GOVERNMENT OF GUAM
RETIREMENT FUND
STABILITY · SECURITY · REWARDS

Quarter Ended 6/30/11 Performance Meetings & Annual Manager Reviews

August 24, 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
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:
Terry Dennison, Mercer Investment Consulting Inc.
Maggie Ralbovsky, Wilshire
Howard Yata, Wilshire
Doris Flores-Brooks, Office of the Public Auditor

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9:00am-10:30am DC Plan

Economic & Capital Market Environment

Terry Dennison: Good morning everyone. Obviously this has been a fairly eventful period in the economic situation. I'm going to spend a fair amount of time talking about why we see the volatility and the uncertainty that we've been seeing. The market incidentally today was up about 3%, 3% even on the Dow and 3.5% on the S&P largely because of hopes that Chairman Bernanke is going to announce quantitative easing 3 program at the Jackson Hole meeting of central bankers on Friday. It's interesting that the market so positively received that because the sense was that QE2 accomplished nothing, but we're done to any hope at all now to stimulate the economy because clearly we're in a situation where the economy is slowing down, the opportunities to stimulate the economy are very limited. The GDP numbers came in very poor for first half, they actually reduced the first quarter GDP to four tenths of 1% and the second quarter GDP to 1.6% which is significantly below any level that will reduce unemployment, you need about 2.5% of GDP growth to just hold unemployment stable and if we look at the components of the economy, about 9% of GDP is from Government spending and Government both at the Federal and also at the state and county levels have been reducing their spending, they've been reducing their employment, reducing their purchasing and that's going to have a slowing effect on GDP. The one area of economic activity that has done well since the market rebound or the economic rebound has been manufacturing and now we're starting to see manufacturing beginning to slow. Surveys in New York and surveys in Philadelphia have indicated that activity at the industrial level is beginning to slow, consumer spending has dropped off dramatically, second quarter consumer spending was up one tenth of 1%. At least on the mainland if you go to the malls they're almost empty, I was out this weekend doing a little shopping and it was striking, I went to an electronics store, computer store in Los Angeles where usually on the weekends the checkout line goes out 100 feet and you can just walk right in. Basically people stopped buying anything because they're concerned about the economy, they're concerned about their jobs, high oil prices, people are just slamming their wallets shut. Remember, 70% of GDP is from consumer spending.

Clearly there was a lot of concern about the debt limit, that really was kind of a phony argument, but the longer term issue regarding the debt is very non-phony. There was a lot of hair pulling about the reduction by the S&P of the rating for the Treasury debt the double A+, the reality is we have a balance sheet like Greece, we're lucky we don't have a rating like Greece. The current deficit right now in terms of current budget deficit is $1.5 trillion dollars. When I was growing up in the Mid West there was a senator from Illinois Edward Dirksen who had a comment these sorts of amounts of money and he said a billion here and a billion there, pretty soon you're talking about real money. Just to put that in scale, $1.5 trillion dollars is 1,500 times as big as $1 billion dollars, so we're now talking about just staggering amounts of money. You see in the press where somebody says you can cut $10 billion dollars from the budget if we do this, that's less than 1% of the deficit. The Federal Government is now borrowing 40 cents for every dollar it spends and the reality is while we now approximately 100% of ratio to federal debt to gross domestic product, that actually understates quite dramatically what the problem is because if we can compare that like with United Kingdom, United Kingdom all of the debt of the Government is issued at the Federal level, so if they have 90% debt to GDP that's all the public debt there is. This 100% ratio of debt to GDP doesn't include state and local Governments, it doesn't include the debt of pension plans for public funds, but even at that we're dramatically understated.

Right now Greece which has been down graded to junk and is probably going to default has a debt to GDP of about 160%. If you add in 3 big non-balance sheet items, Medicaid has a $35 trillion dollar deficit, that's 239% of GDP, Medicare has $23 trillion dollar deficit, that's 156% of GDP and Social Security has an $8 trillion dollar deficit, that's 4% of GDP. So Greece which has been down graded to junk has a debt to GDP ratio of 160%, the U.S. is about 500%. Our total debt if you add up not including State and Federal or just talking Federal $76 trillion dollars and $76 trillion dollars is about 6 times 6 years worth of total creation of wealth in the country. It is probably more money than exists in the world, I mean it's a fascinating situation when we owe more money than there is in the world. The reality is and we actually owe this and you can say, well it's not on the balance sheet, but we actually owe it and people expect to get Social Security payments, they expect to get Medicare payments and the reality is there's no creditable possibility of that without smother effects we'll talk about in a minute. Doris Flores-Brooks: But I'm kind of like a gasp and I usually read really closely some of these things going on but I've never ever heard anyone trying to quantify the total debt, is it because they don't want to? Terry Dennison: They don't want to, the numbers are so horrifying... Gerard Cruz: You can't even conceptualize how many zeros. Doris Flores-Brooks: But for someone to say that our total debt is 500% to GDP, that would be alarming to the world and I think the general public needs to know that. Nobody, even like the Peterson Institute and all those others that talk about that, espouse that to know where we truly stand. Terry Dennison: Well I think part of it is certainly political and part of it I think is almost sociological. If you tell people we're $76 trillion dollars in debt and have no creditable possibility of every paying it off, people are just going to get drunk, but unfortunately those are the numbers and if you add in the local debt you're at a number well above 80. So that's just Federal, not sovereign state debt... Terry Dennison: We're not even counting that, it's just the Federal. The Treasury is $10 trillion, Medicaid is $35 trillion dollars of liability, Medicare is $23 trillion dollars, Social Security is $8 trillion dollars, that adds up to $76 trillion dollars or about 5 times GDP. Likely and it's a hard number to calculate, more than all the money in the world. Doris Flores-Brooks: But that's a discussion that the world needs to learn about, we need to learn about. Gerard Cruz: Speaking of which they're looking at, today they're looking at another round of quantitative easing. Terry Dennison: Yes, I mentioned that the market today was up 3%, the Dow and 3.5% the S&P because of hopes that Chairman Bernanke will announce QE3 in Jackson Hole on Friday, but everybody recognized that QE2 accomplished nothing. Just to show you the level of despair, we have a very positive day in the market expecting a possibility of a repeat of a program that was known to produce nothing useful. Gerard Cruz: But they're talking about doing something a little different, I know it's quantitative easing but they're talking about... Doris Flores-Brooks: How much more easing can we have, we're practically at zero. Terry Dennison: That's the trouble we're in right now, you can't cut interest rates they're already zero, 10 year treasuries are trading at about 2% which means the yield on the S&P 500 is higher than you can get from lending money to the U.S. Government for 10 years.

Gerard Cruz: I don't understand why and I'm no smarter than anyone there but it seems like the problem isn't the lack of money in the system, businesses have money. Terry Dennison: Businesses have lots of money. Gerard Cruz: Banks have lots of money and reserve ratios are low, there's no demand and consumption is 70%. So how do you spur consumption unless the Government just does direct loans to individuals, banks aren't lending. Terry Dennison: About 8 years ago, last time I was in Japan, Japan of course has been facing this for some time, the latest brain storm from the Government was to give everybody in the country a $200 dollar gift certificate which probably illustrates just how desperate it is. The problem is nobody will give you goods for a piece of paper and that's the ultimate limiting problem of the U.S., it's not that the U.S. will ever default because they own a printing press. The Government will absolutely pay social security, what they can't guarantee is that you can buy anything with the money because if you've got the kind of inflation you need to be able to deal with this kind of debt, basically you're destroying the value of the currency and if you have a barrel of oil and a bushel of wheat, why would you give somebody a tangible good in exchange for a worthless piece of paper.

So what we're talking about is not is the Government able to pay, they'll always be able to pay, but the thing they can't guarantee is the money will ever be worth anything. Gerard Cruz: Right, but with inflation so low isn't that at this point in our history not a real risk? Terry Dennison: It's not an issue, in fact right now the concerns about deflation are rising that you could see falling prices because of weak demand but that doesn't represent a healthy situation. Gerard Cruz: So what levers do you pull then? Terry Dennison: That's the great dilemma, that we're out of bullets, we're at a place where you can't grow out of this without stimulating demand and we have no tools left to stimulate demand. Basically the issue with the debt has really precluded significant deficit spending, the --- solution, let's just have the Government throw a lot of money at the problem, because the Government doesn't have any money. Doris Flores-Brooks: We did that the last time and it didn't work. Gerard Cruz: But those bridges in the road haven't even been built. Terry Dennison: Realistically we wasted what we did, we spent it on foolish things and really accomplished nothing.

Now the problems here are not as acute as they are in Europe, the problems in Europe are right now. These are problems that are going to be an issue in the future. We'll get to Europe, that's why the market is doing so poorly, it's not that the U.S. is going to go broke next week. The reality is we have made promises we can't keep, there's no way that younger people are ever going to see anything of consequence out of Social Security. There was a survey done by a national polling firm several years ago that found that more people in their 20's and 30's believe in flying saucers than believe they'll ever see a nickel from Social Security.

Doris Flores-Brooks: So our movement to have Government of Guam employees in the DC Plan, we really shouldn't even think about that, because I look at my employees and I really feel sorry for them because all they do is have the DC, they don't have Social Security. If you are working in the private sector at least you have the hope that you will get Social Security. I have always felt that Social Security no matter what will always be there, is that true? Terry Dennison: It's true, it will always be there, the problem is you won't be able to buy anything with it because the money won't be worth anything. These problems aren't this second, they aren't going to be this week, but they're out there and beginning to look insoluble.

Clearly unemployment continues to be an issue, it's still at 9.1%, the level of economic activity we're seeing is probably going to cause unemployment to rise, if not statistically, in reality. There's a graph in here that 45 million Americans are now getting food stamps. More Americans get food stamps than entire populations of major countries. We have a graph in here that is just astonishing. Doris Flores-Brooks: Guam is giving out $90 million dollars a year in food stamps. Terry Dennison: We have demographic issues where people are simply dropping out of the work force; the structural unemployment is because the training we have been giving people is not suiting people or the actual jobs that are out there. Clearly as the construction business died as the end of the housing boom, the people who were building houses are not going to get into healthcare, they're not going to become computer programmers, they're simply unemployable and many of these people who are unemployable will frankly never work again.

Doris Flores-Brooks: Do you have any statistics as to how many baby boomers have elected once they turn 62 take Social Security early? Terry Dennison: I have not seen that number but there was an article today that a lot of people have been claiming Social Security disability and that's going to go bankrupt really fast. That has been basically long term unemployment insurance, a lot of people claiming they've been disabled and that's going to run out of money really soon.

In terms of what the economists think, 2 pretty significant people, Marty Feldstien and Nouriel Roubini believe there is a better than 50/50 chance now of a recession. I would say that if present trends continue you're going to see economic down turn not just in the U.S., but globally in the latter half of this year going into the beginning of next year. Obviously part of our problems in this country are political, the fact that we can't reach any sensible decisions and the people out there on both sides, my side and the other side, don't make any sense. If you want to see something really amazing, Google Hilary for 2012. I think she's going to run, I think she'd be a shoe in. Google that and you will be astonished at what's going on and there's a lot of people saying a mistake was made, we would have been a whole lot better off with her.

If we turn to page 3, obviously we've got that revision downward of GDP growth, first quarter the original was 1.9% down to .04% and periodically the Government goes back and they restate the past, even going back a number of years and they restated the bond where the recession to be about 2% worse than it was, so the recession was really, really severe. The second quarter GDP was 1.8%, again you need 2.5% to hold unemployment constant. We might not see unemployment go up because you now have so many discouraged workers.

If you turn to page 4, big areas of concern the Euro area, the Euro looks like it's simply in the process of falling apart. The development today was the Bundesbank which still exists, it's a central bank for Germany is now of course getting it's monetary --- the European Central Bank believes and has publicly stated in terms similar to the arguments that have been made to the German constitutional court that all of these bail outs are against German and EU law. So we might see all of these bails outs ruled illegal. Gerard Cruz: Who has the power to bail them out? Terry Dennison: No one does, then it just all collapses. Gerard Cruz: So that will collapse the Euro? Terry Dennison: Certainly the Euro and probably the EU. Doris Flores-Brooks: When did this happen, I didn't hear that, when did it happen? Terry Dennison: Just today the Bundesbank came out with a very stern release saying they thought the bail outs contradicted the Maastricht Treaty and the Treaty of Paris which underlie the development of the Euro. In words that I saw being discussed as very similar to the arguments that have been made to the German constitutional court and if they're ruled illegal and you can almost make an argument that Chancellor Merkel would like that to happen because it gets her off the hook, that would be the end of the Euro. The speculation is that the Euro would be replaced by a hard Euro and a soft Euro and interestingly the countries, this you will find fascinating, the countries that are expected to participate in the new Euro are Germany, Austria, Finland, Luxemburg and Flanders. Flanders is half of Belgium, Belgium hasn't had a Government for 2 years and that is suggesting that Belgium will disappear as a country and Flanders which is the Dutch speaking part will be part of the hard Euro and Wallonia which is the French speaking part will become part of France or just drift off to nothing, so literally you are now seeing the potential of entire countries fall apart. Doris Flores-Brooks: What about France? Terry Dennison: France will probably be in the soft Euro, they're having a lot of trouble, they're very indebted, they just talk loud with a very pleasant sounding accent, but the reality is they're in a lot of trouble too.

Back to page 4, if you look at the debt to GDP in the upper left hand corner, the Euro area and this is strictly the Euro area, not the non-participation European Union countries such as the UK, debt to GDP and you can see it's high and growing and the U.S. is the blue and it's high and growing also, the green China, China has very little public debt, in fact they have $1.8 trillion dollars in treasury securities and about $800 billion dollars in Euro securities, they have lots of money. They've been diversifying out of the dollar and of course the problem is they're buying probably junk.

The next is the unemployment rate, we'll spend a lot of time with this. Very slow growth because of a very weak demand, again you can see the 2 lines for unemployment have spiked up and have stayed high while the Chinese unemployment, it's not to say the Chinese don't have trouble, because if you look on the bottom panel, you can see that inflation in China and some social disconsent is significant. I saw an interesting discussion in one of the economic blogs about the nature of inflation which is very different country to country. In the U.S. most inflation is housing inflation and the market basket that's used to calculate the CPI has got a significant housing component to it. Outside of the U.S. particularly in the developing world, food by far is the largest part of the market basket. China is seeing a huge inflationary increase in the price of food. Gerard Cruz: That's not good inflation. Terry Dennison: That's not good inflation, it is socially disruptive inflation and it's very distorted inflation. Part of the reason that cereal prices and I don't mean like Kellogg's, things like wheat and corn have risen so dramatically is demand from China to feed pigs, because if a Chinese person gets some money they would like to eat pork and realistically that's putting tremendous upward pressure on the prices of food. The reality is the Chinese have money and many of the other developing countries particularly those that --- don't and what you're going to have is the Chinese and this sounds very negative, the Chinese will have their pork and the other people will starve. So we have a lot of issues there.

If we turn to page 5, GDP growth, a couple of modest adjustments, again the bar for first quarter which looks not great but it looks at least okay, really ought to be almost zero, it's 0.3% and the forecast which was 1.8 when we produced this book came in at 1.3. The upper right hand corner the purchasing managers index, again manufacturing has been the one big support of the economic activity in the U.S. We're seeing a decline in manufacturing that's getting closer to that break even line, interest rates have continued to fall, you can tell that it's not, the impact rather or the flight capital from Europe is significant, who is buying all these bonds and driving our interest rates. Now remember the bonds are just down graded, you typically don't see a security which has been declared to be less than perfectly credit worthy get the kinds of money come in that we've had, this is flight capital from Europe. People are getting out of the Euro, they're getting out of the concerns around that, the Swiss are having a terrible trouble with trying to keep their currency under control because all this money is flowing into Switzerland. The Swiss Frank for a while was at par with the Euro and they're trying to drive down the value of the Frank because it's making their exports prohibitively expensive. All this money flowing in and driving down our interest rates and again, one of the impacts of that is right now interest yields, real interest yields are very negative. Any income you get from a bond is less than the rate of inflation, so your real yield is negative. Again, the yield on the 10 year treasury touched below 2% last week and is now below the yield on the S&P 500. You make more money with yield buying stocks than you do buying bonds.

Page 6 looking at the unemployment, again unemployment has been high, stayed high, some very negative things, that bottom line, the red line is the employment to population ratio, this is the ratio of people that are in work, that has been steadily falling. A way that GDP is created is obviously people working, the fewer people that are in the labor force the lower GDP, it's just mathematic. Despite massive stimulus, very expensive stimulus, the reality is that unemployment has stayed very high and if you look at the so called U6 statistic which is people who have been unemployed or involuntarily working part time, it's about 16% nationally, they do publish that number for a few smaller markets. In Los Angeles county it's nearly 25% and Los Angeles county is not actually the worst hit in California because the housing crash really happened in Riverside and San Bernadino counties and the reality is there you must have U6 type unemployment well over 30%.

Doris Flores-Brooks: Can we just go back to that civilian unemployment rate, so you're saying 58% of the total population is employed. Terry Dennison: Yes. Doris Flores-Brooks: Compared to a high of about 63%, is this the lowest it's ever been from a ration point of view? Terry Dennison: Yes. Now part of that is the impact of the baby boomers, the leading edge of the baby boomers is now past 65, those people born in 1946 are 65 or older so this number is going to for demographic reasons come down, but demographics are part of our problem that we are aging too, not as rapidly as the Chinese are aging, but we're aging too. Doris Flores-Brooks: But it's been said that baby boomers like me are reconsidering retiring and continue to work. Terry Dennison: If they can work.

Page 7 is probably the scariest chart amongst a book full of scary charts. What we've done is look at every post World War II recession and we've looked at unemployment and we've normalized it so the zero on the horizontal axis, that is the rate of unemployment scaled so they're all at the same point at the peak for each one of these recessions. So what the line show and they're coded 1948-2007, that typically within 18 months of the peak unemployment before the recession were back up to that peak employment or actually above it, so the employment basically rebounds quite rapidly, in fact the steeper the fall, the quicker the rise in general, bear that in mind because we're going to talk about the impact of that. So realistically what you have is in most post World War II recessions if you go to 18 months after peak unemployment, pretty much all these lines have recovered back zero or above. Look at the last recession, the one we're in right now, no rebound at all, we're now 32 months past peak employment before the recession and the line hasn't even started to move up significantly. Doris Flores-Brooks: But the 2001 took a long time. Terry Dennison: Right, that's a very ominous thing because basically what we're saying is the last 2 recessions have not had that vigorous rebound. 2001 it took us a long time, 47 months to get back to that zero line, back to peak employment, we're not even making any progress with this recession. When I talk about structural unemployment people unable to move to a new job because their house is under water, they don't have skills that anybody will pay for, this is an extremely worrisome sign because every previous recession, the steeper the recession, the faster the rebound. With the revised numbers for the recession of 2007 where we may have lost 8% of GDP, the reality is we've had hardly any rebound at all.

Doris Flores-Brooks: Guam is so different and this is the world and I know this is because of how we're going to invest on the Retirement Fund, but for us living here what's our hope, because Guam doesn't get factored into all of these equations? Terry Dennison: Your economy is not as broad as the mainland U.S. Doris Flores-Brooks: And we're just primarily Government and military and a little bit of tourism. Terry Dennison: Yes, exactly. Doris Flores-Brooks: What scares me is the Government of Guam is a very heavy player, but the Government of Guam realistically cannot continue the way we are because we owe so much in tax refunds. We're not having the true discussions to address our deficit and our people can't go to the mainland because there's nothing there. Terry Dennison: The dynamics in small market, particularly an island both in the physical sense and in the economic sense are a lot different, but realistically if things improve in the U.S. to a proportion and either --- lagged by you, you'll do better. One of my clients, one of my few clients in Alaska, they've hardly had any recession. They've got oil, they've got a small population, they don't have a lot of social costs, they have a lot of things going for them. This particular chart when we saw this, the reaction was OMG.

If we turn to page 8 it doesn't get any better. Clearly one of the things that's holding back the economy is household deleveraging and it's not that households want more debt, they're not being given the opportunity to get more debt, in fact they're being driven to reduce their debt. Doris Flores-Brooks: But isn't that what as good consumers suppose to do, that's what the banks want us to do, you can't go to a bank if you owe money. Terry Dennison: That's what's called in economics, the paradox of thrift. Everybody calls thrift the virtue. Doris Flores-Brooks: Get out of debt, don't have debt, that's the mantra today, live within your means. Terry Dennison: The problem is that we spending again represent huge proportions of GDP growth. Now we've had our wallets slammed shut in many cases before by others, by credit agencies, by banks, but that upper left hand chart is interesting because if you look at that, this is total, household total liabilities is a percentage of nominal personal income, so it's basically how much you owe versus your income and for many, many years that number was about 60% and then all of a sudden we started to see that number go up and up and up and this has to do with using your houses and ATM and using your credit cards, if you weren't dead too long you could get credit cards and this number got up to 140% which is more than twice its historic level. If we assume and it's not necessarily that we have to get back to that historic level, but suppose we needed to, we've only lost, we've only reduced that relationship by a quarter, we still have 3 quarters of the deleveraging to go and when you drill down into the numbers, it's not that we have paid off a quarter of this, we've just defaulted on a quarter of it, we haven't paid off hardly any of it for real and that's reflected in the broader economy. Realistically we've moved the worthless securities out of the banks and into the Government, we haven't done anything to actually get rid of them, we've just moved them, they've been taken off the bank balance sheets and put on the Fed balance sheets, they're still there, the toxic junk is still there, so it's continuing to damage the economy.

The next chart on the upper right looks at something called potential versus actual GDP and this is a number that comes from the Congressional Budget Office that looks a the population and forecasts with what we would expect GDP to be, potential GDP. I've seen this chart going back to about 1840 and the line of that is very, very straight, all the way back to 1840 and basically the real GDP wiggles a little bit around that growth rate but it's very, very steady, you'll see the depression it dips and then it comes back, but even the depression on that long line is just a little blip, it's very unusual for it to not come back and actually exceed it for a while.

Look at that upper right hand chart, what we've now got is a huge gap between potential and real GDP and while the slope of the line, the angle of the line has started to look like the potential line, the difference between those is actual wealth we have probably have lost forever, we will never regain that wealth. That's a huge blip, you can see the blip in 2005 there was a bit of an upward blip, a little tiny blip, look at this huge downward blip, that is wealth, the area under these 2 lines, that area is wealth gone forever.

The lower left hand chart also in its own way scary. This is looking at the net worth for households and non-profits as a percentage of GDP. You can see that is actually fairly stable at 305% and then there are 2 blips. There's a blip in the late 1990's and a blip in 2006 and 2007, both of those represent asset bubbles. The first in dotcom stocks when we were all going to retire in 3 years because every stock you bought just went through the roof and in 2006 and 2007. Basically what that's saying is for us to feel wealthy, for us to have full employment, for us to feel like we're comfortable financially, we have to be at an unsustainable and basically evil environment. The last 2 times we felt rich we were in bad situations, unsustainable situations and you can see that net worth has now dropped dramatically and is only getting slowly back to that line and part of that is coming from the lower right hand chart which is personal consumption expenditures, this is how much money we spend and as we saw with the GDP gap and these 2 are obviously related, basically that is a huge gap and significantly here the slope of that line is lower. Doris Flores-Brooks: I'm sorry, what are the 2 lines? Terry Dennison: The red line is the term trend of personal consumption expenditure growth, now obviously we have less money to spend so it's fallen. The thing that's interesting is not only is there that gap, that gap is getting bigger, it's not like we have reduced our expenditures by X percent relative to our income, our income is going up but our expenditures are not going up. Now that means we're saving more money, we're paying down debts. Doris Flores-Brooks: Which is good. Terry Dennison: Which is good, but again the paradox of thrift. Everybody says thrift is good except if you want growth in the economy in which case thrift is actually bad, that's the paradox.

The green line is the new trend and basically we did the regression there, the trend isn't growing, it use to be a quarter a month, it would increase, now it's only growing 17 hundreds of 1%, so literally we're now spending less per dollar of income. Now we're being forced to do that, it's not that we don't like retail therapy, who doesn't. The reality is that in the same sense that we as a society made promises we can't keep, we've been spending at levels we can't sustain. Realistically this generation approximately around the table, more me than the Chairman or Paula (Blas), but more me have basically been on a 40 year binge with our children's credit cards, we are probably the richest generation there will ever be in terms of wealth because subsequent generations are going to have to pay the bills.

Page 9 is interesting because one of the outcomes of globalization and the availability of relatively lower cost labor in Asia and other developing worlds is worker's share of U.S. national income which was previously fairly stable has now dropped dramatically. Unions are ineffective, there's so much unemployment, wage increases are very scarce and the economy is growing. Now part of it is going to corporate profits, but the reality is if 70% of our economic growth is dependant on personal consumption and worker's share of U.S. national income is at an all time low, how are you going to get any growth.

Doris Flores-Brooks: What I keep on hearing is that the U.S. is starting to be a country of the differences between the haves and the have nots. Terry Dennison: It's growing, there's actually a statistic called Gini Coefficient and the Gini Coefficient is an interesting number because it measures how unequal incomes are. If you've got a Gini Coefficient, it's one way or the other, if it's zero one person has all the money and if the Gini Coefficient is one, everybody has exactly the same income, so it's a measure of inequities of income and ours is not huge but it has been growing. The rich have been getting richer at the expense of the lower and middle class, there's no question about it. Doris Flores-Brooks: And that was one of the reasons they said that the riots in the UK is because by that class of people who have been on welfare for decades and they finally just got fed up. Terry Dennison: It will happen here. Doris Flores-Brooks: It will happen here, that's why I've been reading that the U.S. may be next. It's scary that it happened in the UK because the UK is so much like the U.S.

Page 10, we've already referenced this. The food stamp program is good because we just can't have people starving, but it does give you a sense of just how difficult, you look at the lower left hand chart, the huge increase in the number of individuals receiving food stamps, right now the population of the U.S. is about 320 million, so about 1 in 7, 14.5% are getting food stamps and there are more people getting food stamps in the U.S. than live in Sudan, Argentina, Kenya, Poland, Canada, all those countries. Doris Flores-Brooks: $90 million pumped into Guam's economy and the saying is don't ever go to the stores on the first and second of the month. The U.S. can't sustain that either with the budget deficit and everything. Gerard Cruz: But what do you do, squeezing the budget too hard is not an answer. Terry Dennison: It's going to have to be, raise taxed on everybody because all of this wealth is pyramidal, the money is in the middle class. All of this, tax the rich, the rich don't have enough money, you're talking about $1.5 trillion dollars Doris Flores-Brooks: But they need to be taxed anyway. Terry Dennison: They have to tax everybody, you're going to see presumably more on the wealthy but they're going to have to get it into the middle class, it's 250,000 and up, there's no money there, when you're talking about this you're talking about having to raise taxes on everybody and of course that's going to depress the economy too. Raising taxes on lower, forget the arbitrary 250, but raising taxes on lower isn't that taking consumption money out of their hands at a higher relative level. Terry Dennison: Yes, this is the problem. We're running into a situation where our options are shrinking.

Doris Flores-Brooks: But a lot of them like in the Government of Guam if you look at the money we owe, we owe the money because of the earned income tax credit, the child, what this is, like the rest of us who pay have already paid, it's because of the way the tax structure is done what we're giving out is to people at the low end money that they didn't even put in. This is social redistribution of wealth because the people at the low end didn't even put in the 4,000 or the 3,000, they are getting in back in the form of tax wealth for a checked called income tax refund. Terry Dennison: Right and at some point here you're going to have major social unrest, you're going to have how Germany views Greece inside the U.S., you're going to have the people who are working and paying their mortgages being pretty resentful of people who aren't working and still living in their houses and not paying their mortgage.

Page 11 clearly the thing that has to happen, something has to give here and what's going to give is the value of the currency. The thing that's interesting, if you want to see proof of this is, what is the only currency you can't print, gold. The one currency that is very strong right now is the currency you can't print which is gold. It's a store of value, people see it as a store of value, that's why it's money, it's currency the Government can't print. Gerard Cruz: Who has the biggest supply now of gold? Terry Dennison: The U.S. does.

If we turn to page 12, lots of numbers on page 12, if you weren't worried before, I'll get you worried. Go down under Outlays to the one next to the total spending, interest. this is from the White House and the U.S. Census Bureau, mostly the White House. Basically what it's showing is what the U.S. budget is going to look like. First of all in terms of interest, they're forecasting that interest in 2011 will be $207 billion dollars, by fiscal year 2016, it will more than double to $562 billion. If we start to see interest rates rise because of inflation, this number will consume the entire disposable income of the Government. The Congressional Budget Office did a study that assumed that by 2015 interest rates on treasury securities will be back up to normal 5 and 6% levels. Gerard Cruz: By when? Terry Dennison: 2015. If that's the case the interest expense of the U.S. Government will begin to dwarf all of these other things put together. Look at interest compared to like general Government and transportation, we're already spending 5 times as much on interest as we are on transportation, you can see that number doubled, you can see it consume the entire Federal budget.

Look at gross public debt near the bottom, from 15,476 to over 20, nearly $21 billion dollars in 6 years because look at the deficit, now they're forecasting the deficit gets better from 1.6 trillion shrinking down to a mere 650 trillion but that's full of assumptions that are unrealistic.

Finally the personal debt owed per person, they're expecting the population to go from 313 million to 328 million but the debt owed per person is going to be up to $about 64,000. Doris Flores-Brooks: Is that the personal debt? Terry Dennison: No, that's the ratio, that's the total Government debt. Gerard Cruz: Deficit, that's an annual deficit right? Terry Dennison: Yes that's the annual deficit.

House prices are showing some improvement in certain pocket areas, but declining in others and it's partly due to difficulty in financing back to traditional old documentation requirements, requirements for down payments. If you look at the supply of new homes for sale or existing home inventory, there's a huge overhang and this does not include the shadow overhang, these are for example in an existing home there's a 9.3 month supply, new homes a 6.2 months supply, that doesn't really include the shadow, these are people who would like to sell their house but can't. So we're not going to see significant increases in housing prices for a real long time.

Doris Flores-Brooks: What did you say about the shadow again? Terry Dennison: Well, it doesn't look like the house overhang is as big as it really is, if you look at the numbers there near the bottom for existing house inventory for existing homes is 9.3 months supply based on sales and new homes is 6.2 months supply, the reality is there's a much greater supply because numbers of houses had been taken off the market because there's no creditable possibility of selling them in the present circumstances.

Page 15 looking at what's going on in the markets where previously we saw nothing but green numbers, we're now starting to see some negative numbers, although second quarter was pretty much zero for all the different categories, but it's begin to pull down the year to date numbers and actually the 3 year returns are generally below long term assumptions for equity returns, long term assumptions are in the low 8's, we're not seeing much there, they're not even achieving over the last 3 years the sorts of numbers you would assume they would produce. Down at the bottom we're still in more of a growth market than a value market and we've started to see small cap stocks out perform versus large cap stocks.

Looking at the performance of the U.S. equity markets on page 16, now we're looking here at data ending 6/30 so these numbers while they don't look fabulous are now much, much worse if you look at them for 3rd quarter, but even at that you can see that small cap for the 2nd quarter basically under performed across the board. The annual numbers, the dark blue bars are still very strong, but we're starting to see some decay here.

(Pages) 17, 18 and 19 are interesting because you get a sense of what's running. In the top 2 bullets on each of these pages we show one of the strongest performing sectors and the weakest performing sectors. For all of them the strongest performing sectors are health care, consumer staples and utilities. Doris Flores-Brooks: What are consumer staples? Terry Dennison: Food, as opposed to consumer discretionary. When you are feeling threatened, what do you cut out, going to the movies or eating, going to gambling casinos or eating? Obviously the financials did poorly, energies did poorly, information technology a typical growth sector, across the board we're seeing sectors that are defensive, health care, generally you spend money to take care of yourself if you have money, consumer staples, you eat, you don't spend money on luxuries, if you do, spend money on staples and utilities, you pay your electric bill and the thing that's interesting is you see it consistently across the board.

Turning to page 20, in the developed world still in a growth stock environment. Just to remind everybody the difference between growth and value internationally is huge, you can see how infrequently growth stocks out perform and by relatively small amounts and for fairly brief periods of time. This recent period is a little unusual, it's much longer than the typical period for growth stock out performance. Typically value stocks out perform by much larger amounts almost consistently. Looking at EAFE versus emerging markets, emerging markets continue to out perform, they're not doing great, they're just doing better than the developed world. If we looked at the developed markets, now obviously these are in dollar terms with the dollar down a couple of percent, most of these local markets basically lost but because you were holding non-dollar denominated securities you benefited from that, so the developed markets are slowing down. We just got and this is another thing that's now front in mind in Europe, very poor growth number from Germany, 2nd quarter GDP growth in Germany was one tenth of 1%, so the paymaster of Europe, the one country able to bail out the Euro is now slipping into recession itself. Again, we're running out of options, there's nobody left to pay.

Gerard Cruz: So what do you do, what if the world just defaults? Terry Dennison: Well, I sent you an article from Der Spiegel, I sent it for distribution at the last meeting. Der Spiegel which is a German newspaper, I read European newspapers every morning and most of them have English language because their economics coverage is much better, the economics coverage in the UK and mainland are much better than the U.S., the U.S just talks about which star is sleeping with which other star, here they really talk about what matters. There was a very interesting article which I thought I sent somebody, I will resend it and the title of the article is, "Is the World Going Bankrupt?" the whole world and basically it's very hard, it's 5 pages long, it goes into detail on what's going on in the U.S., what's going on in Asia, what's going on in Europe and basically it comes to conclusion that we're a hopeless mess that's insolvable, the world is insolvable. Doris Flores-Brooks: But what's the solution? Terry Dennison: Why does there have to be one? There's no law of nature that says there has to be an answer. There is a mess you can get yourself into that you can't get out of. Doris Flores-Brooks: What scares me is that the U.S. will be like the Roman Empire that fell, England that fell, that's the part if I had to echo any concern is that the U.S. will be the next country that falls and it will be China the re-emergence of China again. Terry Dennison: China has its own issues. Doris Flores-Brooks: But how likely because there is always the beginning and the fall, every country does fall, if history repeats itself, it's going to happen.

So the question is, when? Terry Dennison: It's not going to happen this month, it's not going to happen this year, it may not happen this decade. Doris Flores-Brooks: That's still too little time, we need at least 50 years. Terry Dennison: We don't have 50 years. I'm going to resend this article, the implications are frightening, the problem is it's very hard to knock a hole in the argument. The implications of this article the whole world is going bankrupt are very worrisome, the problem is it's hard to knock a hole in their argument, their argument has internal logic to it, it makes sense. We have created a debt mountain that going to strangle everything. Gerard Cruz: Unless we do something pretty drastic. Terry Dennison: Unless we do something pretty drastic and again, I don't want to sound gloom but the reality is it is very serious and we need to take some serious steps, the longer we just kick the can down the road.. The advantage we have in the U.S. is we're going to see it collapse Europe before it's out time and maybe we learn a lesson, Europe is ahead of us. Doris Flores-Brooks: How did Europe get there so quickly because this thing didn't happen over night but it seems like we've just been talking about it over night. The U.S. had huge growth and productivity throughout the 90's and 2000's to help us move on, Europe didn't have that same luxury, I think they're a little more, their work ethic, except Germany is a little different. Terry Dennison: Realistically for 10 years Germany and this is the employers and the employees because the unions are a very powerful management of German companies said, we're going to restrain wage growth, we're going to pay ourselves less and become more profitable and more stronger. For a given job in Germany the pay might be 50,000 Euros a year, in Spain or Greece it's 80,000 Euros a year, so they produce less and get paid more, they take vacations, they've got longer guaranteed employment, they retire earlier, the reality is you can't pay for that. Gerard Cruz: And Europe is a little different, when they try to create the EU and model it after the U.S. and it wasn't the United States, they didn't have the same hold that the Federal Government of the U.S. has that the EU tried to emulate. Terry Dennison: Well there have been studies that basically Virginia subsidizes ---, there are all sorts of studies, but it doesn't matter because we're all using the same currency, there's free movement of labor and capital. And there's the glue at the Federal Government level that holds everyone together that the EU just doesn't have. They created laws that said, okay you have this much debt you cannot become part of EU, but then they cheated and a lot of these countries like Greece... Terry Dennison: They wanted them in, they wanted them to be in, if somebody will allow you to use their credit rating so you can spend lots of money to have a great life there's going to be a tendency to do that. You know if you have a credit score of 840 and you let somebody use it to get a loan you're credit score will go bad. The bargain of the Euro, the central bargain of the Euro was in exchange for German interest rates, these countries that had German productivity, they enjoyed the interest rates but they're not anything like the German productivity la dolce vita maintained its hold and they just borrowed and borrowed and borrowed and then all of a sudden the world woke up and said, they have no possibility of being able to pay this off and realistically the level of austerity that is going to be necessary to make that work will cause revolutions, that's not going to happen. Gerard Cruz: It did in Greece and in Paris where they wanted to raise the retirement age to 62, it caused riots, that was just last year. Terry Dennison: And that's why it's not easy.

I think the U.S has the best chance, I think the U.S. has a better chance than China because there are some strains in China with demographics, huge inequities. Doris Flores-Brooks: I don't know after this last battle and the intransients of both the Republicans and the Democrats and I've lost confidence. Terry Dennison: Well that's why I think the 2012 election is going to be really interesting because I think it's going to be very surprising what happens. I think we might see a very interesting election. Gerard Cruz: But we also have to admit there was nothing like what we saw in 2008 and 2009 moving into this administration, it was a pretty bad hand. Terry Dennison: I don't disagree, it was a huge mess which has now turned into a bigger mess, I'm not sure you could have solved it. If you read some of these articles that have been published in Vanity Fair, which doesn't sound like the most logical place for interesting financial articles that you ever see, but Vanity Fair has been publishing fascinating articles about what went on during the Lehman weekend and so forth and I've said before I've seen nothing that is causing me to change my mind, it would be like the Cuban missile crisis, we had no idea how close we came to the end of the world. Literally you had people knowing that if they didn't come up with a solution before the markets opened on Monday, it would be the end of the world and they did stuff that they weren't even sure it was legal, but it was the only way to get something solved. The reality is it was a horrible messy situation but we'll have to see.

Continuing on page 21 we talked about the fact that adjusted for changes in currency the foreign stock markets are not really producing positive returns. EAFE in local currency terms actually lost half a percent. Over in the far right emerging markets are doing slightly better but not great.

Page 22 focuses on emerging markets, the thing that's interesting is the BRICK countries, which again is Brazil, China, India and Russia for the quarter were laggered performers and China the enormous engine of growth, it's very important to differentiate between how the economy is doing and how the markets are doing. The economy continues to do well, but the markets are not. Literally for the year to date up 1.1%, down 1.8% for the quarter and China really has not been a significant producer of positive returns now for a number of quarters in a row. Doris Flores-Brooks: And that's due to? Terry Dennison: To some degree valuations, stocks got over valued because everybody thought they'd go to the moon and again, no tree grows to the sky.

The last page I'm going to talk about is page 23, fixed income. Obviously with yields continuing to fall, well actually they have now on occasion fallen below zero, last week there was so much money flowing in to the treasury market that Mellan Bank said we won't take any more deposits unless you pay us 13 basis points a year. So basically the banks didn't pay you, you paid the bank to deposit money. We'll see again very good returns when we look at 3rd quarter because treasuries have fallen even more, again they can't really fall below zero, but I've been saying for 12 months or 4 quarters now, they can't keep falling like this and they keep falling like this, that's not a good sign.

The rest of it I think we can skip here, let's go to the DC Plan.
(End of discussion on economic & capital market environment)

DC Plan Performance

Terry Dennison: Go to page 29 under tab 2. Some manager updates, BlackRock is purchasing the remaining Bank of America shares or its shares that Bank of America owns. Bank of America is not doing very well, their stock is the leading decliner in the S&P 500. In addition to a plethora of law suits regarding sub-prime mortgages, banks in general have suffered severely because of concerns about their exposure to European debt, so BlackRock I'm sure were pretty happy to get the $2.5 million dollars. Succession plans for DFA, nothing that's really a concern, Hartford has made a few team changes, this is your fixed income manager, we still think highly of them, we think they're strong.

Looking at asset allocation on page 40 and then 42 and then 44 for the various plans, obviously for the combined plans because of the 401(a) Plan very high allocations to Lifestyle funds, which again is really the most attractive investment for the typical participant. Doris Flores-Brooks: And you believe that still? Terry Dennison: Because at least there is a professional making the asset allocation decision. The problem with and we haven't actually seen, we look at the flows of money in and out of 401(k) Plans and basically participants have not panicked, we have not seen a huge flow of money out of equities, either they're just stunned which is possible, traumatized, but they seem to be standing pat. Doris Flores-Brooks: Which is what you want them to do. Terry Dennison: Which is what you want them to do. The other problem with trying to time the market to get out and try to get back in you have to make 2 decisions, you have to know when to get out and when to get back in and actually the second one is the harder one to bank.

401(a) Plan nearly 70%, this of course comes of the mapping exercise we did with the default fund. Smaller allocation to the 457, this is entirely voluntarily, but it's still more than a third of the plan invested in Lifecycle funds. This is a good indicator of plan health for the participator perspective, so we're pleased to see that.

In terms of performance on page 46, frankly pretty good looking numbers, particularly down in the active funds below the Lifestyle funds. Generally green checks across the board. We'll get into a little bit of detail on the funds here in a minute. One of the laggers is the Hartford Total Return Bond Fund, obviously it's been a difficult environment for fixed income managers, it continues to lag, we'll look at the numbers in specifics. At some point we might want to take a look at replacing that fund because in a difficult environment, having the somewhat safe fund under perform might be a bit of an issue. We're not ready to make a recommendation to that effect right now. Gerard Cruz: Is it a significant underperformance? Terry Dennison: It's not significant that's the reason, we've held on to not making that recommendation. It has under performed; let's turn to the actual numbers.

If you turn to page 48, the Hartford Total Return Bond Fund, incidentally the Galliard stable value fund is doing just fine, but if we look at it, it's under performed the benchmark for periods other than one year and it's kind of in the middle of the 3rd quartile, it's not great, it's not an emergency which is what I said, we're not ready to do anything. Gerard Cruz: They've always been kind of in the middle of the road. Terry Dennison: They've always been kind of in the middle of the road, they're not terrible, there are options that are potentially better. The TIPS fund continues to lag the benchmark a bit, it's interesting for 3 years and 5 years the performance was outstanding, in this environment it's not proven quite as strong, but again not a real issue. The international fixed fund is one that really kind of fell out of bed, where previously the performance was hugely above the benchmark for 3 years 8.7 versus the benchmark of -4.5, that's a huge value added. Five years positive 7.2 versus the benchmark of 4.4, both of these were first quartile or top of second quartile. Recently they've had a bit more of an issue on a relative basis, nothing that we think requires action at this point, it drawn relatively little money only half of 1% of the portfolio.

The really good story and it's interesting because if you look at the summary again back on page 46, it looks like, oh dear, the BlackRock Lifecycle funds are doing poorly. Well they were, but let's take a look at how the world has changed, remember because our policy says we look at this on a 3 year and 5 year basis, you dig a hole and it's going to take you some time to get out of that hole, but look at the progress they've made for one year numbers. The current portfolio which is like a 2010 fund where previously it was lagging the index, but still slightly above the median, look at it for the last year, year to date and 3 months, right up into the middle top of the first quartile solid numbers ahead of the benchmark, same thing for 2020 improvement from mediocre to really excellent, 2030 mediocre to excellent, 2040 mediocre to stellar, 2050 mediocre to top of the charts. So it's going to be a bit of a time, we'll have to see if they can continue doing this, obviously the market environment is different now than it was in 2nd quarter. A lot of public funds would be interested in seeing what yours turned out to be. A lot of DB Plans were up over 20% for the year ended 6/30.

The Maxim funds moderate improvement, these are the new funds that have been added that have a lifetime income asset to them, they're basically doing fine, they have almost no money in them, it's curious that until Rosie put her $173,000 in them there was peanuts in any of them. That's interesting because that's almost got to be one person. Doris Flores-Brooks: Which on is this? Terry Dennison: Well if you look on page 50 the SecureFoundation Fund, the 2015 fund has $1,700 dollars in it, the 2035 had $1,900 dollars in it, the 2045 had $2,500 dollars in it and the there's a grand sum of $743 in the 2055 fund. Doris Flores-Brooks: Are these in dollars? Terry Dennison: Those are in dollars. There's $173,000 dollars and I would say statistically that's probably one person. Somebody just said, okay I see a lifetime income option, I'm going to drop my entire balance into that.

Getting to page 51 these are the more separate or more individual type funds, basically the performance is pretty darn good. Index funds continue to track perfectly, just almost creepy perfect. Vanguard Windsor II which is one that we have had some issues with going back a bit has now have come back very strongly versus the index, they were 90 basis points ahead of the index, made money instead of losing money and basically they are now first or 2nd quartile across the board. The AMCAP Fund and again our concern here continues to be the size of the fund and the unlikelihood of continued strong performance mainly because of its size, basically it goes up and down, sort of median, sort of benchmark, not a big deal. The Franklin Small-Mid Cap Growth Fund trending down a little bit, lost money, 60 basis points, the index was up 40 basis points, coming down now out of 2nd quartile drifting for shorter periods into the 3rd or 4th quartile. The Baron fund which was one for those of you who have been here for a long time, we had some issues long ago about has just continued to knock the lights out, on a year basis up 41% with the benchmark up 37.5%, 22nd percentile, excellent, strong performance for all of these periods not just on a relative basis but against its benchmark also. Pretty much a similar story with Champlain Small Company Fund again some of the performance before you had it was outstanding but the performance continues to be really very strong, first quartile for year to date and for the quarter.

Turning to the international funds, Thornburg beginning to slip a little bit, again extremely strong for 5 years, better than 3 times the performance of the index but trending down more toward looking index like and about median performance. DFA while the returns have not been as strong, still a strong performer relative to the benchmark particularly 3 years and 5 years with just eye popping numbers.

So no recommendations, look pretty good, keeping an eye on the Hartford Fund.

Wilfred Leon Guerrero: I have a question, 401(a) is mandatory, right? Terry Dennison: Yes. Wilfred Leon Guerrero: They have to go to Great West, but 457 as I understand some department agencies, Government of Guam entities have options whether they can go to Great West or somebody else, how is that? Gerard Cruz: UOG and GCC, they were given the ability to do it. Doris Flores-Brooks: When I was at UOG, I had a 403(b), it's called a 403(b), not a 457 because 403(b) is for educators. Terry Dennison: Not for profits. Doris Flores-Brooks: They were allowed because I do have a 403(b). Gerard Cruz: GCC also. Paula Blas: Yes. GCC doesn't have a 457, they have a 403(b). Gerard Cruz: Yes. Paula Blas: So the 457 Plan is voluntary, it's not a mandatory plan. Doris Flores-Brooks: But his issue is that they can go to anybody as opposed to going to Great West. Paula Blas: The 403(b) is totally different from the 457 and it's not a mandatory contribution. Doris Flores-Brooks: But his point is that at the university, because when I opened up my 403(b), it was with Vanguard. Paula Blas: Right, that's different from the 457 because you can actually max out on both, the 403(b) and the 457, your contributions. Wilfred Leon Guerrero: The question is how come you work for the University of Guam, you have options that aren't available with the Department of Administration employees. Paul Blas: Because you're not an educator. Wilfred Leon Guerrero: How about the hospital? Paula Blas: I think even the hospital.

Wilfred Leon Guerrero: What is the 457? Paula Blas: The 457 is just deferred compensation. Doris Flores-Brooks: But that you have to go to Great West. Paula Blas: Yes, but there is no one else offering a 457 Plan. Rosalie Bordallo: See we bid out the plan administration for that 457, we had put out an RFP and Great West won it. Paula Blas: Government of Guam employees it's voluntary for them, the 457 Plan. Wilfred Leon Guerrero: Right, but if they work for the Department of Administration and they want to participate in a 457, they have to go to Great West. Rosalie Bordallo: Correct. Wilfred Leon Guerrero: If you tell me the contract is such that they have to go there then that's the answer. Paula Blas: It's a Government sponsored plan, so if it is Government sponsored and you as an individual want to defer your compensation under the 457 then you have to go through Great West. Wilfred Leon Guerrero: But what about the people at the University of Guam and the Guam Memorial Hospital? Paula Blas: They don't have a 457 Plan, they have a 403(b) Plan. Doris Flores-Brooks: But his point is how come the 403(b) Plan is going elsewhere. Paula Blas: Government of Guam as a whole wasn't the one that offered it.

Wilfred Leon Guerrero: The Government employees are being treated differently, that's the issue, why? Doris Flores-Brooks: Your question is, I was originally in a Merrill Lynch and then I changed to Vanguard, a 403(b), I did do that. Paula Blas: I can't contribute to a 403(b), you have to be an educator or work... Terry Dennison: You have to work not for profit. Paula Blas: So the hospital, UOG... Wilfred Leon Guerrero: Okay, we're talking about regular employees, not educators or what have you and that was the issue that was brought to me. Doris Flores-Brooks: What is the situation that the employee is asking? Wilfred Leon Guerrero: Asia Pacific people are asking how come Government of Guam employees, some Government of Guam employees, they have to go to Great West and others have options. Antolina Leon Guerrero: If you're through the Government sponsored plan, the 457 and you are a Government employee and you're going through the Government sponsored plan, you have no choice but to go to Great West. Doris Flores-Brooks: And that's his point, why can't they go to Asia Pacific? Antolina Leon Guerrero: Because we did an RFP and that's who won. Rosalie Bordallo: That's the provider who was selected. Paula Blas: It's no different from offering a group life insurance. Wilfred Leon Guerrero: Okay so the contract is such that it is set up that way. Okay, then that's the answer.

Diana Bernardo: I just wanted to make a comment on the American Funds, it says Mercer presented the search in March and a decision to replace has not been made, but really a decision was made at the May 2011 meeting. At the main meeting I believe the Board made a decision to make a replacement and the replacement was Nuveen, so the decision was

made in May, I think it's not effective until July, I just wanted to note that. Terry Dennison: Okay, got it. (end of tape 1)
(End of DC Plan performance discussion)

<u>11:00am-12:00pm Bank of Guam</u>

(start of tape 2)
Jennifer Sanchez: Good morning everyone and thank you for inviting us here today. I am Jennifer Sanchez, I am the Hagatna branch manager, along with me, everyone knows Patricia Salas and Lesley Leon Guerrero, she is actually our new director of customer service.

Today I'm just going to go over briefly basically the banking services agreement that's between the Retirement Fund and the Bank of Guam. Just a brief background, of course the request for proposal that was the No. GGRF-064-08, the Bank of Guam did submit our proposal to you on the 30th of October 2008 and it was signed by the bank or accepted by Government of Guam Retirement Fund the 4th of June 2009, to date we haven't had any changes or amendments to the current contract and also to date we service 10 deposit accounts which comprise of 3 time deposit open accounts which are interest bearing savings accounts , one non interest bearing checking account, 6 interest bearing checking accounts and 1 safe deposit box. Wilfred Leon Guerrero: What is the safe deposit box for? Paula Blas: For our back up tapes for our system. Jennifer Sanchez: So the safe deposit box currently you have is 10x10x22.

Right now our scope of work basically outlines the establishment and maintenance of the Retirement Fund's depository and operating accounts. Online banking services which is our cash management services, direct deposits for the retirees, check storages which we do for up to 90 days, sweep accounts that are available to you, which are basically from account to account, our Bank of Guam accounts internally, of course all fees are waived, any errors and adjustments are reported timely and any questions that we have on adjustments that are made we also ensure that we report them timely, our cut off deposit times of course for business days are 5 o'clock in any branch location and if they are online of course 3 o'clock, we also offer services for any lost or stolen checks and we ensure that we also remain competitive.

So basically what you can see is outlined is our online banking services, normally per account that we do charge would $10 dollars per account per month, however of course it's waived and we also outlined a list of basically all the features that are available to the Retirement Fund, they're normal charges and of course everything is waived. Rosalie Bordallo: Can I ask a question, looking at this supposedly everything is suppose to be free, why do we get charged this really nominal amount in some of our accounts, it's like $.150 or 60 cents? Jennifer Sanchez: There should be no charges. Do you know what account? Rosalie Bordallo: Our pension payroll account. Jennifer Sanchez: Do you know if it's ever been addressed to anybody? Rosalie Bordallo: No, I don't think so. Jennifer Sanchez: So naturally if you do see service charges of any nature, please let us know. As in the agreement, we don't charge all the fees are actually waived.

Wilfred Leon Guerrero: What about the checks, I remember one time you guys were talking about a huge amount of money to print checks? Rosalie Bordallo: That's an operational cost from the Fund's part, not the bank. Paula Blas: When we opened up an account with the bank we actually had to order new checks with the new account numbers. Wilfred Leon

Guerrero: How much is that? Rosalie Bordallo: It depends on the amount we order. We usually order 10,000 checks at a time so that runs us about $2,500 for the printing of those checks. Antolina Leon Guerrero: How often? Rosalie Bordallo: Every 6 months. Jennifer Sanchez: Do you order from a local vendor? Rosalie Bordallo: American Printing. Wilfred Leon Guerrero: That amount is strictly for the printing of the checks? Rosalie Bordallo: Right. Paula Blas: It's like ordering personal blank checks, your own checks, you have a fee for your checks. This is our requirement, we need at least 6 months supply at a time so we order in the thousands. Rosalie Bordallo: Because at a minimum we run 900 Medicare checks each month. Jennifer Sanchez: I think your volume too for just debits alone in all your accounts put together a month is about 4,000 items which is also inclusive of the ACH.

Wilfred Leon Guerrero: What is our deposit? Jennifer Sanchez: You average upwards of about $7.5 million a month. Paula Blas: Our payroll is $7 million bi-monthly. Wilfred Leon Guerrero: So it's $15 million a month. Jennifer Sanchez: But you also pay out.

We also offer online banking which you guys do use for your direct deposits. I just wanted to go over it briefly, it's basically an electronic payroll data that you guys do input, our hours are of course normal banking hours, 8-5 for any services used that you have and then cut off times for the initiation of ACH transactions depend on on-island and off-island or on Bank of Guam which is on-island accounts and then all the other banks basically fall under off-island accounts and of course with these for example if it is a Hawaii bank it would need to be uploaded 2 days prior to the effective date before 3 o'clock and then any Bank of Guam would need to be uploaded 1 business day before 3 o'clock. We do have back up plans in the event there is a typhoon or a natural disaster of any sort which would prohibit operations which is included in our business continuity plan of course, that is also outlined in our proposal to you. We do have generators at all our branches and in addition to that, we do back up our data at off-site locations, not of course at the bank and then on a monthly basis also we do warehouse other data at of or San Francisco branch.

Notifications of any changes or problems on your EFT files or ACH files are of course are basically addressed upon notification from you and any errors and adjustments again are basically handled accordingly.

Lesley (Leon Guerrero) again is actually our newest member on board, she is our Director of Customer Service so besides Joylnn (Cruz) Lesley (Leon Guerrero) oversees the whole department.

Rosalie Bordallo: What is your normal time upon notification of an error in one of the accounts to basically fix it? Jennifer Sanchez: It depends on the error. Rosalie Bordallo: Okay what is the longest? Jennifer Sanchez: It should be immediate, the response time and normally adjustments are made within 24 hours. Rosalie Bordallo: What happens if adjustments aren't made within 2 weeks? We do follow up and still the adjustment never gets done. Jennifer Sanchez: Is it like checks clearing for the wrong amount, are they normally items like that? Rosalie Bordallo: Yes, those kind of items. Jennifer Sanchez: Normally if it's clearing off of another bank, let's just say for example the payee cashed it or deposited it at First Hawaiian Bank and it was encoded incorrectly and the sent basically the wrong amount to us we have to go back to the bank and adjust or if it's within a certain threshold and we basically should correct it right away and take care of it. Rosalie Bordallo: Okay, what is your threshold that you would just clear it immediately, $1, $2? Jennifer Sanchez: I think even more than that. I don't want to give you a dollar amount and it's incorrect, but normally I've seen even $5 or $10, those discrepancies should be... We send emails to you and some of those are still sitting. Jennifer Sanchez: Do you think you can give us a consolidated list and we'll follow up on those. Antolina Leon Guerrero: Have you gotten responses that they're working on it. Rosalie Bordallo: We've gotten responses that they're working on it, but it's been like months. Jennifer Sanchez: Do you get responses back from us voluntarily or do you have to constantly follow up? Rosalie Bordallo: We follow up. Jennifer Sanchez: Okay, these are things we need to know.

Wilfred Leon Guerrero: You have benefit checks that are due out on the 1st and the 15th of each month, when do you get those deposits to cover those checks? Jennifer Sanchez: The money used to pay out whoever your recipients are? Wilfred Leon Guerrero: Right. How soon do you get them? Jennifer Sanchez: It depends on... He's asking how soon do we get the... Paula Blas: We actually move the money into the accounts before we do EFT's. Wilfred Leon Guerrero: How many days? Rosalie Bordallo: On the same day that the money is going to be moved is the same day that money is going to be transferred so it could be a matter of 10 minutes that I'm transferring from the TDOA and then the upload will occur right after that. Wilfred Leon Guerrero: I'm talking about like, I receive those pension checks, the deposit is made sometimes quite a bit early, that's what I want to know. Gerard Cruz: Your direct deposit comes in early, is that what you're saying? Wilfred Leon Guerrero: Yes. Gerard Cruz: It depends on when they run the file, if the 15th for example is on a Sunday, then chances are they'll run the file on Thursday and you'll get paid by Friday. Patricia Salas: If it's a Bank of Guam to Bank of Guam, often times you'll get your deposit the day before payday. Jennifer Sanchez: Like the wee hours or the night before. Diana Bernardo: Weekends and holidays affect the timing of the receipt.

Patricia Salas: Has it been a problem or are you just curious? Wilfred Leon Guerrero: Well as somebody receiving the check I appreciate having it in my checking account, my pension check several days before the 15th or the 1st. Jennifer Sanchez: We don't set that, whoever sends the files sets that. Antolina Leon Guerrero: You want it before the 1st and the 15th? Wilfred Leon Guerrero: As somebody receiving it, but as a Trustee looking at this our infusing the bank with cash... Gerard Cruz: No, you're not. The cash is in the bank regardless, the cash is there, it's just moving it from an interest bearing account to the operating account. Rosalie Bordallo: But a lot of it is depending on when the pay date actually occurs, if payday, if the 15th is on a Saturday or Sunday or holiday, we have to upload on the Friday, the 13th. If you're Bank of Guam you're going to get it on the 13th. Gerard Cruz: But what he's saying is as a Trustee... Rosalie Bordallo: As a Trustee he's seeing the money go out to early right, but what I'm saying I don't have control on that because if I have to pay the retirees on, if the 15th falls on a Saturday, Sunday or there's a holiday, I have to do the upload on Friday, the 13th and you see there's 2 days there. I can't do it on Saturday and I can't do it on Sunday, but they have to be paid by the 15th. Gerard Cruz: No, but you can effect a date an ACH day to pay on Monday. Antolina Leon Guerrero: But we won't do that, that's what they're saying they can't do that. Paula Blas: By law I have to pay them on the 15th and at the end of every month, so if the 15th falls on a weekend, we give them the benefit by giving it to the Friday before. Gerard Cruz: I don't disagree with the method, I'm just trying to explain to the Chairman the reason why he's getting paid a couple of days before the 15th if it's on a Saturday or a Sunday or a holiday, but to answer your question, the money is at the bank.

Paula Blas: If it's an off-island bank we actually upload it 2 days before, if payday is Friday we upload it Thursday, but we don't do it until 3 o'clock on Thursday to the bank or right before. Wilfred Leon Guerrero: My checking account is Bank of Hawaii and I see it early which means the Bank of Guam, it was already uploaded to the Bank of Guam. Rosalie Bordallo: But First Hawaiian Bank is considered an off-island bank. Wilfred Leon Guerrero: It's not First Hawaiian, it's Bank of Hawaii. Paula Blas: Same thing. Rosalie Bordallo: Any other bank than a local bank we need to give it 2 days in advance, now Bank of Guam is very efficient and does it immediately that same day and you get it the next day, that's beyond my control, but the bank dictates that off-island banks have to go out 2 days prior to when you want them to receive it. Antolina Leon Guerrero: Just to ensure that it gets there on time but sometimes they're quicker than 2 days and that's why you get it early. Paula Blas: For the minimal interest that I lose on TDOA by moving it over versus the number of people that are going to complain because they didn't get their paycheck, it's worth it. Rosalie Bordallo: And it's not the 15th and they'll call on the 14th and say, where's my money?

Paula Blas: What is the interest on the TDOA: Jennifer Sanchez: .125. Joe T. San Agustin: So that's what you're losing. Gerard Cruz: But it's .125 per year, APY. Jennifer Cruz: What happens is, the funds are still there, it sits there but it's on hold. Gerard Cruz: But you're still earning when it's on hold. Jennifer Sanchez: Right, so it keeps a reserve in there. Gerard Cruz: So when the receiving bank says they receive it and post it, they come and clear it and that's when it's debited. Wilfred Leon Guerrero: So it's only when the actual transfer takes place. Patricia Salas: But it's a valid concern because you're worried about how much you could be earning, but the reality is you're still earning the interest that you can until we sweep. Wilfred Leon Guerrero: Okay.

Rosalie Bordallo: So on the problem of errors and adjustments, we have this problem that you guys tend to use only the pension payroll account, the oldest account and when we have a reject like a return check or you guys go against the pension payroll account when the check originated from another account... Jennifer Sanchez: So we also need to look at what your designated charge bank account is, because that is specified by... Rosalie Bordallo: I mean, I don't understand why I only have one designated charge bank account, I need multiple charge bank accounts. Jennifer Sanchez: It really should be coming from where the check originated from, but we need to go back and see if you actually requested for one designated charge bank account. Rosalie Bordallo: I don't think we've ever requested for that, that's just what you guys informed us it had to be, but you can check. Jennifer Sanchez: Because normally it should be what comes out of your, example, payroll account, it should charge back against it, operations, the same. Rosalie Bordallo: Right, but see we're seeing that problem of ACH that rejects from another account... Jennifer Sanchez: Only one charge bank account, okay. Rosalie Bordallo: We need to have that fixed where it Jennifer Sanchez: Comes out of whatever account it's affecting. Rosalie Bordallo: Right.

Jennifer Sanchez: Any other? Rosalie Bordallo: Your online banking, have you ever though of making it a little bit more user friendly with the downloads. We're actually changing... there is a process... Rosalie Bordallo: You're going to have Excel formats. Jennifer Sanchez: Yes. Gerard Cruz: Are you getting it from a vendor? Jennifer Sanchez: Yes, we actually have one right now, but we're getting it from another vendor. Patricia Salas: It's going to be a lot more user friendly. Rosalie Bordallo: It's not too bad the actual online, it's the downloading of data. Patricia Salas: The new one will be a lot better, a lot more user friendly. Rosalie Bordallo: That's it for me, I'm good.

Jennifer Sanchez: And of course our fee schedule that was also outlined for you, all the accounts are waived. Can you let me know which accounts there were charges at? Rosalie

Bordallo: Pension payroll which I guess was the one designated as the charge account. Diana Bernardo: The one item you were going to look into is the missing check numbers and the statements? Jennifer Sanchez: Yes and I know I did ask customer service to put together which ones are actually, because I know you guys fax over requests right? Rosalie Bordallo: Right. Gerard Cruz: With missing check numbers on the statements? Rosalie Bordallo: Yes. Diana Bernardo: Operations was an issue because there are a lot of checks with the same dollar amount, we can't see which ones are clearing. Jennifer Sanchez: So you don't know which check it is.

So this is just an example of basically what the Retirement Fund predominantly processes for this certain period, you basically just gone back and took what has been done. So for the year on Cashman there's been 19 stop payment requests at $10 dollars, all these fees break down to just the time period indicated, so with your sent files, on average you have about 16,200 and at 10 cents an item it's pretty much about $1,620 per month that you are saving and of course bi-annually right about under $10,000 just for your ACH files. For your deposit accounts, like I mentioned earlier, there's about roughly 4,000 plus debits that come out of the account, that's not just paper checks that come out but also I've seen debits that you actually do from account to account so those are also included at 10 cents per debit and then at 15 cents per credit so for 6 months you actually averaged a savings of about $2,500 dollars.

Also currently our Trust services and our BG Wealth Management services are available, I know right now the Fund doesn't use any of our services, we just wanted to put it out there for you for future reference. Just for reference, right now our wealth management department partners up with Money Concepts Capital Corp., they actually have a world wide alliance with other financial planning centers around the world.

We did want to advise you that we are coming out with a new online banking Cashman services account, our vendor right now is actually S1 and we're looking at probably first or second part of next year, but prior to that we are going to have a test phase and we are going to solicit users. Gerard Cruz: For the online banking? Jennifer Sanchez: Correct, just for the test group so we are going to solicit users from Retirement Fund because you actively use the online system.

Also we are looking at remote deposit capture. Gerard Cruz: Weren't you doing that before? We haven't rolled it out yet. This is where you're actually able to scan your deposits at your location. Gerard Cruz: Who are going to be your beta testers for that or are you just going to roll it out? Jennifer Sanchez: There's going to be beta testers. Patricia Salas: They are our just largest users. Jennifer Sanchez: So that's coming soon. Gerard Cruz: And you're going to receive it automatically or are you going to get a file once a day? Jennifer Sanchez: You're actually going to transmit to us once you're done, you're going to settle, balance, transmit and then we're going to post. Gerard Cruz: Through batch like once a day and then you just post, immediate posting? Jennifer Sanchez: Correct. Gerard Cruz: How do you verify that they don't come in the next day with the paper checks? Patricia Salas: Well we're going to, whoever is on the RDC we have to scrutinize as if we're underwriting for a loan. Rosalie Bordallo: So this is not open to the general public, just to select customers? Jennifer Sanchez: Correct. Gerard Cruz: That's pretty good. Rosalie Bordallo: For our purposes. Gerard Cruz: There's plenty of risk. Jennifer Sanchez: That's why it's only going to be limited to select customers. Gerard Cruz: You don't give immediate credit right, you just clear it, you still put the requisite holds on it wouldn't you? Jennifer Sanchez: We post it and then I think it balances what's on fluid and what's available right away. Gerard: You would have to put the 4 day hold on it, you're not, you're going to give immediate credit on it? Patricia Salas: I'm almost thinking that we are going to give immediate credit on it. Jennifer Sanchez: That's why it's only going to be limited to select customers. Gerard Cruz: But if they're check intensive they're going to be checks from other institutions, so if you give immediate credit and those things start to come back... Rosalie Bordallo: It's customers like with us, we know if we get on it, they already know we don't have bounce checks. Gerard Cruz: But you're not the only customer that they have. They're going to use for their check intensive customers so if your check intensive customer is say K-Mart for example, K-Mart doesn't know how many checks are going to come back. Patricia Salas: I'm really in the opinion that we were offering this to give immediate credit. Jennifer Sanchez: Correct. That's my understanding. Gerard Cruz: But you can't get immediate credit, you can get immediate credit if the Fed is open and ACH process the clearing immediately so you can get immediate clearance from the Fed, but like now the Fed is closed so you can't get any clearings done with them. You can do the electronic postings now up until a certain point... Patricia Salas: And it won't be available until... Jennifer Sanchez: But then we really won't know until... Gerard Cruz: Until they come back, until the bank on the other end says it's good or not. We've explored that, that's why I'm asking and we've never been able to hurdle how you, for an account without a line of credit to back that, because you treat it like a line of credit right? Jennifer Sanchez: Yes. Gerard Cruz: How would you if the account doesn't have any money, avoid it from going negative if checks start to bounce? Patricia Salas: The people that we're giving it out to originally, they have money in their accounts already. Gerard Cruz: So then that's fine. Maybe the threshold is you have to have a certain minimum balance rolling. Rosalie Bordallo: I would think your thing is you said how about K-Mart, well I'm sure if K-Mart had an account they would have a couple of million dollars and if a $50 check comes back... Gerard Cruz: But you can't make that assumption though because there are still some smaller medium size businesses that are cash intensive that even though they have a lot of transactions run their balances, their cash balances are relatively low. Paula Blas: But you're talking about checks. Gerard Cruz: It's no different from walking in to a bank and clearing a bunch of checks, the only difference is that they don't have to walk in to the bank, they just scan the checks and send the substitute by electronic versions or the internet. Paula Blas: But for smaller businesses... Jennifer Sanchez: We probably wouldn't offer it. Patricia Salas: I'll let you know.

Paula Blas: Your clearance for off-island checks are 4 days? Jennifer Sanchez: Eleven, on-island is 4. Gerard Cruz: Unless you waive it, you have the option to waive it right? Jennifer Sanchez: Right, it's discretionary. Paula Blas: But does it really take 4 days to clear? Gerard Cruz: No, it takes less. Jennifer Sanchez: Sometimes it will come back after the fact. Sometimes even after the 11 day hold it could come back on day 12, 13. It's discretionary, you can do 20 days... Gerard Cruz: You can do as long as you want, depending on where it's clearing from. Jennifer Sanchez: Especially if the check has never cleared also. Gerard Cruz: Or if it's clearing from out of the U.S. Patricia Salas: Then that's a collection item. Jennifer Sanchez: Normally with us we don't even do that as a regular deposit item, we send it on a collection basis. We've been thinking about RDC for a few years already. Gerard Cruz: It's just hurdling the clearing thing, it's setting up an expectation on the customer's side thinking they're getting their checks faster so the money should be available sooner and not being able to meet that expectation because you still have to go through the regular clearing process, you're just getting it sooner.

Wilfred Leon Guerrero: At any one given time what's the balance in our account? Jennifer Sanchez: It depends on which account. The TDOA's predominantly have $2 million, but normally I can tell you like as of last Friday you totaled out of all of your 10 accounts, you had about $7.5 million. Paula Blas: That's because it was payday. Jennifer Sanchez: Even the Friday before that you had right under $8 million. Wilfred Leon Guerrero: So at any one given day we're looking at $7-8 million dollars? Jennifer Sanchez: Except when you're... Gerard Cruz: Off payday weeks. Jennifer Sanchez: Right. Wilfred Leon Guerrero: The 19th is, we had checks mailed out on the 15th so the 19th is 4 days after and we had $7 million dollars? Jennifer Sanchez: Yes, you average about that. Wilfred Leon Guerrero: And that's earning interest at what rate? Jennifer Sanchez: Your TDOA's (time deposit account) they earn 0.125 and all your premium checking accounts earn 0.25

Lastly remittances, we're actually working with Metro Bank because we're going to get an influx or we foresee an influx of foreign workers. Basically right now they can walk in to Metro Bank and remit their whole paycheck or what not to their family in the Philippines, we're actually looking at offering that service.

Wilfred Leon Guerrero: How many loans do you process on a daily basis? Jennifer Sanchez: It depends, what kind of loans, like consumer loans? Wilfred Leon Guerrero: Combined loans. You have $7.5 million dollars you lend out. Patricia Salas: But that's how banks do business, we take deposits and we lend it out at a higher rate, that's what we do. If you have on deposit on average with us $7.5 million, we're lending out... the other thing is you're not really letting us sit on it so our actual earnings is not what you're thinking that we get to sit on it for a year or 6 months and we use that money that you're letting us sit on, your money is coming in and it's going out, it's really transitory. Wilfred Leon Guerrero: We've got a balance in our account of $7 million and on a daily basis what do you average in terms of loan approval for other customers, not ours. Patricia Salas: I couldn't tell you that. Gerard Cruz: What's your yield on your earning assets, 6%? Patricia Salas: No, no. (end of tape 2) (End of presentation by Bank of Guam)

<u>1:00pm-2:30pm DB Plan</u>

Economic & Capital Market Environment
DB Plan Performance

(start of tape 3)
Maggie Ralbovsky: I'm going to start with the capital marker review and I understand this might be the second time you hear about it today. This is as of end of June and things have changed a little bit after the end of June, it's actually gotten a little more volatile so I'm just going to give you a little bit of an update as well for things that happened after June.

The first page, page 3, this is a quick summary of all the mess that was going on in the world. The U.S. stock market started to be very volatile after the end of the first quarter. The main reason was because the QE2 program was coming to a screeching halt as of the end of June and people were debating whether that's going to have a material impact to the pace of recovery in the U.S. During the second quarter there was not a decided consensus as to what the ending QE2 what may do to the U.S. economy, things were trading sideways, the U.S. stock market actually returned a negative 0.1% so it was almost flat, but that doesn't tell the whole story, during that quarter was ups and downs, ups and downs, so it wasn't a straight line going to the finish line it was actually very, very volatile. At the same time the

European situation has started to worsen, not only the peripheral countries, the smaller peripheral countries are dealing with a wall of maturity of debt but also the larger peripheral countries, Spain and Italy have started to be attacked by the market, basically the market started to trade their bonds less and less attractively and makes the ECB, the European Central Bank more and more necessary to go into the market and buy these bonds to exhaust the resources so that added to the anxiety in the market. In addition the slowdown in the emerging markets as well as the violence in the Middle East continued to cause concerns, so the second quarter of this year it was a very volatile quarter and it has not had a strong direction but it was very volatile.

For the fixed income market I think last time we talked a little bit about the fact that S&P was threatening to down grade the U.S. debt, at the same time 10 year Treasury was rallying because the market was concerned with the weakness, the underlying weakness, not about the fact that S&P is going to down grade the U.S. but rather the reason why they want to down grade the U.S.

So fast forward to after the second quarter, I have a quick summary here on page 4. After the ending of the second quarter the S&P did down grade the U.S. and the U.S. equity market did drop 15% within a week after the down grade. At the same time the Treasury market rallied more than 10% which tells us as the market reaction was not because they have any doubt of the U.S. credit quality, but rather they are concerned about the reasons the U.S. was down graded which caused the equity market to sell off.

The European debt crisis also has worsened towards the ending of the second quarter. Right now there was a consensus that Europe does not have a solution because Germany does not want to put up capital to bail out everyone basically. If European debt needs to be consolidated into what people call Euro bonds, people think that's the only way to save Europe which is to issue one single bond rather than every country to issue their own bond and certain countries get attacked by the market and the European Union have to rescue one country at a time, so they started to rescue and the first one was Iceland, then it was Ireland and then it was Greece and then Spain and now people are moving on to Italy, it just attacked one country at a time. So the theory is that if you want to resolve that you just issue one bond which is the Euro bond that's backed by the strongest economy in Europe which is Germany and the German tax payers basically will be shouldering majority of this cost of bailing out all these other weaker countries. Germany obviously didn't want to participate and they were trying to come up with some compromise, having everybody cutting their spending, austerity, it's causing a lot of pain in the lower income countries which makes the world believe there's no solution to the European debt crisis, it's just a slow moving train wreck one episode at a time. That's why there was a very strong concern of the failure of some of the banks because most of the European debt is held by European banks. The European Central Banks stress testing of the banks were very loose, they used a very loose standard to stress test the banks and they were also very, very un-transparent as to what the stress test parameters were which makes the market really have severe doubt as to whether the stress testing result was valid.

So with all this mess going on in the second quarter so far has been really, really bad. I did have a July flash report for the total fund return, it was down about 75 basis points for GGRF's total fund, so that wasn't too bad as of July. I have not seen the August number but the stock market was down more than 15%. Joe T. San Agustin: Did you say it dropped 75 basis points for the month of July? Maggie Ralbovsky: Yes, the total fund overall. The sectors that saved us from a deeper drop were REITs and fixed income, both of these are up. Joe T. San Agustin: That one kind of balanced it out. Maggie Ralbovsky: Yes.

Doris Flores-Brooks: Could we go back to your comment on the S&P because you were saying not so much the down grade, but the underlying cause, what about the fact that Moody's and Fitch each have a slightly different reading and how does that affect overall? Maggie Ralbovsky: The reason the S&P down grade really didn't mean much to the financial market is because Moody's and Fitch still rated the U.S. as triple A and many, many of these guidelines people put together if an entity is split rated meaning the rating agencies rate them differently, split rated entities are considered to have the higher rating. The U.S. in many of the guidelines are still considered triple A rated even though S&P down graded them which makes it still eligible to all the triple A requirements of the holdings. So the essence that the S&P down grade is not a direct impact to any of the financial programs out there it is more a confidence shaker, people were shocked that this could even happen and they dug deeper to say why this has happened, what was the reason they got down graded and I think that's more important than the fact they were down graded.

Wilfred Leon Guerrero: This is diverting from your discussion, but Joanne (Grimes) asked you whether there are any legal implications to this split level rating and what is your response? Maggie Ralbovsky: Yes, I looked at your policy, it does not impact you, the split rate doesn't impact you. Wilfred Leon Guerrero: So what do we take as a rating? Maggie Ralbovsky: It's split rated, you picked a higher one. Split rated conventionally are considered to have the higher rating. Joe T. San Agustin: We're not obligated to get rid of it because it was down graded. Paula Blas: It's still investment grade. Joe T. San Agustin: But we're not obligated to get rid of it because the yield is still there, sometimes some laws will say you have to get rid of it. Maggie Ralbovsky: No, you're not. Doris Flores-Brooks: How do we classify, because the auditors are going to have to know how to classify, they're going to say are these triple A or just say investment grade, like in the back of your financials your investments are rated, so how are Government bonds going to be rated? Maggie Ralbovsky: So the convention is if they're split rated you consider them having the higher rating. Doris Flores-Brooks: And then footnote the down grade right. Maggie Ralbovsky: Yes. Joe T. San Agustin: Is there a legal violation for holding on to a stock that's been down graded? Maggie Ralbovsky: There are certain entities that require triple A ratings for all their holdings but we do not have such requirements. The thing is they didn't not just down grade U.S. Treasuries, they down graded half of Lehman Aggregate, the Barclays Aggregate Index. With the down grade of U.S. Treasuries they down graded FNMA, Freddie Mac, GNMA, all these agency bonds and down graded all the triple A rated insurance companies, everything so the theory is nobody within the sovereignty can be rated higher than the sovereignty itself. Wilfred Leon Guerrero: Does FNMA have a different rating than the U.S. Treasury? Maggie Ralbovsky: It's the same because it's backed by the U.S., therefore when they down graded the U.S. Treasury the also down graded FNMA, Freddie Mac, GNMA, all the agency securities.

Doris Flores-Brooks: Is there buyer's remorse on the part of S&P, meaning they shot it off too quickly or when do you think S&P will take a re-look? Maggie Ralbovsky: If you ask me I think this is S&P's way of making themselves relevant again, if you think in 2008 how they lost credibility, they ranked all these mortgages triple A, all these sub-prime mortgages were triple A and they all went so bad and they were examined by Congress at some point people were saying rating agencies were dead, so I think this their political stunt. Wilfred Leon Guerrero: So as far as you're concerned the split rating is not an issue? Maggie Ralbovsky:

No, it's not an issue at all. A treasury is a treasury it doesn't matter what the S&P thinks they're rated.

I want to move to the details of the performance of the market on page 5. I circled certain places, this is the indication of the weakness in the U.S. economy has continued from the previous report. For every one of these bubbles I circled you can see there's a continued weakness for example the GDP, from a positive territory, strongly positive in the prior quarters, the most recent quarter was really very, very weak and there's a forecast post by the forecasting services which basically is a consensus average that's forecasting 3rd quarter to be negative for the U.S. GDP, of course that is not considering the fact that the Federal Reserve may come out with a QE3 program and that is why today we had a very strong rally in the U.S. stock market because everybody was expecting a QE3 program. Same thing is true for the job site because the job growth has come to a really stand still. The CPI inflation has also turned negative for this quarter, that's mainly because the oil transportation pricing has gone down. Manufacturing is still in expansion mode but has been really decelerating. So all these are indications that worry the market for a double dip recession.

Wilfred Leon Guerrero: I don't really understand what those numbers mean, the one in the bubble, like seasonally adjusted, you have -.02. Maggie Ralbovsky: That is the consumer price index, the price appreciation, that says that during the 2nd quarter of 2011 price appreciation for the basket of goods, a family of 4 consumes that was defined by the U.S. Government, that basket of goods have gone down in pricing and mainly the main driver of that is the dropping of oil price because transportation was a big driver in that. Okay, what about the other bubble? Wilfred Leon Guerrero: Consumer sentiment, 71.5 what is that? Maggie Ralbovsky: That is the University of Michigan survey of consumer confidence, so this survey conducts a quarterly survey that asks consumers how confident you are for the future and it is considered a leading indication for people spending money, so if somebody feels very confident for the future they're more likely to spend money and therefore the economy is more likely to generate better results because people are spending money. Wilfred Leon Guerrero: Is 71 high? Maggie Ralbovsky: 71 is not high. Wilfred Leon Guerrero: What's a high? Maggie Ralbovsky: 85 is high. You can see 10 year average is 81, so 85 is considered really good times, below 70 is really bad times, but we're sort of teetering the borderline right now. Joe T. San Agustin: A high of 76 a year ago to 71.5. Maggie Ralbovsky: That's right. Doris Flores-Brooks: Compared to the 10 year average of 81. Maggie Ralbovsky: That's right. Joe T. San Agustin: That's quite a spread. Rosalie Bordallo: That's quite a drop. Maggie Ralbovsky: That's considered as a leading indicator for consumer spending. Wilfred Leon Guerrero: Is this survey the benchmark for all consumer confidence? Maggie Ralbovsky: Yes, this is the main survey and they publish is every quarter and people watch it and it is considered one of the leading indicators. Doris Flores-Brooks: So as the next one goes even lower, how low has it ever gone? Maggie Ralbovsky: In June 2008 I think it went to 48 or something so it could go really low. Doris Flores-Brooks: But that was at the heart of the recession. Maggie Ralbovsky: That's right.

I'm going to move to the next page. On the next I want to point out one particular portion on the top right hand chart and that is the direct Government spending and you can see that was negative for 1Q 2011, 2Q 1011 and then very small for 2010. The reason that is an important thing is because Government spending has become a more and more important portion of GDP and that is shown on page 7, if you look at page 7 on the bottom right hand chart has 2 lines, the blue line that goes down and there's a red line that goes up. The red line is Government program, so Government programs portions as a percentage of GDP has been going steadily going up since 1959 and we're pretty much double the size of history. The private sector wage has been going down as a percentage of the GDP, that's the top blue line and it has gone down really more than 10% during this period of time. So because the Government spending becomes a more and more important part of GDP, the Government spending drop also has a bigger impact to the GDP and given the debate in the U.S. whether the U.S. have too big of a Government, too much spending, the T-Party movement, which is an indication that this spending probably will have a very strong barrier to pick up, that's another reason people think we're heading to a double dip recession because this is an important lever that cannot be pulled at this point in time. That is an important thing that gives the market fear that they may enter into a double dip recession.

The next page is unemployment rate, the heat map, the redder it is the worse it is and pretty much the bigger economies in this country are in worse shape than the smaller places. What do you think Guam would be? Doris Flores-Brooks: Guam would be red. Paula Blas: We're 12, 13. Maggie Ralbovsky: Maybe like in California. So I think last time we also talked about that fact that these unemployment rate calculations actually understates unemployment because of the discourage workers syndrome, some workers just quit. This is another reason why consumer spending may be depressed, the unemployment rate is really not improving. Doris Flores-Brooks: Can I ask about Hawaii because from Guam we always look to Hawaii, it's main industry is tourism so why would its unemployment be so low? It's a very expensive place to live and it's actually lower than Alaska. Maggie Ralbovsky: I guess I'm not a good person to answer that question. Speaking from my neighbors I know they have time sharing in Hawaii, every summer they go to Hawaii. Probably because of the geographical proximity to the mainland they probably get a lot more repeating visitors.

So CPI breakdown remember earlier we talked about why the CPI was actually negative this month and you can see that headline inflation number is actually masking the composition of the different basket, so the bottom right chart is the basket. We'll talk a little about this basket because people have debates about this basket. The basket was actually put together in the 1950's, what the Government has done is to take a typical family of 4, so a family of 4 in the 1950's will consume a basket of goods and they fix the percentage and you can see food is 15%, housing is 41%, 7% for medical care and 17% for transportation. This is the basket the Government calculates inflation with and the Social Security benefit, all these CPI adjustments are based on this. A lot of people are trying to change this because they're saying, you know, the aging population, the medical care price has gone up, education has gone up, so there's many movements out there trying to change this basket, but the basket stays as is right now and you can see this month drop is basically transportation drop. Food prices actually went up pretty strongly, the food prices have been going up for the past year, you can see the trend is actually continuing. Doris Flores-Brooks: I'm surprised your medical care is still low. Maggie Ralbovsky: 7% is probably not a good indication, especially for the retirees, they spend a lot more in medical care.

So all indications are weak, what has the equity market done, the next page. If you recall last quarter we talked about the small cap premium, small cap was trading at historically high premium versus large cap and that has corrected itself this quarter. Small cap under performed large cap, if you just look at the top table you can see that the worst performing sector in the U.S. equity market was small value was down 2%. Small cap as a whole under performed large cap by over 100 basis points, small cap was down 1.1%, large cap was up 0.1% and this is a typical end of the cycle indication, every time at the beginning of a bull cycle it's the small cap that leads the way for recovery and the end of the cycle small cap started to lag and eventually large cap really out performed, that's the end of the cycle. So this makes people continue to fear this is the end of the bull market because this indication has shown up, although one quarter is not a stable indication, so if this trend continues it will show us maybe this is the end of the cycle.

Another indication of the end of the cycle is the quality effect which is demonstrated on the next page, page 11. The bottom chart shows us the different credit rating performance for the past year, year and a half, so for example you can see that from March of 2010 to December of 2010 the lower the credit quality, the better performance and that trend reversed itself, you can see from December 2010 to June 2011 the higher the quality the better the performance there was. Doris Flores-Brooks: Can you say that again? Maggie Ralbovsky: On the bottom chart you can see there's a reversal of trend. The first group of bars was for March 2010 to December 2010 and the lower the credit quality, the higher performance that sector had, not by every bar but the trend is that and that has reversed itself for the most recent 6 months which is also the end of the cycle indicator that quality started to matter, people's risk appetite has started to abate. Doris Flores-Brooks: But did that also have effect because of the way S&P very liberally rated? Maggie Ralbovsky: No actually this is for equity, this is not for bonds.

So, fixed income market on page 12. The fixed income market has had a positive return actually for this quarter was strong and after the end of this quarter got even stronger especially with treasuries and agencies and high quality corporates, actually have rallied after this quarter, continued to the rally because interest rates have gone down tremendously. During this quarter if you look at the treasury yield curve it says current quarter and previous quarter and one year ago, if you compare the one year ago versus current quarter you can see the treasury yield curve was very steep, meaning the short end actually went down, the long end went up which is forecasting a strong recovery. People are forecasting, maybe everybody was saying, 2Q recovery and then maybe one half of next year, something like that. That has changed since the ending of 2nd quarter so basically after June 30th that long end has compressed tremendously, fast forward to today, 10 year Treasury is trading at 2%, so if you just draw a line at the maturity of 10 you can see the end of this quarter at the end of June quarter, treasury at 10 year was trading at close to 3% and today it's trading at close to 2%. That was a huge drop because people are pricing out that recovery, pushed the recovery back further into the future, that's why the QE3 started to resurface, people are projecting, actually pricing into the capital markets, the Federal Reserve is going to come up with a QE3 program, printing more money basically, it's going to be very bearish for the U.S. dollar. When you print more money the U.S. dollar is going to lose value. Doris Flores-Brooks: It already has lost a lot of value, especially relative to the YEN. So Bernanke is going to print more money? Maggie Ralbovsky: That's what the market is expecting and that's why today the market rallied 3% on that speculation. Doris Flores-Brooks: So we'll know by Friday then. Rosalie Bordallo: It's a speech he's giving, that's all he's doing, it's not where he's going to come out and say this is going to be definite, it's just a speech. Maggie Ralbovsky: If it doesn't happen I think it's going to be disappointing, so the volatility is just going to be there, expect that.

On page 14, one thing about the treasury yield curve being so low is the fact that it lengthens duration for your fixed income investment. On the bottom right hand corner of page 14 is an illustration, so a 10 year treasury if it's at 5% yield the duration is 7.6 years and if today it goes at the current yield, it's 8.4 years, so it just lengthens the duration, it makes the fixed income portfolio more and more sensitive to interest rate rise that's why it's a pretty scary time for people to be in the treasury market because you buy a treasury 10 year treasury, you get paid 2% and if interest rates go up by 1%, you lose 8%. The asymmetrical risk factor is so strong that you really are scared to be in treasuries, but you're scared not to be in treasuries. Joe T. San Agustin: Sometimes you don't have a choice, like the Euros, they're all running to the states. Maggie Ralbovsky: That's right. Doris Flores-Brooks: What percentage of your portfolio is in treasuries because I know you have bonds too? Maggie Ralbovsky: Actually all of the managers of GGRF are under weighting in treasuries. Doris Flores-Brooks: So they're below their target. Maggie Ralbovsky: Way below. Doris Flores-Brooks: And in some respect that's okay.

Wilfred Leon Guerrero: We're also going to get a report from Northern Trust for securities lending because that's how they're doing their securities lending. Maggie Ralbovsky: Yes, I learned a lot more after the last meeting, actually I learned a lot more about your program. Wilfred Leon Guerrero: We don't really know how much we have in treasuries, that's how they're paying us. Maggie Ralbovsky: But you only have $16 million dollars in loans. Paula Blas: $60 million. Maggie Ralbovsky: I thought it was $16 million? Paula Blas: No more than I think at one time... Wilfred Leon Guerrero: Every time we loan them out we get treasuries. Maggie Ralbovsky: Right, but I thought they told me right now there's only $16 million dollars on loan which means you get a little bit more than $16 million in collateral, treasury collateral and it's okay because it's collateral. When people return the security you just don't get their treasury back, you're not really shouldering any risk. Wilfred Leon Guerrero: But potentially we loan up to... Rosalie Bordallo: 300. Maggie Ralbovsky: You say that because I asked Northern Trust and they said there's no limit in their documentation, they didn't think there is a limit, so maybe they just didn't know or did they change relationship or something? Paula Blas: In a whole year I don't think they've lent more than, the maximum was like $60 million I think. Maggie Ralbovsky: The reason is this, your program does not reinvest the collateral, only European clients do that, only European borrowers will post a treasury and pay a fee to borrow your security and it has to be a security that's in high demand otherwise people won't take such a term to borrow your security, therefore it has a limited demand but it's a very, very high quality program which really limits your loss, it's a very, very minimal level, there's a very low chance you're going to have a loss. Your goal is to reduce your custody cost so it serves the goal. Northern Trust doesn't like it though. Paula Blas: I was going to say, they're probably going to be here tomorrow saying, look, we have to revisit this because we're not making any money, I'm just expecting that. Maggie Ralbovsky: With the turmoil in Europe, we don't know how much of that debt is going to go bad, the banks are all probably going to hold all the bags, it's really not the time to lower the quality of collateral so I think it's good right now so I wouldn't be worried about our collateral treasury, treasury is good.

Okay non-U.S. capital markets on page 15, you see that emerging markets this quarter actually lost money, EAFE was actually so volatile and at the end of the quarter it was showing a positive return. The European Union is in the center of the storm, on the next page you can see Italy was the subject during this quarter. Italy's spread of 5 year bonds, this is spread over German bond. German bond yield was considered almost like the treasury yield equivalent in Europe and the spread of Italy's bond increased 1.5% in 10 days, that kind of volatility is very scary, basically the market is attacking Italy. Greece is not getting any better, Ireland, Portugal, Spain, Italy, they're all in the problematic territory.

Real assets, the next few sections have investment categories that the Fund doesn't currently invest in, but in the real asset category you do currently have the REITs so maybe we'll take a look at the REITs global public real estate. You can see REITs had a pretty strong return and actually that strong return continued into the 3rd quarter. We're going to hear from 2 REIT managers today so maybe just keep a mental note of the strong performance in REITs for this quarter.

I'm going to skip the next few pages because it's about alternative investments and right now we don't have any participation in those. I'm going to move to the next tab after tab 1 is our fund's performance, page 25. The portfolio for every category as well as total fund marginally under performed, none of these categories under performed severely, they're all like less than 25 basis points. For this quarter the Fund ranked 79th percentile, I have a page later to show you the longer term ranking it was actually quite strong, longer term strong ranking. You can see the total Fund was up 0.83% for this quarter, I'm going to discuss each one in more detail later.

The graphic view is on page 26 compared to the benchmark. You see that every category is a little bit short, domestic equity is the only negative return category for this quarter.

Longer term on page 27, the Fund has done quite well compared to the policy index, it has beaten the index pretty much every time period for the last 10 years.

Universe comparison on page 28, for 10 years the Fund ranked on the 14th percentile which is very strong. Remember 1 being the best, 100 being the worst. For 3 year, 5 year you're on the top 5th percent, very, very strong performance, number 2 for 3 years, number 3 for 5 years, that's very good. Doris Flores-Brooks: This is the overall rate of return, 7.10 under 3 years? Maggie Ralbovsky: Yes and you can see the median return is only 4.76%, the median for the public funds. Wilfred Leon Guerrero: You say low numbers is good, if we're at 79th percentile for the quarter, somebody did well. Doris Flores-Brooks: Because it's a high number we're not doing so well relative to the average right? Maggie Ralbovsky: Yes for this quarter. Doris Flores-Brooks: For this quarter, for 2nd quarter we were okay, so this is going to affect the quarters going forward because you have to make up this return and the next quarter to be above. Maggie Ralbovsky: Yes, all the short term returns I reflect in the long term so it's already reflected in the 3 year and 5 year numbers. Wilfred Leon Guerrero: And this you're comparing us with just the funds that you're handling? Maggie Ralbovsky: No, this is all the public funds in the TUC universe, TUC is the trust universe comparison, it's a service where all the consulting firms pull their data together, so all the public funds that use consultants when they report they all pull their data into the TUC universe that everybody uses like a benchmark for comparison so it's all public funds in this and not just Wilshire's public funds, not just consulted by Wilshire.

Wilfred Leon Guerrero: What is policy index? Maggie Ralbovsky: Policy index is your benchmark index assuming there's no active management and there's no fees paid and no deviation of rebalancing, nothing, just passively managing it with the index based on your asset allocation policy. Is this policy index Wilshire's policy index? Rosalie Bordallo: No it's ours based on our asset allocation, how we have 30% bonds, 20% REITs. Antolina Leon Guerrero: It's just an index fund based on those allocations. Rosalie Bordallo: Right, that would be our return. Joe T. San Agustin: On the one year column there you're saying the Fund made over 24% compared to the benchmark of 20.35? Maggie Ralbovsky: For the one year period you made 23.92%. Joe T. San Agustin: Higher basically than the median? Maggie Ralbovsky: That's right, you're actually in the 10th percentile meaning you beat 90% of the funds. Joe T. San Agustin: And the policy index was 55. Maggie Ralbovsky: Right.

Paula Blas: This is if we went passive? Maggie Ralbovsky: If you went all passive. Paula Blas: And the total fund composite because we're active management right now this is what it is. Maggie Ralbovsky: That's right. Doris Flores-Brooks: What does the median mean, 20.59? Maggie Ralbovsky: That's the median of all the pension plans, all the funds in the universe. Median meaning as many above and below so it's not the average, it's the middle. Doris Flores-Brooks: And that's based on their actual returns regardless of whatever index they might be following. Maggie Ralbovsky: That's right, so major difference is asset allocation, your asset allocation determines your return range. Doris Flores-Brooks: Is it possible to get what the average return was, I was just curious, you prefer to use the median? Maggie Ralbovsky: Yes because nobody is really the average person, the median person is the middle person. Doris Flores-Brooks: So there were as many, to rephrase it, on a one year basis there were 101 funds and the median there were 50 of us above 20.59% and 50 below the 20.59% and then comparing our returns 23.92 we were 10th overall in the best return. Maggie Ralbovsky: That's right.

Doris Flores-Brooks: Now for the quarter, although the first quarter is factored into one year, but for the quarter by itself we didn't do so hot, we were less than the benchmark and we were 79th from the bottom. Maggie Ralbovsky: 79th from the top. Doris Flores-Brooks: If 50 is the median... Maggie Ralbovsky: That is below median. Doris Flores-Brooks: We're 79th in the rank of 101. Maggie Ralbovsky: Yes, however we also want to observe the fact that the bar is very tight. For this one quarter the best and the worst the difference that big do you see what I mean, like this bar is very tight. Doris Flores-Brooks: So the median in that was 106 and we made .83 which is even slightly less than our policy? We've been doing pretty well except for this quarter. Maggie Ralbovsky: We cannot expect every quarter to out perform and we cannot expect every quarter to be in the top 10, that's just not going to happen. Wilfred Leon Guerrero: Is that unusual because you're like in the top 25% and then next quarter you're down. Maggie Ralbovsky: It's not unusual at all. Think about what prevails in the long run, what prevails in the long run does not mean you will always prevail in the short run because some quarters fixed income do well, some quarters equities do well, so if a fund is heavy in fixed income when fixed income do well, they will do well, when a fund is heavy in equity when equity does well, you will do well. Wilfred Leon Guerrero: So dramatic change is not unusual? Maggie Ralbovsky: Dramatic change is not unusual at all. Antolina Leon Guerrero: Because we're really concerned with the long term as opposed to the short. Maggie Ralbovsky: Exactly. You want to focus on the long term, you want to understand the short term, you want to understand why you under performed, who is the culprit, but it shouldn't be the factor to make a decision.

Page 29 is the detail on how many you allocated to each manager and how much you allocate to each category. The graphic view of this in total is on the next page, it might be easier for us to follow. On page 30 we are comparing the actual allocation versus the policy which is your benchmark allocation and we calculate the differential in this bar chart at the bottom of this page and you can see at the end of this quarter fixed income is under allocated and domestic equity is over allocated and that obviously has changed after this quarter ending and I have each asset class minimum at maximum later on you can see none of these are above or below the tolerance by the policy so bottom line, no forced rebalancing is necessary.

Page 31 is a cash flow statement for this quarter. It starts with the beginning value of each of these managers and net contribution or distribution, net contribution if it's negative it's basically distribution so you're basically taking money and rebalancing sort of thing. Then investment gains and losses, ending value and time weighted return for each of these categories. Wilfred Leon Guerrero: Do we have a chance to look at the balance for today? What's the balance of the portfolio? Antolina Leon Guerrero: Or since the quarter closed or the closest to today. Diana Bernardo: As of August 22nd it was at 1.208. Maggie Ralbovsky: Compared to 1.366, 160 million, it's about 10% down, 12% down.

The next few pages you can see we acquired the historical data from your prior consultant for the purpose of keeping the record and you can see before Mercer started counting we only have a return data from your prior consultant. Mercer has kept a better record than the previous one you can see that. The cash flow we started calculating that first quarter of this year so we'll have more cash flow information as time goes on.

On page 36, annualized 7.74 since 1993. Doris Flores-Brooks: How does that compare overall? Maggie Ralbovsky: I don't have that data, the universal comparison only goes back 10 years. Joe T. San Agustin: Our actuarial rate of return is 7%, this is 7.74. Maggie Ralbovsky: That's right, so beat the actuarial return assumption.

U.S. equity composite, (page 38) the pink ones are under performing the green ones are out performing ones and here is the asset allocation range and every one of these categories are within the range. You have half the manager's out performed, half under performed, the totally composite under performed marginally by 23 basis points. We do have 3 managers on watch and our recommendation is to continue to keep them on watch and I have a write up for each one of these and we did put MetWest on watch until the end of this year, the other 2 watches are more open-ended, we want to observe them a little bit. Atalanta Sosnoff was because of the poor performance and I also want to show you their style is not actually a core style, you hired them as a core manager, I do have historical data to show you that they have never really been a core manager, they've always been a growth manager. I want to combine that discussion with our passive, active discussion, maybe we can schedule it for tomorrow. Joe T. San Agustin: Is that a real concern, are we suppose to treat them differently, is there any damage? Maggie Ralbovsky: Well yes, because when you designed your portfolio you meant for them to fill in the core bucket, then you have 2 growth managers, 2 value managers and you're hoping you're balanced out your total portfolio and because they did not play the part you had them play, your entire portfolio has a growth bias and that bias... Joe T. San Agustin: So that really hurt us. Maggie Ralbovsky: That's an unintended bias. It does well when growth does well, it does not do well when growth does not do well and that wasn't your intended bias, so the problem is not that they are a growth manager, but rather they're not suppose to be a growth manager. They always define themselves as a core manager, but they're never a core manager. They're not really fulfilling the goal. Joe T. San Agustin: Can that be positive or negative? Maggie Ralbovsky: In the portfolio sense it's negative because it did not help you control your unintended risk, it's causing your portfolio to take a risk that's not intended.

I have a big book which I provided 2 for the Fund that's detailed for every manager, every holding and every period. I don't want to waste paper but I want to give the Fund 2 copies for file and the reason I want to refer to this is I just want to show you quickly under U.S. equity tab 1, page 3, this is Atalanta Sosnoff's style map versus the benchmark. You can see we hired them as a core manager that's suppose to track Russell 1000 and they have been decidedly in the growth category so they have not been a core manager since hired, they have always been a growth manager. Joe T. San Agustin: Is there a contractual violation there? Maggie Ralbovsky: No it is not. Joe T. San Agustin: I'm looking for accountability. Rosalie Bordallo: Here's the problem, Atalanta was never hired originally as a core manager, it was a name or style we pegged on Atalanta when Mercer came in and we tried to pigeon hole them into the core. Joe T. San Agustin: But do they have knowledge that's what they're suppose to be? Rosalie Bordallo: Yes they do. Joe T. San Agustin: And they consciously did not comply? Maggie Ralbovsky: No, that's their style. Rosalie Bordallo: No, they're not at fault, if anything we're at fault because we wanted to hold on to them. Antolina Leon Guerrero: Because they performed so well. Rosalie Bordallo: Right, because they performed so well.

Maggie Ralbovsky: Here's the thing, the manager is the manager and there may not be anything wrong with the manager stand alone, but it's not fulfilling the intended purpose for our portfolio so that is the issue we have. Joe T. San Agustin: But if it's a positive result, it could be by accident, but it's okay, it's fine, it's good. Doris Flores-Brooks: It is unintended consequences. Joe T. San Agustin: Unintended consequences that are positive. Maggie Ralbovsky: During certain periods of time they did well when growth was in favor they did well. Antolina Leon Guerrero: Right now it's just the opposite, they're not performing well. George Santos: It use to be okay, it's not okay. Doris Flores-Brooks: So you should go against the style, it's the fact that you chose them.

Maggie Ralbovsky: I'll show you their long term performance, their long term performance is still good and they were probably very strong historically because their near term was not very strong. I'll show you later their historical performance. In terms of structural design, they are introducing a structural risk to the total portfolio that wasn't intended.

Rosalie Bordallo: Can I ask a question, you know by law the Fund or the portfolio should have a value tilt, do you realize that? Maggie Ralbovsky: Yes because of the dividend requirement. Rosalie Bordallo: Right, only 50% of and even that 50% was down to 25 unless you get a waiver, so by law your tilt is always value, is that happening? Maggie Ralbovsky: It's not happening, you actually right now have more of a growth tilt. Rosalie Bordallo: Which is kind of strange in that is says that 50% of your portfolio still needs to meet a value tilt. Maggie Ralbovsky: If you look at page 5 of this big book again under U.S. equity tab, page 5 before the previous tab, if you look at the X, the X is the combination of all your managers. In designing the portfolio, the goal is to have that X to be close to the middle, be benchmarked against the market without taking style bias and you are on the growth side. Antolina Leon Guerrero: But could that happen not necessarily because of, I mean because of the market changes as opposed to, could we have not started on...I'm just wondering if we selected managers that satisfied the intent of portfolio, but because of changes in the market we started to drift as opposed to, we picked the wrong manager? Maggie Ralbovsky: Yes, so I do think that the drift happened with a couple of managers and it's not a permanent drift, so you do allow managers to drift because they see where the market opportunities are, what you want to prevent is a permanent bias that is not intended and Atalanta Sosnoff is that permanent bias. You do have other managers that drift like INTECH, like MetWest, MetWest use to be a pretty value manager, right now you see that's it's prodding like a relative value, it's not a...

Rosalie Bordallo: Can I ask, this picture here, this is as of 6/30, but is it covering a quarter period? Maggie Ralbovsky: This is the quarter. Rosalie Bordallo: So we don't know the long term? Maggie Ralbovsky: That's why I wanted to show you Atalanta Sosnoff's long term here which has the different dots. Antolina Leon Guerrero: And that's why it's completely to the right. Maggie Ralbovsky: That's right, it is stationed to that right, every manager has one of these and some of your managers do drift once in a while in different places, you allow that. Joe T. San Agustin: How much of a drift do you tolerate? Maggie Ralbovsky: You tolerate them if they are not decidedly in a bias category that's not intended so you do allow them to drift, but Atalanta Sosnoff their long term has always been on the growth side, which by itself is nothing wrong, but if you intended for them to be a core manager then that is structurally a mismatch.

The manager on watch for MetWest they actually out performed this quarter, remember we put them on watch for organizational issues, we said we were going to give them until the end of this year to perform and this quarter they had performed well, actually this whole year they have performed quite well so we may take them off watch in a couple of quarters.

Wilfred Leon Guerrero: What is this focus list? Maggie Ralbovsky: The focus list is Wilshire's high conviction list. Antolina Leon Guerrero: What does that mean? Maggie Ralbovsky: Wilshire's manager research group's top pick. Antolina Leon Guerrero: But it's always a positive thing. Doris Flores-Brooks: One did well, one did not. Maggie Ralbovsky: That's right. INTECH did well and Winslow didn't. Wilfred Leon Guerrero: How long do they keep this? Maggie Ralbovsky: They change every quarter, so I watch them if there's any change I'll update the committee. So far this quarter had no change of ranking by our manager research group and I always take our manager research group's opinion as one data point, not the only data point, I want to acknowledge other data points. Wilfred Leon Guerrero: What's the difference between good and above average? Maggie Ralbovsky: Good is above 3, above average is above 2.5, if a manager is below average it's a manager we probably shouldn't keep, but if it's above average there's different categories above average, the best ranked managers are on our focus list, then it's a good manager, then it's an average manager, above average manger.

Eaton Vance is another manager on watch and that manager on watch was based on the fact that their analyst ranks had a lot of turn over so we want to watch them. They have a very strong portfolio manager but she is supported by a group of analysts that had constant turnovers so we have concerns about that kind of organizational change. It is a relatively new manager of yours so we really don't want to give a manager very short time to perform so we want to really watch them. At least give them 3 years to perform for you. Paula Blas: It's only been on board one year. Maggie Ralbovsky: Yes, so give them a couple of more years to perform for you.

I have some summaries on page 39 and 40 of these managers and I think we have gone through pretty much the details so I'm going to skip these, but you can read them later.

Here's the style map, actually this is a page I showed you earlier in that big book so here is another page here on page 41. This is the style map that you want the X, the total portfolio to be closer to the middle which it is not and the main reason is actually Atalanta Sosnoff and you can see Eaton Vance also drifted to growth, but Eaton Vance drifts back and forth so this is not a constant drift, but Atalanta Sosnoff is a constant bias over there.

The next page 42 is the long term performance of the composite against the benchmark. It tracks pretty well, it tracks pretty closely, since inception it actually out performed, so as a whole as a total performance-wise it has been pretty strong short term and long term.

Now the different managers on the other hand you can see on page 43 and 44, we talked about Atalanta Sosnoff, you can see since inception they're still above the benchmark and since 10 years ago they beat the benchmark by 1.54%. For the one year period, however they under performed by 11%, so you can see this manager really does not track the benchmark very well partly due to the fact it is not a core positioned manager. Antolina Leon Guerrero: It's being measured against the wrong benchmark. Maggie Ralbovsky: Basically. Joe T. San Agustin: Do they realize that? Maggie Ralbovsky: Yes, they agreed to this benchmark, but it is a high tracking error manager and they constantly position themselves on the growth side. Historically they have done well, so that's that manager. The INTECH and Winslow, these are your 2 growth managers, they actually compliment each other. You can see that since inception they out performed, both have beat the benchmark by over 1%, these 2 managers have done well historically and they are true growth managers, so we really like these 2 managers and they're actually on our focus list.

We talked about the Russell 1000 Value last time which is a place holder. MetWest we talked about a lot last time and this time as well has done well. Robeco is your other value manager, which has done well. Eaton Vance, this is the manager that's on watch and has only been with us for a year or not quite a year so we need to give them a little more time, but we do want to keep them on watch. Numeric is your other small cap manager, it actually compliments Eaton Vance very well, it's a quant manager that has a very stable positioning, stable style, so this is your anchor for your small cap, it's a great anchor actually. On the total for this quarter under performed by 23 basis points, longer term composite has done well.

I'm going to move to the non-U.S. equity composite on page 46. The allocation is within range, no manager research updates in terms of scores since the last time, all your managers ranked in good status. Fisher is the one that out performed this quarter and every other manager under performed somewhat. The total composite they under performed by 14 basis points which is minor in the scheme of things.

Let's look at some details. Earnest Partners and Fisher maybe we can just take a quick look at their style which is on the style map. Fisher is the green diamond on the style map, they have a slight growth bias which compliments actually with your other manager Earnest Partners who have a slight value bias, they actually balance out. You have a small cap manager, Dimensional, it's a manager that supplies liquidity to the market, they always trade very well, we really like them in the long run, but they always have a little bit of a value bias. Capital also always has a little bit growth bias and Capital is managed by Capital International which also manages American Funds. Our concern with them is the size of this manager especially for emerging markets funds, they really have accumulated a lot of money in that less liquid category which may in the long run impair their ability to be nimble, they may be forced to hold larger cap of emerging markets because they just couldn't get enough of the small cap in the emerging market category. So we do have a little concern over this manager because of size, not to the point where we're putting them on watch yet, but if they continue to under perform we may do that. Dimensional as I said is a small cap manager that we think trades really smartly which adds value in that space and Fisher and Earnest Partners really compliment each other. So that's how this composite stands.

The next couple of pages are for the longer term performance, you can see the total composite is on page 49. Since inception I'm sure there are some stories to be told why this composite under performed historically, but for the 5 years that we have the current managers it appears to have tracked the benchmark quite well.

The details of these managers are on page 50, you can see that since inception, Earnest Partner only has one quarter of data, but every other manager has beaten the benchmark, managers with longer term performance. I think this composite is in good standing with one caveat and that is our concern of the size of Capital International as an emerging market manager.

I'm going to move to the fixed income composite now on page 52. There is one rating change from our manager research group, I highlighted it in yellow. All 3 managers under performed slightly, I highlighted in yellow that is one rating change from our manager research group which is Garcia Hamilton. This manager usually ranked above average, now it's ranked at average, it's a slight down grade, it's not a severe down grade. The slight down grade was based on a recent due diligence trip our manager research group had and their concerns are the firms resources, there's limited resources in the firm and also has a high tracking error style because they only hold like 30 bonds, so that was noted as part of the reason it was slightly down graded. Antolina Leon Guerrero: Are the limited resources a new problem, a new finding? Maggie Ralbovsky: It's not, it has always been limited resources, I think the reason it was noted was they went on to this trip and they probably felt more... Antolina Leon Guerrero: Impacted by it. Maggie Ralbovsky: Yes, impacted by what they see I guess. I think they have 4 people managing the fixed income portfolio, I think 4 or 5 and limited resources is also referring to the system, the compliance... Antolina Leon Guerrero: They're a small group right? Maggie Ralbovsky: Yes, very small, boutique management. It's not a material change because it's still average and above average, it wasn't very big of a difference. The under performance for the total composite is 21 basis points for this quarter.

I do have some summaries I do want to show you the style map for these 3 managers and you can see how they positioned. The diamond is the benchmark and so everything is in relative to the benchmark, anything above the benchmark on this chart has a longer duration than the benchmark, everything below obviously has a shorter duration, anything towards the left hand side has a lower quality than the benchmark, anything towards the right hand side has a higher quality. In that kind of language you can see Garcia Hamilton has a longer duration than the benchmark which will actually probably help them when interest rates go down, longer duration helps them. The other 2 managers tend to have a little bit lower quality than the benchmark which will probably hurt them when quality rallies which is the environment we're in right now. So just with that background you can probably almost forecast what they have done for this quarter.

The next couple of pages are the performance, you can see that for the composite, page 55 has the composite returns since inception, has tracked the benchmark since inception, has beat the benchmark, certain periods under performed. I'm sure certain periods of under performance has some contribution from your legacy manager, Aberdeen which probably contributed negatively to the interim performance.

Your current managers on page 56, you can see Garcia Hamilton has done very well since inception, the most recent quarter they did under perform, historically they have done well with a pretty concentrated portfolio. Franklin Templeton was a little bit up, a little bit down, this manager actually has a very high fee, I do want to review them as part of the discussion tomorrow. Diana Bernardo: I noticed that and I checked that and I think what happened was because Paula (Blas) sent you a copy of the contract and it was a while back but there was a last page that I think was missed, so the fee is actually closer to everybody else. Maggie Ralbovsky: Do you know what is the fee that they are charging because I prepared something for tomorrow? Diana Bernardo: This is a copy of the last 2 pages that Paula (Blas) gave and I think the calculation was based on this, but there was also this page, so if you base it on this page it comes out. Maggie Ralbovsky: So let me note it. No wonder, it was like 42 basis points and I was thinking how crazy is that for fixed income. $150 million so it's 16 basis points, so that's more in line, okay, very good. So I have a discussion tomorrow which will need to be revised, but the conclusion is probably not going to be too different because they under performed. So here's the fixed income managers, no recommended change at this point.

I'm going to move to the REITs managers. The allocation is within range, they under performed by 22 basis points, one manager out performed and one manager under performed and I think they're going to present later today. These 2 managers, the summary is on page 59, Cornerstone is a subsidiary of Bapson Capital, historically they were just a real estate property manager, they're now making a big push into securities space and I believe their fees are very low compared to this other manager Security Capital. Security Capital is a little bit odd in terms of their ownership being owned by JP Morgan and JP Morgan owns another REITs team that basically competes with... they own both and JP Morgan basically just lets them run themselves separately. Joe T. San Agustin: Is that other company, do we have them as one of our managers? Maggie Ralbovsky: No we don't have JP Morgan's other REITs. The reason we thought it was a little odd was because sometimes when some parent company holds 2 of exactly the same strategy, they always sort of have a horse race and they decide which one to pick... the other strategy is not as strong as this one.

Wilfred Leon Guerrero: How come on your notes and manager's status you both have these on the focus list and one of them has under performed? Maggie Ralbovsky: You can't expect everyone on the focus list to out perform every quarter, but yes, both of them are on our focus list, that doesn't mean every quarter they will out perform, it just means that we have very strong opinions that in the long run we believe they can generate good performance and the focus list is not easy to make. Wilfred Leon Guerrero: But this quarter they under performed. Maggie Ralbovsky: It's just one quarter. Antolina Leon Guerrero: She said her research group is just one data point, it's one factor in considering who gets on the focus list. Maggie Ralbovsky: The research group I always use their but I don't use their input exclusively as the only opinion, so I do want to consider the consults input and clients experience and our own experiences as a manager and I do think among these 2 managers Cornerstone is the stronger one. Security Capital because of this ownership it always has a little bit of a possibility the pair may rationalize resources, something may happen, but you had them since 2009, a couple of years, it's not a long term manager yet. We'll hear from both of them today and any questions you can ask them. (end of tape 3)

<u>2:30pm–3:15pm Security Capital</u>

(start of tape 4)
Ken Statz: In the presentation we have an update of our firm just to give you a sense of what's happening in the firm but we'll talk about the market and how your portfolio is doing in this market and most importantly where are things coming next and how are we positioning for that. So let me give you 2 seconds on the firm and the first thing that's so important in this meeting is we have pictures on page 5, this is new and the point of this is just reminding people what we do at Security Capital at times might sound stocky, we buy this stock, we sell that stock, but at the end of the day we're buying real estate and this just

gives you an example. I think there are 48 pictures here and there are over 29,000 properties that are represented by companies traded in the public markets that we have a choice of and as you know the companies focus on property type in region usually so we can have a lot of selection. This just gives you an idea of the quality of the real estate because sometimes when people including us forget, this are just tremendous quality assets that we're picking and once we put together a portfolio of 20 securities for you they represent over 9,000 properties in over 400 markets. The quality of the cash flow which we're going to talk about today because when times are so volatile, the only things we can talk about first are facts which are the cash flow, cash flow yield currently on your portfolio and then talk about what do we think will drive that cash flow up or down and can you profit. This is just something fun that we put in the first place to show these are incredible quality properties that we're talking about.

The firm itself is thriving, we are still owned by JP Morgan, remember we were sold to JP Morgan back in 2008 and so we just hit our 8th anniversary so that's tremendous. The firm treats us very well but they also leave us alone. We do everything in Chicago and our oversight is in New York, but they do a very good job making sure we follow all the rules that everything, T's are crossed, I's are dotted other than that they let Security Capital and the 20 professionals located in Chicago do their job. That's been the same since 2003, I think that's why the relationship has been so good and we're growing very rapidly right now, earlier this year hit about $6 billion dollars in assets up from $1.9 billion when you joined us, so we have about tripled in size. The reason for that is I think we're trying to fit risk and return very carefully in the real estate markets and because of that a lot of clients like what we do because we can explain the risks we took and show you the returns you've got and that's really the name of the game right now. That's a quick update, same people, same process, no regulatory proceedings or anything like that against us, everything is as we spoke last December.

Maggie Ralbovsky: Is it all U.S.? Ken Statz: Yes, Security Capital does all U.S. which is different now. Maggie Ralbovsky: JPMorgan has another platform, why do they want to keep that? Ken Statz: What you're referring to is when JPMorgan bought our parent Bank One we were just there briefly, we didn't choose JPMorgan as our new parent and certainly JPMorgan would not have bought a REIT manager because they have their own REIT group, but because they bought Bank One and we were a brand new REIT group there they just said, okay, we have 2 REIT groups. Now why they haven't changed it since 2003 is we work in the real estate group under --- and the other REIT effort works in the equity group and when you think of REITs, are they stock or are they real estate. The other team is part of a stock equity group, we're part of the real estate group and what we find is investors tend to either go one way or another. When they pick a REIT manager they either buy a very diversified stock investment group because they're smart for stocks or they buy a real estate manager because we can talk cash flow, we can talk, I wouldn't have bought that building, my experience in real estate would be different and so what we're finding is many people in our opinion pick REITs for real estate first and I think that's why we're growing so rapidly, but they keep both groups and one is just part of the equity group, they would never change that because it's part of what the equity group does. At $6 billion dollars we might seem large, our parent runs $1.3 trillion dollars so that's what we're part of.

Let's talk about your portfolio and the market so let's turn to page 20. I'm going to update these numbers, this is crazy when you're updating by the week, usually you put in your quarterly numbers and then you talk about maybe is something amazing has happened. I'm going to give you updated numbers as of August 23rd, as of yesterday, let's flip forward to page 21 so you can see year to date. If you take year to date 2011, the answer is since August 12th the answer is about the same, you're down about -.4%, but in between then like in August everything has been up 4, down 6, down 3, up 4, so you're about the same but the REIT market is up about .6, so both the REIT market and your portfolio isn't flat so far this year.

We'll talk about volatility in between time and let's talk about what we prepared in your portfolios since we spoke in December, the tilts we've been taking and why your portfolio, I think we're taking less risk than average and I'll explain why and your portfolio is about par right now on a relative basis. We actually rather like the REIT market right now. Last time we spoke in December we thought things were getting rather pricy, things seemed to be gravitating to paying a lot for real estate which I'll show you some graphs. Since then the REIT market is flat, but parts of the REIT market are still very elevated in price and parts of the REIT markets, some companies are very inexpensive so that flat performance in REITs is hiding a huge change in valuation and there's some parts of the REIT market we think are extremely attractive right now to give maybe 11 or 12% rate of return over a 3 year period, we think that's a good return and it's supported by cash flow.

Even though it's been really volatile, let me dig into what's really happening in cash flow and cash flow expectations from real estate, what's going to happen to occupancy in a bad economy or a weaker economy, what's going to happen to rents and what are you paying for that right now, is there an opportunity to make returns in the U.S. real estate market. So I'm going to look at your portfolio in a little different way which would be on page 22. Like I said earlier you own about 24 securities in your portfolio and we list the top securities here on the left. What is more important is the bottom, what kind of real estate those companies represent and what kind of tilts are we taking in your portfolio based on that real estate, that's the most important question whenever you look at a portfolio of REITs. The question we would say is answered with our belief that your portfolio is very defensively positioned right now on a cash flow basis. We're trying to put in your portfolio higher cash yields in areas that we think will be still well protected even if the economy weakens and you can see that by how we put your portfolio together on the bottom. Where we've taken a lot of money out of your portfolio and rearrange it is in 2 columns called retail, regional shopping malls in the United States and shopping centers, those are the 2 areas that are very sensitive to the economy and consumer spending. A lot of the problem with the market this year is the consumer's been weak in the United States because of housing, their houses aren't worth what they thought they were so consumer spending has been weak, but what's been happening is on top of that consumer spending weakness, we now have the Government cutting back on spending and so the 3 areas, consumer, Government, corporate spending, those are the 3 big drivers of the economy. We had a weak consumer and because of that we didn't like companies that owned shopping centers. What we're finding is when retail tenants come to renew they still want to cut their rent, they still aren't making enough money in the United States and there's a lot of vacancy. What we're finding is that's an area where we don't find the cash flow quality very good because the cash flow leases that are supporting owning shopping centers is here but as tenants leases come up they want to cut a new lease lower and so not is it only hard to keep your occupancy, but the quality of your cash flow is going down. Even if the new tenant hasn't signed the new lease yet we say that lease over the next 5 years is going to roll down not up. I went to the Micronesia Mall and that's a perfect illustration of the problem with retail right now. When you walk that mall and I did this morning, that's a tough mall, that quality of cash flow is very poor and there's a reason for that, there's a Macy's, Macy's is good, but then the tenants in between, number one there's a lot of vacancies and vacancies where you wouldn't normally expect it, what we call throats in a mall, the throat right by Macy's, lots of vacancies right there and that's troubling because it should be well leased, you want to be by the Macy's throat and that's where there's a lot of vacancies. When you look at where there are tenants, a lot of it is local, a lot of it is what we call non-credit and in a bad economy those go bankrupt because they can't get funding, the bank will take their line, they don't have a lot of resources. I looked at that mall today and said, this is a perfect example of why you are under weight in retail, not at some point we won't buy more stock, we will but they're still struggling, it's very hard in retail especially if you don't have credit tenants to really have good quality cash flow. So think of that mall, there's always a price you pay, if it's very inexpensive fine but what we're really trying to look at is quality of cash flow and even cash flow that's going to grow even if the economy is weak and that's an example that is repeated many times in the United States. There's just too much retail right now for the amount of spending that can go on, so think of that and that's one of the reasons you're under weight here. That's a good example of cash flow quality that we don't want right now.

When the economy gets better all of a sudden it's great because all of a sudden they'll get more tenants and all of a sudden the holes will fill and when the economy is great you want local tenants because you can squeeze them for more money and that's kind of what landlords do, but right now you don't want that kind of tenant, you want credit tenant. So one area that we've been very cautious on is your retail.

Now flip where we've been over weighted and let's go to multi-family and apartments for rent. These are big apartments, the companies that you own, own like 200 or 300 units in a complex, some of their apartment buildings cost over $300 million dollars, they're huge quality apartment buildings on both coasts. The multi-family business in the United States is booming, absolutely booming and we've talked about this before I think last time I was here, we really like the fact that in multi-family all the problems for single family homes are accruing to the benefit of multi-family because people have to live some place, households are being formed, but people are now choosing to rent, not buy, some people don't have the choice to buy because they can't get a mortgage or they don't choose to enter the housing market right now and so your multi-family portfolio which are huge are 96/97% leased and there's nothing being built and so all the pain in single family homes is to the benefit of multi-family. Now that's been well known that you've owned a lot of multi-family, your stocks have done really, really well, in fact even this year when they're flat for REITs, multi-family REITs are up 20% still this year. So people are very excited about the rent increases and they're excited about rent increases even with a weak economy.

We're starting to sell down, last time when we talked we were at 24/26% multi-family, we're selling stock of multi-family not because we don't like multi-family, but you're paying a lot for it right now. People are excited the stocks are up and we just think there's relative places that are more attractive. So we're selling down your multi-family where you're 24 times cash flow. Flip that, it means you get a 4% cash yield, 4% cash yield to own commercial real estate, we want a 6%, 7% cash yield. So it's great, rents are going up in multi-family, you won, you made a lot of money owning multi-family, but these are still stocks so we're selling those and we're buying healthcare.

Now you're over weighted in healthcare, why would Security Capital want you over weighted in healthcare, everyone knows the Government's spending is going down, Medicare, Medicaid, nursing home funding, everything is being cut right now. Well, we think the stock market right now already figured that out, they beat up those stocks that own nursing homes, medical office buildings, anything to do with long term healthcare in the United States, those stocks have suffered and so their cash yields are very high. So we're selling your multi-family to 4% cash yield and we're buying your healthcare at 7% cash yield. That's a huge difference in terms of the price tag we're buying and so we like these companies because we think the market is already very depressed, they think that there's a lot of problems in healthcare funding, but the companies that we're buying for you own private pay healthcare and there's a big difference. We don't own Medicaid nursing homes, we don't own the areas that are really tough in terms of trying to get Government funding, we own assisted living, independent living, medical office, all of the areas that are private pay and that's a very powerful story because of the aging. What we're doing is we're mixing your real estate differently today than we did last time we talked, we won over in multi-family and now we're putting into work in a very controversial but we think well researched story on our side, healthcare because everyone hates healthcare right now they think it's terrible and we like to buy good real estate when the market thinks its prospects are poor but we think they're good because we think you make a lot of money that way, that's how you trade your portfolio. So, we've gotten what we think is defensive actually because healthcare is very defensive ultimately it doesn't really matter what the economy is doing, the aging population, the no supply and the quality of these companies with investment grade balance sheets, that's a pretty good place to be.

Now the other areas are smaller other than office and let me just touch on what we're doing in office, because office is one area where we have not made a lot of money for you this year, we've lost relative money in office. In the U.S. there are 2 office markets, there's the office market coastal New York, L.A. and Washington D.C. and those 3 office markets have been very strong. All the other office markets in the United States are flat to maybe down a little bit and so there's a big difference in what office you own in the United States, do you own New York City or do you own Chicago or do you own Houston. We made a decision earlier this year that you were over weighted in New York, Washington and L.A., those stocks are trading at 24 multiples, again 4% cash yields, they're very strong because rents are going up in New York and we've been trading because we thought rents are going up but they're not going up that much, we've been trading it for very stable REITs that own Chicago and Houston and Dallas because they're trading at 10 multiples so that means the much higher cash yield.

What we're doing is we're trading higher growth markets that everyone loves right now and buying stable income markets, so the biggest news in your portfolio is we've been trying to get you towards stable cash flows that even if the economy is weak we think they will be very high quality and we're paying a very low price for those cash yields and that's what's getting us kind of excited again and last time I was here I was thinking things are pretty pricy. Right now I'm kind of saying, there's parts of the REITs market that you could buy with very high cash yields that even if the U.S. economy is shaky for a while, these cash yields are pretty good and you won't get a lot of growth in the short term from healthcare and offices in Chicago but you're going to get very high cash yields and so we think in this environment cash yields are very important, the higher the better, the better the quality.

So we've moved your portfolio to what we say is very defensive because of very high cash yield portfolio in areas that we think even with a weak economy those cash yields are solid. As people get more excited about the economy again which will happen, we think there's a lot of gains to be had in those securities because people are all of a sudden going to understand they're sitting on 7/8% cash yields and those cash yields are valuable.

Wilfred Leon Guerrero: By cash yield are you talking about dividends being paid? Ken Statz: No and that's a great question because let's be very careful with REITs, some of them are, some of your higher income companies have 7/8%, 9% dividend yield, but in REITs that's only part of the story because remember a REIT pays out by law 90% of its taxable income, now their taxable income might not have anything really to do with our cash flow. So at Security Capital we look to the cash flow, we pay attention to the dividend but that's not what I'm talking about, we're saying if we own this, let's take an example, there's a company called Mack-Cali, it's very large in your portfolio, it's 3% of your portfolio, Mack-Cali owns office buildings but their office buildings are across the river from New York, they're in New Jersey and it's a very good portfolio, they have an investment grade balance sheet, it's a very quality company, but their cash yield if you would buy their real estate through the stock market, their cash yield is about 7.5% in your pocket cash yield, there's not a lot of growth right now, but it's very stable, so when we think the 10 year treasury is at 2%, that's 7.5% cash yield to own the real estate is darn good, to own the real estate that's a big spread and it's very attractive.

If you went across the river and if you still owned your big Boston properties position which we sold down, Boston properties is all New York, Washington D.C., Boston and San Francisco, their cash yield if you pay their stock price is 3.8%, 3.8 to own one side of the river obviously it's a big difference New York city and New Jersey, but we'd rather have 7.5 in our pocket right now than buy 3.8% and hope that it grows in this economy. So that's what we've been doing in your portfolio, selling down the very high profile, very high quality portfolios but they're priced to perfection, they're priced at a very high level and a very low cash yield. What we're trying to do is get your cash yield up, but not sacrifice balance sheet quality. So that's the strategy we've been doing and in the down turn you've been about average, the market in the 3rd quarter is off about 9.6%, you're off 9.3%. So far that strategy has had a little benefit but we actually think, especially if the economy does weaken significantly from here those big cash yields we've embedded in your portfolio are going to become very powerful and very valuable because that means the bond market is going to stay low for a long period of time and people once they get over the shock of the economy weakening, they're going to start looking around for the big question in real estate, where can I get income, where's income? If the U.S. Treasury gives you a 2% return for 10 years, where do I get income and once people get confidence in the cash flow at a 7, those stocks are going to perform pretty darn well. So we think the bond like approach we're taking right now will work very well for you and we think you can get out sized returns in owning bonds as long as the cash flow is good.

The biggest risk we see in REITs in general would be if not only people start worrying about cash flow like they are and that's why the REIT market is doing this because everybody is saying, if the economy is worse, what can Governments do right now, this seems to be dragging us maybe into another recession, the biggest risk that we're watching would be whether what happened back in 2008 which you missed, you came in beautifully right at the end, that's why you made 22% a year since you've been in REITs with us, that's terrific, you made a lot of money, you actually took money out perfectly, terrifically so I'm always interested in what Guam is doing because you get in right and you get out right, but it's been very, very smart, it's been really good.

I want to turn to a very important 2 pages to show you what are we worried about and what should you worry about and let me look at the first thing, page 29. Here's the big question I think you all have to think about, you came in right at the end, right at the end of 2009 and so that's why you made 22%, but how do we know we're not in 2007 and 2008, because the stocks are very volatile again and they're really starting to shake around, I mean up 10, down 9, up 6, you know what is going on here. The first thing is cash flow and cash flow quality, the big question in the market's mind is, in a weakening or weaker economy could your REITs have serious difficultly with their rents and occupancy and paying their debt bills. You own the leveraged equity, there's debt ahead of you, every REIT that we own for you has a balance sheet and they've got debt and the last time the reason you got in so cheaply where it went from peaks of early 2007 down to the depths of 2009, 2 things happened, one was cash flow quality because of the incredible recession went down and cash flow went down, but most importantly their balance sheets started to blow up, their interest to cost and their debts started to rapidly go up because people were afraid. What I'm telling you today is the only thing we're talking about today in REITs and the volatility is cash flow because of a weaker economy. The debt of REITs is not blowing up, it's not changing like it did in 2008 and 2009.

So I'm watching 2 things for you, cash flow we're going to watch very closely, but if you turn to my second page 36, you don't own debt with us, you own equity in commercial real estate, but look at, I call this the EKG of REITs and this top green line here is the debt interest rate charged to REITs by the bond market and you can see when the REITs last collapsed, something I'd be very worried about if this was happening, the debt cost sky rocketed from 4% to 14%, the bond market was saying, these companies are in serious trouble, they can't roll their debt and because of that the equity got crushed. You came in after it was crushed, but the question is could it be crushed again? The answer so far is no, the bond rates and this is though June, but I can update that REIT bond that 4.1%, its yield right now and these are corporate investment grade bonds with about a 7 year duration on average for REITs is 3.7%, so very, very different than 2008. When the bond market and they got it right first, the bond market will tell you if there's more trouble ahead with REITs then you should take money out on the equity. If the bond rates start sky rocketing, get out because that means the bond market is seriously concerned about the quality of these companies able to roll their debt and they're afraid that the REIT equity will get crushed because the bonds are going to take whatever they take, what's left over is for the equity. So when it went to 14%, the market was saying there's nothing left for the equity, a lot of these companies are bankrupt.

Now that was distress selling, there was a lot of craziness back then. We're watching and we own REIT bonds for other investors, so we're very big in the REIT bond market, the REIT bond market since all of this happened yields have gone down not up. So the bond market which has been very good is saying, this is a cyclical slow down perhaps in cash flow, but this is not a credit crisis, this is not what happened in 2008 and 2009 and so that's very important, unless we see bonds acting very odd and they don't, in my opinion the REIT equity, it's a cycle right now, what's going to happen to cash flow, but it's a cycle that won't result in 75% declines in the REIT equity. So number one, check that off, if we see bonds starting to act odd we will call you because if they start to act odd then you should take money out of the equity REIT market. The bouncing around isn't so much fun, but it's the bouncing around, I mean it's bouncing within a range. So that's very important, the REIT bond market is very tight, the REIT preferred market is very tight and because of that the REITs have great access to capital, there's no concern on that side, so that's very important.

The final page I have is page 41. In a nutshell we will tell you what the REIT market should make over the next 3 years. That 10.1% on page 41 is an indication of what's happening right now in REIT pricing and the important thing is spread. What we do on this page is we take all the cash flow from your portfolio that we're forecasting and then we put in the market price of the equity and the debt and we say, what is the market paying for that and when the market is paying a fair price, that yield and that spread will be at very good levels for just the 10 year and it will be a very good 10/11%.

The REIT market was starting to get pricy and it was starting to get in the 9's and when we see 9's that doesn't sound so terrible, 9% rate of return, but that spread to long term treasury is starting to get very tight, that means the market is paying a lot for the cash flow. This is the page that tells you in a nutshell on a spread basis when Security Capital believes the cash flow is getting attractive. Now this is for the overall REIT market, your portfolio if you wanted to put a dot on it right now is 11.5% and 11.5% is what we think your portfolio will return over a cycle of 3 to 5 years. That doesn't mean it won't have a lot of volatility, but 11.5% that's a very good spread to treasuries. Now obviously it's easy to be at a good spread to 2.6 or 2.2 or whatever. We don't use 2.2, we kind of say long term treasuries right now are probably being forced down by fear but 3%, what is your spread over 3%, because 3% seems to be more of an average in terms of treasury yields, long 30 year, 10 year, you're probably at about an 800 basis points spread total rate of return and a lot of that is in up front cash flow. That means right now in your portfolio we think you're owning high quality real estate, good balance sheets and we think you should probably make about an 11-12% rate of return and that's up from the 9-10% rate of return we would have said 2 months ago, why, because prices are down.

The cash flow quality, we were just talking to all of our companies... Wilfred Leon Guerrero: So next year when we meet you're going to be reporting 11.52%. Ken Statz: If the economy gets a lot worse maybe not so good, the only thing that will make it really bad is a bond rate shot up, if the market got frightened again then your equity is going to have a tough time but right now where the cash yields are we're actually pretty confident right now. We like the REIT market and we like being in the income side of the REIT market, not the growth side of the REIT market because on the growth side your cash yields are so low. Wilfred Leon Guerrero: You're going against the grain, what everyone is rushing to that building you're moving out. Ken Statz: Yes, that's what we try to do. I think our job for you is to buy good quality real estate that people don't want because if it's good quality real estate that everybody wants that's nice, but you're going to pay a lot and why have the liquidity of the stock market and not use it.

Our firm is moving people into equity because we have some clients that can buy equity preferred in debt so we choose whether you're in debt preferred or equity, that's another product that we have. We have been selling their debt and buying their equity right now, moving them up into the equity. So that is not just me telling you, that's me doing it for clients. We will see, it's still very volatile because of concerns on the economy, but when we talked to our companies they're not finding any change in business right now, last time when everything froze, nobody was making decisions, they're actually not finding anything different right now. So it's not the same as it was that time, not that things won't slow down, not that occupancies won't wait, but it's not the same and hopefully I can report good numbers in a year, but in the mean time if there's a bond problem, I will call. Wilfred Leon Guerrero: If there's a bond problem what do you propose? Rosalie Bordallo: Sell. Ken Statz: Because the equity markets and the bond markets for REITs don't move like this, they are different buyers, Security Capital is one of the few firms that buys everything, we buy debt preferred and the equity and so we watch everything very closely. Last time then the bond market went crazy, the REIT market kept going for like 12 months on the equity side. If we start seeing problems in spread widening on the bonds, that's a very important sign and I'll make sure I'll call you because that would worry me, that would mean we're missing something, but we're not seeing that, it's very, very calm in the bond market.

Thank you very much.
(End of presentation by Security Capital)

<u>3:30pm-4:15pm Cornerstone</u>

Scott Westphal: As you know I'm Scott Westphal and I brought along Dave Wharmby for a couple of reasons, one if them is he essentially works with me on strategy on the U.S. portfolio, he also manages our global portfolio and with so many global events going on right now that are impacting the investment markets I thought it would be good if you had some perspective from a global perspective to help you understand some of the dynamics that are going on in the investment world that are affecting even the U.S. markets. So I thought it would be helpful to hear his comments as well so hopefully you will enjoy his comments. Dave (Wharmby) is going to kick us off and talk about some of the organizational things that are going on in our company that we want to make sure that you're up to date on.

Dave Wharmby: Page 4 is our organizational structure, as you know Cornerstone is a subsidiary of Mass Mutual and Mass Mutual remains as one of the highest rated financial companies in the world and you'll also recall at the end of 2009 we made the decision to merge, Babson was one of our sister companies and had a real estate finance group that specialized in real estate debt, we merged that group into Cornerstone to create a full service real estate investment advisor. That sort of merger was effective as of January 1st of last year and the integration went very, very well. Some places where we have offices in the same cities we merged them so Chicago and Hartford and Glastonbury we merged the debt and equity offices together and it's one senior management team that runs the entire company. So now we have the 4 quadrants of the real estate space together under one space and the relationship was always very good between us on the equity investment side and Babson our sister company on the debt investment side, but we get significant additional leverage.

Scott Westphal: What we mean by the 4 quadrants is both public and private equity investments and public and private debt investments so we consider that sort of the 4 quadrants of investing in real estate.

Dave Wharmby: Page 5 highlights a little bit of the strategies we advise clients invested all throughout the real estate capital stack so we invest directly in physical real estate, physical properties on behalf of clients, we originate loans across the spectrum from first mortgages to mezzanine debt and bridge loans for clients, we invest in real estate securities which is what we do for you, we also invest in public debt so we invest in CMBS and corporate debt. So that's all been a great capability to bring in-house and particularly the public debt group, the group that invests in CMBS and REIT corporate debt, we run very closely together with them, we manage a small product together with them that's for our parent company that invests in both debt and equity listed so some interesting synergies with that.

Page 6 is just our map of office locations around the world, I won't spend too much time on that other than to point out where we're sort of globally located in the markets that we invest in.

Page 7 is the team organizational structure. The 2 things to point out here is the continuity and depth of experience in the bench, Scott (Westphal), myself and Rico Kanthathan who is in our Hong Kong office and the 3 of us have been together since the very beginning of Cornerstone's real estate securities platform and your team that manages your fund has been together since inception of our management.... Wilfred Leon Guerrero: This merger that's taken place, is it causing change in leadership and philosophy and approach? Scott Westphal: The CEO of the company continues to be David Riley and it just what it does really, we always interacted with the people on the debt side that were part of absent because they weren't affiliated with the company and the reason we interacted with them was because it was very important for us to understand what's going on in the real estate debt market as well as the equity markets because the cost of debt affects the real estate companies that we invest in because it affects their cost of capital. All this really does now is put all of the real estate companies or real estate efforts under one company, one corporate entity and it really enhances our ability to interact with them and to better understand the debt markets and the equity markets so it's been real positive for the group. Dave Wharmby: Same senior leadership team and that's basically the organizational update and unless there's any questions it's the same team that we had working for you since inception.

We have a market overview section here that contains a bunch of data and in the interest of time I'll just focus on a couple of things on pages 9 and 10. We're reporting to you on performance to the end of the 2nd quarter but there have obviously been a lot of changes since then and the first 2 pages here highlight that a little bit. From our point of view there are sort of 2 big things that are going on at the moment that are rattling the equity market and one is the sovereign debt issue in the Euro zone, really from our point of view and from how it directly impacts real estate or could impact real estate is the real issue there for us is liquidity and its impact on liquidity. The European banks still have a lot of U.S. CMBS on the balance sheets and they have a lot of debt from Southern Europe on their balance sheet as well so even though the banks are healthy in Paris and in Germany, they're still at risk and the risk for us is liquidity dries up and that could effect capital for capital ability for real estate. So that's one thing that we're keeping a very close eye on.

The second issue is the U.S. debt down grade and it's not so much the debt down grade itself, it's the Federal Reserve coming out after the debt down grade and their reaction basically confirming the market's fears that the U.S. economy had indeed slowed down and slowed down to the point that the Fed would pledge to keep interest rates at zero for 2 years. So those are the 2 things I think the market is trying to price in is they're worried about liquidity based on Europe and they're worried about they're now trying to price in a new slower growth global environment and so you see U.S. GDP forecast sort of the consensus view has come down below 2% now for 2011.

I talked a little bit about the potential impact that a liquidity crunch could have on real estate, the counter to that is that real estate markets are really in quite good shape across the world and particularly in the United States demand is outstripping supply prices and rents are improving and that's a situation that we continue to watch employment and the U.S. economic growth forecast, both real estate markets are still in very healthy condition and will continue to fair pretty well on the low rate environment. So the biggest threat, sort of the take away from that, the biggest threat we say is a liquidity crunch and investors still have that remembrance of post Lehman and the global financial crisis and so whenever there's sort of that threat of liquidity coming out of the system we see the equity markets reacting pretty violently, we saw that 2 weeks ago.

Scott Westphal: Thanks Dave (Wharmby). I'm on page 11 and this chart most people will find pretty surprising is that from a GDP perspective the United States is basically back to almost pre-crisis levels. The real problem is that in terms of employment we're no where near pre-crisis levels and part of the reason for that is companies have become more efficient, they become very conservative in deploying capital, they become very conservative in hiring people and because of that they have essentially kind of agreed to do more with less and it's increased their efficiency in their profitability but unfortunately it hasn't done much for the U.S. labor markets. The other thing that has hurt the U.S. labor markets a lot if that some of the more labor intensive activities or sectors in the U.S. labor market like construction are down dramatically and we employed a lot of people in the United States during the residential housing boom, that housing boom obviously ended badly and now we have a lot of people that were in the residential construction business and also in the real estate business but they would be mortgage brokers or people that were in real estate sales, a lot of those jobs have gone away and the fear is those jobs may take a while to return and that's one of the reasons why the forecast for employment is as modest as they are and one of the reasons that we don't think we're going to get to pre-crisis employment levels until 2014 so essentially 3 years from now.

If you go to the next page, this basically looks at what's happening with employment growth. The blue bars basically show you employment growth and the red bars we call it diffusion index and it shows the breadth of jobs across different sectors of the labor market and anything above 50 means there's reasonable breadth, but ideally you'd like to have greater breadth like we had a couple of years ago and if we could get greater breadth then that would help broaden out the benefit of these jobs, but unfortunately in the area of both construction jobs as I mentioned earlier and in the area of Government jobs, many Governments have cut employees in order to balance their budgets.

If you go to page 13, this is basically a review of what's happening with property prices, there are 3 indices here. The first 2 indices, the NCREIF and the MIT transaction based indices are what we call institutional indices, they're essentially what we call institutional grade properties that pension funds or endowments might invest in, higher quality properties and higher quality markets. The first index the NCREIF index is appraisal based, the second one is transaction based and as you can see here there is a recovery in both of these indices. The other line here the greenish line which is showing really no recovery or little recovery little recovery is really a broad based property index that really includes all types of property, both lesser quality properties what we call non-institutional properties in secondary markets and as you can see when you add those other property types in here the recovery is somewhat challenged.

If you turn to page 14, this is our outlook on the various property types, the multi-family property type or the apartment sector property type is one we favor quite a bit. We think that the multi-family sector really benefits from a number of things, one there's a lot of pent up demand for apartments from essentially people that wanted to get jobs in the past couple of years but weren't able to, those people that are getting jobs now do want to create new households, do want to rent apartments. There's also a very positive demographic trend going on right now, the age cohorts essentially 18-26 years old that have the highest --- (52)to rent, they're a very, very large piece of our population right now so that creates a lot of demand for rental housing as well. The third thing is that we have a tremendously weak housing market so a lot of people out there who are able to buy homes right now are deferring that purchase because they're afraid the home prices may go down further. Lastly there's a fairly limited supply, in a normal year we build about 320,000 apartments in the United States, right now we're building about 170,000, so limited supply and all these other benefits add up to a pretty positive picture for multi-family apartments.

Office is really a story of 2 types of office buildings CBD and suburban, the fundamentals for CBD are really positive particularly in places like New York and San Francisco, some of the suburban markets are coming back but a lot of the markets are going to take a while to come back because of the sort of anemic employment growth that we have right now.

Industrial continues to do well in coastal markets and what we call inter-modal markets where they service trains and trucks, but a lot of the other industrial property tends to be somewhat challenged.

In retail we're basically favoring quality malls and basically grocery and grocery anchored community centers.

As far as hotels are concerned, it's kind of a very strange dynamic that's going on, we still have very strong revenue growth. One of the terms we use in the hotel sector is a term called (54) it's basically a combination of growth rate in hotels and growth and occupancy and we've had very positive (54.12) dynamics are statistics over the past year and have continued to have pretty strong numbers, but there's an awful lot of fear out there that because there's this turmoil in the U.S. economy that continuing growth in (54.29) may no longer continue to grow and so because of that even though there are attractively valued and they're putting up good growth, they're not performing particularly well and that's largely because of this concern about the weakening economy.

This is our view of what's happening with vacancy rates across the various property types and as you can see vacancy rates and all property types are declining, some more quickly than others. Apartment vacancy rates really never went up that high and a lot of that has to do with the fact that the amount of supply we had if new markets come into the market was pretty constrained. In the office area, the CBD office will actually decline quite a bit, probably below 9% in a lot of markets but the national numbers will be much higher than that so the companies that we're investing in office are essentially CBD companies that focus their efforts in markets like New York, Boston, San Francisco and Los Angeles.

This is a continuation of a story we talked about before, supply of new real estate continues to be at very, very low levels, this is largely because the developers have gotten religion to some extent and also the fact that financing for new construction is very constrained at this point so the amount of new development we have coming in to the markets is very limited and this continues to be a very big benefit to the U.S. real estate markets.

As far as our strategy for the U.S. REIT strategy we do have to acknowledge that we are heading into a bit of a soft patch right now, we don't think that we're going to go into what we call a technical recession we think that we'll probably get into a 1.5% kind of growth environment, maybe 2%, but I think the concern is that when growth is that slow that people even though they're not in a recession they'll feel like they're in a recession and they may act like they're in a recession and that will affect consumer spending and affect growth in the economy so it is a concern of ours although we think certain niches of a lot of property types including retail will do well during this time period.

As far as the transaction market is concerned, it continues to be very healthy, there's a lot of money out there in the United States looking to buy high quality real estate of all the different property types, particularly in apartments and some CBD office markets and we believe that money will continue to flow based on our surveys of how much available capital is out there.

As far as the shape of the REITs themselves, they're balance sheets are really in pristine condition, they have raised a lot of equity over the last couple of years, they've been able to lower their debt costs through the lower rates that are available in the market and we think that their balance sheets aren't as good as shape now as they've been in the last 10 years.

Our preferred sectors continue to be multi-family and self storage and I talked a lot about the positive aspects of multi-family. The fundamentals of self storage tend to mirror those of apartments because when a lot of people move into apartments they tend not to be able to put all their stuff into their apartment so they tend to rent self storage units and so both of those sectors are doing extremely well, we're heavily over weight in both of those sectors right now.

This (page 18) is just an overview of what we're over weight in and why. I've already reviewed apartments. Healthcare we're under weight primarily because there is a major issue with the U.S. Government budgets concerning the reimbursement levels for healthcare companies. Healthcare companies primarily provide housing for the elderly and a lot of that money comes from Medicare and Medicaid reimbursement. Medicaid and Medicare reimbursements are under tremendous pressure now with the Federal budget so we're under weight in the group because of these concerns. Retail was really a tale of 2 different types of retail, we're over weight in regional malls, A quality regional malls and we're over weight in high quality grocery anchored community centers, other than that we're under weight. Industrials we're under weight because of both the valuation and the concern about the vacancy. (Page 19) Office we're over weight in CBD and we're also under weight in lodging also because of what I talked about in the conversation.

(Page 21) These are the top 10 holdings as you can see we have a number of high quality apartment companies in the form of equity residential in AvalonBay, we also have CBD companies like Boston Properties and we also have Public Storage which is the largest storage company up there and then in addition to that we have Simon Property Group which is the largest A quality mall company in the universe.

On page 22 this is a quick overview of the characteristics of the portfolio versus the benchmark and nothing too earth shattering here.

On page 23 I want to spend a quick minute on this because one of the things that we've done over the last month and a half is we've changed the characteristics of the portfolio quite a bit and part of that was because we had such a dynamic change in the fundamentals of the U.S. economy and so if you look at the June 30^{th} portfolio here the major changes are that we increase the apartment over weight, we increased the self storage over weight pretty dramatically and we also went to an over weight in regional malls. We took down our weighting of healthcare and shopping centers and also industrial. So basically those are the changes and that largely reflects a very rapid change in the fundamentals for the U.S. economy.

On page 24 this is a review on performance as you asked us to present it and that's everything I have. I'd love to take questions with time permitting. Wilfred Leon Guerrero: What kind of return can we expect from you going forward? Scott Westphal: Let's talk about where the REITs are versus their underlying real estate. The REITs right now are selling at anywhere between an 8 and a 14% discount to their underlying real estate value so that to me is a pretty positive thing. They also aren't being able to essentially refinance any debt they have out there at extremely low rates because of low rate environment so they have positive sort of mark to market on the value of the real estate, they have a positive situation with their cost of capital because of the cost of debt markets and the fact that they have very pristine balance sheets and they have very limited new supply in the market place, all those are very positive. The couple of risks that are out there that we do need to concern ourselves with are we heading into a double dip within the U.S. economy. I don't think we are, I am concerned that if growth gets so slow that it may seem like we're in a double dip and that may create the type of sentiment and consumer behavior that basically acts like we're in a recession. If we can avoid a major down turn in the U.S. economy, I think these companies will go back to trading at a modest premium to their underlying net asset value which means they can gain anywhere from 7-14% discount plus a moderate premium, they also will collect a dividend of about 4% and they also will generate earnings growth of say, 7-9%. If you put all that together you get a pretty positive picture assuming that we don't go into a major, major down turn and I hope that explains it to you sufficiently.

Wilfred Leon Guerrero: Early we had Security Capital and I just want to make sure the approach you guys are taking is different and from what I'm hearing it is different and that's good for us because we want to be diversified. Scott Westphal: We have always been aware that you look at us differently and you expect different things from us and we want to be consistent about providing that to. Wilfred Leon Guerrero: Financial advisor tell us. Maggie Ralbovsky: Earlier you said that your big concern is the liquidity issue in Europe, if something happens in the banking system in Europe will that induce double dipping in the U.S., will that spread to the U.S., what's the implication for the world if that happens. Dave Wharmby: It could and that's certainly the concern and that's why you saw the Fed speak out about the solvency of the European banks because they are worried about that liquidity and if you have liquidity dry up like it did post Lehman that will have pretty dire effects for global economy. I think 2 things are different and I think we're along the process of delivering and I think that the Governments around the globe are much more aware of the risks of allowing something like that to run to far so in Europe where there has been the political will to make promises but not follow up, I think you're beginning to see some follow up. So we highlight that was the one big risk that's out there, but we don't see that scenario developing, we think that you will continue to find liquidity in the system and as Scott (Westphal) mentioned, the U.S. REITs that you're invested in have pristine balance sheets, they have all raised a lot of equity, they're holding cash, they don't have any debt maturities of significance for the next several years, so the companies are very well poised to withstand even a slight liquidity crush. Scott Westphal: Plus to the extent they do have debt maturities, you have a 10 year treasury now that is hovering right around 2%, that is extremely positive for their ability to refinance so even if spreads widen out a little bit they're still going to have pretty attractive environment to refinance debt. We have companies that

have $3 or 4 billion dollars worth of liquidity available to them... Maggie Ralbovsky: Does that mean even your global portfolio you're over weight in U.S., do you think U.S. is the most attractive sector in the global portfolio? Dave Wharmby: We are over weight in the U.S. in fact some places, some distinct places in Asia as well, Australia, certain parts of Hong Kong because of valuation. Maggie Ralbovsky: How about the currency effect, in my mind it seems to be a pretty large effect for real estate, if the QE3 really comes along wouldn't that impact U.S. dollar pretty significantly and actually make the U.S. relatively speaking to the rest of the world in REITs actually not do very well? Scott Westphal: Well there's a lot of doubt whether QE3 will happen or not, but just to go back to QE2, when QE2 happened the price of real estate sky rocketed and the reason it sky rocketed was because when you think about it, the intent of QE2 was to inflate asset values and by inflating the asset values particularly the stock market that would put more cash in people's hands and hopefully they'll go out and spend the cash and stimulate the economy and it didn't exactly play out that way, but that was the intent and so the market ran pretty significantly when that happened. I don't think QE3 if they do something it's going to be smaller and I don't think it will necessarily have the same effect but there's an awful lot of people out there who are pretty responsible who are campaigning against QE3 so for that reason if we do have a QE3 I think it's going to be more modest and it's going to have a somewhat different outcome, but it's a tough one to call. Dave Wharmby: There is a deleveraging out there that has to occur, it was delayed by the past stimulus and quantitative easing and we still have to get through that. (end of tape 4)
(End of presentation by Cornerstone)

Respectfully submitted,

Stephanie A. Herrera
Recording Secretary

Affirmed:

Wilfred P. Leon Guerrero
Chairman