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Quarter Ended 3/31/12 Performance Meetings & Annual Manager Reviews

May 30, 2012
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, Trustee
Wilfred Aflague, Trustee

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

Other Present:
Maggie Ralbovsky, Wilshire
Doris Flores-Brooks, Office of Public Accountant

10:00am-10:45am Economic & Capital Market Environment

(Start of tape 1)
Maggie Ralbovsky: Tomorrow I have a discussion as a continued discussion from last time but maybe I will refer to one page from tomorrow's book later on just so you get that book ready.

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Okay, I'm going to start with page 3. The 1st quarter was another strong rally quarter for the equity market around the world and this time international equity also participated. If you recall, for the 4th quarter of 2011 U.S. equity was up 12% and international equity actually was down, wasn't catching up as much bur for this particular quarter we just went through the entire equity world market went up. It appeared to be a quarter where people just decided to be very tired of worrying about Greece and we just decided to take a break from that so it was a quarter where risky assets all rallied especially for the information technology and financial sector, both of these sectors were up, actually more than 20% for this quarter alone.

Wilfred Leon Guerrero: Can we get clarification first? You're talking about 4th quarter, ending December 31st? Maggie Ralbovsky: I'm talking about the quarter ending March 31st. Wilfred Leon Guerrero: I thought you said 4th quarter. Maggie Ralbovsky: I said compared to the 4th quarter where international equity did not participate. We're doing the 1st quarter, I'm comparing that to the 4th quarter to make a point that the entire world actually participated in the rally. So the performance that we're looking at is? Maggie Ralbovsky: March 31.

I will have more detailed numbers for the quarter, for the different asset classes as well as your managers but before that I want to give you an update on Wilshire's annual public fund funding study which from page 4. Wilfred Leon Guerrero: When can we catch up so like when we review this at least a month after, not 2 months? We're in May right now and you're looking at March. Diana Bernardo: One thing about Maggie's (Ralbovsky) presentation is it really has a lot to do with the timing of the preparation of the reports. Maggie Ralbovsky: That's right. Wilfred Leon Guerrero: From my perspective I'd sure like to read April for this one. Maggie Ralbovsky: We have the April flash. Have we sent out that yet? We send a flash report out on a monthly basis. Wilfred Leon Guerrero: I want to meet with you a month after the quarter ends. Maggie Ralbovsky: That's actually pretty hard because it takes us 5 weeks for the books to done, it takes 5 weeks for the books to be prepared, for the big book to be prepared because we collect all the holdings and we do all the attribution and stuff like that. Antolina Leon Guerrero: Do you do this for similar funds? Do you make these kinds of presentations? Maggie Ralbovsky: For all our clients. Antolina Leon Guerrero: All of your clients, so you do meet with all of your clients... Maggie Ralbovsky: On a quarterly basis and it's usually always 6 weeks later after the quarter ends, that's always the case. It takes the custodian banks 2 weeks to get their numbers, it takes us another 2-3 weeks to prepare our books, but we do prepare the raw numbers for return for the flash report. Antolina Leon Guerrero: How quickly does the flash report come out? Maggie Ralbovsky: I think the flash report comes out 3 – 4 weeks after, so I think the flash report is out I just don't know... Gerard Cruz: I think we received it. I've seen it. It's in an email form, it just doesn't have as much detail. Paula Blas: You just have the returns on it. Maggie Ralbovsky: Correct.

Okay, so I do want to give everybody an update on the funding survey. We do this once a year, this is for the public funds which GGRF is compared to. You can see that for this particular one you can see the summary from the top chart on page 4, this is a progression or a trajectory of the funding ratio. The top chart is based on market value, the bottom chart is on actuarial value and actuarial value tend to be smooth so there is an amortization of loss, so if one year you experienced a significant loss, the actuary actually smoothes it to recognize the loss or gain through an amortization period, therefore it looks like the funded ratio is more smoothed but eventually it's all going to converge so we usually focus on the market value funded ratio and you can see that the median funded ratio for State funds are 75% and last time I looked at GGRF's funded ratio it was 45%. I think that's relevant given what I read about the proposal lengthening the amortization for unfunded liabilities basically to reduce the contribution rate on the Government side. Rosalie Bordallo: Correct. Maggie Ralbovsky: I do think that we need to keep the current under funding in perspective and try to, if I were have to say that I have an opinion I would say let's not do that because it's probably more important to move up the funded ratio than to close the funded ratio gap rather than to leave it. Joe T. San Agustin: What do you mean? Maggie Ralbovsky: Currently the funded ratio is 45%. Antolina Leon Guerrero: Which has been the lowest in a long time, right? Joe T. San Agustin: Our funding ratio? Antolina Leon Guerrero: Yes, the unfunded liability. Maggie Ralbovsky: Your payment is $175 million out of the $1.2 billion fund which is more than 10% a year, so you really rely on the contributions so to not get a drawdown of the principle and if the contribution rate gets reduced, you may enter into a situation where you have to drawdown the principle to pay the benefits. Joe T. San Agustin: Which we have been doing. Maggie Ralbovsky: Well no, not really because your contribution rate is more than... Antolina Leon Guerrero: The contribution rate is already approaching 30%, that's why the Governor is doing that and our rate compared to other retirement funds... Maggie Ralbovsky: But you cannot compare to other retirement funds because our retirement funds are 75% funded, number one, number 2 they're not closed plan and this is a closed plan, therefore you have accelerated payment and the payment is more than 10%, it's actually 15%. So it's basically a tug of war if you think of it, if the drawdown to the Fund exceeds the current for the Fund, you eventually will be in a depletion sort of a scenario.

Joe T. San Agustin: How much of a spread do you anticipate funding the return versus the needs to meet the cash flow? Maggie Ralbovsky: You cannot exceed the return. If you exceed the return you're going to pass the point of no return. Joe T. San Agustin: That's what I'm saying, what is the spread that we have right now. Maggie Ralbovsky: Your current contribution rate is based on an amortization period as well as an expected return of 7% and your actual expected return is actually not going to be 7% and we actually have an estimate and it's actually, all the public funds, nobody has been more than 6.5%. So basically you already have a shortfall there. Joe T. San Agustin: What if the contribution, let's say other plans are restricted to pay any annuity, but has to be invested 136 -134Maggie Ralbovsky: Less than 5% drawdown.

Gerard Cruz: What he means is, what is the expected return based on our existing allocation? You said it was 6.5%? Paula Blas: Of all funds she was saying. Maggie Ralbovsky: I actually have an expected return calculated for the Fund, 6.3%. Gerard Cruz: Okay, so our expected return is 6.3%, our actuarial return is 7%, so we're short 70 basis points. Maggie Ralbovsky: That's if you keep the current amortization. Gerard Cruz: And allocation, the amortization and the allocation. The amortization is not related to the rate of return. Maggie Ralbovsky: It is. It is the unfunded ratio to the amortized and the unfunded ratio is based on an expected return. Gerard Cruz: I know but the expected return is a fixed input, in other words we determine the expected return based on our strategic allocation and from that input and the input of the amortization period we develop the contribution rate, not the other way around. So what I'm saying is that the expected rate of return is an input that we create. Maggie Ralbovsky: It is currently 7%. Gerard Cruz: And that's correct. But it's not, in other words the amortization term doesn't drive the expected return. Maggie Ralbovsky: No, but the expected return drives the contribution rate. Gerard Cruz: I understand. So, the spread, to go back to the question that's being answered is negative 70 basis points currently. So that's where we are in the world of theory, our actual return though is where? Maggie Ralbovsky: Your actual achieved return. This is backward looking. Gerard Cruz: Of course. Let's just use this fiscal year. Maggie Ralbovsky: We should use a 10 year. Gerard Cruz: Or 5. Maggie Ralbovsky: Total fund for 5 years, 4.87% annualized, 10 years is 6.47%. Gerard Cruz: So we're tracking close to the expected return. So the response to the Chairman is that we are short by 70 or so basis points, .7%. Where he is leading is that if our actual return is greater than the actuarial rate, then in his mind he's saying that there is excess return but in this case there is not. Maggie Ralbovsky: No, there is not. Gerard Cruz: To justify, I'm sorry just to complete my thoughts, there is excess return to justify an extension of the amortization period and therefore a reduction of the contribution. Maggie Ralbovsky: Okay, I see what you're saying and from my point of view using 7% as the expected return to calculate the contribution rate is already underestimating the contribution rate. Gerard Cruz: It's already shorting the contribution rate because it's already over stating our expected return. Maggie Ralbovsky: That's right and if you lengthen the period even more you are even more under contribution so then there will be a point of break even that past wish, you can never catch up and I don't want to bring up the NMI situation, it's the most distressed situation but that was after the point of no return and that's a slippery slope, you can never catch up.

Doris Flores-Brooks: And Mr. Chairman is not here but in the actuarial report, the increase in these benefits, the changed increased the actuarial accrued liability by $64 million dollars, that change and I'll repeat it when it comes in, that's in your own report right now, that increased the unfunded liability by $64 million dollars right there. Where are we going to get the money to fund that?

Maggie Ralbovsky: Okay, if I may move on, that is how to compare to... Doris Flores Brooks: Mr. Chairman if I could, I know you were saying it was already calculated and everything but the change and increase in actuarial accrued liability for these benefits, it increased the unfunded liability by $64 million dollars. Joe T. San Agustin: Sure, they've been increasing the unfunded liability for years because of the generosity of the Legislature providing benefits. Doris Flores-Brooks: It's a generosity that we can no longer afford. Joe T. San Agustin: All retirement benefits, the military benefits, those increase contributions, but I'm talking about the spousal benefits, from the very beginning, from the history of the Fund 100% is given to the spousal benefit if the person dies, that's from the very beginning, that's to cover all the children. Doris Flores-Brooks: I don't dispute that. Joe T. San Agustin: All we're doing is restoring the benefit, in fact we're still ahead because we didn't restore it 100% because we're still have a limited, the dependant up to 21 years old, 18 and limited 5 dependants the unfunded is increasing because of all our generosity, we have extended all our benefits that you don't find in any common retirement system. Doris Flores-Brooks: That's true.

Maggie Ralbovsky: So to answer your previous question whether we have generated a spread over expected returns, we have not for the past 10 years. That's why I'm concerned because our increasing trend to tap into the principle has been increasing over the last 10 years. That's why we're insisting on the investment return, on the probability of diversifying the investment, that's why we're always open to your suggestions to improve the investment returns, I'm always open to improve investment returns rather than improve the contribution because that's a fiscal policy of the Government. Maggie Ralbovsky: But don't reduce the contribution. Doris Flores-Brooks: I don't think anyone is going to reduce the contribution but whether or not the Government can afford to increase it is a different story. I don't think they plan to reduce it. Maggie Ralbovsky: But I thought they're going to plan for an amortization period which is the same thing as reducing contributions. Joe T. San Agustin: It was the prime motivation of changing from DB to DC. Maggie Ralbovsky: I understand that but it accelerated the near term pay out. Joe T. San Agustin: That DC was to reduce cost from 9 to 5% and close the plan. Gerard Cruz: But that didn't affect the security ratio anywhere nearly as drastically as any... Well clearly because the unfunded in only on the DB side. Joe T. San Agustin: The DB side is a closed plan. Gerard Cruz: But the unfunded liability, the security ratio was impacted because of the early out. Doris Flores-Brooks: That was the biggest hit in 2000. Gerard Cruz: Not the closing of the plan. We would have still been at the 75% security ratio. Doris Flores-Brooks: It was the early out that really hurt. Rosalie Bordallo: It exhausted the funding of the supplement. Joe T. San Agustin: All those extra benefits, education, When you start closing all those plans, all those generous benefits that we gave to entice our people to come back to GovGuam, educational credits, military credits, even this double, where you can get an extra compensation when you work outside, the teachers particular when in the summer when they're unemployed and they can double up their retirement plans... Rosalie Bordallo: That's non-base. Joe T. San Agustin: And we still have a lot of people who are non-base on the payroll. Doris Flores-Brooks: Yes, up to now. Joe T. San Agustin: And that contributed to the unfunded.

Maggie Ralbovsky: Okay let's move on, I just wanted to put the problem into perspective. Gerard Cruz: So are you going to recommend that we reduce our expected rate of return? Maggie Ralbovsky: Well Wilshire actually issued that opinion to all public funds, to 6.5, but I know CalPERS they are our client and they reduced from 8 to 7.5 after we issued the opinion, so it's not to say 7 is excessively high compared to the universe, I think on average it's 7.5. so you're actually lower than the average, but based on your asset allocation right now it does not support 7% expected return. Doris Flores-Brooks: Say that again. Maggie Ralbovsky: The current asset allocation in our view does not support the expected return of 7%. Doris Flores-Brooks: Because the asset allocation... Gerard Cruz: It's just the universe of returns in our existing allocation supports a return of 6.4, 6.3. Doris Flores-Brooks: So the question would be, what would you have to do in your asset allocation... Gerard Cruz: No. If we mess with the allocation too much what happens is that it also affects the risk of the portfolio. Maggie Ralbovsky: That's right. Gerard Cruz: So our position has been not to chase return at the expense of inflating our risk. So what we need to do in order to calibrate our portfolio is to reduce our expectation of return and how that affects the Fund is on the contribution rate. Maggie Ralbovsky: That's right. Doris Flores-Brooks: So we're not going to go after a higher return we're just going to... Maggie Ralbovsky: The return is given by the market and the market has been such that every asset class expected return has gone down and we can only shoot for a target risk level of whatever the market generates and from our point of view with treasury at 1.7%, everything is priced off the treasury rates and treasury is 1.7%, you really just can't imagine a place where all the risky assets get inflated to a higher rate of return, you just can't get it.

Okay, so we're going to move on to the next page, page 6. Page 6 here is the universe average asset allocation. Gerard Cruz: Did we get a copy of this? Maggie Ralbovsky: I sent a copy last week or the week before in email. Gerard Cruz: Did we participate in the survey? Maggie Ralbovsky: I don't know. The list of people who participated is in that report, I don't know, if Paula (Blas) did not participate then you guys did not participate. I don't know did you file? Part of the survey comes from a filing that they pulled from a data base, so if you have that filing then you would be there but I don't think you were there. It's listed, 102 participating entities are there and I don't think you were there.

The average asset allocation you can see that has 51% equity, U.S. and non-U.S. combined and the average asset allocation also has more different pieces, I'm just trying to compare to the GGRF asset allocation. Wilfred Leon Guerrero: These are public funds? Maggie Ralbovsky: These are public funds, only State funds actually. Wilfred Leon Guerrero: I see people investing in private equity and we're not allowed to do that. Maggie Ralbovsky: Well there are many things you're not allowed to do. Gerard Cruz: How does that affect our expected return? Maggie Ralbovsky: You're expected return right now is 6.3%, but as you also mentioned... Gerard Cruz: So there is no material impact? Maggie Ralbovsky: As you mentioned earlier that we need to put into the context the risk and you can see the expected return and risk is graphed on page 7, so for the 6.4% return the universe is taking, you see the risk level and yours is at 11% at 6.3. Gerard Cruz: 11% at 6.3 whereas the universe is 11.4 at 6.5? Maggie Ralbovsky: Yes. Gerard Cruz: So we're right on the frontier. Maggie Ralbovsky: On the universe you're just a little bit shy. Tomorrow I do have some more data because I think last time the Board asked me to prepare some discussion on that topic which I have, so tomorrow I will have more discussion of this. This is just to put the framework together. Okay, so that's the funding survey and you do have a copy in your email box, if you want another copy, let me know.

For the 1st quarter, here is the economic review starting from page 8. Everything changed in the 2nd quarter. We could also add a little to bring us up to date, but for the 1st quarter the U.S. economic indicators have continued to be quite consistent to a slow recovery sort of a profile, the recovery is taking hold, you can see I circled the 2 bubbles on the bottom, 2 charts, one is for GDP, one is for job growth. Both of these charts are slightly positive so it's consistent with a growth kind of profile but a very, very weak recovery really cannot be compared to the previous cycle which I think last quarter I provided you with the previous cycle comparison. All these indicators are still below average of previous cycles, however it's positive, compared to Europe, compared to those countries in the European Union, it's actually quite good. Europe is dealing with either a deep recession or mild recession, basically recession is the core case for Europe. Okay so in the U.S. there are a couple of constraints to growth and these 2 constraints still continue to be the constraints. Number one is the employment constraint, you can see that we graphed the unemployment higher than the usual unemployment rate as well as the wage growth. These 2 factors will determine the weak consumer spending behavior which really contributes to a slow growth.

Now the second indicator of a slow growth is the debt constraint on page 10. The consumer debt you can see on the bottom chart, household debt as a percentage of disposable income currently is still above 110%. There has been some tapering off, you can see from the top mainly due to modifying the mortgage, basically people default on mortgage, people walk away from their houses and that has wiped out some of the debt, but still in an aggregated level, high debt level still shows that the consumer spending pattern will be weak because of the debt being still relatively high. Savings rate has dropped which actually supports the slow growth scenario, when people actually decided to take on more debt even though they have a lot of debt to the extent they can they actually have increased debt level which has contributed to some of the weaker consumer growth. Gerard Cruz: I'm sorry, say that again. Maggie Ralbovsky: Even though they are pretty high with debt level on household, there has been some optimism I guess in the spending pattern you can observe people are actually taking on more debt, the savings rate actually has dropped which partly due to the low rate of financing, rates are dropping with a very supportive Fed, partly due to that, partly due to the policy by Government agencies to actually encourage the debts to be given to certain people, so those have an aggregated effect of dropping savings rate. That is actually good for recovery because you want people to be able to spend money; however it also indicates a very lengthy period of sluggish recovery because you still have this indebtedness that cannot be resolved so it's double sided. Later on you can see that other countries are even worse.

Right now this is the U.S. market return on page 12, you can see that it was a very strong quarter, basically different sectors all included everything. Another observation you can make is growth significantly out performed value, that's on the second panel. Large growth was up 15.6% and large value was only up 9.9% and keep that thought in mind because that actually contributed to your portfolios out performance because your portfolio is currently positioned quite in a growthy sort of a profile. Antolina Leon Guerrero: How do I read that? If you look at the second panel, Wilshire U.S. Large Growth Index was up 15.6% and U.S. Large Value was up 9.9%, that's a significant out performance of the growth sector. Gerard Cruz: That doesn't happen often does it? Maggie Ralbovsky: No. You see the chart here on the bottom right hand corner, growth versus value, they change relationship in the current quarter. Gerard Cruz: The growth has been out pacing value for some time. Maggie Ralbovsky: Yes. Gerard Cruz: What do you account for that? Maggie Ralbovsky: The banking sector. The finance sector mostly in the value index and that's a sector that's been beaten so badly, but this quarter it's up 20%, this quarter finance was up 20%.

The next page shows us the bullishness in the market place where we calculated return based on credit quality and you can see that the lower the quality, the better the return. People call it junk rally which is consistent with the --- of liquidity into the market that just --- the junky sectors. Wilfred Leon Guerrero: What do you mean by lower quality... Maggie Ralbovsky: The rally may be short lived when you look at this because junky sector rally usually don't... Wilfred Leon Guerrero: What do you mean by lower quality versus... Maggie Ralbovsky: If a company has a higher debt level it's considered lower quality, so there's the credit rating for these companies and the lower rated companies are considered the junky sectors. Gerard Cruz: They could be a good stock though, that's just jargon to represent the level of debt that they have on their balance sheet. Wilfred Leon Guerrero: Lower quality is high debt? Maggie Ralbovsky: Yes, usually lower quality means higher debt and usually when you see lower quality rally that is consistent with the liquidity ---, so when you have a lot of liquidity in the market place it has to go find something to buy and that usually pushes up the lower quality securities.

Page 14 is for the U.S. fixed income sector. On the right hand side there is a graph of treasury yield curve and for this particular quarter actually the current quarter you can see the yield curve moved up a little bit. This is for the 1st quarter and after the ending of the 1st quarter that has changed, treasury has significantly went down because of the new worry of Greece being booted out of the Union. I'll talk about that when we see the credit spread. Gerard Cruz: So Garcia Hamilton did well. Maggie Ralbovsky: For this quarter, yes because it's very high quality. You can also see the credit spread has gone down for this quarter. Another thing you can observe here is for the high yield credit spread which is the orange line on the bottom left hand chart, it is still above historical average, it's still at 600 basis points which is relatively high considered to historical averages. So even with that rally, high yield index is still relatively cheap.

Okay, I'm going to move to page 16, which is the international sector. This is Q1, Q2 has changed significantly. In Q1 you can see that every country has actually done well, emerging market was the best performing market for this quarter. As I said earlier it's a quarter where people decided not to think about Greece, it wasn't like the Greece problem was over, or the

European debt problem was over, it just fatigued, it was just fatigued by the market place. Gerard Cruz: Actually there was optimism in quarter one, wasn't there? Maggie Ralbovsky: Because LTRO was viewed to be a positive thing and at the time people were pushing the, us included, we were pushing the projection of another problem coming in at least a year away because the LTRO is a 3 year program, but what happened after the 1st quarter ended was 2 elections went the wrong way. The first election was the French election where (Nicolas) Sarkozy actually lost and Francois Hollande, the socialist candidate actually won the election and he immediately said that France does not support further austerity and he wants growth oriented which means he wants to have stimulus rather than to cut the debt level and he also threatened the previous pact. The previous pact, the 17 country pact was based on a commitment of not spending more than 2%, running less than 2% of deficit for all the countries, if you run more than that you have to pay into this penalty fund, so that's the pact and (Nicolas) Sarkozy said he does not support that pact, not (Nicolas) Sarkozy, (Francois) Hollande is trying to threaten that pact. The second election that went the wrong way was the Greece election, until this day they still don't have a Government because the socialist candidate actually could not, did not win the majority and they couldn't form a correlation so they're actually going to have another election in June which is throwing a lot of uncertainty into the market place. Right now the party that actually won the election, but not majority is threatening to put Greece out of the union.

Wilfred Leon Guerrero: Help me understand this graph you have here on page 16. What we're looking at is the 1st quarter of the year? Maggie Ralbovsky: That's right. Wilfred Leon Guerrero: And that's in blue. Maggie Ralbovsky: That's right. Wilfred Leon Guerrero: We just started the year so why are there differences? Maggie Ralbovsky: That's not a year to date, that is one year so for the past 12 months, March to March. The orange line is March to March. Antolina Leon Guerrero: That's a full year whereas the blue is the quarter. Maggie Ralbovsky: That's right. Wilfred Leon Guerrero: Why would you want to make that kind of comparison? One of these bars is from January to March, right? Maggie Ralbovsky: That's right. Wilfred Leon Guerrero: And the other one is from March to March? Maggie Ralbovsky: The past 12 months, that's right. Antolina Doris Flores-Brooks: Comparing the quarter to the past year, how did this quarter do to a year ago. Maggie Ralbovsky: It's just a one year return, if you don't want to see it I can delete it. Wilfred Leon Guerrero: I'm just trying to figure out what you're telling me. Maggie Ralbovsky: I'm trying to tell you the past year. Doris Flores-Brooks: The quarter was better than the past one year, that's the bottom line because this was a good quarter, the quarter ended March was the best quarter compared to a year ago. Maggie Ralbovsky: Why do you want to know the past year, is that your question? Wilfred Leon Guerrero: Yes, what difference does it make? One of these bars is like the blue one, January to March and then the orange is for one year. Doris Flores-Brooks: Including March, right? Maggie Ralbovsky: That's right. Wilfred Leon Guerrero: I don't understand the relevance here. Doris Flores-Brooks: Going forward we're doing better than we did in the past year. Maggie Ralbovsky: I think it's relevant to see a longer term, if you don't want to see one year we can make that 3 years, if you want to see fiscal year we can make that fiscal year. Paula Blas: I think at least if we have the quarter and with the year to date represented the fiscal year to date your one year could be whatever the last 12 months so that way you could... Gerard Cruz: Actually you have it all here on the table form. Maggie Ralbovsky: So are you saying you want to add fiscal year to date? Paula Blas: No, I'm looking at your first chart where you have the quarter and the year to date and it's the same and one year is the last 12 months. Maggie Ralbovsky: That's right. Paula Blas: I think it might be helpful if we did the 2 quarters on the YTD, make it fiscal year to date as opposed to year to date so we can trail what the fiscal year is also. Rosalie Bordallo: I think what Dr. LG wants to know is why you're doing a comparison. If you look at the bars, the yellow bars or the orange bars are one year and then the blue bar is the current quarter, now if you looked at this you would say for the last year they were really down. Now when you compare this bar, the length of this bar compared to the quarter you can actually say they've made up quite a bit because if this doesn't exist here, this would have been out to here. Maggie Ralbovsky: That is true.

Doris Flores-Brooks: But going back to your original comment, this was a great quarter, why again was it a great quarter and was this quarter a fluke or is it something we can hope for? Well the 2nd quarter is pretty crappy right now. Maggie Ralbovsky: Well the reason it's crappy, I'm trying to finish the story, the 2 elections actually accelerated the problem because the problem could have been pushed back to next year or so but now all of a sudden you have 2 main countries in the pact saying, we don't like the pact, we're going to re-write the pact. Now what is the exit for Greece? Well it is a European Union, when they formed the union there was no exit. You mention a freeway with no exit and you have this car now flipping over and over and all these other cars are trying to avoid it and this car needs to get off the freeway but there is no exit. So now the European union is trying to figure out how to build an exit ramp as fast as possible or the car just has to somehow get off the freeway in a disorganized manner.

So that's the situation Greece is in, the situation the situation the European Union is in. The problem is that Greece really doesn't want to be in the Union from the current Government and they have these austerity measures that already are impacting unemployment rate at 25%. Now you still have to cut more which is a social problem, it's just really not going to be successful, I don't think austerity is going to work at all and Greece's condition is so different from Germany and Germany doesn't want to commit to a stimulus kind of policy because that's going to make Germany... Wilfred Leon Guerrero: Is Greece still relevant? Greece is in isolation, Greece is a very small country, however you have to think about who owns Greece debt, it's all those Spanish banks, Italian banks, that's what LTRO did, is to give these banks a free loan to buy Greece debt, not just Greece but also Italian debt and Spanish debt. Now if Greece debt defaults which is a certainty if they leave the Union, it's going to default immediately and when it defaults these banks have all this debt, right now they are marking to par because it's being guaranteed by the Union. Now if they write down those debts which means people are going to run on those banks, now the pressure of running on the banks, the bankers will know that every banker will fail if people start running on the banks. So the question is, can Germany have enough of a will power to support all these banks. If Germany wants to do it they can do it. Germany is probably 70% of the GDP there, if they want to do it they can do it, but the problem is Germans are still paying for the East Germany Unification, they're still paying for that. That has increased the German debt level, the debt level was increased because of that event and if they want to take on this new task it's going to push down Germany's credit rating. So that is a huge question mark and Angelo Merkel is losing support in her own country to do that so even if Germany can do it they may not be able to do it which means Greece is not an isolated problem. If Greece cannot be back stopped you're going to have a banking crisis in Europe and whether that's going to spread to the whole world is a question mark, it's not priced into the market place. Right now the market probably is priced into a no exit scenario for Greece, muddle through a recession kind of scenario. The market has not priced into a systematic sort of a banking crisis in Europe. Doris Flores-Brooks: The market has not priced Greece exiting because if Greece exited it would be a greater disaster. Maggie Ralbovsky: Well Greece to exit, what's going to happen? Nobody knows, so that's the thing, I don't think the market priced into a bad scenario for Greece exiting. They may have priced into Greece exiting but nothing happens, like all the other banks will be just fine kind of scenario. If that's the case the European Union equity is cheap, it's actually very cheap, it's trading at, compared to debt it's at a very cheap level, however, you cannot make a case to say it is cheap if you have a banking crisis. That's the scenario we're in, it's very treacherous because you don't know if you should pull out or not pull out because if you pull out, you may be so wrong, so dead wrong because it's so cheap maybe nothing happens, but if you don't pull out you may also dead wrong when you have a banking crisis. The market is pricing in the middle of the ground sort of scenario and the outcome is either here or here, it's not in the middle. The whole capital markets is priced into this here so pretty much it's all wrong.

Gerard Cruz: Haven't the banks though 3rd and 4th quarter of last year, didn't they write their exposure to Greek debt? Maggie Ralbovsky: U.S. did. Gerard Cruz: No, European banks, French particularly and Italy. Maggie Ralbovsky: They wrote down some of the old mortgage, the previous round of stuff, they did not write down the new debt they took on with LTRO. Gerard Cruz: Right, the debt that they took on with the LTRO, the Central Bank, was used to create a buffer of capital in the even that Greece was to default. Maggie Ralbovsky: They actually bought sovereign debt. They used that LTRO money... Gerard Cruz: As collateral. Maggie Ralbovsky: They used sovereign debt as collateral and they borrowed against the European Union. Gerard Cruz: Correct. So the owner of the sovereign debt is Central Bank. Maggie Ralbovsky: ECB and Central Bank and these country banks. Gerard Cruz: But I thought that the program was to buffer the country banks in the event at that time what was going to be a default, an eminent default. Maggie Ralbovsky: The program is to give them a free loan they can lever up to buy a high interest loan, therefore if you give them long enough of time it creates a buffer. If Greece defaults prematurely, you take away the time horizon for that buffer to be created. It is a positive leverage, a positive carry... Gerard Cruz: But the default of Greece, wouldn't it affect the Central Bank more? Maggie Ralbovsky: Yes. Gerard Cruz: So Germany is saving Europe wouldn't be saving the countries as opposed to saving the Central Bank. Maggie Ralbovsky: Yes. So the ECB's loss will be very large. Gerard Cruz: It will be huge. Maggie Ralbovsky: That's right but most of that will be Germany's debt because ECB is pledged by all the member countries.

Gerard Cruz: So you can have a European Union without Greece under that scenario. Maggie Ralbovsky: You can you just have to back stop all banks. Gerard Cruz: The banks are going to be back stopped by the ECB is what I'm saying. The ECB will back stop the banks. Maggie Ralbovsky: Right now they're not back stopping it yet, they will have to. Gerard Cruz: It's because they're going to have to cash in their guarantees. I mean if the country banks don't pay on their loans, if those loans go into default, then the ECB is the entity holding it. Maggie Ralbovsky: That's right. So now the new proposal being proposed is the bad bank/good bank/bad bank sort of scenario. They're basically saying all the country banks cap their debt at a particular level, everything above that goes into a particular fund, it's called the European Recapitalization Fund or something like that and that fund will issue debt to the market place and promise to pay for the future. Gerard Cruz: I guess my point is, you can have a European Union without Greece. Maggie Ralbovsky: Yes. Gerard Cruz: Greece will just kind of fall to the way side. Maggie Ralbovsky: Yes, I think that's the best scenario actually. I agree, I think the market is trying to price into that but what it's not priced into is it's all being controlled by these politicians and 17 countries have to agree to that. If it doesn't happen you're going to have a banking crisis. Gerard Cruz: But it's going to be a survival banking crisis.

Wilfred Leon Guerrero: It's proceeding as if Greece doesn't exist. Maggie Ralbovsky: If Greece's debt is not being held by other people, you can but the problem is the debt is held by other banks and certain banks are just going to fail. Just like the subprime issue in the U.S. in 2008, 2007 was a small, subprime wasn't a huge market, most mortgages are not subprime. What happened was the systematic domino effect, the contagent that happened after that, so it was the contagent that wasn't priced into that. Gerard Cruz: But it's a survivable event is what I'm saying. Maggie Ralbovsky: Yes. Doris Flores-Brooks: And by comparison, if the U.S. banks are... Maggie Ralbovsky: U.S. banks are all out, mostly out of it. Doris Flores-Brooks: So it's not going to affect the U.S. as great although the after effect. Gerard Cruz: The after effect will be, there's going to be ripple. Doris Flores-Brooks: It's like the tsunami, the tsunami is in Europe but we'll feel it. Maggie Ralbovsky: It's not a direct effect, it's probably not that big, the direct effect and the systematic effect, it's very hard to map out.

Doris Flores-Brooks: I'm more curious what's going to happen to France now that they've changed. Gerard Cruz: They have a socialist leader. Maggie Ralbovsky: Yes, they have a socialist leader. He basically wants the U.S. policy, he wants a stimulus. The European Union's charter says no printing of money even though they're trying to print money in the back door way and he is trying to create a European debt market, it's called the Euro bond market that basically have an explicit subsidy from Germany to the rest of the European Union and start to print money, Angela Merkel said no. So that's the situation right now, it's just very, very fluid.

So that's the situation after the end of this quarter, it's still going on and so far month to date, this month the European equity market is down 8%, the U.S. market this month is down 4.5%. Basically the world market rally that we had in 1st quarter has already been wiped out for this quarter.

Page 18 has the real assets category. We did have the REIT market listed, it's one of the investment categories of ours.

Wilfred Leon Guerrero: Let's go back to that chart that I asked you about, now explain to me what happened with 1st quarter, how come in a number of these countries 1st quarter wiped out the losses from last year? What happened in the 1st quarter? Gerard Cruz: 2nd quarter. Maggie Ralbovsky: 2nd quarter we wiped out 1st quarters gain. Maggie Ralbovsky: It was because of all the countries are printing money, stimulating everything and then you have all of this liquidity, people have to buy something and at the time it appears the Greece problem is not going to happen this year, the problem is going to be pushed to the next year or something. Doris Flores-Brooks: Now it's happening already now.
(End of discussion on economic & capital market environment)

<u>11:00am-11:45am DB Plan Performance</u>

Okay we're going to move to page 21. Page 21 is a summary of this quarter for the different composites. For GGRF... Gerard Cruz: We did well. Maggie Ralbovsky: We did well, we did very well... Gerard Cruz: That's 2 quarters in a row that we did well. Maggie Ralbovsky: That's right. Total fund was up 9.66% for the quarter and that actually ranked at the 1st percentile. Before we go there I want to show you a page on this other book, page 8, it's the other book that says "GGRF Current Statute Governing GGRF's Investments." This page graph's GGRF's percentile ranking among all the pension funds universe. I'm on the public pension fund universe, the purple line is GGRF's actual performance in the past how many ever years, 6 years. This is however much quarterly data we have, so we start from 2006 and I put S&P 500 on that as well to show you the strong reliance on equity market of this fund. This chart is showing the percentile ranking and you can see that right now for this particular quarter we are at the top, like 1% so is S&P, it has a very strong correlation with S&P. Doris Flores-Brooks: Is that good or bad? Maggie Ralbovsky: Actually it shows you the lack of diversification in my view. Gerard Cruz: But then if you go back to your earlier comment where the public funds, 51% are in equity. Maggie Ralbovsky: That's right. Gerard Cruz: So we don't differ too much from... Maggie Ralbovsky: 10 percentage points different. Gerard Cruz: We are 60% equity? Maggie Ralbovsky: You are 65% equity. Doris Flores-Brooks: And the universe is 51%? Maggie Ralbovsky: 51%. Gerard Cruz: But the universe is also a higher ratio in, well they have a percentage in private equity. Maggie Ralbovsky: That's considered equity too. Doris Flores-Brooks: So is the 51 including private equity? Maggie Ralbovsky: It's all equity.

Bonds, I have another page, on page 16 in the same book actually gives you the remainder. REITS is actually equity, you're only 30% in bonds. Gerard Cruz: 40. 38. Maggie Ralbovsky: No, 30, you're only 30% in bonds, 70% in equity. Gerard Cruz: 70/30, I thought we were 60/40. Maggie Ralbovsky: No, you're 70/30. Gerard Cruz: Because we funded REITS with bond money. Maggie Ralbovsky: It's not how much in equity, it's what kind of equity, it's just really very correlated. Anyway, that's a discussion for tomorrow. Doris Flores-Brooks: Can you diversify within equity to achieve what it is you're eluding to that you're going to discuss tomorrow? Maggie Ralbovsky: Yes. I wanted to go global equity because the law is 15%. Doris Flores-Brooks: The law didn't allow it because you said we can buy the bonds but we can't buy the equity or vice versus. Maggie Ralbovsky: You can buy up to 15%. Gerard Cruz: And you want to go global. Maggie Ralbovsky: I wanted to go global, remember 50/50 allocation and I also wanted to have the high yield which was approved, so I do have some discussions prepared.

Okay, I'm on page 22 now, this is for the different composite, you can see all composites with the exception of real estate, out performed, real estate only marginally under performed. So every composite did well and this is the longer term return here on page 23, compared to the benchmark pretty much with the exception of one year, every other period we also beat the benchmark. So all in all it's good for this particular quarter. Gerard Cruz: But even on the one year, the 3 year, the 5 year, the 10 year and inception. Maggie Ralbovsky: Yes, it beat the benchmark. Gerard Cruz: Under what market cycle or scenario does our portfolio not contemplate? I guess what I'm saying is that in quarter year to date, one year and since inception we beat our benchmark. Maggie Ralbovsky: That's right because since inception if you recall the 4 chart... Gerard Cruz: The risk buckets. Maggie Ralbovsky: Since 1982 the U.S. market has been in the growth dominated market place, low inflation... Gerard Cruz: So you're thinking that we're not going to be there? Maggie Ralbovsky: That's right. That's our thinking, we think there's significant drive. Growth has run the course, the course in the whole world right now because the debt for the entire world is very, very high... Gerard Cruz: And so you're saying we should invest in debt? Maggie Ralbovsky: No, we should be balanced in the 4 different quadrants. Gerard Cruz: Okay, but the only quadrant where we're under weight right now is fixed income. Maggie Ralbovsky: No. You don't have credit bucket at all because you don't allow it. Gerard Cruz: Credit which is fixed income. Maggie Ralbovsky: Yes. We don't think of that as the core fixed income, we think of that as the credit bucket. You do not have a lot of the inflation hedge bucket either. Gerard Cruz: But you're contemplating a de-leveraging scenario which would be the opposite of an inflationary. Maggie Ralbovsky: However it could also be a stagflation kind of scenario. Gerard Cruz: Which is still, I mean putting money in an inflationary bucket would counter. Maggie Ralbovsky: No, stagflation which has inflation and stagnation. Gerard Cruz: I don't understand where you want us to be, if throughout our history, if throughout the market cycles, through inception we've out performed benchmark and I just don't agree that credit is the way to go, I don't. The credit bucket, I don't think that's the place. Maggie Ralbovsky: I think it's better than equity.

I wish I had that 4 quadrant slide. Gerard Cruz: I remember the 4. Maybe it's tomorrow's discussion. Maggie Ralbovsky: It is tomorrow's discussion. Gerard Cruz: I just had to bring that up because the proof is in the actuals, right? Maggie Ralbovsky: The proof is that if the past repeats, we will do great. That's all you proved and what I'm trying to make an argument for is that the past is not going to repeat because all the ingredients for the past is not there anymore. Gerard Cruz: I know, I understand that and I can almost buy that, but where you want to take us though or rather, where we're under weighted and so where we need to put money in order to bring us to a proper weighting is a bucket at least one bucket that I know of that has... Maggie Ralbovsky: Why wouldn't that be a... Gerard Cruz: Well because if the scenario is a deflationary environment then putting money in fixed income, in credits would be counter to where I would want money. In other words, in a deflationary environment what you do is you reduce interest rates, it's deflation so you try to stimulate inflation by reducing interest rates and interest rates are at a point where we're already close to zero. Maggie Ralbovsky: You're talking about core fixed income, I'm talking about using credit as a substitute for equity. Gerard Cruz: I understand, but even if you think that companies are going to borrow their way out of... Maggie Ralbovsky: No, that's not what I'm thinking. Gerard Cruz: Okay so maybe not corporates, not core, then who is the borrower, countries? Maggie Ralbovsky: No, if you think of the pecking order of a corporate capital structure, the credit is in the middle so you have the bank loans, then you have the credit, then you have the equity. If there is no growth the equity gets squeezed, the credit borrowers are going to be fine because they're going to get their money back. Gerard Cruz: But you're contemplating a bankrupt default. Maggie Ralbovsky: No. Gerard Cruz: But that's the only time you would get your money back unless they're paying... Maggie Ralbovsky: That's the only time you will not get your money back if it's default, but if there is no growth you don't get return from equity, do you agree to that? Okay, the equity holders are the residual holders, if the world is entering into a period where there is no growth or very low growth, anemic growth, you cannot envision a scenario where stocks do great, can you? Gerard Cruz: That stocks do better than fixed income? Maggie Ralbovsky: No, stocks do great. Gerard Cruz: Great is a relative term, but compared... Maggie Ralbovsky: Compared to credit, if credit right now has 600 basis points spread... Gerard Cruz: If the economy is not doing well then there is no business out there that's going to apply for credit and why would you as a business need credit if the economy is stagnating? Maggie Ralbovsky: Okay, you have these existing credit buckets out there that are trading at 600 basis points above treasury right now. Gerard Cruz: Right now, but it wasn't 600 basis points above treasury last quarter. Maggie Ralbovsky: It was more than that. Gerard Cruz: Okay, so that's my point. Maggie Ralbovsky: Average is like 400 basis points, right now it's above that and you're excluding that whole sector for equity. What I'm trying to make the case for is that for future is anemic growth, that segment would do better than the equity.

Wilfred Leon Guerrero: Your profession has always been telling us that if you take a look at a pattern and equity always out performs fixed income. Gerard Cruz: Over the long haul.

Wilfred Leon Guerrero: But what you're telling us now is that it's just going to change. Isn't that what you're telling us? Maggie Ralbovsky: Well no, the long run, how do you define long run? Who said in the long run we're all dead? The thing is that if you survive the short run, you can see the long run, but if the short run volatility kills you, you don't see the long run that's what I'm trying to... Gerard Cruz: But are you saying our portfolio is in a place where the short run volatility is going to kill us? Maggie Ralbovsky: I'm thinking, I'm saying the short run you're so overly relying on the equity, so you pretty much know how you do just by looking at one thing and that's what the equity market has done. Gerard Cruz: Well no, not necessarily because when the market... Maggie Ralbovsky: Look at that and try to prove that here. Gerard Cruz: But when we've out performed in these areas in down markets, look where we are relative to the equity... Maggie Ralbovsky: Look how strong the correlation is. Gerard Cruz: No, I understand the correlation and that's because we believe as consultants have told us over the years that in the long run the equity markets are going to out perform fixed. Now with that argument, our job is then to survive the down turns. Maggie Ralbovsky: Then why don't we put everything in equity? Gerard Cruz: Because we need to survive the down turns which we have done successfully because we out performed during these down turns. Maggie Ralbovsky: All I'm arguing is exactly what you're arguing, it is to use all the tools we have available to help us smooth out the short term. Why do we have to say certain asset classes are just off limits? Gerard Cruz: My concern is that during the up cycle is we're not going to be here, we're going to be down here. Maggie Ralbovsky: That's right. Well you probably will just be down here but in the down cycles you're also not going to be here. Gerard Cruz: But we're here. That one last quarter we were at the bottom but all the other down cycles we beat the benchmark, we beat the S&P. I guess our concern is that we're in a place where our Fund position is such that we're under funded severely and we have already agreed to that, so we have to do better on the up and better on the down and we have that, our portfolio has done that. Maggie Ralbovsky: With equity, but equity is not your only benchmark, is it? Gerard Cruz: I'm talking about our benchmark in general, our benchmark in general that you showed us on the bar graph a few slides ago. Maggie Ralbovsky: Can we save that discussion because I have other benchmarks to show you. Gerard Cruz: We can, whenever you want. Maggie Ralbovsky: We can discuss that tomorrow.

Page 26 is the current asset allocation versus the actual. You can see the differential here, I know Diana (Bernardo) is monitoring it and I also noticed that there are a few categories that were bumping towards the maximum very close so that says the rebalancing needs to be taken place. Overall that is still fine.

I'm going to move a few pages down. You have the cash flow pages here, you can look at it at your leisure. Wilfred Leon Guerrero: I want to look at the one where we compare ourselves with other public funds. Doris Flores-Brooks: Is there one? Maggie Ralbovsky: Yes, you have to universe comparison here, didn't we talk about it on page 24. Wilfred Leon Guerrero: We skipped it. Gerard Cruz: How did we do comparison to... Maggie Ralbovsky: You did great, you were in the 17th percentile.

Okay, let's go to this page in the other book, it is the page before tab 2, because we keep wanting to go there. I went back to history and I dug up your actual performance because I know this question is going to come up. Let's follow through the thinking process, I added certain asset classes that you do not currently have and I also broke your current statute limits to test to what if you didn't have those statutes limits what you could have done historically because Gerry (Cruz) has pointed out that historically you beat your benchmark, but your benchmark is performing under the constraints of the current statute. If you had no such constraints, could you have picked a better benchmark. So what I did is that I plotted your current policy. I have 2 places for the current policy, one is forward looking, one is backward looking and you can see the forward looking is that yellow square on the chart, we talked about 6.3% return going forward and the backward looking is the past 10 years, your current portfolio has done is the triangle, the red dot triangle in the yellow bubble on the top. Then I did 2 policies, those 2 policies are C and D and these 2 policies have some of the asset classes that you do not currently have, number one. Number 2 also has different constraints for global equity so it actually allows more global participation and those policies in the historical period have done better actually with the same risk as your current. So this is actual return of these 2 policies, C and D in the yellow bubble and I also plotted the C and D going forward, forward looking. You can see forward looking our expectation has actually gone down tremendously, however, forward looking risk is actually very similar to historical risk. Antolina Leon Guerrero: Am I reading this wrong, the forward looking risk return is actually less than what we actually returned? Maggie Ralbovsky: That's right. Gerard Cruz: Because what she's (Maggie Ralbovsky) saying is that the world has changed. Doris Flores-Brooks: Going forward we're going to do worse. Antolina Leon Guerrero: Even if we change to these... Maggie Ralbovsky: That's right, but the C and D are more diversified and we expect it to do better than your current and back testing actually has shown that same sort of result. Antolina Leon Guerrero: Because C and D is better than the yellow square. Maggie Ralbovsky: The yellow dot is what you actually achieved. I'm sorry, the red circle is what you actually achieved.

Why did you do worse than your current policy? Because your current policy is the current policy, what you actually achieved has some historical policies in it, you probably changed asset allocation somewhere. Gerard Cruz: We did. We made the adjustment in our current allocation in 2003, 2008... Joe T. San Agustin: Based on recommendation, so what you're saying is that's not proving out to be good? Gerard Cruz: No, it is. What she's (Maggie Ralbovsky) saying is that these current policies, the triangle and the square in my understanding is this is what our returns would have been had we had our current allocation since inception. Maggie Ralbovsky: That's right, since 10 years ago. Joe T. San Agustin: We lost out in other words, basically. Gerard Cruz: Well, we lost some opportunity. That's correct. Joe T. San Agustin: The spread in 10 years versus, what was our loss? Maggie Ralbovsky: So this is the 10 years. 10 years your actual return was 6.47% and the risk is somewhere around 12%. Gerard Cruz: You don't change much on the risk side. Maggie Ralbovsky: The current policy did much better, well not much better but did a little better and C and D did a little better than that and on a forward looking basis we expect C and D to do a little better than the yellow square which is the current policy, so I plotted your actual there too. C and D we reduced U.S. equity, you can see we reduced it from 40% to somewhere around 23, 22%. We increased global equity, basically moved from U.S. equity to global equity. Joe T. San Agustin: These adjustments can be made with the current allocation. Maggie Ralbovsky: No it cannot because you have a 15% limit. For this particular one I did not even add high yield, I have another scenario where I added high yield.

Wilfred Leon Guerrero: What is global equity? Maggie Ralbovsky: Global equity is 50% U.S., 50% non-U.S. Wilfred Leon Guerrero: So right now we're zero on that. Maggie Ralbovsky: That's right. You don't have a global allocation. You have U.S. and non U.S. allocation, non-U.S. allocation is subject to a 15% limit and global is to break down those limits and have the global opportunity set come together. Antolina Leon Guerrero: And global is considered non-U.S.? Maggie Ralbovsky: Global is considered 50% U.S. and 50% non-U.S. Antolina

Leon Guerrero: But in terms of our statute this is going to be considered non-U.S., is that what you're saying? Maggie Ralbovsky: With your current statute you have a limitation of 15% non-U.S. Wilfred Leon Guerrero: Our limitation right now is, how much can we put in non-U.S.? Maggie Ralbovsky: 15%. Rosalie Bordallo: But you can use mutual funds and ETFs and not count it. Wilfred Leon Guerrero: We're using mutual funds to get around this, did you take that into consideration when you're looking at our current allocation? Maggie Ralbovsky: I did because there are other things that I wanted to do.

I have another page, I used up all your ETF limits for some other categories to move your expected return to 7%. Wilfred Leon Guerrero: What page? Maggie Ralbovsky: It's after tab 3. So this is the ideal perfect world, so if we change the statute as I suggested last time. What we could do is move the expected return with the same risk level we can move the expected return to 6.7% and also if you want to increase the risk a little bit to move the expected return to 7%. That can be done but we need to add high yield, we need to add risk parody which I talked about a little before which will use up your commingled fund limit, which will also require you to move the non-U.S. limit. So move non-U.S. limit, move high yield limit and keep the current commingled fund limit and we can get to 7%. Wilfred Leon Guerrero: My sense is that you just said something profound and I don't understand what you just said. Maggie Ralbovsky: Okay, what part do you not understand? Wilfred Leon Guerrero: The last point that you were making. What was the last point that you were making? Maggie Ralbovsky: The last point I was making is that last time if you recall we discussed certain things I would hope we can change in the statute and if we change those things as I suggested, here is the optimization we can perform and right now it is impossible to perform. As the Chairman mentioned earlier that we're hoping to find ways to make this optimization more optimized and currently we're bumping into all the boundaries of the statute. Wilfred Leon Guerrero: Can you say in simple words what changes in the law need to be done? Maggie Ralbovsky: Three things I said last time. The first thing is to allow high yield which we did, we allowed it. The second I suggested but was not approved, I was asked to prepare some discussion which I have done that is the global opportunity set. If we break that we make the allocation to global equity, so that is the second proposal. The third proposal is to keep the current 15% limit, but redefine limit not by vehicle but by asset class, so whatever is in non-U.S. equity even if it is in a commingled fund, it's treated as non-U.S. equity. The limits should be defined as the asset class, not the investment vehicle, but keep the 15% limit for something else like things we cannot define like risk parody. Risk parody, let's say we add 8% risk parody to this and 8% commodity to this, for the last policy you can say we can expect 7% return, so this is a perfect world if all the proposals are accepted. Joe T. San Agustin: In your world you don't want any limitations. Maggie Ralbovsky: No, that's not true. I do want limitations, but I want rational limitations, not just artificial limitations that make no sense. Joe T. San Agustin: Artificial limitations are raised legislative action policies. If it was a Board policy maybe we can do that. Maggie Ralbovsky: That's why I want to discuss this.

Okay on page 34, I'd like to go back to the original book and then we'll talk about this other book tomorrow. Page 34 is the summary of the U.S. equity. I know that currently we have 2 managers on watch, one is Numeric, that was due to the departure of the principle person on this account and we did set the end of 2012 as the watch period ending and I still want to keep that ending period there so we can make a decision at that time. So far so good, the new person on this account, I actually met that person, I have a bigger summary 2 pages later, but the bottom line, I do think their resources are adequate, I do think that performance continues to be good. So far so good but I want to keep this on the watch list for 3 more quarters. Wilfred Leon Guerrero: Remind us again what you mean by good score, focus list. Maggie Ralbovsky: Focus list is the best ranking and good score is something above 3, so our total score is 5 and nobody gets 5 so anything above 3 is considered good and among the managers above 3 there are like 10 in each category that can make on the focus list. The focus list is really the highest ranked conviction driven managers. You do have a couple of those and most of the managers ranked pretty close to 3. Eaton Vance is below 3 so that's the only manager that ranked a little lower than 3. Three is a very good score, only 25% of the managers ranked 3. Wilfred Leon Guerrero: Why are you recommending putting Numeric on watch? Maggie Ralbovsky: For the organizational issues.

Wilfred Leon Guerrero: Do we have anything on fixed income because those are the people we're meeting this time. Maggie Ralbovsky: Yes. If you move a few pages up fixed income is on page 49. We have 3 managers in that category and they each take a little bit of different style. Franklin Templeton is the one that has a very large organization and they tend to have a very large portfolio with many, many securities and they tend to perform very close to core, so their style is very close to core and the other 2 managers Garcia Hamilton tend to be high quality, their style is very much bias towards high quality, they don't hold anything below double A ranking and Income Research tend to be very credit driven so they tend to hold a lot of asset backed securities as well as very low on treasury, they tend to hold more credit so they tend to have a credit bias and Garcia Hamilton tend to have a high quality bias and Franklin Templeton tend to be very broad and core oriented. So the 3 managers tend to have a little bit of a different style and last time we put Franklin Templeton on watch because since inception for the past 15 years they have under performed.

Wilfred Leon Guerrero: On your notes here, score increase to 3.05 from 2.9, when did this happen? Maggie Ralbovsky: For Income Research Management, that happened this last quarter so every time I give you a change of score, Income Research made the change. Sometimes these changes are just an update because they are commissioned to meet with these managers at least every 6 months and when they meet with the manager they adjust their scores and most times the adjustment is not material, so none of these is considered material. The Franklin Templeton reduction scored 3, it's still a good score but it did get reduced and Garcia Hamilton got reduced and Income Research increase above 3 which is good. So these 3 managers do different things.

I did put a chart on the next page for Franklin Templeton because that's the manager on watch. On this chart this is the universe comparison compared to all the core managers in our data base and every data point is a 3 year return so this is the rolling 3 year chart, every data point is a long term return so this is not quarter by quarter return. Anything above the middle line you can see is above the median and anything below the middle line is below the median. The bright blue dots are Franklin Templeton and I circled the gray bubble to show you their recent performance deterioration. In the most recent period you can see that for many, many quarters on a 3 year annualized basis they ranked below the 80th percentile.

You can also see Garcia Hamilton recently has been doing very strong, has very strong performance, they ranked in the top 10th percentile in most recent periods. Income Research is sort of in the middle but nothing very dramatic. I think the most dramatic one is the Franklin Templeton in the recent rankings. Rosalie Bordallo: But in this diagram you see Franklin Templeton in the last year heading upwards. Maggie Ralbovsky: Yes, it has improved. Rosalie Bordallo: You see IRM heading upwards and on the flipside you see Davis going downward in the last year. Maggie Ralbovsky: Yes, so obviously every period you have these kind of , it's the pattern that matters. If it's concentrating a particular region I think that matters. Rosalie Bordallo: Right, I understand that but at the same time if you're talking about a year for these guys, these are 3 dot points so it's close to a year, you're saying put them on watch and we're doing that but at the same time you're not saying that it seems like they might have made a turn because they now in the last year have been going back up. That's what I'm getting at is you're only saying that they're flat when in reality there is kind of a slight change. They're still on watch, yes but there has been some improvement with them. Maggie Ralbovsky: Right, no dispute to that. I want to show you this data, it's data points and you can draw any conclusion that you think is appropriate. I do agree that recently their performance has been improving but since inception they're still under for more than 10 years so it's a very long term period but they did have improvement in the most recent period. Doris Flores-Brooks: What is your recommendation? Maggie Ralbovsky: My recommendation is to keep them on watch until their since inception return is above the benchmark.

Page 52 is their holdings based, all these 3 managers holdings based style. The way you read this chart is to compare with the gold football ,the gold football is the benchmark. Anything plotted towards the right hand side is in terms of average quality is lower, but they're all very similar to the benchmark, you can see that they do take a little bit of different positioning. Anything above the middle line is for duration to be higher than the benchmark and you can see Garcia Hamilton has a little higher duration and Franklin has a little lower duration and the Income Research is right on the duration target which probably also explains their positioning for the current quarter. When duration is higher interest rates go down, you do better, when interest rates go up you do worse, that's how you read that.

Page 43 just very briefly, there is no recommendation of any change of the composite but I did show you the recent score change for Dimensional, actually it was a positive increase for DFA, the score was increase to 3.5 which is a very high score. All these managers are ranked above 3 so these are all greatly ranked managers. Antolina Leon Guerrero: Even in spite of their under performance. Maggie Ralbovsky: That's right. It's relatively short term, I think for some of the manager's under performance. Antolina Leon Guerrero: This is just for the 1st quarter? Maggie Ralbovsky: Yes and all these managers, the one's you had for more than 3 years have done well. The one's that are under performing you haven't had them for 3 years like Earnest Partners. So bottom line I think this composite is doing well and they're all great managers.

REITS is on page 56. I highlighted in yellow the manager allocation is very close to the maximum so I think we need to think about that when we pay the benefit and do the rebalancing. They're bumping up towards the maximum limit but there is no change of score, both managers are still very strongly ranked and their under performance was very minor, it wasn't dramatic so there is really no concern on this composite.

MetWest is also bumping towards the limit, MetWest is very close to the maximum limit.

Diana Bernardo: One of the things we maybe want you to talk about tomorrow is in light of this and I don't know if you're maybe going to reallocate or what not, but there is going to be bond monies that we're expecting to get in June, about $24 million, so we'd like your opinion as to what to do about it, where to put it or I'm not sure if we're going to keep it. We're not going to keep all that for operations are we Paula (Blas)? Paula Blas: No. We should keep it for a couple of pay periods. Doris Flores-Brooks: What is your average pay period? Diana

Bernardo: About $7 million. Maggie Ralbovsky: So $10 million in reserve. Diana Bernardo: Maybe $8 million. Maggie Ralbovsky: So then you'll still have $16 million. Since we're not changing asset allocation, we'll just allocate to the one's that are under allocated. Diana Bernardo: Let us know. In 2009 we also got in $20 million but at the time we kept $9 million and invested the rest. Maggie Ralbovsky: I will do a rebalancing sheet based on the current balance.
(End of tape 1)
(End of discussion on DB Plan performance)

1:30pm-2:15pm Garcia Hamilton

(Start of tape 2)
Jeffrey Detwiler: Well it's great to be here. As you know my firm has had a relationship with the Retirement Fund for over 10 years, so you're one of our oldest and one of our largest clients and we greatly appreciate the opportunity and it's an honor for me to be out here. We have a presence out here in this region, we also manage money for the University of Guam, as well as Century Insurance, as well as the Republic of Palau and really a lot of that business is a result of the relationship that we started with you many years ago. Again, thank you very much for that.

I know there were some topics that we wanted to cover based on the email that I received, just want to hit 2 of those before we move down into performance. There are no organizational changes although as the firm continues to grow we do continue to hire good people but from a top down standpoint the organization remains the same and there are no SEC or litigation issues of any kind.

A little firm update on page 1. Our organization as you know, we were founded back in 1988, today we're 100% employee owned. We have a very deep and seasoned team with 11 members on the investment team with a combined 177 years of investment experience with 6 CFA charter holders. The firm is at $2.9 billion dollars in assets, of that $2.3 billion is in fixed income. Whether it's fixed income or it's equity, we maintain that high quality strategy. Toward the bottom we have a breakdown by type and also breakdown by client.

Moving to page 2, I thought it would be helpful for you to see some recent accounts that we brought on. The firm continues to grow, during that 6 month period from the end of the 3rd quarter to the end of the 1st quarter we added about $55 million in client accounts. As of 3/31 we have another $133 million pending, so these are accounts that hired us but have not been funded yet. So the firm continues to grow.

A reminder on our investment goal and philosophy and again, this has not changed since day one for the firm, our investment goal is to out perform over a full market cycle using our high quality strategy with less risk and low turnover. We're not trying to target a specific return, we're not trying to be the number one manager, we just want to out perform using our high quality strategy over a full market cycle. That stems from our investment philosophy on fixed income which is the fixed income portion of your portfolio has to be there, you can take your risk somewhere else, whether that be small cap or international, but you want that fixed income to be the rock in your portfolio. So the tenants of our investment process are maintaining liquidity, preserving principle and maintaining a higher current income. That extra income is important because if the market moves sideways or if it moves against you the fact that you're getting extra income will act as a cushion or help you out more.

On page 4 I thought it would be helpful as a review to mention a few things about our investment process. Again, we're a high quality manager so the only things we invest in are treasuries, agency debt, mortgage backed securities and corporates rated A or better. Within the spread product space and that's anything that's a non-treasury security we limit the credit risk, that exposure to non-treasury securities to 10 years end a duration whereas an index will have long credit exposure, we will only own treasuries in the long part of the curve. That's a way to contain the credit exposure, the credit risk in the portfolio. We try to avoid any type of big surprises, that means we won't do any non-dollar because we don't want the currency risk, we won't do any high yield because we want to maintain the high quality, we won't do any zero coupon and there won't be any derivatives or leverage of any kind. We won't purchase anything like an asset backed or a CMBS or a CDS or a CDO or any types of those exotic types of derivative securities because we don't think we need to take on that extra risk to out perform. The reason that we are able to out perform is through our flexibility, being able to actively move among sectors and move along yield curve, but it's important that we maintain the risk controls in your portfolio, so we have proprietary models that we'll take a look at later in the presentation as well as proprietary software to help us monitor the risk in your portfolio. We're monitoring the risk on a daily basis to make sure that the amount of risk that we take on is inline with the amount of return that we should be expecting.

The next 2 pages, pages 5 and 6, we have the performance numbers. Page 5 is in the format that you had requested, so you can see that for the month of April we out performed by about 5 basis points. The 1st quarter significant out performance by about 290, the 4th quarter out performance by about roughly 20 basis points. We did under perform for the fiscal one year period but since inception we have been achieving that goal out performing using our high quality strategy. You can see on average 10.05 versus the benchmark at 7.40 and really this time period that you came on board with us in the fixed income side has been part of this recovery of the market because we entered sort of that bear market recessionary time period in 2007 and 2008 and since then we have been recovering out of that with the Fed action as well as the different programs that have been enacted. So we've really seen a nice rebound and it's been a great opportunity, so we've had that recovery trade on in your portfolio.

On page 6, just kind of a more standardized way of looking at things. You can see with the strong performance so far year to date that we've made up a lot of that under performance from the 3rd quarter of last so the one year number is much closer to the benchmark , 2 year average 1% and ahead on average 3 year about 3% and the since inception number. Again all this achieved by avoiding any type of high risk type securities, low liquidity securities, maintaining our high quality strategy.

Page 7, this is a page that I know that we've looked at over the past few years and this is really the crux about what we've seen as far as the opportunity and it's been a real driving force as far as performance for your portfolio. What we're looking at here is historical spreads and spread is the additional yield that you receive above treasuries. For example, if the yield on a treasury will be 2% and the yield on a corporate bond of the same duration would be something like 5% then the difference there, 3% is the spread. We've highlighted some different crisis points over the years, in the late 90's obviously we had the

Asian/Russian financial crisis, the early 2000's we had the dot.com bubble fall by the accounting scandals Enron and WorldCom and you can see spreads spiked up. These were opportunity points and opportunity for you to buy a corporate bond or a financial corporate bond at a very cheap level and a higher additional yield above treasuries. Then we got to this steady state environment as the market recovered in the mid 2000's followed by after the flat yield curve and we had certainly the real estate bubble and the financial crisis, you can see in 2007 and 2008 spreads spiked up in a pretty significant way. This peak here with Lehman Brothers, if I could take this chart back for as far as I could to show you historical spreads, the last time we were at that type of spread, additional yield above treasury was the Great Depression and this was roughly around the time when you came on board with us on the fixed income side, at that time we were making the decision of, are we going to enter a depressionary environment, are we going to fall into the abyss or are all the different programs that are being enacted going to provide liquidity and keep us out of falling into the abyss. From a fundamental standpoint and from a technical standpoint we said we need to start putting on the recovery trait for your portfolio and obviously it has benefited significantly. As spreads have tightened and as spreads tighten prices go up, it's an inverse relationship between yields and crisis, so as spreads tighten corporate bonds have out performed.

You can see today the blue line which represents financials is wider than the red line which is the corporate index as a whole, meaning that the financials are the cheapest within the corporate sector. So that is where we have the most exposure in the corporate sector in your portfolio, in the financial sector. Looking at a more recent time period you can see late 2011 which is around August/September, you can see spreads spiked up in a meaningful way. I'm going to focus on financials. Going from around 200 to about 300 basis points, does everyone see that area? That's the area where we had under performance in your portfolio, right at the tail end of your fiscal year and that was due to the downgrade of the U.S. Treasury, renewed concerns about a double dip recession in the U.S. and concerns about the periphery of Europe. What we felt at that time was we should stick with the recovery trade and not follow the herd mentality in treasuries, that safe haven trade.

In the 4th quarter of 2011 you can see that kind of V shape where spreads came down and then came back up. Basically in the 4th quarter there was a lot of volatility but everything generally remained unchanged from September 30 through December 31 from the standpoint of rates and spreads. So in the 4th quarter that out performance that you saw, that was due to the extra income that we received. So the fact that we were yielding more allowed us to out perform.

Now for the 1st quarter of this year you can see that blue line has come down from around 350 down to about 239, so over 100 basis points of spread tightening and that's really the main driver for the out performance for this year. We hadn't gotten all the way back down to where we were below 200 basis points in financials so we haven't completely made up that under performance from the 3rd quarter, but we still feel that this is the best positioning for your portfolio.

Another way to look at this is on page 8. It's one thing to say that you're getting an additional 3% in yield when treasuries are at 5%, but it's another thing to say you're getting an additional 3% yield when treasuries are at 1%. So we thought it would be helpful to look at this on a ration basis, a ratio of the additional spread above the absolute yield of the 5 year treasury. You can see as we look at the 3rd quarter of 2011 that the ratio of spread to absolute on a 5 year treasury got to about 4 times which is very similar to this peak in Lehman Brothers. So what that's telling you is based on where treasuries were and where spreads were the market was expecting a Lehman type of event, so again we had to make the decision as money managers, are we going to have a Lehman type event, is the U.S. economy going to fall into the abyss or is this a severe overreaction. In our minds we felt it was a severe overreaction, we stayed the course and we've seen spreads tighten since then. We think there's still a possibility for volatility going forward, however we still think that this makes the most sense for your portfolio is to take advantage of the attractiveness of corporate bonds compared to where treasuries are. Gerard Cruz: In corporate bonds you're leading towards financials? Jeffrey Detwiler: Towards financials yes, we have an over weight to the financial sector, correct and the types of financials that we own are the big banks and brokers, the types of firms that the Government invested in and made sure stayed functioning during that volatile time period in late 2008 and in early 2009. Gerard Cruz: Mostly domestic? Jeffrey Detwiler: Domestic, 100% domestic, correct. Gerard Cruz: Do you see anything that's happening in Europe as affecting? Jeffrey Detwiler: I think the biggest impact that Europe is going to have as far as an effect to the U.S. is that safe haven trade where there is going to be continued demand for treasuries, so we think that... Gerard Cruz: Driving rates up... Jeffrey Detwiler: No, driving rates down, prices up. I think that's a very strong possibility that we can see continued volatility in yields and treasuries. We think a good neutral rate for the 10 year treasury should probably be closer to 2.5%, however with all the fears and concerns it's very possible that treasuries can stay at these low levels for a period of time. As far as the U.S. economy goes, I think that if we have kind of a muddled European situation we can see a decoupling between the U.S. and Europe where investors start focusing more on U.S. fundamentals and not paying as much attention to headlines. That's what we saw in the 1st quarter, sort of a renewed focus on fundamentals and what we're expecting is that continues. Gerard Cruz: Are you seeing that play out during the 2nd quarter? Jeffrey Detwiler: We've seen a little bit of a give back, treasuries, rates rose in treasuries in the 1st quarter, now they've come back down. Gerard Cruz: They've come back even lower than they were in the 3rd quarter or 4th quarter. Jeffrey Detwiler: That's right and as far as spreads go, spreads have widened but they haven't widened back out to where they were in the 3rd quarter. So yes, there is going to be volatility but we feel that we should stay the course because if you start to trade in the portfolio in and out you know there is very good chance you're going to miss it so our belief is if you wait until the all clear is there and you see the whites of their eyes, you're going to miss the trade. Once everyone knows something and believes something the trades already gone. Although yes you're right, there's volatility and this month is certainly going to impact performance, I think longer term we have to have that horizon of where is the best opportunity to invest.

So as a check and balance to all the fundamental research that we do, our in-house quantitative strategy is to put together technical models. These models don't drive our decisions, but they act as a check, so if we see a disagreement between the fundamental research and the technical research it forces us to do more homework.

What we've listed for you on the next couple of pages are 2 models, the liquidity model and the spread model. The liquidity model as you can see from the 2 lines, the blue line being the liquidity model and the red line being the ISM, they have very high correlation with each other and very good predictive power. The ISM is a manufacturing index, we use that as a proxy for the economy. We're not trying to make a decision or a determination that GDP is going to be 2.8% versus 2.5%, we just want to get a sense of direction. Directionally is the economy expanding or directionally is the economy contracting. So you can see back in

2008 the blue line was pointed straight up, it was in that mid to low 60's area, where the red line manufacturing had fallen off a cliff into the 30% area. That was around the time where we were at the height of pessimism, many investors were calling for a depression. Again, from our fundamental research we said corporates are extremely cheap, we think all of the liquidity that the Fed and the Treasury are putting into the system will help keep us from going into the abyss, let's move into corporates in a meaningful way. You can see the red line rebounded significantly so that divergence basically disappeared. Today the red and blue line are both in the low 50's area so what that means to us is that the economy is still going to be in expansionary area, it may be kind of a slower type growth, kind of in the 2% GDP area but that should be a good environment for bonds, meaning that we shouldn't expect to see any major inflation in the near term in the time horizon and we should expect to see spreads to continue to tighten as the economy continues to grow.

For your reference we've listed the key drivers of the model just so you have them for your reference. Maggie Ralbovsky: Thank you for adding that, that was the new thing you added. Given the LIBOR there's lots of talk recently about the LIBOR being quite artificial, there are investigations that factor, do you think it's still as good an indicator as input, is there anything changed? Jeffrey Detwiler: LIBOR is interesting, you bring up a very good point. One thing you'll note is that the yield curve and real money supply are items that are out there as far as determined by the markets so for example, the yield curve is based on investor expectation, money supply is based on what banks put out. LIBOR is something that's set so it's not as high of a factor in the model because it's not as much of a market item it's more of a determine by bankers item. To answer your question, as it stands, it is not as strong as a driver as the first 2 for that reason and I know that our quantitative strategist John Lohman will continue to review that whether it should be where it is, should it be lowered or continue as a factor, so it is something that is going to be reviewed.

On page 10 we have our spread model versus the Aggregate Index Ex-Treasury. I thought this would be an interesting chart. The Aggregate Index is your benchmark. If you take out treasuries all your left with is spread product and spread product is any security that trades at a spread above treasuries, so for example, corporates mortgages and agencies. You can see again, directionally is what we're trying to figure out, are spreads going to widen or are spreads going to tighten. You can see that there's very good correlation with the direction of spreads. Today the red line which is the spread model is headed downwards so that tells us that this is still a good opportunity to be invested in spread product. The key variables for your reference are listed at the bottom, implied equity volatilities, implied fixed income volatilities and then primary carry trade of FX crosses.

To be more specific on page 11 because corporate sector is the one that we find the most value, I added the spread model versus the spreads on the corporate index. You can see again very high correlation with the direction of the index. Maggie Ralbovsky: Does this mean this spread model is saying the more reasonable spread for corporates should be lower than the current? Jeffrey Detwiler: It is saying that spreads should tighten from here. Similar to the liquidity model, we're not trying to predict an exact number we're trying to predict a direction. Maggie Ralbovsky: Does the direction mean it goes up, that the spread should go up? Jeffrey Detwiler: Well our expectation is that spreads will tighten. Maggie Ralbovsky: Because the red is below the blue. Jeffrey Detwiler: Correct.

On page 12 you have the positioning of your portfolio and as you would expect you do have your over weight to the corporate sector. Again, keep in mind that the corporate exposure that's in your portfolio is 10 years, whereas the index will have 30 years for corporates. Also we have the higher quality exposure, so A or better, whereas the index does have exposure to triple B's. We have a significant under weight to treasuries because we think that they are over valued at this level. We think that the market has severely over reacted. The mortgage component, what we own in your portfolio are 15 year high coupon agency guarantee mortgage backed securities. Gerard Cruz: High coupon, what kind of coupon? Jeffrey Detwiler: 5.5 and 6% and that speaks to us wanting to have more income. The index primarily has 30 year mortgages so more of a negative convexity versus the index with a positive convexity with us. Lastly, no asset backed or CMBS with us or any of the derivatives or leverages of any kind in our portfolio.

Gerard Cruz: These agencies on the red line, those are direct debt? Jeffrey Detwiler: Correct, agency bullets and columns. Gerard Cruz: Also with maturities less than 10? Maturities less than 10 or duration less than 10? Jeffrey Detwiler: Duration less than 10. Maggie Ralbovsky: The coupon doesn't really mean yield. Jeffrey Detwiler: No, that is correct. The average coupon doesn't necessarily mean yield. We do have the average yield number there for you, 3.2 versus 2.1. Maggie Ralbovsky: But your favorite income, high coupon, why does that mean your favorite income if it doesn't mean yield? The market would adjust the pricing and the yield would be the same, it doesn't matter the coupon, right? Jeffrey Detwiler: That is accurate, correct. Theoretically you could have one bond that has an 8% coupon and one bond that has a 1% coupon and theoretically they could both have the same yield. However, when it comes to mortgages, we believe that higher coupon mortgages are under valued and offer more yield, but generally speaking with mortgages there just is sort of a set price that someone is willing to pay for them and as you go down in coupon you tend to go down in yield as well. So, our average coupon we're getting more income, average yield if everything generally moves sideways, even if there is volatility like in the 4th quarter, you should out perform.

Last page (13) I have for you is risk controls, this fall under the category of proprietary software that we use to monitor your portfolio. It's not enough to know that you have the over weight to corporate bonds and the under weight to treasuries, it's also important to know where is your interest rate sensitivity coming from. If you recall from the previous page, I had mentioned that our mortgage positioning was 15 years versus 30 years, the percentage weighting was roughly the same between us and the index but you can see our duration contribution and the interest rate sensitivity is lower. We've generally had this over weights to corporates on in your portfolio since the inception with us and this duration contribution is something that we monitor, not only by each sector but also as a ratio, so the ratio of 1:28 tells us that we have 28% more spread product exposure from a duration standpoint and interest rate standpoint than the index.

Toward the bottom of the page yield curve exposure, where are we within duration buckets. At one point we were roughly neutral with the index or even greater when it came to the over 10 bucket. We have since reduced that exposure because 30 year treasuries have rallied so much, we think that rally has been overdone so we reduce that exposure and we have more exposure in the belly of the curve. So should the yield curve reverse and go back to a steeper standpoint, that would help you out perform.

That does it for what I have prepared for you, please ask any questions. Gerard Cruz: I was going to ask you to explain the duration contribution one more time. Jeffrey Detwiler: Sure. Gerard Cruz: Not the whole thing but the part where the sum relates to the ratio. Jeffrey

Detwiler: Okay. The sum is the total of each of the sectors, treasury, agency, corporate, MBS and ABS. Gerard Cruz: And right now we're lower than the aggregate. Jeffrey Detwiler: We're lower than the benchmark, correct. Gerard Cruz: I'm sorry, lower than the benchmark, okay. Jeffrey Detwiler: The aggregate index and that is because we think that the rally in rates is overdone, we expect rates to rise. Gerard Cruz: Okay. I follow. But then the ratio is saying that we're 28%... Jeffrey Detwiler: The ratio is a spread product ratio, so if you were to take the Ex-Treasury section just adding up agency, corporate, MBS and ABS and then divide it by the same in the index. Because the index, it's largest contributor is treasuries, that means that if you X that out we had 28% more spread product exposure to the benchmark from an interest rate standpoint. Gerard Cruz: Okay.

How long does the composition look like this in terms of percentage of corporates versus treasuries? Jeffrey Detwiler: We have been over weight the corporate sector and under weight the treasury sector basically since inception. Gerard Cruz: So this is not a... the snapshot last year would look just like this? Jeffrey Detwiler: It would look very similar. Now as far as exact percentages, not exactly but certainly the under weight to treasuries and the over weight to corporates has been on for a good period of time. Gerard Cruz: So is that the core of your... so this is what this should look like next year, this is not because of this time of year where it's tactical... Jeffrey Detwiler: No, you're exactly correct. From a top down standpoint which is we are a top down manager, our belief is in the recovery of the U.S. economy and so in that environment you want to be over weight sectors that are sensitive to the recovery of the U.S. and so with that in mind, we have felt that corporates have been extremely cheap since 2008, so we began over weighting in corporates in 2008 and you came on board with us in September of 2008 and we've been reducing that treasury and agency contribution. Now as far as percentages, sure they fluctuate to probably plus 5 to 10% around the number that it is today, but as far as an over arching theme it's been the same as late 2008.

Maggie Ralbovsky: The yield curve positioning changes more often than the sector, correct? Jeffrey Detwiler: That is correct. As far as a tactical play on what the yield curve might do, we can quickly sell treasuries or buy treasuries in the portfolio, so that's something that we can do very quickly or nimbly to take advantage of what we think changes or shapes in the yield might do, but as far as a sector weighting and a duration contribution weighting, that is something that we've had on for a long period of time and that's not something that we want to move around anytime soon until we see that return to the steady state.

George Santos: What is the 2nd quarter looking like? Jeffrey Detwiler: So far for the 2nd quarter we've given back somewhere in the neighborhood of about 40 basis points. Maggie Ralbovsky: In terms of relative? Jeffrey Detwiler: In terms of relative, correct. We out performed in April but we're behind for this month.

Wilfred Leon Guerrero: What can we expect from you next year? Jeffrey Detwiler: As far as performance or? Our goal is always to out perform. We've had very healthy out performance so far for the year even with giving back some in May. My hope for next year is that we do maintain... Wilfred Leon Guerrero: You gave back some in May? Jeffrey Detwiler: Yes, we gave back some. Leon Guerrero: Jeffrey Detwiler: How much? About 40 basis points in relative performance. So given that, we were ahead for the 1st quarter by almost 3% and then 5 basis points ahead in April, we're still ahead in the order of 2.5% or more so far for the year 2012. So my expectation is that we can, you know even if the market generally moves sideways, the fact that we're out yielding by a percent, if the market moves sideways over the

next 6 months that should be an additional 15 basis points in return on top of the 2.5 plus percent that we're ahead so far for the year. I think it's very possible that we will have some of these months where we have big swings up and down... Wilfred Leon Guerrero: What happened in May? Jeffrey Detwiler: We've seen sort of a re-visit to some of the concerns with new elections in Greece, so there have been some concerns about what's going to happen in the Euro area and that's generally letting investors back to that safe haven toward treasuries. We think bigger picture though, longer term the U.S. economy is continuing to recover and will continue to grow and so we're going to continue to maintain the recovery trade in your portfolio.
(End of tape 2)
(End of presentation by Garcia Hamilton)

2:30pm–3:15pm Income Research & Management

(Start of tape 3)
Steve Weiss: I figure I'd start with performance right on page and then we have a bunch of market charts which we can through and then we'll dive into the portfolio and then we can go from there. As always, interrupt me with questions as we're going along.

So performance we have a whole bunch of different time frames here at your request. They're all good except for the year from 9/30/2010 through 9/30/2011. That is attributable to really the 3rd quarter of 2011. If you remember back that was the year, I guess most fixed income managers under performed. If you remember that was when kind of the sovereign debt crisis came into play, the downgrade of the U.S. Government and treasuries had an awesome quarter, so basically if you owned treasuries you did well, if you owned anything else you didn't and we were under weight in treasuries and we didn't perform well. So all that under performance in that time period happened in that 3rd quarter, but you can see it's not totally obvious but all the way to the left there was the quarter right after that, we out performed there, we out performed the 1st quarter of 2012, we out performed in April and we're out performing year to date so got almost all that under performance back so far year to date. That's attributable to the fact that we're actually under weight in treasuries and over weight in spread products, over weight corporates and over weight in some of the different mortgage products and those have performed well as a result. Since inception both on an annualized basis and a cumulative basis we've done very well against the benchmark. This is just the core portfolio, this doesn't reflect the performance of the transition portfolio, we'll get into that in just a second. That transition portfolio was the assets that we inherited almost 4 years ago and I'm happy to say that we're out of all of them, we finished selling everything, it's all been transferred into the core portfolio. Any questions on performance at all? (No.)

The next bunch of pages are market update charts, I won't go through every single one. The top one there on page 4 basically shows 2 data points. One is the yield of the 10 year U.S. Treasury, that's the light blue line and you can see it starts back almost a year ago and you can see that decline, basically from the end of June all the way to the end of September and that's that 3rd quarter I was talking about, that's when 10 year treasuries did very well, the drop being from over 3% in the yield down to 1.70 which is kind of where we are today. You can see the other dark blue line is corporate spreads, so that is the spreads widening as basically the debt ceiling in the downgraded U.S. Government and sort of all that sovereign debt crisis really sort of spooked the market. So treasuries did well and corporates and all the other spread products under performed and that's why we did poorly there. Then you can sort of see spreads grinding tighter over the rest of the year and that's where we got a lot of our out performance by owning more corporates than the benchmark, by owning more CMBS than the benchmark and those types of bonds.

On page 5, you'll recognize the upper right hand chart, that is the employment recoveries of every recession since 1970. Basically the change performance from the peak and you can see the orange line there, this recession continues to drag on and hasn't recovered yet. We were here roughly 12 months ago or roughly about 10 months ago and you can see the picture has improved a little bit and now we've extended beyond the longest recovery periods. This is the one thing, if you wan to step back for one quick second, our outlook and the way we're sort of thinking about the portfolio is that we're cautiously optimistic. You'll see some charts here where you'll look at the balance sheets of corporations, the profits of corporations are all pretty strong especially in the U.S. Again, we only focus on dollar denominated securities and most of which is in the U.S., so that's all strong. Fundamentals are pretty positive in corporate America and technicals and corporate bonds are pretty strong as well, so when you look the supply that's out there and the demand for corporate bonds, that paves a pretty positive picture. So generally pretty positive pictures are painted for both corporate bonds and mortgage backed type securities. With that said, we don't want to get sort of ahead of ourselves and think that we're out of the woods, you've got this unemployment, you still have sort of a housing hangover and then you have the wild card which is Europe. From direct exposure we have very little to Europe, but it's obviously going to drive overall sort of market reaction, so we want to make sure that... and basically the way to protect against that is to own treasuries. So if you wanted to take out your risk in the portfolio to all these exogenous events, you want to own treasuries, the problem with that is treasuries yield nothing. So we're faced with this world of trying to own things that we think have better value than treasuries but we don't want to get and put the portfolio in too much of harms way, so we have a real high quality bias in the corporates and the spread product that we own. So that's our overall outlook sort of how we're positioned and we can get into some more details as we go through.

Page 6 I thought this was interesting. I looked at the upper left hand side and some of the key economic indicators, once again we're not a macro shop as you remember we're really a bottom up security selector so we have no idea if rates are going to go higher or lower, we don't really have a strong opinion as to what's going to happen in the overall economy other than what I just said but the 2012 estimates, this is what the consensus basically is saying, what they expect to happen on some of these indicators. I looked at the book that I brought in here last year for some of these, so the market was basically predicting about a year ago that the 10 year treasury would be at a 4.21 yield, so they got that one wrong. They're still saying it's going to be a 2.53 by the end of this year, it' s at 1.70 right now. I'm sure there are some other estimates out there that have the treasury going the other way too and again that's a coin flip, who knows which way it's going to go, but that one really stuck out. They had the 2 year note at 1.74, unemployment at 8.20 so that was exactly the same, CPI they were predicting 2.20, I guess they're expectations are a little bit higher now and real GDP the predictions were for 2.90, now the predictions are for 2.30. So again, that's what the consensus was predicting and that was interesting especially on the rates continually wrong. Our index is the Barclays Aggregate Index and we're going to keep the duration pretty much in line with that because we don't know which way rates are going to go.

Page 8, the chart on the upper left hand side shows 3 things, it shows the spread again, how much these different sectors are trading over treasuries, for financial basically banks in the U.S. the overall corporate spread and then we took sort of a proxy to measure what's going on in Europe, we took the 10 year Spanish yield, Government yield and subtracted that from the 10 year treasury yields, so kind of a spread if you will, on Spain. You can see in that sort of middle part of 2011 we kind of followed suit, so basically you can see European sort of sovereign not doing well, spreads rising, the Spanish bond and the corporates sort of followed so we were kind of coupled with Europe. You can see their yields rising and our yields rising as well but then you can see it start to diverge, so coming around the bend in 2012 given the positive fundamentals in corporate America, we kind of decoupled. You can see Spain continuing to have its issues but the U.S. market sort of now shrugging that off saying, you know what, we're not Spain, yes it may have had some overall effect on the general level of volatility but our fundamentals are pretty good, so the market is really sort of starting to differentiate that. Could they recouple again if Greece goes the wrong way, possibly but right now it seems the market is really focusing on the fundamentals in the U.S. Gerard Cruz: What's the wrong way for Greece? Steven Weiss: I guess the wrong way for Greece would be if, I think the market probably has Greece going poor, bad sort of built in, whether or not that has the domino effect of bringing down the rest, that's probably not, so when I said the wrong way, I think the domino effect. I think if Greece is an isolated incident and they have their little problem and maybe they even default, they may not have too much of an effect. If that takes down other banks in Spain or Italy then you can start to see some real impact, then you might see us sort of recouple with everything else and spreads go wide. Gerard Cruz: Some people think that Greece being out of the European Union is a good thing. Steven Weiss: Right. Again, we don't have any direct exposure to any of this stuff so it's kind of watching it from afar just trying to figure out how it's going to impact our markets.

The upper right hand side chart is interesting as well, basically this is what banks are holding in their inventory in terms of corporate bonds. You can see banks were very active in holding a lot of corporate bonds up until the crisis and the crisis happened and then they eventually got out of the business for a while and then now there is Legislation saying that they can't be holding bonds anymore. What it's done is it's impacted secondary market liquidity quite a bit, basically trading in corporate bonds and trading in all these types of bonds, it's not quite as liquid as it use to be and what does that mean? It means if you're a smaller firm, smaller client and you don't have a huge portfolio it could impact your trading, transaction costs have a larger impact on what's going on. I think it actually benefits a firm like ours, we're bottom up, sort of looking for different things to do and take advantage of. The liquid situations are really providing liquidity to the market, so if it's a Friday afternoon which is typically a slow trading time and some client or some bank gets a tap on the shoulder and says, we need you to lighten up on corporate bonds today and they're forced to sell, well there aren't a lot of banks so if the bond cheapens up really quickly on a Friday afternoon, we like the bond we can go ahead and come in and buy a cheap bond. So for us I think this type of environment helps but it's definitely a watch out, basically it's changing the way we're looking at the market and the way we're implementing our trades.
On page 9 you saw these 2 charts last time, corporate cash and leverage and profit margins. Profit margins are better than the last time I was here, corporate cash is down just a touch but it's still very strong and leverages is still pretty good when you look at fundamentals, so corporate fundamentals are strong.

Page 10 you didn't see these charts. Banks we're over weight in financials, we like the big banks, we think that a lot of this regulation makes their balance sheet stronger, I wouldn't necessarily want to own their stocks because I think it's going to be harder for banks to make a lot of money going forward but from a big banks point of view in the United States from owning their bonds, their balance sheets are definitely better. You can see their tier 1 common ratios are significantly better than what they were in 2007 and under the stress test they're passing the test pretty well too. They're non-performing assets are down, their net charge offs are down so a lot of positive sort of things in the banks. We've actually at the peak in your portfolio we're probably close to about 40% in corporates and I can't remember exactly for financials, we were at roughly about 21% in financials and we've taken that down to about 17. Even though banks are doing well, fundamentally they perform pretty well in the 1st quarter and we took some of that risk off. So we still like them just not quite as much from a valuation view, they're still the cheapest thing out there, but they're less cheap than they were.

Page 11 is some charts that talk about the technicals I mentioned. What you're looking at there on the top chart on the right hand side is net supply of the different spread products. You group them by corporate bonds, securitized bonds and then emerging market and high yield. In the securitized the net supply is actually still negative, there is not as much issuance, that market is actually decreasing in size and corporate supply is shrinking as well, as is emerging markets. Basically all the spread products are shrinking in supply, so you've got this supply demand imbalance that's helping out. When you think about corporate bonds in the United States, you immediately look at corporate pensions and corporate pensions are getting better funded, their funding status is increasing and they're continually making this march towards creating a LDI approach, Liability Driven Investing, they're trying to buy bonds, lower their volatility. So any time rates back up or any time their funding status improves, they're pouring money into fixed income and they're looking for corporate bonds. So there is really a very strong demand for corporates, so basically you look at fundamentals being strong, supply and demand being positive for bonds, it paints a pretty good picture for owning corporates and other spread products.

Page 13, CMBS is a sector that we've liked a lot and own quite a bit relative to the index. On the upper left hand side is the commercial property price index and when you look at the overall index it seems to be putting in a bottom, when you look at the sort of trophy properties you can see a strong rebound. So CMBS feels like it's putting in, commercial real estate maybe feels like it's putting in a bottom, delinquencies while up, the rate of delinquencies is slowing. So when you think about the bonds we own, CMBS you can own them in different ways and if you do remember you did own them in a lot of different ways before we started running it but we focus on the 30% credit enhanced, really top of the stack, so not the AJ's and not the AM's. We finally sold our last AM that we inherited, that was the last bond to go. So we have 30% credit enhancement which means that there needs to be 30% of losses before the bonds that we own for you would be impacted by that. What this is saying is that delinquencies are up around 8 or 9%, so if all those delinquencies turn to losses which they rarely do, but even if they did you would still have another 22% of protection before our bonds took a hit. So there is a lot of protection and that should give you comfort in the CMBS that we own.

Page 14, you probably heard me say in the past the Aggregate Index owns about 31% of fixed rate pass thru securities, so these are bonds that are backed by fixed rate mortgages, your standard mortgage backed security. We have traditionally owned very little of those, we typically didn't like the convexity profile which means we didn't like the way they were performing in up and down markets and we didn't think there was a tremendous amount of value. They have under performed a bit over the past 6 months and what we're doing is going in there and sort of taking our bottom up approach and seeing if there are any bonds out there that we'd like to own more than others and what we're finding is some of the older vintage, some of the 2004 and 2005 vintage mortgage backed fixed rate pass thrus. The people who have these mortgages have had 4, 5, 6 times an opportunity to refinance. So when you look at a mortgage backed security what you want to do is try to get your money back. You don't want to get your money back sooner than you think and when you get your money back sooner than you think is when people refinance their mortgages. So we're looking at these bonds and we're saying the people who have these mortgages have had 5 times at this point given the interest rate cycle, have not and so we basically look at those and say we have a pretty good understanding that there's not a lot of refinance risk, there's not a lot of pre-payment risk in these. So we're finding those bonds and we're going ahead and we're adding some and we've taken that allocation pretty much from 1 or 2% up to 5 or 6%. Gerard Cruz: Why do you suppose they haven't refinanced? Steven Weiss: It could be a number of things, it could be they're upside down, it could be there's not enough equity and they still don't qualify for one of the programs... Gerard Cruz: The relief refi doesn't really look at whether or not you're upside down. Steve Weiss: I think the heart program changed some of that, one of them did look at loan to value ratios, but it could be they don't think about it, they don't know about it. Gerard Cruz: A lot of times what we're seeing is they just don't qualify not because of the collateral but because of no income or just some delinquencies. Steve Weiss: So there's that too. Gerard Cruz: Wouldn't that classify those, if you couldn't refinance those things after 5 cycles of drops, isn't there some greater credit risk even though there's not payment risk or pre-payment risk? Steve Weiss: There could be credit risk in a sense that these are backed by the agencies, we don't have to worry about not getting repaid, the agencies are guaranteed. If these were non-agencies then you're absolutely right. Credit risk isn't an issue, right now it's just refinance risk and what the chart on the upper left hand side is showing you is the refinance incentive, so as refinance opportunity goes up 50 – 150 basis points basically the speeds, speeds determine how fast you're going to get your money back and when you look at 2009 to present experience here, speeds are a lot lower than they were in the past. So basically from our point of view if we can find a bond that we like that we think speeds are low, we know we can clip some of this extra yield and they're not going to get hurt as much as others. So that's basically the story there.

The next page (15) is munis, we do own some munis, they are taxable munis and we view those the same way we view our corporates, we want to focus on the stronger municipalities out there. We love to buy essential service revenue bonds, electric utilities or water and sewer bonds where people have to pay their bills. If we go to a general obligation bond we much rather own a high quality GO like Washington State or maybe even Michigan is run very well and stay away from Illinois and California because they're just a little too volatile.

Let's jump into the portfolio real quick. We have there 3 columns and the last column was as of the last time I was here compared to the end of April and compared to the index as of April. On the upper left hand side you can see the yield is down overall in the portfolio from 3.07 to 2.62 and that's pretty much a function of treasuries yields dropping since last time I was here and spreads tightening just a little bit but it was still a healthy yield advantage over the index, the index yields 2.07 and we yield 2.62, the duration the 3rd line down there is pretty much spot on and we had the higher convexity again because we're avoiding a lot of those fixed rate pass thrus and our credit quality is high. If you go up to the right hand side you can sort of see where the yield advantage is coming from and the top line there is

Governments and you can see in the middle column right now we're about 20% invested in some type of Government bond and the index is at 40%, so we're half the amount and that's where a lot of that yield advantage is coming from. We're under weight the lowest yielding sector of the market which is treasuries, the treasury component is almost 36%, we only own 7% in treasuries, so we're really trying to find other places to go and again, you can go a whole bunch of other different ways, our goal is to try to find a higher quality ideas in here. You can see we are under weight agencies, but we're over weight in guaranteed Government bonds and those Government guaranteed bonds are mostly SBA's, the Small Business Administration certificates, as well as some bonds that are backed by FDIC, remember there was that program back during the crisis for some of the shorter duration bonds backed by FDIC.

For credit, last time I was here were at 37.5, we actually took that up to 40% pretty much around that spread widening time in the 3rd quarter of last year, we've trimmed that now back down to 36% so we took about 4% off of our corporate over weight but still very much over weight relative to the index. Finance was up at 21 it's now down to 17.6, we're over weight in all these different sectors, we're actually just slightly market weight to utilities.

Securitized is up a bit, that's where we've taken some of these proceeds and put them in. Again, increasing our allocation you can see RMBS that bucket has gone up 10%, some of that has been increased in hybrid ARMs, so again those are the agency backed bonds that are backed by those floating rate type mortgages where at the 5.1, the 7.1, not the pure fixed rates, we've taken that up, we've taken our exposure to fixed rates up, we've also increased our allocation to Fannie Mae DUS, the DUS program which are basically multi-family housing deals. Gerard Cruz: The residential mortgage backeds, these are also agencies? Steve Weiss: Yes. Nothing we own is private, there are no non-agencies in here at all, everything is agency backed. For us we'd rather not take risk and if you're going to get paid, we'd much rather try to analyze when you're going to get paid back and that's basically our approach to securitized, with any type of structure or organized deal that you're trying to analyze, we just want to avoid that whole, we want to avoid the credit risk component of that and focus on when you're going to get your cash flows back. For CMBS for example, we're basically the same where we were. For us right now the biggest risk in CMBS is actually whether or not, because we own these very diverse pools, everything bond we own is backed by 150 -250 properties and it's spread across property type and geographic so again we're not really worried about the credit. One of the risks in CMBS is if a property is having trouble they're going to go ahead and basically try to renegotiate the terms and extend the loan, so there is extension risk in CMBS and if we own bonds at a discount, that we're trading below par and they extend the maturities that would be bad for us, but we actually own bonds that are trading at slight premiums, 1.01, 1.5, 1.02 so if they extend the loan a little bit it actually helps, you get to keep that yield for a little bit longer. If the extension risk became where every loan was extending, you'll never get your money back and you have to worry about your 30% credit enhancement, but we're fine so we think it's a pretty decent investment.

Municipals are about the same, again mostly invested in revenue bonds, not GO's and cash is low.

Gerard Cruz: Commercial mortgage backeds, the term is only 15 years so they don't extend too long. Steven Weiss: Right. Gerard Cruz: So even if an extension goes up, about 20 tops. Steven Weiss: Right. A lot of the stuff we focused on was 2004 or 2005 vintage so some of them their 10 years is coming up.

From a guideline perspective we aren't really bumping up against anything. I know in the past we've had to ask for waivers because we own all that securitized stuff and it was keeping our credit quality low and now that's all gone so there's really nothing in the guidelines that we're bumping up against. We don't need flexibility, I think we're always a little nervous about clarification, I think we have a pretty good understand about how your guidelines work but there are a lot of different moving parts and it's just how to interpret those. We gave to Maggie (Ralbovsky) a list of all the different guidelines and how we're interpreting them and how we're interpreting them in your different documents that are out there just to make sure we're all the same but we don't really need relief from anything.

Page 18 is the transition portfolio. So what you're looking at here, maybe focus on the bottom left and the absolute last line there. We've basically sold from a security point of view almost $68 million dollars worth of bonds basically since inception, since we got all these different bonds. We've collected about $7 million dollars worth of coupons for you and about $11 million dollars in principle pay downs, so as these different securitized bonds paid down we got that return of principle, so a total of $87 million roughly transferred from that transition portfolio back to the core portfolio. You can see the lower right hand side kind of shows the history where initially you gave us roughly 55 million in securities right at the beginning, right at the end of basically October 15th and we were using the pricing service to price those bonds and then it became apparent to everybody in the world that the pricing service was wrong, it was really based on reality so we went ahead and started to override some of those. It actually caught up and the portfolio was marked down to roughly 40 million and then if you remember, we transferred back from the core portfolio back into the transition portfolio some CMBS, about $15 million dollars worth of CMBS because what we thought was liquid clearly wasn't liquid anymore. That was sort of that kick up there, back up to about 58 or 59 million in market value and then that 59 million in market value basically we sold about $8 million dollars higher and collected all that principle payments along the way.

Gerard Cruz: The transition portfolio was how large when you got it? Steven Weiss: It was about 55 and then when you add the CMBS back in... Gerard Cruz: 59 or 60? Steven Weiss: That depends on the pricing. Gerard Cruz: And the proceeds? Steven Weiss: The total proceeds that we moved back... Gerard Cruz: 67... Steven Weiss: Of the sales of the bonds, yes, but it's hard to do the math per say because of a lot of that was principle pay downs along the way so you get the principle back. It's hard, I know we wanted to talk about generating a performance number but to generate a real performance number is tough. We did generate one and we kept sort of track of it and it shows like 100% which is probably kind of close but it seemed a little high to me. The bottom line is if you do back of the envelope you can get to basically a 50ish percent type number which if you think of the cumulative performance, the core portfolio was 33 so by doing that, I guess by you guys allowing us to be patient that was the best decision that we sort of all collectively made. Not selling at the bottom was great, it allowed us to generate a lot of coupons, a lot of return on principle and we got back to a market base. Basically the reason we were able to finish this up was there is the big AIG portfolio that the Government held and it was called the maiden lane transaction and there was a overhang in the market and they actually moved about 7 billion of that in the beginning of the year and it gave the markets sort of a renewed confidence overall that these things were going to be okay and it brought a bid back to it and what we needed to happen was we needed for the market to get so frothy, if you will, they wanted to give good prices to small odd lots. While it was a lot of money, it was a lot of line items and it was small for you guys and we really needed a really strong market to allow us to get out of those at decent prices and that finally came right at the end because we were holding on to the stuff that was not quite as liquid. Overall I would call it a pretty decent success there.

In terms of firm update, turn to page 26, not too much has changed. If you remember I sent an email and spoke to, I think I left a voice mail for Paula (Blas) and obviously I'm keeping Wilshire in the loop, we parted ways with a portfolio manager late last year and it's the first time it ever happened for us. We probably made it a bigger deal than it actually it, I'm sure this happens at firms all the time where people leave, for us it never happens so for us it was new. Our investment team right now is 33 people so one leaving isn't really all that big a deal and actually allowed us to promote some people who were doing a good job anyway. We added 3 new shareholders at the beginning part of the year, we're totally employee owned, there are now 23 employee shareholders. We've got about 115 employees total, so about 1 out of 5 employees is a shareholder which is great. Assets are up about $4 billion since I was here last time, half of that is market value with rates declining and bonds increasing in value, we've also been generating some business kind of in the short duration area as people are looking for cash substitutes and we still are generating assets in the long end as corporations are implementing LDI.

One note is that the employee who we parted ways with has since sued us so we do have a lawsuit. We're fine from an insurance point of view, it's not going to be a financial impact and we're doing our best to make it not a distraction. John Sommers who founded our firm who's not as invested with the day to day, he's not handling a lot of day to day investments, he's focusing on dealing with all of the nonsense that goes along with that. Wilfred Leon Guerrero: What is the lawsuit about? Steven Weiss: He is suing us for wrongful termination and age discrimination, he's 48. I guess technically if you're over 40, if you get an employment lawyer and you're over 40 you can automatically tack that on. We don't think we have a case. It's unfortunate, it's one of those things where you never like to see this happen especially it's tougher for John (Sommers) and for Jack Sommers, they were all friends and it's just one of those things that just didn't go well and it happened. It's not a distraction, it's not going to be an impact, it's just something that I had to disclose to you.

I think that is it unless anyone has any questions. George Santos: How are we looking this quarter? Steven Weiss: This quarter we're doing okay. I think it's a little volatile, but April was great, we out performed a lot there. I think right now through the first month in May I think we're trailing a bit treasuries, but out performing, if you add April and May together, we're out performing. The returns, I'm sure you know this, basically with us you have a pretty decent bull market in bonds, that annualized return of 8% isn't going to happen going forward unless there's another run to lower yields which would be the worst for everyone so hopefully that doesn't happen.

Wilfred Leon Guerrero: Any other questions? (No.) Steve Weiss: Okay, thank you very much.
(End of tape 3)
(End of presentation by Income Research & Management)

Respectfully submitted,

STEPHANIE A.H. LIMTIACO
Recording Secretary

Affirmed:

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