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**RETIREMENT FUND**  
STABILITY · SECURITY · REWARDS

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**Defined Benefit Plan**  
**Quarter Ended June 30, 2012**  
**Performance Meetings & Annual Manager Reviews**  
August 31, 2012  
Retirement Fund Conference Room

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**Katherine T.E. Taitano**  
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**Board of Trustees Present:**

Joe T. San Agustin, Chairman, Board of Trustees  
Wilfred P. Leon Guerrero, Ed.D, Chairman, Investment Committee  
Gerard A. Cruz, Trustee

**Staff Present:**

Paula M. Blas, Director  
Diane Bernardo, Controller  
Rosalie Bordallo, General Accounting Supervisor

**Other Present:**

Maggie Ralbovsky, Wilshire Associates

**Other-Recommendation**

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## **Other Recommendation**

Gerard Cruz: Is this the only thing you want to discuss? Wilfred Leon Guerrero: I know you want to put someone on watch, Numeric. Maggie Ralbovsky: That's already on watch. There are a couple of guideline issues I want to discuss with the Board which were raised with the past couple of manager meetings. Gerard Cruz: Maybe we'll do that first. Maggie Ralbovsky: Okay, let's do that one first if that's your preference, the guideline discussion.

During the presentation by Cornerstone which is the REIT manager, I don't think Dr. Leon Guerrero was in that meeting, but during that meeting the REIT manager mentioned that he thinks the REIT valuation is very volatile and at times he felt it is overvalued and right now the guidelines is such that the manager is not allowed to hold any cash, therefore even if the manager thinks that particular time period has very overvalued securities, he still has to buy them. So it was proposed for the manager to hold some cash, to allow the manager to hold some cash. We did talk about the fact that the current statute has a limitation on commingled funds so if the manager holds cash we would prefer them to just buy overnight securities, like T bills or Federal home loan bank notes and discounted notes and stuff like that instead of getting that cash being swept into the custodian's fund because in the latter case it will be counted as the commingled fund. Wilfred Leon Guerrero: I was not aware that we have a policy against them having cash. Maggie Ralbovsky: Well we have guidelines that do not allow them to hold cash. Gerard Cruz: As an investment. They can have cash that they hold for a short period of time when they liquidate, but that's only suppose to be for purposes of transition, when they sell and they're in the process of buying, but as a matter of just holding cash as an investment vehicle, no. Wilfred Leon Guerrero: Right. Maggie Ralbovsky: Like hold for a week because the manager thinks that securities are too expensive and he will want to use that dry powder, cash is viewed as dry powder, the jargon to buy on the next dip, buy high, sell low kind of thing. Some managers think they can time the market, some managers don't, so for example the REIT manager did not even care but certain managers think it's... Wilfred Leon Guerrero: Are we talking about the law or just the Board... Gerard Cruz: Board. No, it's not the law it's just the guidelines determined by the Board.

Wilfred Leon Guerrero: Okay and how would you like to see it resolved? Maggie Ralbovsky: To allow the manager to hold somewhere between 5 and 10% in cash. Wilfred Leon Guerrero: For? I think you're going to have to spell out the time because otherwise... Rosalie Bordallo: I think currently a manager can petition the Board for that flexibility to allow for an increase in the allocation of their cash so it's not something that's set in stone at this point because I do know that we have put waivers on certain managers to allow them to increase their cash. Paula Blas: Actually during 2008 and 2009. Maggie Ralbovsky: So would the manager's presentation be considered as petition? Rosalie Bordallo: They would have to ask, they would have to officially request to the Board in letter form. Gerard Cruz: They can do that but as a matter of if there is any reason why we would deny is our question. What are the risks of them holding cash and does it bump up against any other limits, are there other unintended consequences? Maggie Ralbovsky: So the traditional objection to that proposition of the manager holding cash is that they are not considered asset allocator because they have a particular mandate, that's what they're hired for to have that expertise and to invest in the REIT market rather than to be an asset allocator to

determine whether REIT is the right time to invest in because that's the job of the Board. So that's the traditional objection to that proposition, at the same time we could also recognize the fact that market timing margin is part of the investment strategy, so if you think the manager has the expertise in doing that and that's part of the value addition to the manager then that becomes not an asset allocator question but rather an intrinsic part of the investment strategy. So Cornerstone was trying to make a case for the latter, they're saying... Gerard Cruz: Security Capital actually, Ken Statz. Paula Blas: Security Capital. Diana Bernardo: It was Security Capital, it was the first manager we saw yesterday. Maggie Ralbovsky: Okay, it's Security Capital. He made a case to want to classify this cash holding as part of the investment strategy to basically time the low point of the valuation and get out at the high point of the valuation, so it's not the asset allocating function but rather a strategy function. So my view is that this manager made a case for this as part of the strategy and we should not prevent it.

Rosalie Bordallo: Can I ask a question? When the guy initially proposed to be hired was that part of his proposal? That's my concern, you hire a manager for a specific reason, because you liked his style and then later on he wants to change his style. That's my concern, the manager when he proposed says this and this and this, was an allocation to cash being allowed to go that high in the original proposal . Gerard Cruz: What is he asking for, 10%? Maggie Ralbovsky: I think between 5 and 10. Paula Blas: Between 5 and 10%. Gerard Cruz: Of his allocation? Paula Blas: Yes. Wilfred Aflague: And what's his allocation? Paula Blas: Wouldn't there be a natural mechanism that if you allowed that it would also mean that it would affect his performance? That's \$85 million, so \$8 million. Paula Blas: If you're not fully invested it's going to affect his performance. Gerard Cruz: He knows it's still going to be a measure of his performance and he did say though that his practice added 100 basis points to performance, the practice of putting some money in cash. His comment was that currently in his space, in his mandate he's seeing (he didn't use the word significant but) a lot of volatility that he feels that he could put the money to work for us but given the amount of uncertainty, it might be just as wise for him to pull some of that money back and hold it in cash and let the volatility run its course. This is a REIT manager, this is not like a typical buying stocks or large cap, small cap, so he's buying buildings. Wilfred Aflague: But is he just putting the cash aside to wait for the volatility to smooth out or is he going to time the market? Maggie Ralbovsky: He's trying to time the market. He has made a case to say he has the ability to time the market which added 100 basis points value. Wilfred Aflague: Are we convinced that he can do that, that he can time the market? Maggie Ralbovsky: No, he's just talking about the volatility of this period and he's also just using that as an option, not to say he's always going to hold 5% in cash but the ability to do that. Wilfred Aflague: Can he show us evidence that he's done this before with other investors with him? Maggie Ralbovsky: That's a good question, we can ask for that. Wilfred Leon Guerrero: At any rate from what I'm hearing is that you would have to put in a request to do that and I guess at that point we can turn around and ask, are you doing this for the other... Wilfred Aflague: I would like evidence that this works. Gerard Cruz: Maybe that's what we'll do, just respond to him and ask him to make a formal request and then based on that... Maggie Ralbovsky: And in that formal request maybe show us evidence that he's done that. Paula Blas: Attach the evidence that Mr. Aflague is talking about. Maggie Ralbovsky: Okay, I will follow up on that matter.

Now there is another guideline issue that surfaced during the presentation and that was with regard to Eaton Vance. Nancy (Tooke) mentioned that currently in the guidelines there is a \$3 billion dollar hard limit for the biggest stock they could hold, at the same time the Russell 2000 Index which is their benchmark can have securities above \$3 billion dollars, right now it's at 3.3 I think she said. Gerard Cruz: The \$3 billion refers to their market cap because Eaton Vance is a small cap manager. Maggie Ralbovsky: The Russell 2000 Index is the next 2000, so if you look at the entire market of U.S. stocks the top 1000 stocks defined by market cap is in the Russell 1000 and the next 2000 stocks are in the Russell 2000, so there is not a definitive definition of small cap in terms of market cap it, it's not like saying anything below a particular market level is small cap but rather the next 2000 stocks. So given the fact the market cap moves up and down if we have a definitive cut off as a definition of small cap we will at some point enter into problems, so usually people will have a definition that's relative to the market instead of being an absolute number. So I think we should probably revise that definition to be consistent with the Russell 2000; instead of saying the manager cannot hold any securities with market cap above \$3 billion, we say that the manager cannot hold any securities exceeding the top market cap of the Russell 2000. Gerard Cruz: Exceeding the top market cap? Maggie Ralbovsky: Exceeding the biggest market cap of the Russell 2000. Gerard Cruz: How would you word that? Wilfred Leon Guerrero: Wouldn't it be better instead of saying Russell 2000 to say the benchmark? Gerard Cruz: Because we change the benchmark. Rosalie Bordallo: Well can't you just say they can only purchase items that are only within the Russell 2000? Paula Blas: Market cap. Rosalie Bordallo: No, don't even say market cap because if it changes again... Maggie Ralbovsky: But the thing is after 2000 there are another 4000 stocks in the U.S. Rosalie Bordallo: But aren't we going for small cap? Maggie Ralbovsky: Yes, so the manager can probably currently still hold securities below the 2000, so I think not exceeding the market cap of the Russell 2000 or something like that. Wilfred Leon Guerrero: How about just using the word "benchmark" instead of identifying Russell 2000? Maggie Ralbovsky: Rather than saying Russell 2000, just say benchmark? Their benchmark is the Russell 2000. Wilfred Leon Guerrero: That's what I mean.

Rosalie Bordallo: Here's your problem, if your benchmark is the Russell 2000, if their benchmark is the Russell 2000 they shouldn't be going below the 2000 if their benchmark is the Russell 2000. Maggie Ralbovsky: No, not necessarily. Their performance should beat the Russell 2000 and the Fund does not have micro cap allocation, so the small cap can probably hold some micro cap. Rosalie Bordallo: Okay, so you want flexibility to allow them to go above, well because we're saying giving a definitive number as to the capitalization we would have to remove that and just say what's ever held in the Russell 2000. Maggie Ralbovsky: Well the biggest security in the Russell 2000. Gerard Cruz: Nothing larger than... Maggie Ralbovsky: Nothing larger than the biggest security. Rosalie Bordallo: Nothing outside Russell 2000. Gerard Cruz: But they can go 1000, so we're not creating a floor, we're creating a cap. Maggie Ralbovsky: Yes, however until you find a way to word it, that's the intent. Rosalie Bordallo: Right, we understand that, but my concern is if you're telling me that what we're using to basically look at their performance is the Russell 2000 and now you're saying they have the ability to go beyond the Russell 2000 then that benchmark that you're using to compare it or to judge their performance is not good in the sense that you're using other things that are not even in the Russell. The micro caps then are now can add a lot of value and I'm saying, well their performance is being

judged against the Russell 2000 and now they're going outside the Russell 2000. Maggie Ralbovsky: In fact every manager goes outside of their benchmark. Rosalie Bordallo: Right, I can understand that but that's where you call them in and say, look, I hired you to be this type of a manager, yes you're enhancing your performance by going outside of what I basically hired you for and yes you benefited from it, but at the same time it's misleading to me because if I hired you to be this animal and you start adding different things then you're really not that animal anymore in essence is what I'm saying here. Maggie Ralbovsky: Well the thing is the securities below the top 3000 is less than 2% of the market cap in the entire U.S. market, so the opportunity down there is very little. I do appreciate the comment. Rosalie Bordallo: But what I'm saying here is that if I hired you to do this... Maggie Ralbovsky: As a purist you say that, as a purist you say... Rosalie Bordallo: Yes, I can understand but here now it affects your performance and how I judge you because you're showing me a performance of how you beat out the Russell 2000 by 200/300 basis points but the reality is you did that by taking greater risk, by going into a lower area that really that wasn't your mandate to begin with. Maggie Ralbovsky: The thing is we don't have a micro manager, a micro cap manager so it will be a good thing for the Fund. Rosalie Bordallo: Right, you don't have a micro manager or micro cap manager, then maybe you should hire a micro cap manager instead of saying, it's okay to deviate, it's okay. I mean, that's what you're saying in essence. Maggie Ralbovsky: Yes, that is what I'm saying, it is okay to hold micro cap for small cap because all small cap managers hold micro cap. Rosalie Bordallo: Right, but what I'm saying is that it becomes misleading to the Board when they say, look, I hired you to do this job and you're doing a great job because your numbers are great but the reality is you're doing a job and also kind of moonlighting on the side to enhance that job. Maggie Ralbovsky: Not exactly. You could say the same thing for every manager, for example all your EAFE managers hold emerging markets, all of them, all your growth managers probably hold some stocks that's not even considered growth, every manager holds some out of their benchmark security, even your REIT manager holds up to 8% in something... Paula Blas: So in their portfolio a percentage if we allowed something like this would be no more than what? Maggie Ralbovsky: Well the total market cap for all the securities in the U.S. below the top 3000 is 2%, 98% are in the top 3000 that's why most people do not have a micro cap manager because it's very easy to over weight that piece, it is such a small opportunity set and the liquidity there is not very strong so usually people let their small cap manager do the micro cap portion and usually they do it, most of them do it, it's not saying that everyone will do it. Usually when people constrain their small cap manager they don't want them to be large because usually they have a large cap allocation and they usually do not constrain the bottom because they don't have a micro cap manager. I think in the case we really should consider to get managers to use all the opportunity sets that will benefit us instead of really micro managing them. Rosalie Bordallo: But see my concern here is really a legal issue here. If I hired you to do this job and this is what the RFP specified and now you're going outside what your contract says you're doing. Maggie Ralbovsky: The contract doesn't say they can't do small cap.

Paula Blas: The thing about it is even with the RFP, this is what I'm trying to understand, just the fact that we hired a small cap manager and they're able to actually pick up some pieces in the micro cap, that doesn't change their appearance as small cap manager. Rosalie Bordallo: I don't know, you're saying that but you haven't analyzed the portfolio to say, look they're really... Paula Blas: That's why I was asking Maggie (Ralbovsky) what was

the percentage, how far can they possibly... Rosalie Bordallo: How far are they benefiting from this area? Maggie Ralbovsky: They may hold one or 2 securities. Rosalie Bordallo: But at the same time they may is not telling me they could also have 20% in that area, that's what I'm saying. Maggie Ralbovsky: Theoretically you can't, in reality those securities are so tiny it's very, very illiquid for any manager to trade in size, so usually a manager holds very little in those areas unless you're a micro cap manager you know where to source those securities. Rosalie Bordallo: That's also what I'm trying to get at. Okay, this guy is deviating into a lower area that's really what we did not hire him for, isn't it better just to get a specialist in that area, just to hire a manager in micro cap? Maggie Ralbovsky: Well as I said, most small cap managers define their universe as anything below the 1000 so they have the ability to do the bottom areas and the reason I don't think we should hire a micro manager or maybe that will change or it could be changed. Rosalie Bordallo: You see what I'm trying to get at is you hire someone who has a specialty and he's saying his specialty is small cap. Maggie Ralbovsky: Which includes micro cap. Rosalie Bordallo: Well I don't know how the RFP read, I think it was just exclusively small cap, but you gave him the Russell 2000 as his benchmark which means that you're really not going to micro cap, you're going the Russell 2000. Maggie Ralbovsky: Well, the benchmark is the performance benchmark. Rosalie Bordallo: Well that's it, it's a performance benchmark and you had given him this performance benchmark because that's what you expect him to basically invest in. Why would you give an inappropriate benchmark if you know that he's always going to beat this benchmark because he's moving outside that benchmark? Maggie Ralbovsky: Every manager has other benchmark securities, that's just a matter of fact. If we constrain the managers into 2 small pieces, then you really tying the manager's hands to perform and we don't want to tie the manager's hands to perform. Rosalie Bordallo: I think there are different outlooks on this, the thing here is if I hire somebody, how much do you want to allow him to stray is what it is. He's straying from what I hired him to do and that's where your attribution reports come in, it shows basically how far they've been straying to get the performance and that's my concern here. Maggie Ralbovsky: If you want to pick that point, your international manager Fisher holds 10% in emerging markets, that is your biggest deviator. Rosalie Bordallo: But Fisher has been called for that. Maggie Ralbovsky: But you're using EAFE as a benchmark, why would you use EAFE as a benchmark if someone holds 10% in emerging markets? Rosalie Bordallo: But here I'm saying, 10% emerging markets, they're not allowed to, they weren't allowed to, they did pick it up and we did make basically an exception and they're not suppose to be picking up anything after that exception.

Paula Blas: Why doesn't Nancy (Tooke) just submit... Maggie Ralbovsky: Nancy (Tooke) did not say she wants micro cap, she did not say that. What I'm saying is that we do not want the bottom constraint, she did not say she wants micro cap. The whole thing I think is more philosophical than in reality, I don't know if she even holds micro cap, we can probably take a look. I think it's more possible for Numeric to hold micro cap because Numeric is actually a smaller manager, it holds smaller securities. Philosophically speaking, small cap managers do cover micro cap space and micro cap there is not a specific definition of what is micro cap, just like your large cap managers hold mid cap. Anything below 750 stocks is considered mid cap. The more you constrain a manager, the less they can do. Gerard Cruz: I see what you're saying. Rosalie Bordallo: There are 2 different ways of looking at it. Gerard Cruz: As a purist I agree with what you're saying, I'm

just taking it from a practical standpoint. We know that our large cap managers, our large cap value manager MetWest has held growth funds and growth stock and they still do, they own Apple and they were able to get in and growth managers have held what we would consider value companies as stocks too. If we're going to apply that rule for small cap, then we need to make sure we're willing to apply that rule across all managers. Rosalie Bordallo: Yes and I understand that and that's the point I'm trying to get at, how far are you willing to let your manager who you hired under a certain mandate stray from that mandate. That's what it is that you need to decide. Gerard Cruz: Here's the challenge, when we ask the manager why are you holding a stock that we think is a growth stock, their rationale some way justifies that to them they see value in it. We could ask that question and whereas 2 different managers and 2 different mandates hold the same stock and we have asked that question and they've come up with the rationale that for a growth manager this stock is growth and for a value manager this stock is value. From where we sit it's difficult for us to police that purchase, that transaction because we get into the position where we begin to manage their portfolio for them. Rosalie Bordallo: But I think from a fiduciary standpoint you have a responsibility to do that to some degree because... Gerard Cruz: But where do you draw that line though? When you hire a manager and trust their process... Rosalie Bordallo: (Just real quick), if I want Facebook's IPO's, would you consider that a growth at this point because... Gerard Cruz: Right, sure. Rosalie Bordallo: Now a value manager goes and picks up Facebook and you don't say anything to him, that's a breach of your responsibility, especially now that it tanked, it's been tanking. Gerard Cruz: Yes, but the fact that it tanked is a luxury that we have today, but the purchase have been several, I mean if we call the manager's attention to... Rosalie Bordallo: By what definition, would you have put Facebook as a value stock? Gerard Cruz: What if they paid dividends and met the earning... Maggie Ralbovsky: Yesterday I asked a question to Nancy (Tooke) that it seems to me that your portfolio seems growthy and she said, well, that's because growth is trading cheaply, growth is now value, so really these concepts are so arbitrary I think from the seats we sit at we want to look at the total portfolio, the total composite. As I mentioned that 2 days ago that the total composite now has a little growth tilt to it and that is the thing that I want to pay attention to and I really think that and I really think we should limit our micro managing the managers because those managers are hired for... Gerard Cruz: A classic example is Oppenheimer. They came in as value and we said, why are you buying Enron on the way down? Why are you buying them on the way down and continue to buy on the way down? They were able to justify the reason, I don't know if it's justification but they were able to explain the reason why they were doing it. Rosalie Bordallo: Because at that point when they were down they were thought at as value. Gerard Cruz: Sure, I understand. I guess my point is, at that level the manager is going to have an explanation for it and if we question every stock purchase... Rosalie Bordallo: No, I'm not saying... Gerard Cruz: We don't, I don't have the time to do it. Rosalie Bordallo: It's the same thing as, you see your portfolio moving towards a growthy weight right? Gerard Cruz: Sure, but that's a big picture question, why are you moving in this direction? Not like, why are you buying these, why are you taking these positions? Rosalie Bordallo: It's moving that way because they're buying positions that are, that's the only reason it happens. So, if you're value managers are moving tremendously in that direction, you're putting yourself in the danger that look, the reason why you have 2 different styles is really to balance the portfolio, not to let it tilt to one side too much and if you don't address it and say to your managers, look, we know that you're moving to a growth style, can you please




explain why or at least ask for justification. Gerard Cruz: I agree with that. Rosalie Bordallo: You can end up with major losses. Gerard Cruz: I agree. I agree in that context that if we see from a macro level managers looking more growthy then we need to ask those questions, absolutely. Wilfred Leon Guerrero: It becomes a procurement problem basically that's what you're pointing out.

Paula Blas: Maybe we can table this, there are other things we need to discuss. Maggie Ralbovsky: Can we move on to the next agenda item and we'll maybe we'll come back to this later? Gerard Cruz: That needs to be an action item if we intend to go forward with this. Maggie Ralbovsky: I would like to constrain the top market cap to the largest holding in the Russell 2000 because the current guideline does not have a bottom constraint, this does not add a bottom constraint but rather change the definition of small cap to be below the largest holding of the Russell 2000. Wilfred Leon Guerrero: So do we want to make that recommendation to the Board right now or do we want to wait or what? Maggie Ralbovsky: I would. I would like to make that ceiling constrain revision from \$3 billion, an absolute number to a relative number as the largest holding, the market cap with the largest holding in the Russell 2000. Gerard Cruz: Which is currently about \$3.3 billion. Paula Blas: But you want to say, you just want to give it a specific number? Maggie Ralbovsky: No. Wilfred Aflague: I don't understand what we're saying about market cap. Maggie Ralbovsky: The market cap is the stock price times the shares outstanding, so if a company has 100 shares outstanding each share trading at \$50 dollars, the market cap is 50 times 100 is \$50 dollars. Wilfred Aflague: Now why do we need to define... Maggie Ralbovsky: Because right now in the guidelines the manager is not suppose to hold any security larger than \$3 billion dollars in market cap. Wilfred Aflague: Okay. Maggie Ralbovsky: Because the market cap is a moving target and the benchmark of Russell 2000 at this particular point in time has the largest stock at 3.3 billion, the manager is given an absolute number at the ceiling while the benchmark is a moving target, I want that to become consistent. Wilfred Aflague: So we want it to be not a definite number but we want it to be a relative so that when the market shifts... Maggie Ralbovsky: We don't have to change all the time, that's right. Wilfred Aflague: Is this a problem or a concern now? Rosalie Bordallo: No, that's not and you should never put solid numbers in anything because that's the problem, market cap in 10 years ago was maybe \$10 billion, now it's \$100 billion, so you set it at 10 and you're going to always have to change. Wilfred Leon Guerrero: Do you have the wording for that? Diana Bernardo: Maggie (Ralbovsky) is going to make the recommendation. Paula Blas: To allow the constraint to be a relative number of the largest security in the Russell 2000? Maggie Ralbovsky: To revise the current constraint of \$3 billion as the largest holding constraint, right now in the guidelines there is a holding constraint. We want to revise the \$3 billion maximum market cap holding constraint to the maximum market cap, not exceeding the market cap of the largest holding of the Russell 2000. Paula Blas: This is really just an amendment to the guidelines, right? Maggie Ralbovsky: Right. Paula Blas: So that amendment is actually, I mean, it's revising the guidelines but the amendment to allow... Maggie Ralbovsky: To revise the current maximum holding of \$3 billion market cap, the maximum holding size of \$3 billion market cap to a maximum holding size of no larger than the largest holding of the Russell 2000. Paula Blas: To revise the maximum holding size of \$3 billion market cap... Maggie Ralbovsky: To no larger than the largest holding in the Russell 2000. Paula Blas: We'll come up with the right wording.

Wilfred Leon Guerrero: The other thing that you wanted to bring up, is that an action item?  
Maggie Ralbovsky: Well we can talk about this (Directed Brokerage) next time, it's not an urgent matter but there is an impact to the IPS. I think Joanne (Grimes) wants this to be approved by the Board right?  
Wilfred Leon Guerrero: We're at the point where we need to officially convene an Investment Committee Meeting.  
Maggie Ralbovsky: I understand. So we can talk about this next time because you want to also talk about securities lending, so we can talk about both of these matters next time.  
Wilfred Leon Guerrero: But we have all the recommendations identified, right?  
Maggie Ralbovsky: The recommendations also include keeping Numeric on watch to the end of this year and keep Eaton Vance on watch.  
Gerard Cruz: Hold that. (At this time the Regular Investment Committee Meeting was called to order).

**Respectfully submitted,**

*for*   
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**STEPHANIE A.H. LIMTIACO**  
**Recording Secretary**

**Affirmed:**

  
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**WILFRED P. LEON GUERRERO, Ed.D.**  
**Investment Committee Chairman**