating has joined our firm as a marketing analyst, he is also the nephew of Ruby Dang who is one of our equity analysts. So we continue to expand the firm as needed to help facilitate growth.

In the appendix we have all the bios of the firm professionals and from there I'll open up to any questions you may have. Wilfred Leon Guerrero: What are you going to do if the U.S. Government defaults? Jeffrey Detwiler: What are we all going to do, if the U.S. Government defaults that means much to everything, people aren't going to get paid, it becomes a question of what is risk free because if the Treasury defaults then where does that take us. I don't think it's going to happen but if it did happen it would be Armageddon, it would be terrible, it would be a total catastrophe and I think the powers that they understand that or at least I hope they do, but if they don't it would be awful. What I think will happen is that because the deadline is August 2nd, we will have a deal on August 2nd. If the deadline was July 25th, we would have had a deal on July 25th. I think that both the republicans and the democrats are going to draw this out for as long as possible and I would love to see them just get together and not go on camera and not go back and forth, they need to spend time hashing this deal out. If a deal doesn't happen, which I think it will, but if it doesn't, the President can always use the 45th amendment which says the debt of the U.S. Treasury cannot be questioned and he can raise the debt ceiling himself. I don't think we'll default, there's the deal that I think will happen, that's number one, if that doesn't happen I think the President will do it himself and number 3 if he doesn't, there's also still reserves, because the Federal Reserve has access as well. So there are 3 areas before we get to an area of default, which I don't think we'll get to. (end of tape 1)

(Start of tape 2) Jeffrey Detwiler: We have 6 partners, the largest shareholder in our firm is the fixed income director Gilbert Garcia and he has approximately 45% ownership, the second largest is our marketing person Janna Hamilton and she has 25%, from there is Dan Kallus the director of equity investments and co-portfolio manager Curt Rohrman, there's also our controller Kevin Lunday and then our chief compliance officer Beth McWilliams. Between Beth, Janna and Gilbert we're about 75% women minority. From an investment perspective we only have one fixed income partner and we have 2 equity partners, however from a percentage standpoint the fixed income partner is the largest. Maggie Ralbovsky: You can't count Garcia.

Jeffrey Detwiler: I can't count him? Maggie Ralbovsky: I'm talking about you and you're not minority. Jeffrey Detwiler: I've been with the firm since November of '07 and the plan is that one day I will become a partner but it will take a little bit of time for my tenure to increase before that will happen. Maggie Ralbovsky: How do you feel about that? Jeffrey Detwiler: I feel great about it, I enjoy working at the firm, the firm gave me a tremendous opportunity. I worked at large firms in the past, I worked at Franklin Templeton for a few years, I worked at Invesco for 7 years and what I found working at these hundreds of billions of dollars under asset management terms is that they didn't really give you the opportunity to spread your wings and wear multiple hats and do lots of different things, they gave a clear responsibility, it was defined, but that was it and that's okay for some folks, but I felt I could do more so after obtaining my masters degree from the University of Houston, I saw an opening at Garcia Hamilton and they were gracious enough to accept me and I've grown tremendously with the firm and I'm doing a lot of different things with firm and as I continue along with the firm the opportunity for me to become a partner will develop. Gerard Cruz: What happens if it doesn't, where does that put us where a majority of your intellect and majority of the company, I mean what kind of redundancy is in place to ensure our funds are protected if things don't work out as you see it? Jeffrey Detwiler: Are you saying for example if something happens to Gilbert Garcia? Gerard Cruz: Yes, there are only a few in the organization and yourself that manage such a large portion of the organization, what happens if you or he both get hit by a bus, who carries on the process? Jeffrey Detwiler: Step one would be John Lohman, he actually managed the fixed income portfolio for a period of time during the late 90's before Gilbert Garcia came on board, he joined the firm in 2002. He's been with the firm for 15 years, he's a highly intelligent individual and he would be certainly I think the first to step in, in that sort of eventuality. There's also a Nancy Rodriguez who is another fixed income portfolio manager who has been with the firm for 12 years and then beyond that we have Karen Tass who is a fixed income analyst and Matt Wells. Obviously you never know what could happen, but the reality is Gilbert (Garcia) is not going anywhere because his name is on the firm, but if something were to happen to him there are still good people in place to help out.

Thank you everyone so much, I appreciate it. (end of tape 2)
(End of presentation by Garcia Hamilton & Associates)

Other 1:00pm - 4:00pm
Review of Current Asset Allocation

(start of tape 3)

Maggie Ralbovsky: I thought we'd start with this book, there's a book that says "Manager Evaluation Summary." I will not go page by page, it's a thick book, I only want to point out a few things from this book. We prepared this book as a starting point to establish communication from Wilshire to the Committee, our base views of your current managers because this is our first time here so we want to show the Committee where your managers stand with our evaluation process. From next quarter on I will write a simple paragraph as simple summary comments of your managers in the executive summary so I will not show this book on a quarterly basis, I will only show you this book maybe once every year or when we have updated evaluations. Howard Yata: Also to let you know there's 2 different processes for us to evaluate managers, one is the quantitative information you saw yesterday, the

performance measurement book, this is a qualitative evaluation, there's some quantitative but there's a qualitative evaluation that goes on at Wilshire by different set of people who all they do all day long is meet managers and they meet with managers and try to understand from those meetings whether their organizations are solid and you'll see all the details here, but then they assign from a qualitative meaning a quantitative score. Maggie Ralbovsky: I will talk about that.

Let me just review this first page again, remember yesterday we talked about asset allocation and today this book is about manager selection so I just want to put this into perspective as to why we're doing this. First of all page 4 is a summary of your current manager's scores, I know there was some confusion on this target column, the target is basically your current allocation targets to these managers, it has nothing to do with the scoring or anything like that, it's just for you to see what kind of exposure your assets have with these managers, so for the purpose of manager evaluation you have to know that target, it's not the target score. It is your allocation target, it's your asset allocation target to these managers. Howard Yata: For example Atalanta Sosnoff had 6% of your assets. It gives you an importance factor for each of the managers, so if you go to the bottom those 3 fixed income managers, those are important because they're all managing 10% of your assets. Maggie Ralbovsky: Then there's a total score column and the weighting of the total score comes from the next 6 columns, so those are the weightings for us to come up with a total score and to put the total score in a scale that is understandable, we rank managers from 1-5, with 2.5 being average, so if you take all of the managers out there, the average is 2.5, therefore if a manager ranked above 2.5 it is in the top half, if a manager ranked below 2.5 it is in the bottom half and usually when a manager is ranked below 2.5 they are being terminated because if anything can be done we should pick the manager that's above average. Also, usually highly ranked managers are considered to be above the score of 3, so above 3 tend to be in the top quartile in terms of opinion. Managers between 2.5 and 3 are in the zone where we usually watch them especially when they're very close to 2.5. If you just do a quick scanning you have more than half of your managers above 3 and you do also have a handful of managers below 3, Atalanta Sosnoff is your lowest ranking manager. Joe T. San Agustin: This is comparison by its peers? Maggie Ralbovsky: Upon it's peers. Joe T. San Agustin: How do you allocate say 3% for organization because I'm trying to find out how you arrive at this? Maggie Ralbovsky: I will talk about that.

On the total score column you see that I want to point out that Atalanta Sosnoff is a manager that is very close to the middle zone, 2.55 and then you have MetWest at 2.91 and that was a recent down grade, that manager use to be a manager that's ranked very high and given the CIO departure of 2010 that was down graded and now it's at 2.91 and even Numeric they're both in the 2.91 range. Moving down you can see that Garcia Hamilton is at 2.85, Income Research is awfully close to 3 so I wouldn't count that one. So these are the handful of managers that are below 3 with Atalanta Sosnoff being really below 3. Also on the most right hand corner there is an overall assessment with 4 managers being on focus list. What is focus list? Focus list is our conviction list so we ask every manager research analyst to pick their conviction list managers and put on their focus list and these analysts are actually being compensated on the performance of the focus list manager so they have some skin in the game. We want to see which research analyst eventually can prove to be insightful, just because they rank somebody good and if they don't turn out to be good

we want to know if this analyst is any good, some analysts are good, some analysts are not as good so this is a way for us to track an analyst performance. Wilfred Leon Guerrero: Your analysts? Maggie Ralbovsky: Our people who are doing as Howard (Yata) said are doing every day nothing but met with managers. Joe T. San Agustin: They're the one's that are scoring. Maggie Ralbovsky: That's right, they score these managers. For the focus list managers these are their conviction list and you can see you have Winslow, INTECH, you have Cornerstone and Security Capital on the focus list. That's how you read this chart.

Now let me answer the question of how they are scored on the next page. First of all we start by wanting to have each of these categories scored independently of each other. The reason is that many times when you ask a person how good a manager is their impression is colored by the past performance so many times people start with performance and if a manager's performance is good then they go out and meet with this manager and they start to score the different categories, but their opinion is already colored, they're already thinking this is a good manager because their track record is good. Then they start to score the different categories in that fashion and eventually they are all too correlated so all the different categories correlate with each other and eventually get a score that's not very predictive for the future because when we hire a manager we're not hiring them for their past performance, we want them to generate future performance. So the overall goal is to make an assessment to say we have the confidence in this manager to have the ability to generate future out performance and how do we do that, we decided to make each of these categories independent of each other. For example, organization is our assessment as to how possible the people you're seeing today and you're hiring them to do the job today will be here next year, 3 years down the road, 5 years down the road, how possible that infrastructure in that company that's set up is encouraging this kind of longevity, is encouraging people to treat this to have the people there having the same goal as you and the are compensated if you do well, so it's an alignment of interest, it's infrastructure to encourage longevity. So that's how we assess an organization and in this portion, the very, very important thing is the ownership structure to see if the ownership structure encourages people especially experienced professionals to be there for the long term. I commented earlier Garcia Hamilton structure because they are quite concentrated in ownership that is a flag, we want to flag it, we want to say, those other who are contributing to the success of the portfolio they in a way are not compensated according to their proportion contribution because they're not owners of the firm and people who are owning the firm may not be viewed as contributing as much so that's something we want to know. So the important portion of organization is ownership structure. Wilfred Leon Guerrero: Who is the sub-advisor? Maggie Ralbovsky: It's just the manager they're evaluating.

Another important thing under organization is to say if we believe their organization can encourage stability, how was the stability, have they had turnover in the past 3 years, who were the turnover, was it important turnover or natural, we want to make adjustments for that, that's number 2 criteria. Number 3 criteria is the average experience and these people on the team do they like each other, have they worked together with each other, is their organization structure making sense to us as to can people work together, those are very important assessment qualities. Joe T. San Agustin: How are you going to assess that, you're talking about an organization environment. Maggie Ralbovsky: We had very good examples today already. For

example, Income Research they scored very high on organization because they're 100% employee owned, all the key people who are managing the portfolio have ownership, they're very dispersed ownership structure, every one out of 5 employees have ownership, they do not have a person who is the star, basically they don't have a person who holds more than 50% of is dominant, the majority of the shares and they have very low turnover in experienced people, the turnover he mentioned was a client servicing person. Howard Yata: They haven't lost a portfolio manager. Maggie Ralbovsky: That's right, they haven't lost a portfolio manager and people have been working together for a long time so obviously they have a protocol, people like each other. This manager should be scored high on that.

On the other hand if you look at Franklin Templeton, they are a publicly traded company therefore all the people that have many, many people in that company, they actually do not directly own the company, they have to rely on some sort of other incentive structure to encourage these people to stay and they also have a team that's very dispersed around the world so you have to ask, how do they communicate with each other with different time zones, do they really like each other, do they really care about each other's opinion even though it's a selling point to say we have great resources covering the whole world, but is that really going to be translating into insights into the portfolio, that's a question mark, you want to see how that's executed. So that's how you make the assessment, you make a qualitative assessment to see if you think that story makes sense. So that's organization.

The information is 20% and what is information, we want to know the information source of this particular manager. Do they have a competitive advantage in gathering information, are they having any unique information source, do they just buy data from us like vendors or do they dig into fundamental research and get their own data. We know there are 2 kinds of managers in the universe, one is a fundamental manager, one is a quantitative manager and quantitative managers usually gather very large amount of information from different vendors, for quantitative managers they usually buy data from everybody, all the data vendors because they have a huge computer that can process the data, so we want to know if they just buy from all these very commonly available deal resources because if you do that it means you have no unique data sources. There are quantitative managers out there who get unique data like INTECH in your company, they don't buy any of the fundamental data other quantitative managers buy they actually come with their own data that is based on volatility, that is based on the trading pattern, they're a manager that has a unique information source in our view. So that's how you assess a quantitative manager.

For a qualitative manager usually their information source is internally generated, they usually send somebody on the road to go kick the tire, meet the management, talk to the consumer, talk to the competitor, supplier, all that stuff and then they come up with their own information.

So that's how you make an assessment as to whether a manager has a unique information source and how broad the information source is. Once a company has the data they have to come up with their forecasting, they have to come up with a way to translate that data source into a forecast of how a particular company will do. If it's viewed favorably or unfavorably, so that opinion on a particular company based on their information source is called forecasting. There's also 2 ways to forecast, one way

is quantitative forecasting and in quantitative forecasting methodology you actually don't have a strong view on a particular stock, you have a view on a bunch of things, on a bunch of stocks so you have an actual view on 5, 000 stocks and each one a very little bit of insight, then you try to weight it so that you can express your view with very large group of stocks.

On the fundamental side you really want to know a particular company really well because you actually don't have a view on a lot of stocks, you have a very deep view on a few, so that's the difference between these 2 kinds of forecasting methodology and we make assessment as to whether their forecasting process can be repeated. So if a manager generated great return in the past is that because of their unique forecasting methodology and if it is, can we expect that forecasting result to be repeated in the future and usually an indication that it can be repeated is a very systematic way of doing things rather than sporadically defined random way of doing things so people will be able to tell you exactly how they do it and it makes sense, it's consistent with their past performance and it is repeatable.

Portfolio construction, once you have already generated the forecasting insight about 10 stocks let's say, how do you put the portfolio together, do you just equal weight it, so there are companies that do equal weighting, there are also companies that do conviction driven weighting so it's a very nebulous kind of thing, you ask them how do you weight your 10 stocks and they say, I have highest conviction on these 3 therefore they have better weighting and have lowest conviction on these other 3 that have lower weighting and the middle ones are just average weighting, so that's one way to do it.

For the quantitative managers usually what they do is they do an optimization. How do they put together a portfolio, they start with a model and they say, here's our neutral position which is the benchmark and I'm going to try to optimize based on the tracking error, the tracking error is their budget, risk budget, so my tracking error is 2% and all these different securities I like have a tracking error already, they all have tracking error and how do I constrain them so that the total portfolio has a 2% tracking error, so they use the quantitative way of doing the portfolio construction.

So those are the different ways out there and we want to hear people's rationale, their way, why do you think you should equal weight it, why do you think you should conviction driven weight or tracking error driven weighting, they will tell you, our experience has told us that our highest conviction stocks always do better than the lowest ones, there is some theory behind it and we want to hear it and then make an assessment to see if it is logical, if it is consistent and then give them a score.

Once that's done you want to know the implementation, how you trade the stocks. There are different ways to trade, to start with, A, B, C, D, every morning the trader gets a list stocks you want to sell, stocks you want to buy by alphabetical order, they call different brokers starting with from the alphabetical order, that's the one way to trade it. Another way to trade it is that you actually look at the market liquidity, you trade to only feed into the liquidity rather than demand liquidity, meaning if you want to sell a stock you want to find a natural buyer and you sell it rather than you put it out to the street for bid because you get a much better execution in the first way to do it than the second way to do it.

Yet another way to do it is called the dark pool, the computer thing, you actually put into your indication into the market placing a dark pool, nobody knows what's the other side of the trade and all the people who want to buy also put their indication in the dark pool and the computer matches you up so in that way you're anonymous, you do not advertise your position to the entire street. The reason you want to do it that way is because there are a whole bunch of sharks out there and those sharks are those hedge funds who are people out there who do nothing but front run you so if you advertise them, I'm going to sell 10 shares of Google, they will sell ahead of you, when you sell, the price will go down, so there's these kind of front runners that if they know what you're going to do especially when you're a very large manager, every position, every trade you do you can impact the market and they just front run you and they can make a lot of money. So you want to be as discreet as possible, the A, B, C, D kind of trading really is bad. So we make assessments as to how they trade and what is their average trading cost in the past, so implementation is scoring for that.

The manager attribution, this is the category where I have the least confidence on when people put a score there because they're saying, do you look at your attributions and attributions as I explained to Dr. Leon Guerrero, attributions are a way to decompose your past performance, once you generate it at 1% out performance where did it come from, you decompose it, it's sector weighting, it's duration, it's security selection, in equity space you can say it's country weighting or currency weighting, whatever it is you decompose the component of out performance. Then we ask the manager, what do you use that information for and the manager will say, I put that in my final report to clients, that's bad because you didn't use that information. If they tell you, I look at it every day then I will adjust my process based on that insight, for example today when I heard Franklin Templeton say, our past performance most of our value deduction was from duration positioning, that means I'm always wrong, something is so wrong in positioning on duration then my feedback should be, maybe I just have no skills to time it, I should just forget about it and just be neutral to the market. So that kind of feedback if they say, we look at it and we adjust our process then they deserve a high score. So that's a very, very qualitative assessed score, sometimes it's not very accurate. You can see each of these categories are independent of each other.

We try to hire people with great education background and have experience in the industry and we also try to use methodology to give us insight. We have each of them pick 10 stocks on their focus list, they can only change it once a quarter and at the end of the year when we evaluate how many of their focus list managers actually out performed on a one year, 3 year, 5 year period and then if they do well they get a bigger bonus, if they don't do well they get a smaller bonus and we also have a score for them. Howard Yata: If you think about it, it's not unlike what managers do with their portfolio analysts and over time if an analyst is good they get rewarded and they try even harder to do a better job. If they do a poor job and you give them feedback on why they did a poor job, it gives them opportunity to better themselves going forward. So we're just trying to make sure that we hold them accountable, they're not just scoring something just for the heck of it, we're trying to hold them accountable for those scores so that they try to improve their ability to make these assessments, it's not easy to do.

Wilfred Aflague: What are some types of problems that you have with your analysts?
Maggie Ralbovsky: Turnover is an issue, research group turnover so we want research group analysts to be there for the long term, we do have some very senior analysts, but there's also some junior analysts who keep turning over. In one sense it's a job you have to like because you have to sit there every day and meet managers, like today we met with 3 and these people meet with managers every day all day long and it's a job you really have to like to sit there and talk to somebody and do scoring. Another thing is that sometimes people think that this is place for them to train themselves and then after that they can go some where to be the CIO or something, so there's different personal reasons for leaving that job as well. Howard Yata: I think one of the dangers as well is the fall in love danger, you find a manager you like and you like their information, you like their forecasting so you're always going to give them a good score. Joe T. San Agustin: Or go with the flow. Maggie Ralbovsky: Yes. This a comfort zone as well, this is a manager everybody uses. So we do have those issues and the way to help us correct some of those issues is we actually have a system of quarterly committee meetings, we have committees that are consultants are on so like we are on certain committees and we will talk to the manager research analysts and they will present to us their scoring, their new scoring, their changed scoring and we will say, I don't think that makes sense given my experience with this manager you should downgrade the score or you should upgrade the score. So we have this kind of a system where the consultants put their opinions into the process as well. Howard Yata: We can't dictate the score. Maggie Ralbovsky: That's right. Howard Yata: We can say, I don't think that manager deserves a 4.0. Wilfred: You can question the score. Howard Yata: That's right, come back and tell me why it should be a 4.0.

Wilfred Leon Guerrero: How many people do you have that are doing this kind of stuff? Howard Yata: About a dozen. Maggie Ralbovsky: Over a dozen people are doing this. Joe T. San Agustin: Is there any danger to being too familiarized between the analysts and the managers? Maggie Ralbovsky: Yes there is. As Howard (Yata) said, you fall in love with the manager. Howard Yata: Eventually at the end of the year if those are managers on their top 10 list and they have 10 managers they fall in love with and they don't do well, down goes their bonus. So there is a financial incentive tied to all of this, we live in a capital society, we all want to make money, everyone wants to make money, analysts want to make money. So, if they fall in love with all the managers and the managers don't do well, they're not going to make money and that's the financial incentive and we want their incentives to be the same as yours, the same as ours, to pick good managers and do good work to help you make those assessments. Maggie Ralbovsky: But still there are times the scores come out and we wouldn't agree. I looked at Franklin Templeton's score and I don't think they deserve that high score.

So that is that and maybe I can go over a couple of managers. I want to maybe put Atalanta Sosnoff as an example because this is our lowest ranked manager and you can see we have a summary section that says what kind of style this manager is. On line 3 it's a concentrated fundamental bottom up conviction weighting driven approach. They have 3 things they do, they tend to take large sector bets, they tend to be higher weighted average market cap and they have a perpetual growth focus and we say this is not recommended as a stand alone option in the space, so that's like a summary opinion for that. On the organization side you can see that we tell you they

have Martin Sosnoff that owns 25% of the company, Craig Steinberg owns 19% of the company so that's very concentrated given the fact 49% is owned by somebody else. After the 49% the other 51% you can see 44 of that 51 are owned by 2 people and Mr. Sosnoff he is close to 80 years old, he's in his late 70's, he owns 25% of the company and that's a risk because they're going to have another transition somehow and that system isn't there so that's something we point out and put some red flags here. You can read through this, I'm not going to go through this but I do think we have established reason why this manager isn't ranked very high.

I also want to show you the 4 chart snapshot chart on page 8 as an example so you can follow through with these others when you have time to read it at your leisure. Atalanta Sosnoff you can see that the first chart total return compared to the benchmark, their one year performance is really, really bad. (end of tape 3)

(start of tape 4)

Maggie Ralbovsky: Right now as the next agenda item I'd like to talk about this little book that says "Active Risk Budgeting." Again I want to show you this 4 step chart (page 2) to show that this is a discussion on investment structure. On page 3, investment structure basically has 4 things and the first thing is equity style management, this is something you're familiar with especially in your U.S. equity category, you have large value, small value, large growth, small growth and then you try to put together your total portfolio and see your total composite whether it has growth bias, value bias, that's one thing we monitor and the reason is because the market goes through cycles, sometimes large cap out performs small cap, sometimes small cap out performs large cap, sometimes growth and value, leadership changes. If you observe a very long term history, there's no reason to think you should always have a growth bias or value bias or large cap bias or small cap bias because those, it's called the structural risk, does not pay off. Structural risk eventually becomes an unpaid risk, therefore you should avoid it and that's the theory behind the style management.

The bond risk management is the duration risk, the sector risk management, do you want to be long duration, short duration, do you want to over weight certain sectors, those decisions the fund controls using guidelines, the manager actually executes it. The next decision the fund should also examine is the active versus passive risk which is going to be the focus of this presentation so I'm going to save that discussion until a little later.

The fourth thing we do in this category is manager optimization because you have multiple managers in each category like today we had 3 managers in fixed income. How do you optimize these 3 managers, do they compliment each other, should they be given the same amount of mandate and if not, how do you decide on whether a manager should be given more than the other. So that's another thing we do. In certain categories I actually showed you how you allocate to managers and it appears to me you equally allocate into different managers and some time down the road I want to discuss with you whether that should be the way to do it. You have 2 large value managers, should you give 50% to each of them or should you actually try to do a risk budgeting to see whether one deserves more than the other.

The focus of this presentation is active versus passive and it is important for me to define these 2 concepts just in case we're not clear. Passive is management style like currently in your portfolio there are IShares, so what it does is that it doesn't really guess which security is going to be doing better or worse, it just replicates the index. Let's say you have a Russell 1000 Value IShare and what that fund does is to hold all the 500 stocks in Russell 1000 Value and hold it in the same weighting as the benchmark, therefore the total goal for that allocation is to replicate the Russell 1000 Value return, it does not aim to beat it. That is one management style based on the theory that the market is efficient, therefore there is no reason for people to try to out guess the market because all the information in the market has been reflected into security pricing. That's a totally debatable concept, but the passive management was based on that concept and they tend to be very, very cheap. So cost is one thing I think you can immediately prove on by moving to IShare index fund because IShare has an embedded fee of 25-35 basis points in each of those structures and if go into a BlackRock, same manager into an index fund they charge you 3 or 4 basis points for U.S. equity, maybe 5 or 6 for non-U.S. equity.

Gerard Cruz: What mandates would it make sense for us to go passive? Maggie Ralbovsky: I will answer that question later, let me save that question. Let me move on to the next few pages and we'll definitely answer your question. The theory behind pursuing active management is that you only do active management if these 4 things happen. Number one thing is the market has inefficiencies, number 2 is that the investor has the ability to identify the inefficiencies and take advantage of it, so that's the manager, there is a manager out there that can find the inefficiencies and take advantage of it. The third thing is that we can identify such a skillful manager, the fourth thing is that we have access to these skillful managers. These 4 things have to happen for somebody to do active management. If one of these things don't happen, your neutral position is to index everything.

To answer the first question, is the market efficient, this is a debate that can go on forever. There is evidence that the market is not efficient, the reason is there are some players in the market place that does not seek return, they have other goals. For example, central Banks, when Japanese central banks go into the market to buy a lot of Japanese Yen to support its value, they are not thinking of making money, they wanted something else, they wanted the stability, to provide liquidity so there are these non-return driven players in the market place that cause the market to be inefficient. There's also the sovereign wealth fund, for example the Chinese commonwealth fund, they go into the market to support Chinese banks, not because they think Chinese banks are a great investment, but because they need to support Chinese banks. Then you have retail investors, these are the contrary investors that you see, retail investors buy, you sell, when they sell, you buy, so there's this retail fund flow that people watch actually as signal to do the opposite because they're always making the wrong decision at the wrong time. Then ETF's, why ETF's also contribute to the inefficiency, because ETF funds flow is actually public, so for example people send certain ETF's trade by chunks, they don't trade all the time, so ETF's are basically a vehicle where a manager goes into the market to buy the securities defined by the ETF and then the investor buys this one ticker that includes all the securities in it. It is impossible for the ETF managers to trade real time based on the demand, so if you're sending 100 shares order to buy S&P 500 ETF's, you buy at a pricing that is not a true pricing if you think of it, because when you buy it the

manager hasn't the go ahead to buy the 500 stocks yet, so they give you a pricing that is defined with a lag, so when you bought the S&P 500 at \$100 dollars then the manager goes ahead and uses your money to buy the 500 stocks and then they give the ETF a new pricing which is not the \$100 dollar anymore, but you bought it at \$100 dollars. Certain asset categories have a much bigger lag than others. One example was the flash crash, if you still remember there was one day during a 30 minute period at Dow Jones Index dropped 1,000 points and at the end of the day people say, okay, during the 30 minute period certain trades need to be cancelled and most of those cancelled trades were ETF trades, the reason is people actually bought the shares at this point and because they got a pricing that's the fake pricing that cannot really be honored if you think how the market actually dropped and the manager actually bought different things, eventually the pricing becomes a phantom pricing and that actually contributed to a drop. So eventually there is a trading lag issue with certain ETF's that contribute to the market inefficiency, people can just trade against it, if you know what order is being sent to that ETF and that order information is actually public.

Joe T. San Agustin: Isn't an ETF designed to be a temporary transition? Maggie Ralbovsky: That's how you use it, it's designed as a trading vehicle. I'm not talking about that yet I'm just talking about what contributes to inefficiency. Can we talk about that later how we use ETF.

So let's move on here, I'm talking about market inefficiency. There's pension funds and the reason pension funds can contribute to the market inefficiency is that they have liabilities they need to match. Certain pension funds, corporate pension funds have to buy long term fixed income, it doesn't matter where the rate is at they just buy it because they have to match the liability. Same thing for insurance companies, life insurance companies have 30 year insurance of benefits they need to pay so they need to match it and then there's pilots, doctors, lawyers and other overconfident groups that contribute to the inefficiency of the market.

So I think it's established that certain players in the market place contribute to the inefficiency, therefore there is a place for active management. Wilshire as a firm, we believe there is a role for active management because there is inefficiency in the market place.

Now the next 3 questions we said earlier was can we take advantage of it. Why don't we take a look at the empirical data, we compiled certain data here, these are real data. Page 8 is some empirical data that supports institutional advantage, so as an institutional investor we actually have an advantage, we can actually identify those skillful managers and fund skillful managers and beat the market. Why do we say that, here is for U.S. equity, we put all of the U.S. equity composite, the 60 large public pension funds and for the 60 pension funds we have data for, these are defined as \$500 million dollar in assets so large institutional pension funds. In the past 10 years ending December 31, you can see that 73% of them have U.S. equity composite that beat the Wilshire 5000 Index. Gerard Cruz: 73%, that's a good number. Maggie Ralbovsky: That's a good number.

If you look at the next chart which is for non-U.S. equity, that number actually goes higher to 83%. One thing you can compare these 2 you have 2 observations, number

one observation is that there's more inefficiency, number 2 you can draw is that the U.S. distribution is very tight, you see the U.S. distribution of the very long – in the middle and the non-U.S. is actually very dispersed and the reason is there's more things you can do to cheat in the non-U.S. category, there's emerging markets exposure that's not defined by the index. So there's a question mark there to say, did these managers really have skills or we just didn't have a very fair benchmark. Gerard Cruz: These include emerging market managers? Maggie Ralbovsky: No, this is composite, so the composite is being compared to EAFE, but the manager usually holds some non-U.S. emerging markets, like your managers hold 15% emerging market.

So how about fixed income and fixed income there's even 92% of the managers beat Lehman and Barclays Aggregate and why is that, the reason is most of these managers hold something that's not in Barclays Aggregate like the high yield and things like that.

So the conclusion we have is yes, large institutional investors have the ability to beat the benchmark, therefore they should strongly consider active management; however is there a reason they should hold passive in their portfolio, we think yes they should.

I want to talk about page 12, our philosophy. We generally will recommend clients hold a passive suite of major assets, so which asset classes should they have indexing, we think for these 3 categories, bonds, U.S. equity, non-U.S. equity, all major 3 categories. Gerard Cruz: But U.S. equity on total market? Maggie Ralbovsky: Right now I understand you have the value index, I think usually it's more efficient to have the total market index. Gerard Cruz: So not break it down? Maggie Ralbovsky: Usually large cap, like Russell 1000 Index. So usually we recommend our clients have a suite to cover these 3 categories with 5-10% of the assets and the benefit is this, number one, you can control the total management cost because going into an index fund significantly reduces your cost for that category. Gerard Cruz: What would be the cost of an index fund? Maggie Ralbovsky: For U.S. equity you can get 4 basis points with large cap, for non-U.S. equity you get maybe 8 or 9 basis points with BlackRock and intermediate bonds you get 5-6 basis points and the active managers usually charge you 50, 60 basis points so you're significantly lower a portion of the asset cost. Gerard Cruz: So these would be Robeco... Maggie Ralbovsky: No, Atalanta Sosnoff. Gerard Cruz: Wells? Maggie Ralbovsky: No, Wells is not. Gerard Cruz: Wells is an intrinsic value manager. Maggie Ralbovsky: It's a value manager, you only have one core manager, Atalanta Sosnoff. Gerard Cruz: So in U.S. you're looking at large core. Maggie Ralbovsky: Non-U.S. we're looking at EAFE manager, you have 2 right now. Gerard Cruz: Fisher and Earnest Partners. The bonds are active duration so you're thinking of just intermediate duration. Maggie Ralbovsky: No, intermediate duration is the Aggregate.

So number one benefit is you can lower the cost, number 2 benefit is that you can facilitate your liquidity needs because this fund has very significant liquidity needs, you pay out like 10% a year by liquidating investments. So you have to trade out of the current investment to pay benefits, if you have index funds there you can trade for cost list trades because you sell an index fund, there's no commission, there's nothing, really it's very costless for your trades. If you sell out of your active managers, you have to pay settlement costs, transaction costs and also trustee.

Wilfred Leon Guerrero: You're talking about us buying index funds right? Maggie Ralbovsky: Yes, I'm talking about 5-10% index funds. Wilfred Leon Guerrero: Okay, but how do we determine the category? Maggie Ralbovsky: These 3 categories. Gerard Cruz: So as far as equity is concerned, core manager... Maggie Ralbovsky: You don't have to fire your core manager you just take 5% to an index fund. Paula Blas: Atalanta Sosnoff for U.S., your non-U.S. is Fisher and Earnest and your bonds. Maggie Ralbovsky: Yes, so these 3 categories. You don't have to fire Atalanta Sosnoff. Paula Blas: She's just saying take a portion, 5-10%.

So number 2 is to save on transaction costs on ongoing liquidity needs, the third benefit is to control the style. As I mentioned earlier, style drift eventually does not pay off.

I want to show you these 2 charts. The first one says, U.S. Large Cap versus Small Cap and when large cap out performs I have the line in blue, when small cap out performs I have the line in red and you can see the market goes thru cycles. First of this chart, beginning of this chart small cap is out performing for a few years and large cap out performing, small out performing, large out performing, then small out performing. Same thing for growth versus value, value out performing, growth out performing, value, growth, value, growth. The market eventually works out so what goes up, goes down, what goes down goes up. Usually if we have an entirely active managed composite the drift is unavoidable because you can't really control a manager's drift. So in designing the composite, if you have a passive manager, a passive manager doesn't drift, they are where they are so you have an anchor for your style, then you have the satellite as active managers, it could help control the total portfolios structure risk. Gerard Cruz: But when you have that drift, typically the drift is because they're winning their bets. Maggie Ralbovsky: Right, it's because they have their bets. What I'm trying to show here is that not necessarily all their bets will pay off and if you have all your managers drift to one side, like in the late 90's all the value managers drift to growth, everybody wants to be growth and when the growth popped... Rosalie Bordallo: But isn't that kind of where you come into play and say, hey look, you need to tell your managers I hired you as a growth manager and not a value manager. Maggie Ralbovsky: When you have an index fund it makes that job easier because you can control that. Gerard Cruz: But do we miss opportunity if we have an index fund because they're just strict to the index? I can see the downside protection in the event that we're moving too far out of line and you want to bring them back and for some reason the market changes direction, but if we're tilting and we're paying attention and they get to the point where they're outside the range that we created then we say pull it back or balance them back, doesn't that effectively accomplish the same thing? Maggie Ralbovsky: Usually it's hard for investors to micromanage a manager. Gerard Cruz: When we're tilting and we're winning against the market, our tendency as investors is to keep tilting, but your job as consultants is to reign us in. Maggie Ralbovsky: That's right, so then you have to tell your manager to not do what they're doing and you hired them to do what they're doing, so there's a micromanagement going on between you and the manager and you can never do that in time. Gerard Cruz: Not micromanaging, just a rebalancing, because I'm not saying, sell this position or sell that position. Maggie Ralbovsky: What I'm saying is your managers all drifted... All managers were hired to do certain mandates and I understand what you're saying, when growth is in favor, even your value managers are

going to go into growth. We saw that with our growth managers tilting to value. Maggie Ralbovsky: Right now your managers are all growth. Gerard Cruz: Well they're tilting to growth. Right now we have value mandate managers who have positions in companies that you would define as growthy, they would look at the same stock and say, no there's value here, but using your definition, you're saying these companies are actually growth, I understand that. What I'm getting at is if we and I'm all for putting the risk controls around our portfolio, but if we are driven too far to capture or to put this risk band around our portfolio are we losing our opportunity for at least reasonable return given the level of risk that we agree to adopt, because the liquidity part, absolutely is an issue, but capital growth is also an issue for us because of our under funded position. We need to balance both now, so long as contributions are coming in, we think that the liquidations are going to be relatively capped, at some point we're going to have to liquidate but it's a closed fund, but at some point we're going to have to liquidate anyway. If we go into passive, my concern and maybe my concern is without any empirical evidence and at this point it is without any empirical evidence, but my concern is that we are going to have these controls on with the passive, with going passive and not be able to chip away at our unfunded liability.

Maggie Ralbovsky: First of all I think to address the unfunded liability, it's not about manager selection that's the biggest driver, the biggest driver is asset allocation. If you look at longer term performance asset allocation accounts for more than 90% of the differential, people's decisions eventually come out to be different because 90% was asset allocation. For manager selection because we're talking about manager selection and investment structure, we're not saying we're moving a large majority to active management, we're saying having a small portion in particular categories. In the passive management and I do believe it controls risk and I do believe you do not give up return. The reason is this, because when the manager can all be right, they can all contribute and when they're all wrong, we have seen that when the bubble burst in 2000, they have suffered tremendously. Gerard Cruz: But the bubble burst for us in 2008 and in 2000, but we under our current portfolio construction, we lost half of what the market lost. In 2001 we lost .5%. Maggie Ralbovsky: But I'm talking about just the U.S. equity portion. Gerard Cruz: I know but I'm talking about the whole game, I'm talking about the whole portfolio. Maggie Ralbovsky: I'm not changing your whole portfolio, all I'm changing is the execution of a small portion. Gerard Cruz: I guess my point is, our given portfolio with its current risk profile and its current construction has performed in good markets and its out performed in bad markets and again maybe what we need to see is the number of the expected return if we move into this direction of what it would look like in terms of reducing our risk profile and how much return expected we would not be giving up or in this case we may be giving up, we don't know and maybe the math would make sense for us. I'm just very cautious about tinkering too much with a constructed portfolio that we've seen work exactly who we designed. Maggie Ralbovsky: I totally take your point. At this particular point in time you actually already have passive management and they are actually more in the expensive vehicle than otherwise could be, so you could have pure improvement just by moving those into an index fund. Now the Chairman's point was, okay we have these ETF's there not because we wanted passive management, but rather we wanted to use them for short term purposes. What I'm saying is that by having a stand alone allocation, a small portion, we're talking about 5% of the allocation into these vehicles, every time you do a transition you don't have to run into the same scenario where you have to go out to buy ETF, you already have a vehicle

there that is a stand alone vehicle that is for transition purposes and we know these transitions happen and they will happen again.

Wilfred Leon Guerrero: Is there a way to take our portfolio, the last 2 years or the last 3 years and plug in this 5 or 10%? Maggie Ralbovsky: I don't know because a lot of the benefit of like the transaction cost, savings and custodian cost savings is not entirely transparent. Gerard Cruz: But the other thing is some of our managers that we've had for a long time, we have some really cheap fees. I know Garcia Hamilton we have ungodly cheap fees, 15 basis points, we may on the newer managers be paying the 50-75 basis points. Maggie Ralbovsky: For fixed income you go into index funds 5 basis points, for equity, large cap is 4 basis points. Gerard Cruz: But we're getting active management. I'm not opposed to it, I just want to see the schedule. Howard Yata: I think what we should do is get the fee schedule and show you the differential. Gerard Cruz: That will be helpful if we have data that says this makes sense, then we're all for it. If it's going to save us money that's great, but we're not in the business necessarily just to save money, so if it's going to save us money but wrap around the risk and not affect the performance or our expected return, then yes, absolutely. Maggie Ralbovsky: I can tell you that all our clients have that, everybody has an index fund suite because it's been tested that it helps the fund ongoing liquidity purposes, rebalancing purposes, saving on custodian cost and what we say is that a management of 15 basis points that does not include custodian costs, settles, trades, every trade you have to pay \$10 dollars, \$8 dollars, whatever it is.

Rosalie Bordallo: I think what we're trying to get here is what are we giving up, that's the point, in return-wise we to know if we go index, are we going to lose 100 basis points or 200 basis points and not hit the actuarial rate. That's the fear I think the Board has, we last quarter or last fiscal we hit it but not by a lot and so if active management is giving that extra push upwards to make the actuarial rate and we remove a chunk that can affect the rate of return, is it really in our best interest to do that to be safe but not make that actuarial rate. Gerard Cruz: And I think our history and I know you can't always look in the rear view mirror I get that, but it's hard not to when we've and not out performed necessarily by huge amounts, but the portfolio performed as we designed it, the way we conceived this to work in bad markets, that's how it performed and the way we envisioned it to perform in good markets is also how it has performed. The other caveat for us is when we go to these conferences we hear all kinds of new ways to manage and construct and build a portfolio and there are all kinds of new consultant views on how to do it and so it's very challenging for us to just kind of break all those different types of methodologies apart to understand which makes sense for us. The only thing we can go buy is what's worked for us in the past and where we were and kind of where we are today and so that's kind of our apprehension to move too quickly one way or the other.

Maggie Ralbovsky: Absolutely, if you look at your current portfolio you have 1.5% in the EAFE IShare, you have 4.7% in the Russell 1000 Value, that's already over 5%, by necessity you already have passive management from time to time. Gerard Cruz: Correct, but not as an allocation. If it makes sense to do it, we're open, I can't speak for the entire Board. Maggie Ralbovsky: I wanted to introduce this concept and my goal is to of course come back and to support this concept.

Rosalie Bordallo: You point out that we do have ETF's and that they are higher priced items, could you suggest index funds that we could, because that in itself is just one thing we can really do to cut cost, if we would just go from an ETF to an index fund in these ones that we already have and are just sitting there with... Howard Yata: Actually those are the 2, BlackRock runs both index funds and ETF's. Actually the Chairman made a comment about ETF's being short termed transition vehicles, in fact that's why they were originally created, but people use them for long term investing if they don't want to invest in the pools. I met with a BlackRock person who is in the ETF division and I've asked them point blank if you're a longer term investor, medium term investor, would you invest in ETF or in the fund and he said the fund, there's no doubt because the ETF cost more. They're there because you can trade them on the stock market, you could buy them as an individual but I can't buy the BlackRock institutional pooled fund because I'm not a qualified investor, qualified investors can buy them and get them for 4 basis points. Gerard Cruz: And it's equal liquidity. Howard Yata: Equal liquidity, same day next day availability. Maggie Ralbovsky: And they're participating in the securities lending, so those funds have all out performed their benchmark after fees for BlackRock. Howard Yata: So you're guaranteed that you're going to slightly under perform with an ETF because of the 25 basis points. Joe T. San Agustin: That's why I said ETF's are temporary and that's why the cost is high because there's basically a penalty in a sense where you're leaving it there, for managers and the Board and trustees to allow that, it's a cost and that's why you have to watch it very carefully.

Howard Yata: The difference is it requires Joanne (Grimes) to look at the documentation. Joanne Grimes: There was a multi-purpose for the ETF's, there might have been one possible practical purpose, I believe on the mutual fund, we were running up to the cap on the 30% and there was a thought of how to get the equity exposure. The ETF statute has 20% stand alone cap so in effect... Gerard Cruz: So the ETF can't be defined the same way as an index fund. Howard Yata: It's not a commingled fund, it's a stock. Joanne Grimes: Commingled amendments didn't come in until after the ETF amendments. The mutual fund has a component of you have to buy it at net asset value, there were certain types of purchases that you couldn't determine the net asset value or the purchase would be above or below the net asset value and therefore a technical violation of the statute so some of the revisions to the statute were just worked around, but in any case the mutual fund case has a cap of 30 and the idea was there any vehicle that can provide the temporary and if it was short term actually the break even component of it thinking about that versus a closed end or something like that it made sense. It was a multi-purpose reason for doing that and then the commingled revisions came in after the ETF's.

Maggie Ralbovsky: I don't understand why you say 30%, right now you have Capital International and DFA as commingled funds and that adds up to be 9.1%, why is that bumping to 30% level? George Santos: No, I think what's she was saying is in the past before we amended some of our restrictions. Joanne Grimes: On the direct investments you have to have certain types of stocks, the non-direct mutual fund was to avoid the qualitative limitations for the common stock direct investments where you had to look at each investment.

Howard Yata: The bottom line to all of this is we're not passive fund advocates necessarily, we just want where it makes sense for the portfolio to have liquidity broad

diversification and some kind of ability to moderate the volatility and then reduce costs from whatever it might be, 50 basis points down to 5, we think it makes sense to do that so that's just the proposal here. Once that's in place if you need cash from one account, you call them up and say, I need cash tomorrow to make a benefit payment and it's available the next day. If you have a manager that you think you're going to terminate you can put those assets into the index fund and there's an easy way to transition.

Gerard Cruz: So the conversation was that ETF's relative to the index fund are more expensive, but currently we have 2 ETF's, \$64 million and \$20 million so we have total combined we have about \$84 million. Joe T. San Agustin: How long have they been there? Gerard Cruz: They've been there for a while. Wilfred Leon Guerrero: The \$64 million was MetWest, the \$20 million was something we were suppose to discuss today. Maybe taking that \$60 million we took from MetWest, put it in an index fund. Joe T. San Agustin: Right now it's in an ETF and you want to move it over to an index? Gerard Cruz: It performs the same way it's just cheaper. Joe T. San Agustin: The concept of having ETF is temporary. Gerard Cruz: It was in lieu of a transition manager. Is there any reason why we shouldn't move our existing ETF to similar mandated index funds? Howard Yata: We do not believe so, we believe that's an appropriate movement at this point in time. Maggie Ralbovsky: Unless your goal is to sell those ETF's and go into active management. Howard Yata: You were holding it back because you didn't want to give it back to MetWest, if they do a fantastic job you may say in a year, let's give it back to them. So in the meantime, instead of paying 25-30 basis points, why not pay 5. Maggie Ralbovsky: But you can't say in a year you fire BlackRock commingled fund and put it back so if the goal for you is to sell these 2 ETF's... Wilfred Leon Guerrero: That \$60 million is like the way you described but that \$20 million, we need to figure out what to do.

Maggie Ralbovsky: Let's talk about the \$60 million because you can't just hire BlackRock for \$20 million, they have a minimum fee, you need probably \$80 or \$100 million for the total allocation for that to work. Let's say right now you moved that \$60 million to BlackRock Index fund, a year later you say I want to give this back to MetWest, you sell down to zero that index fund, that is probably not what we are hoping the intention for this whole movement because that's going to make your other... Wilfred Leon Guerrero: We don't have to give them the full 60, we can do what you proposed, keep 5% in an index fund. Howard Yata: Or maybe another manager. Wilfred Leon Guerrero: But we should get that out of the ETF.

Let me describe to you once people have a suite of index funds, on an ongoing basis if you need to liquidate things for payments you just liquidate out of the index fund instead of active managers, so you actually keep the active managers for longer, for more of their strategy for longer, so in a way you can actually enhance your return because you don't have to think about in the next month you have to prepare \$10 million dollars to pull out. Gerard Cruz: I don't think we pull \$10 million. Maggie Ralbovsky: You did. Gerard Cruz: That was one time, that was in January. Maggie Ralbovsky: \$14 million from INTECH. Gerard Cruz: That was a one time shot. Maggie Ralbovsky: So in an ongoing basis do you liquidate from managers to pay benefits? Paula Blas: \$2-3 million a month. Maggie Ralbovsky: \$2-3 million a month you could just pull out from the index fund and then when you need to rebalance you also just have to rebalance the index fund. Diana Bernardo: At the

December 2010 meeting with Terry Dennison there was a decision to fully fund the new managers including Earnest Partners, so we were liquidating and at the same time we liquidated funds for operations. Maggie Ralbovsky: Okay so it was a one time thing. Howard Yata: Can I ask a question, your normal funding for benefits is it about \$15 million a quarter? Paula Blas: No it's a month. Howard Yata: \$15 million a month. Maggie Ralbovsky: And that comes from a contribution entirely, mostly contribution? Paula Blas: Mostly. Maggie Ralbovsky: So you liquidate like a million to \$3 million. Paula Blas: Yes and it varies from month to month. One month we may not liquidate anything, but we average about \$3 million a month.


Howard Yata: So if you had the suite, what we typically do with clients is once a year we might take money from managers and put it into the index fund so that you still have exposure to the asset class and then in order to do this monthly liquidation you take it from the index fund so that you're not calling the managers up and disrupting their portfolio management, we just do it one time a year and get that taken care of to satisfy what you think is going to happen for the rest of the year.
(End of discussion)

Respectfully submitted,



Stephanie A. Herrera
Recording Secretary

Affirmed:



Wilfred P. Leon Guerrero
Chairman