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Quarter Ended December 31, 2012 Performance Meetings & Annual Investment Manager Reviews

February 20, 2013
Retirement Fund Conference Room

Board of Trustees Present:
Wilfred P. Leon Guerrero, Ed.D, Chairman, Investment Committee
Gerard A. Cruz, Trustee
James R. Duenas, Trustee
Antolina S. Leon Guerrero, Trustee

Staff Present:
Paula M. Blas, Director
Diana T. Bernardo, Controller
Rosalia T. Bordallo, General Accounting Supervisor

Other Present:
Maggie Ralbovsky, Wilshire Associates
Takashi Takamura, Capital International
Akira Fuse, Capital International
Ted Simpson, Dimensional

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Economic & Capital Market Environment and DB Plan Performance

Maggie Ralbovsky: Okay, good morning everybody. Gerard Cruz: Do you need coffee? Maggie Ralbovsky: I probably do. How much time do we have this morning until the managers come in. Paula Blas: You have until noon. Maggie Ralbovsky: So happy new year, this is the first report of the new year so it's Chinese New Year too. So this is the first meeting of the New Year I thought I'd provide some outlook both in short term and in the long term. For the short term outlook I have a page that's a visual representation of something called behavior finance. Behavior finance says is that.

Wilfred Leon Guerrero: Every time you come you come with something... Gerard Cruz: With some new word right, shoot. Just when I learn the last few words from last time. Maggie Ralbovsky: Risk parity are you talking about that? We'll see for tomorrow. So behavior finance says that the forces influence in market pricing is not only connected to the fundamentals of the companies of finances but also has something to do with the perception of the market. And the perception of the market is the collective behavior of all investors that place in the market place and there's some human tendencies to do certain things and they just repeat again and again and again. And these human tendencies include that humans tend to price future based on the immediate tasks.

Maggie Ralbovsky: So if you just for example sit down in a big room with hundreds of people, you ask them okay give me everybody give me a projection where the market is going to end or where who is going to win the you know the super bowl, whatever the question is and you ask around the result will be very similar to what happened in the past especially the immediate past. So in the case of market average chances are all the answers you are getting its going be plus or minus 10 15% of what the market is today because it is very, very hard for humans to see a scenario that is very different from all you are seeing now so if you collectively have that kind of tendency then the market pricing will follow particular trend and here's the chart that summarizes this kind of repeating behavior of all the market participants which is on the top chart, top graph top line that says what is discounted, which is to say that the market pricing is discounting follow a very smooth sort of a revision kind of a trend when something happened in the market place the market is slow to react. So what happened during the previous cycle is that in 2006, 2007 when the debt bubble started to burst the market is not recognizing it until much later and the underline condition actually was deteriorating much faster and then however up to today when the market is actually pricing into very, very, very pessimistic scenario you can just look at interest rate its pricing into a very long time low rising interest rate the 10 year even though went up a little bit is at 2% still very, very low below the China inflation. This is to say the market is discounting a scenario that's probably too pessimistic for the underlined condition because the underlined condition actually has improved much better. Now bottom line in the short term outlook we do think there is a positive surprise to be had to the market because the market has pricing into a scenario that is more pessimistic than probably if we knew what was going to happen because of this human behavior.

So that's what it says now under now, we think its possibly were at reflection point at with a stronger than expected surprises to be had in the future. Another indication of such a scenario is that I have an implied volatility across the market table here. Implied volatility is to summarize the risk being wrong in the market place so if somebody has a projection for the future and they think the risk being wrong is very high, chances are the implied volatility is high because you will have less of an agreement as to what the scenario will be so you think IBM is worth 100 I will think it's worth 120 in that scenario the volatility of trading will be high because there's less of the consensus.

Today the market consensus is very strong pretty much you for all the across the different asset classes I listed here, there's very little discrepancy as to consensus. You ask around the GDP average everybody thinks it's between 2 and 2 and a quarter percent for the year, very, very little so which is to say when the consensus very strong there's a very strong chance we are going to be surprised and this time maybe on the outside. Okay so that's the short term...Gerard Cruz: Outlook. Maggie Ralbovsky: Outlook. Gerard Cruz: And the short term what's your definition? Maggie Ralbovsky: Short term in the next 2, 3 years we think the interest rate. Gerard Cruz: That we're in for an up and a surprise to. Maggie Ralbovsky: Surprise to the upward direction. Gerard Cruz: Even with the market is moving as high and sloppy as it has been? Maggie Ralbovsky: Yes because the relative it's actually very fairish for the bond market this outlook. Gerard Cruz: Of course. Maggie Ralbovsky: Yeah because the bond market is pricing into a very, very distress scenario for the next 10 years to the government bond as priced below inflation which is the Japan scenario and this outlook is very fairish for bonds and very foolish for equities because equities compared to bonds is very under value.

Gerard Cruz: Yeah that's true. Wilfred Leon Guerrero: So the next 2 to 3 years. Maggie Ralbovsky: Yes. Wilfred Leon Guerrero: You guys are projecting market. Maggie Ralbovsky: We're projecting what's priced into the market is actually more pessimistic than what is going to materialize. Wilfred Leon Guerrero: More pessimistic? Maggie Ralbovsky: Yeah what's priced into the market is more pessimistic than what is going to happen so which is good scenario for stocks. Gerard Cruz: There is an article by you're right I'm sorry go ahead. Maggie Ralbovsky: That scenario for bonds. Gerard Cruz: A couple days ago by and I understand that these are contrary by nature but by Mark Farber who talked about quite the opposite of what you had just said. Talked about developed markets, U.S. and now Japan are in a position where they debate to the point where future growth is going to be held back by inflation of some sort.

Maggie Ralbovsky: I absolutely agree to that which is on the next page which is long term outlook this is the short term outlook which is the next 2 to 3 years. So the market has just talking about what matters is not what's going to happen in the future but what is priced into the market what's going to happen versus what is actually going to happen. Gerard Cruz: But his advice in the short term is to get out of the developed markets and look more closely into South East Asia. Maggie Ralbovsky: What is short term debt definition? Gerard Cruz: He didn't put a time frame, he just talked about and well he talked about the overriding drag on the countries as a result of debt. He looked at all the developed markets including in Europe which we haven't really talked about in the outlook. Maggie Ralbovsky: Yes you know I actually totally agree to that I have a page for that but in argue that's a longer term kind of a drag list. Gerard Cruz: You don't think that shorter term that the issues of the debt that kind of scooped the market about a year and a half ago in Europe in particular it's not going to wear it's head in the short term? Maggie

Ralbovsky: I don't think in the next year or 2 years it's going to actually be a huge problem because the market has already priced into that scenario. Gerard Cruz: You don't think it priced out of that scenario when they kind of created the. Maggie Ralbovsky: The Draggie yeah the OTM or something? So what has been priced on the market after that is the breakup of the union. So I actually do agree with break of the union is probably not possible at this point at least in the near term so other than that the market is actually stood very pessimistic. So I think in the very near term.

Gerard Cruz: So, okay so what you are saying is that currently in the next 2 to 3 years, the market has priced itself over to the down side extremely to the down side and that from the positioning standpoint portfolios with concentration in fixed income will be hurt in the short run and those portfolios with the higher concentration in equities, primarily develop markets and with the tilt to emerging markets we'll probably outperform. Maggie Ralbovsky: I think so yes. Gerard Cruz: Good because that's us. Maggie Ralbovsky: That's you I actually have the thing for 2013. Gerard Cruz: So we don't need to talk about risk parity.

Maggie Ralbovsky: Oh we do actually we do because this is the think about how long the decision is going to be made right. Paula Blas: Gerry opened the door you came in and he closed it. Maggie Ralbovsky: I know. So I do have a thing for 2013 I do think 2013 our portfolio is pretty well positioned for the current scenario, but towards the end of this year I think the markets need to look forward to 2014 and started pricing into inflation. So the next page is the long term outlook which is an echo what you have just mentioned of the scenarios of developed countries are facing. I have a developed economy total debt versus GDP chart at the bottom you can see that it is really Wilfred Leon Guerrero: What page are you at? Maggie Ralbovsky: I'm on page 3 now it says the long term outlook. You are on that page. No, no it's the page before that, page 3. So let's start with the bottom left hand chart that says developed economies and these are all the developed economies they all have too much debt. With debt in 30 years ago every dollar of debt a country takes on usually translates into one dollar GDP growth.

Wilfred Leon Guerrero: Maggie when you said a lot of debt you're talking about the government right? Maggie Ralbovsky: Yeah, this is the total debt including public and private sector debt. Gerard Cruz: Including private sector debt. Maggie Ralbovsky: Including private sector debt. Wilfred Leon Guerrero: What is this thing we're hearing that people are parking their money some place without getting into the market? Maggie Ralbovsky: Oh yeah I will address that on the next chart but just look at this chart. This is total debt okay it includes persons debt and countries debt. Usually when debt bubble burst people are starting to delever. People want out of debt, they default on their debt they if they get money they sort of suck it up they don't spend it but the government is printing money Wilfred Leon Guerrero: Yeah, buy when they started this stimulus program it seems like the reaction was people were taking whatever money that they have you know and paying off their debt. Maggie Ralbovsky: Yes that's for the private sector. What happens is that the public sector debt surged look at the debt the U.S. Government is having, this is the money through based of the U.S. How much the QE3 and we're at QE4 right now right, QE is a printing money program they print trillions of dollars for those programs and we're at the 4th right now. So that's how much a public debt has been created to fulfill the hole created by the deleveraging of the private sector. I'll address more of that on this chart but just look at this is the pure mathematic calculation total debt versus GDP in the economies that's developed. Pretty much everybody has too much debt and the implication for investments is basically a drag because then the in the future if there's any down turn debt being created will not have the same stimulus effect as when you have a lower base because your sugar high and give you more sugar doesn't get any higher whereas gets less higher kind of scenario. So in 30 years ago when a dollar of debt that being created is directly translating into $1 GDP growth and today in the U.S. is seventy cents of GDP growth and in Europe is much less, its thirty cents of GDP growth. So in the future this is just putting us at a very bad starting point for future down turns where the government will have very limited ways to stimulate and get us out of the down turn fast that's one implication. Another implication is that when the population growth of the different developed nations are at a point where foreseeing decades of aging increased aging population and decreased work force which have less of a working population to pay down this debt and because of the aging of the population the social entitlement program spending naturally has to increase especially health care. In the U.S. in 30 years, medicare will take up to 30% of GDP today is 7%. And 7% GDP is already very, very much a drag to us but just think about in the next 30 years it's going to increase to 30% GDP where we also have less of a working population to support that debt it's going to push the U.S. into a very low gross kind of a scenario for decades if we do not do anything today. That's why the talk of a reforming social entitlement program is very important one for the future generations. So the implication for the long term is very daunting for developed nations where you have the negative demographic trend and where you have too much debt to stall with, you really don't have much of an ammunition left to address any of those issues if we do not reform right now. The scenario for this if you combine that with a very strong emerging market is a scenario called stagflation because you have a stagnation in the development of your economy at the same time because of the surging emerging market they are still consuming a lot of the raw materials, you know the food and the energy you are going to push up the inflation in the world so you are having a scenario called stagflation which is a terrible scenario for all risky assets. The only thing that survives that is that the lower that upper on this next chart lower right hand precious metal gold, this is the scenario these are the assets that kind survive such a scenario.

Wilfred Leon Guerrero: What is stagflation? Maggie Ralbovsky: Stagflation. Wilfred Leon Guerrero: Yeah what does that mean? Maggie Ralbovsky: That means you have inflation, you have no growth. Gerard Cruz: So back in the seventies, when you saw a rising oil prices but a stagnant overall economy, you didn't have any economic growth but you still saw prices rising, because of rising oil prices, so it took more dollars to buy a certain or to buy goods, but your dollar wasn't gaining any value. Like that. Maggie Ralbovsky: During the 70's that's exactly the most recent example for stagflation, during that whole decade for 10 years the only thing that out performed inflation is commodities nothing else. Gerard Cruz: And you had high interest rates, remember when the interest rates in the 70's was really high? Maggie Ralbovsky: So now addressing that private sector deleveraging issue, I have a chart here. So this is an averaging of the prior deleveraging cycles and you can see the public debt versus GDP the orange line driving when the blue line which is a private sector debt versus GDP is dropping so that is when the private sector delever but the public sector lever up so that the economy doesn't go into a very, very deep depression kind of scenario. So what needs to happen is for when the blue line starts to trend up, the orange line needs to trend down otherwise we will have a hampering inflation. So the Fed has a task to withdraw that public debt when private sector starts to relever and that timing is critical for us to avoid inflation and we think chances are they are going to be late in doing that. Chances are towards end of this year the market is going to start looking at the future to press into a different scenario which has higher inflation. That's one of the trend I summarize here.

Gerard Cruz: This all takes into account Maggie just pure market forces driving decisions right? In other words, I guess this. Maggie Ralbovsky: The public sector is not. The public sector is political decision. Gerard Cruz: Yeah but how do you but this does this price in things like tax reform, to increase revenues or expenditure decreases as a result of. Maggie Ralbovsky: As a result of the GDP versus GDP growth? Gerard Cruz: Or just overall political to reduce expenses for example does it price in things like a reform in social security? Maggie Ralbovsky: No it does not, so that obviously is part of the questions. Gerard Cruz: So this could actually this could actually work if Maggie Ralbovsky: If they do it right. Gerard Cruz: If for example there was an increase in revenues by increasing taxes. I'm not saying it's popular but I'm just saying that this model doesn't include those kinds of scenarios. Maggie Ralbovsky: It does not. Well it, this is a simply vacation I guess with what could work. So if you raise taxes and do not hit GDP because when you raise taxes chances are you are going to hit GDP but depends on how you raise taxes. Gerard Cruz: Maybe. Maggie Ralbovsky: How much? Gerard Cruz: And where. Maggie Ralbovsky: That's right where. So if you do it right perfectly than if you have these lines coincide when this rises this falls, it's actually what's called a beautiful deleveraging perfectly and if you don't do this correctly it becomes the ugly deleveraging which becomes Japan so you just have to, I think we're at the reflection point for this country really addressed that correctly otherwise our future generations will have a lower living standard than this generation. Gerard Cruz: Agree.

Maggie Ralbovsky: And so to summarize all that we see the trend for short term 2013 here, I think I have addressed most of it. So, we believe there's a build trend global GDP growth however it's a very strong growth compared to the previous couple of years and also very interesting thing to watch is Bank of Japan. Bank of Japan has this new governor, Abba. Then there's a Ave how do you say that? Ave. They already created the term called avenomics. He has this policy that is different from the previous administration and he basically wants to copy the printing money inflate out of the troubled policy. It could work in isolation the thing is that everybody wants that policy to work so you have this potential scenario called currency war. Everybody has their currency racing to the bottom try to create inflation in their economy get out of debt. So the most painless way to get out of debt is inflation but you have to not do it you have to do it in a subtle way that people don't perceive it to come when it happens that's the best way to do it but it's very treacherous right now but Bank of Japan is something to watch.

Now you have the Euro crisis, it's not going away but probably this year it's going to muddle through it. Emerging market growth is expected to accelerate and which will cost the next scenario which is recognition of inflation by the market. The market is not recognizing right now. Right now it's pricing into 2% inflation for the next 10 years and we do think towards the end of the year bond market is going to price into much higher inflation which is going to actually hit the bond market. Gerard Cruz:

The end of this year? Maggie Ralbovsky: The end of this year I think the markets going to start looking forward not the end of this year inflations coming back. Gerard Cruz: I understand that they're going to start pricing inflation by the end of this year? Really? Maggie Ralbovsky: That's right so that's the outlook at this point. We did revise our expectations for the future, you can see on page 5 we did revise up our return expectations for stocks. Gerard Cruz: Wow. Maggie Ralbovsky: Revised down our expectation for bonds. Inflation is revised up by 55 basis points from our advantage point. So. Gerard Cruz: Go ahead, what's your conclusion?

Maggie Ralbovsky: So we still need to talk about risk parity. Gerard Cruz: How did you figure you'd laid the case. You laid the case, you laid the case for not approaching risk parity. Maggie Ralbovsky: No, no that's totally not the case. Why can't you save that question for tomorrow we can address that? I have a thing that prepared for risk parity so. Gerard Cruz: Yes we did. That's a repeat though right. Maggie Ralbovsky: That's not a repeat no I well there's a couple of pages that's a repeat but I provided lot more things in that.

Okay now we're going to move on to look at the past, 4th quarter. I'm going to start with page 9, I do want to address page 8 very briefly which was the fiscal cliff issue because this is a moving target and whatever you write down today tomorrow it may change but bottom line the politicians are pushing the can kicking the can that the beaten up can on the road one more time so their actually moving all the debt ceiling and stuffing into May the only thing right now we're looking right now is sequestration. Gosh I can't say that word. Automatic. Antolina Leon Guerrero: I don't know why they came up with that term. Why is the end of service the entitlement sequestration, I don't know where that word comes from. Gerard Cruz: I know right. Antolina Leon Guerrero: The feds are always looking to create a new word.

Maggie Ralbovsky: So that is supposed to supposed to hit March 1, but I think they're having a deal to push us backwards, otherwise the defense budget is going to cut by half which is going to hit Guam pretty hard I think. Gerard Cruz: Hit everybody. Maggie Ralbovsky: Yeah. Gerard Cruz: Except China will be happier right. Wilfred Leon Guerrero: And Russia. Gerard Cruz: North Korea. Maggie Ralbovsky: Yes, North Korea, that war if there is a war on the peninsula. Yeah that is not passenger market at all. It's a huge tail event. Paula Blas: Pay attention to that. Maggie Ralbovsky: I know. Okay so the past quarter was a great quarter, you can see I circled the inflation numbers because this is the number that the Fed is looking at right now that's why the fed is bold enough to initiate something called the QE4 which gives them $85 billion dollars a month to buy treasury and mortgage back securities, $45 for mortgages and $40 for treasuries that program is going to last until June of this year which is the QE4. It's hard for me to see a QE5, but if you summarize what the market reaction was for the past 4 QE's, QE1 was has cost the 90% rise in stock market, 90%. QE2 was 67% rise, QE3 was 33% and QE4 so far was a 10% rise so I think if you look at that you probably come to a conclusion QE5 is going to do nothing so don't do it. Gerard Cruz: Don't do it? Maggie Ralbovsky: I don't think there's going to be a QE5 because the market Gerard Cruz: But economic growth has to trigger before they stop, right? Because if you stop now without any corresponding growth, I mean you're going to decelerate faster than you accelerated wouldn't you?

Maggie Ralbovsky: As long as you don't withdraw the liquidity from the market. But QE's add liquidity so when you add more liquidity right now it's translating a diminishing kind of return so I think the Fed is going to be very, very cautious in withdraw the liquidity but I don't think they are going to add more in the QE5 kind of. Gerard Cruz: But if you don't add more won't rates start to climb again? Maggie Ralbovsky: You see if. Gerard Cruz: I mean won't rates start to go back up? Maggie Ralbovsky: Yeah I think rate will go back up. Gerard Cruz: Because they already going back up with a $80 trillion dollar purchase a month or $80 billion dollar. Maggie Ralbovsky: Yeah, they are going to go back up because the market is going to start looking into inflation being priced into it. And the liquidity however is finding its way to the risky assets, you see high yield and you see emerging market debts spread dropped tremendously, has dropped tremendously that's not to say high yield is expensive right now we sort of missed that part of it but there's still I have a chart later to show you it's actually still cheap. Anyway let aside, I do think the Fed is. Gerard Cruz: Won't initiate a QE4 or a 5. Maggie Ralbovsky: If you're doing QE4 right now. Gerard Cruz: Right.

Maggie Ralbovsky: Okay, so that's that and spending pattern, I'm going to skip that. We talked a lot about that. The housing condition is a very, very positive sign right now. Page 11 you can see that the house index really has stabilized and started to go back up. That's the bottom chart. The house affordability index on the next page is historically high levels which is to say that houses are really undervalued compared to historical terms given the current interesting environment which makes it actually house ownership being very attractive compared to renting. So if you use a rent equivalent for house price it's much better for you to buy versus rent. And this is a total reversal from the past decade. Antolina Leon Guerrero: Right, from a couple of years ago we're talking about. Maggie Ralbovsky: Yeah renting much better so today owning is much better because it's so much cheaper if you just do the rent equivalent to ownership price. Rosalia Bordallo: But isn't it harder to buy now than it was before? Gerard Cruz: It's harder to qualify. Rosalia: Yeah. Maggie Ralbovsky: Because it's time to qualify from the mortgage. Rosalia: Right so you can these houses out there that are cheaper but. Maggie Ralbovsky: That's right. Gerard Cruz: They don't have 20%. Rosalia Bordallo: Right. Maggie Ralbovsky: That's right. So however now some banks are introducing mortgage 100% value mortgage. So at some point when the prices are so depressed its good news start have it in inflecting points going to have fundamentals eventually will reverse. I do think we are very close to the inflection point when mortgage is become easier to get.

Gerard Cruz: They just have to become easier to get. Maggie Ralbovsky: That's right. Gerard Cruz: There's just still no private labels out there still just the Governments right? Maggie Ralbovsky: Yeah you still just have to Fannie Mae, Freddie Mac kind of an agency mortgage market you don't have the other market you just have to, banks just have to hold it on their books but I do think. Gerard Cruz: But you could only do but you can only hold so much. Maggie Ralbovsky: Yeah but I do think some banks are doing like Bank of New York, Maryland actually and a couple more other banks, they are using peoples investments as collateral to give them 100% loans to buy houses you just hold those on their books, I guess you get less reserves for that? Gerard Cruz: There's less reserve because yeah the reserve ratio is smaller but you can only do that while equity I mean while the market is doing well you can't hold investments in the down market, and so the returns are shorter and you know if you're fully collateralizing somebody's investments then sure you do 100% that's no problem. Maggie Ralbovsky: So yeah you are basically giving loans to people who can afford it yeah who have money who don't need it. James Duenas: Loans for people who don't need money don't need a loan right? Gerard Cruz: But there's still a big market of people who don't qualify. That's the problem. Maggie Ralbovsky: That is why that is why this is the case. Gerard Cruz: That's why it's been such a lag. Maggie Ralbovsky: Yeah. Antolina Leon Guerrero: So can you just buy me a house Gerry. Just buy me a house. Paula Blas: Because he falls in that category. Antolina Leon Guerrero: I will make the payments for it but will you buy? Gerard Cruz: No way. I don't own that category, wrong person. Rosalia Bordallo: She's just renting that's all okay and at 30 years she'll own it. Gerard Cruz: Oh yeah and lease back. Yeah, that's true okay. Antolina Leon Guerrero: Want to shake? Rosalia Bordallo: Witnesses. Maggie Ralbovsky: Okay so. Gerard Cruz: You qualify.

Maggie Ralbovsky: So another thing that's very interesting for this past quarter is if you look at for the quarter for this quarter small cap tremendously out performed large cap. Small cap was up 3.1%, large cap was down 20 basis points. This is a scenario that's very consistent with the beginning of whole market actually this is the. It seems to be indicating the rally has some legs to go because if you look at historical boom market the beginning of that is with small cap out performed large cap it ends with large cap out performed small cap. Gerard Cruz: Yeah, Maggie. Maggie Ralbovsky: Yeah and the next one is when. Gerard Cruz: Good. This is all good news. This is the first time, before it's all been doom and gloom right? Maggie Ralbovsky: That's right. Antolina Leon Guerrero: Yeah, Maggie hasn't a smile for a few quarters now.

Maggie Ralbovsky: So okay so another thing is that this past year was a junk rally year, you can see the 4Q12. Antolina Leon Guerrero: I'm sorry a junk? Maggie Ralbovsky: Junk rally. So 4Q12 so this is by rating, the rating of a company does not mean a company ranked really low in quality doesn't mean it's a bad company, wages they're making is bad or anything, it just means they have a lot of debt on their balance sheet. So a company like somebody buying a house I could use 100% cash to buy the house or I can use 100% debt to buy the house or somewhere in between and all the companies can finance their operations the same way, they could totally finance it with equity or totally with debt somewhere in between and in order for people to understand the capital structure there is such a rating issue by S&P, they basically rate a company's balance sheet. It's not a debt rating it's not any rating that people use to price any security, might be part of it but this particular rating is just for us to understand how much debt a company has. And a lower rated company means they have more debt to equity ratio. And then if you just group companies by the rating category and observe their returns you can see the 4th quarter was a total junk rally kind of a quarter which is also consistent with the greed being buildup in the market place when people seek high levered companies because if you think debt is cheap, you should lever up right? So that's very consistent with that kind of a seeking return pattern.

Maggie Ralbovsky: Okay, page 15 is the fixed income market. I want to point you to this bottom right hand chart which is the pricing of the long term, the Fed. Gerard Cruz: Treasuries? Maggie Ralbovsky: Treasury the Fed no this is implied interest rate for the future which is to say how much tightening it's priced into the curve. So if you first look at the gray line, the gray line first this is before the FOMC meeting in January, the market was pricing into a rate rise 100% in September 2015. That's when the 50 basis point line drawn. Then after that meeting that moved up by 6 months. Market now is pricing into the first rate rise for 100% chance March of 2015. And this is also consistent with the pricing of the inflation in the market basically they are moving up 6 months to thinking inflation is coming 6 months sooner I think this is probably going to further being revised fairish side. Gerard Cruz: Further up? Maggie Ralbovsky: Yeah, so it's fairish for the longer term bonds. Gerard Cruz: So maybe its 14, so I'm sorry so this chart is what is this chart called? Maggie Ralbovsky: This chart is the implied it's the forward curve this is the forward curve chart. So it's the what's priced into the forward curve or the implied fed rate rising I think it's just called the forward curve chart.

Gerard Cruz: Okay so this 50 represents the amount. Maggie Ralbovsky: 100%. Gerard Cruz: A hundred. Maggie Ralbovsky: Possibility rate rise. Antolina Leon Guerrero: 100% okay. Gerard Cruz: Possibility of a rate rise? Maggie Ralbovsky: Rate rise. Antolina Leon Guerrero: Okay. Gerard Cruz: By 50 basis points? No? Maggie Ralbovsky: Well, no not by a 50 basis points. Gerard Cruz: But just a rate rise in general. Maggie Ralbovsky: Yes it's the bottom is how much their implied rate rise but if you translate that into probability, 100% probability is on the 50 basis point line. So for example September actually December, right, the gray line crosses 50 basis points, December 2015. Gerard Cruz: December 2015 okay the gray line? Maggie Ralbovsky: So then you look at the bar below that, that's how much the market is priced into the magnitude of the interest rate rise. Somewhere above 25 basis points you see that? Gerard Cruz: Yeah. Maggie Ralbovsky: So that is a probability weighted of the projections. So if you translate that into a probability that's where the gray line and 50 basis points crosses. Doesn't mean its 50 basis point rise. Gerard Cruz: This is just to probability of a rise? Maggie Ralbovsky: That's right. Antolina Leon Guerrero: But that's when it's. Maggie Ralbovsky: That's right probability rise 25 basis points at 100%. Antolina Leon Guerrero: I only took one class of economics, this stuff just. Gerard Cruz: This is not even economics, this is. Antolina Leon Guerrero: I don't know what this is. Gerard Cruz: This is a decision model this is like. Maggie Ralbovsky: It's a four hour curve. Gerard Cruz: It's statistics. Antolina Leon Guerrero: It's just fantasy right? This is you just playing with numbers okay. Gerard Cruz: Okay.

Maggie Ralbovsky: Okay. High yield. And this is the asset class I really want to add to our portfolio. We really need to change the statute before this happens. This asset class actually has outperformed equities for the past you know 10 years and here is just the 3 year chart. And the valuation is such that currently the valuation can be seen on the bottom page, top chart okay. You see the something called the blue the blue thing something called yearend spread. Okay to refresh our memory, spread is the differential of interest rate a junk bond is paying versus a treasury is paying. Treasury is 2%, a junk bond pays with 6%, the spread is 4%. Okay it's translated into here's the percentage point here. Wilfred Leon Guerrero: What do you call that again? Maggie Ralbovsky: Spread, spread. Antolina Leon Guerrero: Between junk bond and the treasury. Maggie Ralbovsky: And the treasury. So. Gerard Cruz: It's basically the difference you would demand as an investor to add on risk to an investment. Maggie Ralbovsky: That's right default risk, so there is a possibility you buy such a bond there's a default right, treasury is assumed not to have a default, so you demand more return for that.

Wilfred Leon Guerrero: What's an attractive level? Maggie Ralbovsky: Okay I'm going to try to tell you that. So if you just look if you just look at the blue line, you can come to the conclusion that it's you know average right it's roughly this is 4% the average, so it's not particularly attractive. However, if you think about why you would demand a spread and that's because you are taking on a default risk, and if you graph default risk which is the orange line on this chart default risk. Currently the default rate is at historical lows and if you observe the differential between the blue line and the orange line, you can actually come to the conclusion although this is not a most attractive time, it is very attractive, still very attractive. Antolina Leon Guerrero: Because the default rate is low. Maggie Ralbovsky: Is very, very low. And the reason default rate is very low is because corporation has been hoarding cash, they've been pushing forward.

Wilfred Leon Guerrero: This default rate is just the what? Maggie Ralbovsky: The percentage of the bonds. The percentage of the bond that's defaulting for the high yield junk bond. Wilfred Leon Guerrero: But is it everybody or just. Maggie Ralbovsky: The junk bond, junk bonds. Wilfred Leon Guerrero: Right but is it I'm trying to find out. Rosalia Bordallo: Is it just the corporations or is it individuals and corporations? Maggie Ralbovsky: Oh no, no it's junk bonds only issued by corporations, individual cannot issue junk bond right this is like high yield bond insured corporations. By the way 75% of U.S. corporations are junk bond insurers. 75% of them are not investment grade. So. Antolina Leon Guerrero: And again that's because they have high debt. Maggie Ralbovsky: Debt. Yeah not because it's a terrible company you know. Wilfred Leon Guerrero: And you want us to change the law so that. Maggie Ralbovsky: Yes, that's right. Wilfred Leon Guerrero: What you told us, we can own the company but we can't lend the money. Maggie Ralbovsky: That's right, exactly. Remember the key point. Okay, so another interesting thing here is the surge of the ETF. They have been really, really skewing some sectors of the high yield. Because ETF don't hold all the high yield bond, they hold certain bonds and because there's so much money chasing the ETF's it made the certain bonds over priced versus other bonds because when you buy ETF they are only holding certain bonds and they don't hold the other bonds which made the pricing very, very skewed in the space. Bottom line it's actually better for the people not to buy ETF because you are chasing the same bonds with too much too many other people. If you hire manager you can actually pick the ones that's not in the ETF actually priced much more attractively. Okay.

Rosalia Bordallo: But why would if you have an ETF that's being managed by well known managers, I mean they're picking yes I understand what you are saying they moved the market because they're only picking the best quality junk bonds. Maggie Ralbovsky: They are not best quality they're using model trying to replicate index and the index cannot be replicated by holding every security. Rosalia Bordallo: Right. Maggie Ralbovsky: So they use like a sampling models Rosalia Bordallo: But usually they tend to pick the top not or the better quality not the bottom of the, are you saying. Maggie Ralbovsky: Nope, nope, nope. Rosalia Bordallo: So you're saying the bottom is could rise to the top but. Maggie Ralbovsky: No, no, no that's not what I'm saying. Rosalia Bordallo: No you're not saying the bottom of the bottom can't go up because they're. Maggie Ralbovsky: No, okay listen now to me. When you try to run an ETF in high yield sector, let's say there's a hundred bonds it's not actually hundred there's like thousands of them, let's just say there's a hundred. There's a hundred bonds in the high yield sector, ETF cannot hold off hundred, but they are trying to replicate it, and the way to replicate it is you group these hundred bonds into okay here's 3 that's triple B rated, here's 5 that's triple B minus rated, here's actually that will be plus rated, so you group them, then you pick one from each of the grouping because then you replicate it. Then you run a correlation, historically says oh I have a 90% correlation, that's good so here's 10 bonds and buy try to replicate the 100 bonds.

Maggie Ralbovsky: What happens is that when too much money chasing these ETF's these 10 bonds started to become really the higher priced bonds and the other 90 are not just because they were not in the ETF's. So that's how the ETF market is skewing the pricing not only in high yield but also in small cap. That's why some of the small cap managers find it very hard to maneuver because certain securities are being oversold and certain securities have been over bought and some hedge fund actually now started to arbitrage that they are trying to short whatever ETF holds. So, anyway.

Gerard Cruz: Why would you do an ETF versus an index though on the same. Maggie Ralbovsky: You wouldn't. Gerard Cruz: Okay. Maggie Ralbovsky: You wouldn't for the long term investor. ETF are great for short term trading so if you have a view for certain things I want to long this particular sector particular moment tomorrow I'm going to short, ETF is great for you to do that. But if you're long, long term buying holding investor ETF is so, so inferior to our index fact. Gerard Cruz: In terms of every aspect? Maggie Ralbovsky: Every aspect. Gerard Cruz: So you wouldn't have an ETF as a. Maggie Ralbovsky: As a long term holding at all. Gerard Cruz: As a part of a portfolio? Long term if you're the long term user. Maggie Ralbovsky: Correct, correct. Gerard Cruz: Would it be a part of like a. Maggie Ralbovsky: Transition strategy, or trading strategy. Gerard Cruz: Yeah, but would it be part of a target date fund? Maggie Ralbovsky: No.

Wilfred Leon Guerrero: ETF Gerry, was set up to accommodate Government of Guam protracted healing process. Maggie Ralbovsky: No he's talking about like a brokers. Antolina Leon Guerrero: For us. Maggie Ralbovsky: A lot of the brokers sold portfolios have ETF's because it's so easy for the brokers to access and the fees are very in transparent. There's actually a lot of tracking in that. So if you're long buying holding investor you shouldn't have a portfolio with ETF's. If you are on the trading portfolio, yeah ETF's are great. Long and short very easy. Okay? Gerard Cruz: Okay.

Maggie Ralbovsky: Page 18, another thing that happened during this quarter is that Greece was priced back to life and Greek equity actually was up over 70 over 60% this quarter. Gerard Cruz: Greek equity? Maggie Ralbovsky: Yeah, Greek equity because it come back from. Gerard Cruz: From the dead? Maggie Ralbovsky: From zombie. Antolina Leon Guerrero: Just in time for Easter. Maggie Ralbovsky: The walking zombie. Gerard Cruz: Yeah just in time, really. Maggie Ralbovsky: So the international equity as you call that you see is actually outperformed the U.S. equity in this quarter. Rosalia Bordallo: Can I ask, how is Spain affecting this now because Spain seems to be in I mean I think it looks like it might go into some kind of civil. Gerard Cruz: Unrest. Rosalia Bordallo: Unrest at this point which it's already in right now. Gerard Cruz: Wow. Maggie Ralbovsky: Yeah so I think Italy. Rosalia Bordallo: And that's a bigger country than Greece. Maggie Ralbovsky: Yeah so, first of all I think their debt now have a last resort buyer because European Central bank has really opened the door to support these countries unlimited fashion basically have Germany underwrite their debt. And I think that the social unrest is a huge issue not just in Spain but off of Greece you know and Italy. Gerard Cruz: And France. Maggie Ralbovsky: Yeah well. Rosalia Bordallo: Spain is really.

Maggie Ralbovsky: Yeah, 25% unemployment rate and if you talk about austerity when 25% people are out of jobs it's pretty hard when you have a social regime change. I do think that's really something to watch and Germany this year also is going to have an election which is another thing to watch because everything is being underwritten by Germany and if Germany has a change of heart then Europe is going to have another you know day or. Gerard Cruz: When is the election, in the fall? Maggie Ralbovsky: In the fall they are having different I'm not quite understand how their government is formed. It's not a one party government it's like a coalition and depends on how many provinces you have won, it determines the composition of the party and Angular Murko has a very high personal favored rate, I guess it's like 80% people love her, but her party has been losing in the different provinces which could result in the government where she is still the chancellor is it called chancellor? Gerard Cruz: Chancellor? Maggie Ralbovsky: Is she called chancellor? What's her title? Chancellor. She can still be the chancellor but she has a minority of her party in the government. That's a possible scenario and that going to complicate things. So, German election is something to watch for. We won't know anything until later this year. Okay.

Wilfred Leon Guerrero: If something is annualized is that an arithmetic thing. Maggie Ralbovsky: Annualized is that you, are you asking for the formula? Wilfred Leon Guerrero: How do you annualize it? Maggie Ralbovsky: How do you annualize it? Okay, in annualized formula is one process rate raised to the power of how many years will equal to this particular total rate. Okay so maybe I used that. Gerard Cruz: Years or months right? Maggie Ralbovsky: No you use years annualized those are annually annualized rates. Gerard Cruz: Oh you're annualizing an annual rate? Or you're annualizing a quarter rate? Wilfred Leon Guerrero: I don't. I just want to know what it means. Maggie Ralbovsky: Right, so. Gerard Cruz: You get the. Maggie Ralbovsky: You get the total return, you have 3 years and you have 10 dollars. Wilfred Leon Guerrero: I can't see it. Maggie Ralbovsky: You cannot see it? Wilfred Leon Guerrero: No. Rosalia Bordallo: You have to write bigger. Maggie Ralbovsky: 10 Dollars, this is not big enough? Rosalia Bordallo: I think it's because there's too much background mess up there, is your problem. Yeah there use a different color.

Maggie Ralbovsky: So if you start with $10 dollars right and to the end of 2 years, it becomes 20 dollars. Then that's a hundred percent return in 2 years. Now to figure out what is 1 year return. Okay, so the formula is 1 plus this 1 year return raised to the second power equals 100% return. So if you saw for this R that's annualized return, so assuming the 2 year return is not achieved equally, you annualized it you assume it is equally does that make sense? Antolina Leon Guerrero: The exponent is the number of years that you're? Maggie Ralbovsky: Number of years. Wilfred Leon Guerrero: And R is what? Maggie Ralbovsky: R is the annualized return because you lose a total return, you want to solve and annualize it. So this is this is basically tells you what is the average of these 2 year return, because we know market is not equal you know you may have one year dropped 10% next year went up 30%. So annualized return tells you what is the make everything comparable, yes different asset classes.

Maggie Ralbovsky: Okay so the next page is commodities. Gerard Cruz: Commodities next page. Maggie Ralbovsky: And you see commodities have terrible couple of years because commodities don't do well in deleveraging and this is about to change. Wilfred Leon Guerrero: I'm glad that we have all kinds of questions for you about commodities we want to switch to commodities right? Maybe some of our. Gerard Cruz: You want us to put money in commodities? Maggie Ralbovsky: I certainly do. Yeah so there it doesn't do well in deflation it does well in inflation scenario. So that shows you diversification when stocks don't do well and they don't do well. Gerard Cruz: Commodities? Where are we, I'm sorry. Maggie Ralbovsky: The second line Dow Jones UBS commodity index. You see it was down for the year. Gerard Cruz: Yeah, so it does not do well in deflation? Maggie Ralbovsky: It does great in inflation. Okay so this is about to change.

Gerard Cruz: I don't know. Antolina Leon Guerrero: In your crystal ball, this is about to change. Paula Blas: In her short term crystal ball. Maggie Ralbovsky: Okay. Gerard Cruz: We had a good run though in commodities in 08 and 09, no? Maggie Ralbovsky: We had a great run in 09. You see commodity was up 19%. Wilfred Leon Guerrero: We make our money through commodity we go back and wait. Paula Blas: We wait, we wait, sit and wait. Maggie Ralbovsky: Sit and wait and come back in circles. We should wait for another 20 years Rosalia Bordallo: We're not chasing you know returns. Maggie Ralbovsky: Just like fashions right. You take 10 year old fashions. Wilfred Leon Guerrero: That's what I noticed if we procrastinate we'll do fine.

Gerard Cruz: But commodities did well during the last deleveraging. Maggie Ralbovsky: Look at this didn't do well, 2008 commodity was down 35%. Gerard Cruz: Right. Maggie Ralbovsky: It came back. Gerard Cruz: Yeah but look at developed markets, emerging markets, everything else was down much more. Maggie Ralbovsky: Yeah. Gerard Cruz: Look at emerging markets was down 53. Maggie Ralbovsky: Yeah, yeah, yeah I'm just talking about commodities in isolation. Gerard Cruz: I mean in '08 there's really nowhere to hide. Maggie Ralbovsky: Treasury yeah. Gerard Cruz: But going into '09 where there was still deleveraging no, it did 18%. Maggie Ralbovsky: It did 18% because the deleveraging pricing gets reduced, people are pricing into less deleveraging so it came back. Gerard Cruz: I just recalled that during '09 right immediately following 2008, people were so worried about the dollar devaluation that they were moving into gold and fords and only recently did they start to retreat from it when the whole scare of the devaluation. Maggie Ralbovsky: Yes. So gold is part of it, oil is a larger part of this whole thing. The oil went down because of the. Gerard Cruz: That's correct, that's correct. Maggie Ralbovsky: So it's a combination of all those. Gerard Cruz: Oil went yeah oil went down. But oil went down because it's had such a good run and people were talking about alternative sources of energy, looking at ethenol of sources to power gas. Maggie Ralbovsky: And also the slow in China it was a huge concern as well, I think those are changing too. China's slowing has been that expectation has been reduced for the near term even though China has a huge issue longer term much worse than ours in terms of demographic shift. If you think our baby boomer generations too large, theirs is 4 times larger. So it's a huge issue. Gerard Cruz: Okay, so commodities do well in an inflationary environment. Maggie Ralbovsky: Yes. Gerard Cruz: Okay.

Maggie Ralbovsky: Okay next tab. Gerard Cruz: How did we do? Maggie Ralbovsky: How did we do? We did great. Page 23. We the total fund was up 2% with exception of REITs every composite out performed. Gerard Cruz: Good job Mr. Chairman. Maggie Ralbovsky: That's a graphic. Wilfred Leon Guerrero: We did not act, huh. Gerard Cruz: Way to smoke that one. Maggie Ralbovsky: The next step. Wilfred Leon Guerrero: You notice the commodity the approach. Maggie Ralbovsky: Well Mr. Chairman save that for tomorrow because I want to show you the past. Paula Blas: Hold that thought. Maggie Ralbovsky: Hold that thought because for the past Antolina Leon Guerrero: Or just repeat it. Maggie Ralbovsky: For the past 40 years 20 of them this fund policy actually underperformed the cash. 20 of the 40 years okay so let's just say. Antolina Leon Guerrero: The first 20? Maggie Ralbovsky: No the first and the last. Okay anyway let's take a look at the longer term on page 25. Gerard Cruz: Underperformed cash. Maggie Ralbovsky: Yes, 20 of the 40 years. Gerard Cruz: Okay, go. Maggie Ralbovsky: Page 25 is the total fund for the longer term, we finally got 7% for the past 10 years. I'm sure you will expect a return. Paula Blas: This is 20 years right? Maggie Ralbovsky: Yup, so I did add fiscal year to date that column last column, so this is our fiscal year started October 1, we're up 2.03%.

Gerard Cruz: So inception 92, what's inception 92? Maggie Ralbovsky: Inception this is the I guess we have data since 92. Gerard Cruz: I see. Maggie Ralbovsky: Yeah and we don't have the policy with the time being for that time. Okay. Page 26 is the comparison with the universe. Wilfred Leon Guerrero: What's policy index? Maggie Ralbovsky: Closed index is your asset allocation assuming all passively managed and no deviation from the policy, no fees paid. It's basically a benchmark we use to see what is the market opportunity that can be achieved versus what you have achieved. Taking into consideration what has achieved has a lot of different you know actual things you have to do. You have to pay fees, you have to Wilfred Leon Guerrero: You take our policy and translate it into to returns or what you know it works should give you this kind of return, is that what it is? Rosalia Bordallo: Yes, that's what it is. So you have your asset allocation and you say that this is what the market return in your 40% invested in stock and 40% invested in bonds, and then 5% in cash and whatever, this is what your return should have been. That's your policy in this.

Maggie Ralbovsky: That's right that's the market opportunity set basically what can be achieved. Wilfred Leon Guerrero: So looking at this chart it and what's the fund composite, what is that? Maggie Ralbovsky: That's the actual we have done better in the policy that's right we have done better than the policy which is showing 2 combination 2 things. Wilfred Leon Guerrero: So we are making money without, I don't know how to say this but we have a policy we have an asset allocation we are looking at a target right? But somehow we're doing better than the target than what the projected return is. Maggie Ralbovsky: It's not somehow we know why, there's 2 things that happened one is differential asset allocation and one is the manager has done better than their benchmark. Wilfred Leon Guerrero: The money managers? Maggie Ralbovsky: That's right. Wilfred Leon Guerrero: Okay.

Rosalia Bordallo: It's also you know when you say your asset allocation, saying you have the 40% in stock we know right now that we might be up 45, and the bonds supposed to be 40 we're at 35. So you have what you have said that you want to be and what you're actually which is why we are higher because the actual is not exactly on your image of what the policy is. Maggie Ralbovsky: Exactly. Wilfred Leon Guerrero: Okay. Rosalia Bordallo: And it's those little changes or deviations that causes you to make more than what your policy is stating. Maggie Ralbovsky: Exactly, yup. Which is exactly the case page 28. Page 28 is the policy versus the private. Wilfred Leon Guerrero: Right Gerry? Gerard Cruz: Absolutely I'm with you there Mr. Chairman. Yup. Maggie Ralbovsky: So, Dr. LG I have like a snapshot of end of this year end of past year of that policy versus actual which just as Rose just explained, we'll have more equity allocation than fixed income allocations, if you think of a quarter where equity does better, you add a little value from this factor. Of course there's other value being added from money manager factor. So to 10 year history will just be a collection of all these in 10 years so every quarter is tracking of that.

Maggie Ralbovsky: Okay, so. Gerard Cruz: Very good. Maggie Ralbovsky: Very good. Gerard Cruz: Good report. Maggie Ralbovsky: Yeah when things are good everything is usually. Gerard Cruz: Everybody's happy. Maggie Ralbovsky: So we do have a record of all the historical cash flows starting from 1992, this is when we have started to have the record, see that's why we started with 1992. And we don't have cash flow on. Gerard Cruz: So this is showing that our last for the last 10 years. Maggie Ralbovsky: Last 10 years you ranked 48 percentile. Gerard Cruz: So a little better than that. And we returned 7%? Maggie Ralbovsky: That's right. Paula Blas: The 7 is 20 years right? Maggie Ralbovsky: The 7 is 10 years. Gerard Cruz: Seven Ten. Paula Blas: Oh 10 seven. Gerard Cruz: Last 20 years 7.4. Maggie Ralbovsky: Yeah, so I'm trying to get you the 18 year, I don't know why 18 year but we are trying to get you the 18 year universal comparison which was the question from the auditor. So we don't have that specific time period as programmed but we do have the data. So there shouldn't cost them program that period. Gerard Cruz: Why 18 years, Diane? I'm sorry.

Diana Bernardo: Oh we have a write-up on the MD&A, on the first graph so she was just wondering if that was what it was for the fund and what is it? How does this compare to others. Maggie Ralbovsky: Yeah so I'll get that to you. Gerard Cruz: So we can get that information so, 7% is on seven and a half 7.49 for since '92. Maggie Ralbovsky: Okay, shall we move on? Okay. Gerard Cruz: So this year should be a good year for us. Maggie Ralbovsky: Should be a good year. Who won the super bowl, which league won super bowl? Was that the same league? Gerard Cruz: No. Maggie Ralbovsky: No? The other league? Gerard Cruz: The other one. Maggie Ralbovsky: Because the other league then one of the leagues won 80% of the time that market goes up. So this year was not the same league as last year? Against the odds then. Okay, U.S. Equity.

Wilfred Leon Guerrero: No, no I don't want to move from. Maggie Ralbovsky: Okay, let's look at Wilfred Leon Guerrero: I'm still trying to understand these sources of Fund Growth. Maggie Ralbovsky: Okay, so if you start from page 34, let me just explain the most recent quarter then we can go back. Okay, the most recent quarter is the bottom line of you see the 12 line, so we started with $1.3 billion, we paid out about $14 million, we paid fees of $1.2 million and we had investment gains of $29 million, we ended with $1.38 billion and that's a 2.03% time weighted returns. So time weighted returns calculated based on how much time a particular cash flow is in that period. So the longer cash flow stays the more contribution to the total return that particular piece has generated will contribute, does that make sense? So then if you go back in history you can see we uploaded everything from Mercer, no wait. So starting from 03/11 that's when we took over and we have all the ins and outs and.

Wilfred Leon Guerrero: 3/11 okay. Maggie Ralbovsky: Yeah, so you see that has all the different column fulfilled, previous one we only have the ending value because that's uploading from the Mercer time. Then you can see the 12/02, which is on page 32 and that's when Mercer started. So Mercer actually gave us the ending value then I believe before that was even loaded from your previous consultants and which has nothing except for the time when we return or just the return recording, so that's the history. Make sense?

Gerard Cruz: That should be easy enough for us to get though right? No? Maggie Ralbovsky: You mean for the holding value? Gerard Cruz: The information, the ending values. Rosalia Bordallo: Apparently we have that in storage. Maggie Ralbovsky: Yeah if it's important we can you know do that but if it's not important then we'll be happy to load it in the system if you have it. Wilfred Leon Guerrero: You know what my problem is the chart says Sources of Portfolio Growth and I'm not getting it. Maggie Ralbovsky: Okay, the reason it's called the sources of portfolio growth is because the return calculation is time weighted return. So when you calculate time weighted return it's a cash flow driven process. So on day 1 of the month you have $100, day 2 you added $2, day 3 you withdraw $5 and you know every day you keep track of these cash flows, and eventually you have a return calculated that's not a simple average between day 1 and day 30. Rather every day every day there's a waiting given to how much cash you have in that portfolio that's called time weighted return. So these cash flow is very important to keep track of when you calculate time weighted return make sense? That's why we call this source of portfolio growth because the growth of the portfolio is being contributed by all these different cash flow factors.

Diana Bernardo: Do you think we can just change the title to Summary of Portfolio Growth. Maggie Ralbovsky: Okay, so does that make it better Dr. LG? Let's change the summary of portfolio returns? summary of portfolio growth? Wilfred Leon Guerrero: When you said source I want to find out what's the source. Maggie Ralbovsky: These are the sources. Rosalia Bordallo: I think he wants you to explain to him. But I think what he's looking at is what does these titles mean. Maggie Ralbovsky: Titles mean. Rosalia Bordallo: Right. Maggie Ralbovsky: I see so, okay so you have a beginning value which is your day 1 value for that period right, then during this particular quarter.

Wilfred Leon Guerrero: Take one year and let's follow it through. Maggie Ralbovsky: Okay 2012, Wilfred Leon Guerrero: 2012. Maggie Ralbovsky: Okay you started with $1.24 billion. Wilfred Leon Guerrero: Okay. Maggie Ralbovsky: That's the beginning of the year. Wilfred Leon Guerrero: Okay. Maggie Ralbovsky: And during this year you had $20 million dollars of contributions. Wilfred Leon Guerrero: Okay. Maggie Ralbovsky: And you paid out of $50 million dollars. Wilfred Leon Guerrero: Okay. Maggie Ralbovsky: And you paid fees of $4.5 million dollars, and you had investment gains of $179 million dollars. Wilfred Leon Guerrero: Okay. Maggie Ralbovsky: Therefore you had an ending value which is beginning value plus. Wilfred Leon

Guerrero: You're doing good, I understand now. Maggie Ralbovsky: Okay, great. So do I have to change the title now? Paula Blas: No. Maggie Ralbovsky: Okay. Antolina Leon Guerrero: But the title doesn't reflect what this data is. Maggie Ralbovsky: No it does, to me so if you. Antolina Leon Guerrero: There you go, for you. Maggie Ralbovsky: Yeah, so it does not reflect to you. So should we say summary of portfolio growth? Antolina Leon Guerrero: Yeah, but an investment fee isn't a source of growth nor is it a distribution. Maggie Ralbovsky: It's a reduction of the growth, right? Paula Blas: It's the plus and minus, you have to take everything so you won't be able. Rosalia Bordallo: I think if you put negative numbers here. Antolina Leon Guerrero: No, no, no I'm just saying I mean but I can see why it didn't, I mean it doesn't match and it took me a while to figure I mean I get the data. Maggie Ralbovsky: I understand. Antolina Leon Guerrero: But I just wouldn't have picked that from. Maggie Ralbovsky: Yeah so after I explained this though would it make it more sense or still doesn't make sense this source of growth. Antolina Leon Guerrero: No I mean I believe me I understand the data I just. Maggie Ralbovsky: Just mathematically speaking Antolina Leon Guerrero: Right. Maggie Ralbovsky: To come to the time weighted return these are the sources of growth. Antolina Leon Guerrero: And what is the significance of time weighted returns? I mean why is that something that you you're tracking and that we should be tracking?

Maggie Ralbovsky: Time weighted return is the CFA institute definition of return calculation Antolina Leon Guerrero: I see. Maggie Ralbovsky: And I do not know if your previous provider has done that kind of return calculation because historically people have been doing all kinds of different ways of doing return. You could do dollar weighted return you know day 1 minus last day you average it and you calculate it return or you could do something else, there's all kinds of ways to do returns and they can be very different. So to make apples and apples comparison, there was a group called the CFA institute which sets trade standards for our trade in the investment industry and they have made it standard to be time weighted return calculation. So that's what we do. Antolina Leon Guerrero: So that you can do comparisons. Maggie Ralbovsky: That's right, that's all the managers do today but we don't know if historically if that was the way it was done. It's very hard to know at this point. Are we ready to move to the other section?

Maggie Ralbovsky: Okay, here is our U.S. Equity portfolio. Gerard Cruz: This is as of December right? Maggie Ralbovsky: As of December. In the column that says notes on manager performance the pink ones are under performance, the green ones are out performance so you can see that we have 3 managers underperformed and 3 managers out performed. So the small cap managers actually out performed. Gerard Cruz: They are coming today? Paula Blas: No. Antolina Leon Guerrero: Who's coming? Is it. Gerard Cruz: Whose Eaton Vance? Maggie Ralbovsky: International. Eaton Vance is small cap, Nancy remember? O'Toole. Gerard Cruz: Nancy. Really. Wilfred Leon Guerrero: That's Gerry's favorite. Gerard Cruz: Why do you highlight that one that's the only one you highlighted in this entire book? Paula Blas: Which one, MetWest? Gerard Cruz: MetWest. Wilfred Leon Guerrero: MetWest. Maggie Ralbovsky: Oh that's because it's very close to target maximum. Wilfred Leon Guerrero: That's because Gerry wanted to fire them. Maggie Ralbovsky: No I highlighted you mean the yellow highlight? Paula Blas: He has opposed. Maggie Ralbovsky: I totally see the dynamic here so they were highlighted in yellow because their actual allocation is very close to the maximum 8% stipulated by the policy so I just want to flag them so we watch and we don't break the policy. Gerard Cruz: Right so you say. Maggie Ralbovsky: Then I did also I did also highlight 2 changes.

Gerard Cruz: Do we fully are they fully funded again? No? Rosalia Bordallo: Yes they are. Maggie Ralbovsky: They are more than fully funded. Gerard Cruz: So I can't move to fully funded? Maggie Ralbovsky: So there's was a couple of managers that did change score so I highlighted I guess olive color that was the change of ranking but they both are still on the focus list. So there was no. Antolina Leon Guerrero: Focus is a good list? Maggie Ralbovsky: Focus is good list yeah. Gerard Cruz: Good thing. Robeco is being sold right? Maggie Ralbovsky: Robeco is yeah Robeco is on the we call block. Antolina Leon Guerrero: Chopping? Maggie Ralbovsky: Chopping block.

Wilfred Leon Guerrero: Why is MetWest doing well? Maggie Ralbovsky: Why is it doing well? Wilfred Leon Guerrero: Yeah. Antolina Leon Guerrero: Didn't they used to do well? Wilfred Leon Guerrero: As compared to the others. Paula Blas: They've always been. Gerard Cruz: They're okay let it go. Maggie Ralbovsky: Why do you ask this question? Gerard Cruz: They're just okay. Wilfred Leon Guerrero: The only reason why there's been a change in attitude toward the asset allocation is because remember MetWest came in and the Apple computer thing. Gerard Cruz: Yeah. Wilfred Leon Guerrero: And the chairman just wow. Paula Blas: We had a 2 month window. Wilfred Leon Guerrero: Yeah, yeah. Gerard Cruz: But, it's more than that though, MetWest is just a good performer they are just good stock pickers. Antolina Leon Guerrero: Yeah I remember that they were always a good performer. Gerard Cruz: Apple is good. Antolina Leon Guerrero: Even when there was a period when they had trouble. Wilfred Leon Guerrero: No, they never had trouble. Rosalia Bordallo: Because there's a change in management. Antolina Leon Guerrero: Change in management right. Maggie Ralbovsky: Well the CIO left them, yeah they have a significant change of. Gerard Cruz: That was significant. Antolina Leon Guerrero: Investment leadership that was their strategy. Maggie Ralbovsky: That was very significant. Rosalia Bordallo: Right. Maggie Ralbovsky: Yeah, yeah, yeah Antolina Leon Guerrero: And that's when they decided to sort of give them a haircut. Gerard Cruz: No, I said let it go. I said terminate. Rosalia Bordallo: Dr. LG said to do it fast and said hey give them a chance. Wait and see. Gerard Cruz: good call. Wilfred Leon Guerrero: Well the infrastructure we're still there, the CEO was no longer there. Gerard Cruz: Yeah but before they came in they talked about that guy like he was the guy who threw off the trade and then after he left they said he's okay he's not really the guy. Maggie Ralbovsky: You know that's a red flag when people do that, that is a red flag. So I think you know it would have been the right decision as well to terminate them for that.

Wilfred Leon Guerrero: That was the important thing is to maintain that account you know if we haven't done that. Maggie Ralbovsky: It's hard to say if you switch different managers if they have done better. Wilfred Leon Guerrero: No we took precaution. Maggie Ralbovsky: I understand yeah I understand yeah it worked out great and although if you pulled the plug you should could also be a good decision because the people they tell you one thing they don't do the same thing then that's really a red flag. We tell you this guy is very important and then when this guy left you say no he's not very important. Maybe do that all the time and we really just really put a big red flag there if they do that. That's why certain managers are very cautious about it, they just say we're a team approach nobody is very important you know. Paula Blas: Give them things to think about that's why they stay put. Gerard Cruz: Goodness gracious. Goodness. Okay, okay whose turn is it to clean Marks halo?

Maggie Ralbovsky: So I do want to. Rosalia Bordallo: Portfolio tends to stay stable and they said that. Gerard Cruz: Actually they are not MetWest, Wells capital is good. They're good, they're good they're good, yeah I shake Marks hand every time I see him I go and eat. Rosalia Bordallo: Does he look at you with stink eyes. Gerard Cruz: No he doesn't. Mark even said at the time he was worried. Anyway that's okay. Yes, I'm still eating crow 1 and ½ years later. Paula Blas: You're not going to forget this Gerry. Wilfred Leon Guerrero: I think we made the right decision. Gerard Cruz: Yes you did. Wilfred Leon Guerrero: But you know what could have been a very bad decision was to fire them. Maggie Ralbovsky: No it would not have been bad decision. Antolina Leon Guerrero: It would have been a reasonable decision at the time. Wilfred Leon Guerrero: Hey you just went through a manager and you put him on watch list because of same similar thing. Maggie Ralbovsky: Yeah, Intech, Wilfred Leon Guerrero: You didn't fire them. Maggie Ralbovsky: Intech and I'm actually going to ask to remove them from the watch list. It's not a similar thing because this is a CEO the other one is CIO, which is directly he was the architect of the strategy. And this CEO is more a business person. Wilfred Leon Guerrero: But if the infrastructure is still there Maggie Ralbovsky: No this a talent business okay it's not infrastructure, this is not a factory that produces which, the machine is do there it's people you actually leave in the elevator. Wilfred Leon Guerrero: You training them to think the way you. Maggie Ralbovsky: Everyday. Okay great you made a great decision.

Maggie Ralbovsky: Okay, there is a recommendation. Gerard Cruz: Okay. Maggie Ralbovsky: There's a recommendation to remove Intech from the watch list. If you recall last quarter they were here they told us nothing was changed then the second day the CEO left, which was a pretty bad thing that they look at you in the eyes say nope nothing has changed but then the timing is such that the second day the CEO has left and what was puzzling to us was that the CEO just signed the 10 year employment contract like 2 months before this whole thing. Why would somebody abruptly leave after you sign a 10 year contract so we were trying to figure out what exactly was going on whether they had some internal conflict that we didn't know about and our manager research group actually went there to do an on sight due diligence it looks like it's not a systematic kind of a rift it's more concentration particular persons so we actually still have confidence. Our only concern is the fact that they promoted on the next page, Dr. Banner to be the CEO. Gerard Cruz: Dr. Banner? Bruce? Maggie Ralbovsky: Adrian Banner. Gerard Cruz: Bruce. That is a concern. Antolina Leon Guerrero: Bruce's son. Gerard Cruz: Alright. Maggie Ralbovsky: So he is now also CEO and CIO, he was the CIO only. Now additionally to being the CIO he's also assuming the CEO duty which we think it might be distractive to somebody who you know who should be focused on running. Gerard Cruz: One thing or the other. Maggie Ralbovsky: The investments. So that is a concern in our regard however our manager researcher group still kept them on the focus list. They are watching this development. Looks like they supposed they either are going to hire CEO or you know something. Gerard Cruz: They are not sure. Maggie Ralbovsky: That's right. But we are recommending removing them from the watch list at this point. Gerard Cruz: How did they do last quarter? Maggie Ralbovsky: They actually did well, they. Gerard Cruz: Intech. Maggie Ralbovsky: Intech. Actually under performed by 40 basis points. Gerard Cruz: Intech.

Maggie Ralbovsky: Okay and Eaton Vance. Eaton Vance this quarter did outperform but cautiously I am still recommending to keep them on watch list because of their under performance in the previous year was very significant. I did meet with Nancy again and she keeps her story the same way basically she believed the past period market was not looking at fundamentals and she looks at the current market monthly she thinks that the trend is changing and she has good feelings about the future. So, we are recommending keeping them on watch. Gerard Cruz: Okay. Rosalia Bordallo: Can I ask what's their benchmark? Maggie Ralbovsky: For? Rosalia Bordallo: Eaton Vance. Maggie Ralbovsky: Eaton Vance. Small Cap. It's on page 43 the Russell 2000. Gerard Cruz: The Russell 2000? Maggie Ralbovsky: The Russell 2000, page 43. Small Cap. Although they plot right now in growth they are not perpetually growth. The plotting of the style is on page 41, you see that the total composite continue to have growth bias which is the X. The capital letter X we have a slight small cap bias, and pretty well a little bit slight growth bias and that growth bias was contributed by Winslow and Eaton Vance. Eaton Vance is plotting very growthy. Although that Eaton Vance may be balanced out by Numeric. Winslow is not being balance out by your valued manager. Both of your valued managers prop pretty core especially MetWest. So that's something we probably need to discuss again. But really right now.

Gerard Cruz: Which, I'm sorry we need to discuss which one again? Eaton Vance and. Maggie Ralbovsky: We need to discuss the fact that your value manager cannot balance out your growth manager's style. Your value manager not very valuey considered. Gerard Cruz: Value is MetWest and Robeco? Maggie Ralbovsky: MetWest and Robeco. You see Robeco is a little bit of a more valuey than MetWest. MetWest is very core plotting and Winslow is very growthy. Gerard Cruz: Right, well Winslow and Intech your saying balance each other right? Maggie Ralbovsky: It does not. Right. Gerard Cruz: Winslow and Intech? Maggie Ralbovsky: Yeah you see you see the U, the small letter u, is the index you see that? Gerard Cruz: Yeah. Maggie Ralbovsky: And both of your managers are more growthy, than. Gerard Cruz: But is this just a spot in time because Intech is not a style. Maggie Ralbovsky: No it is not Intech it is Winslow. Winslow perpetually plot growthy and MetWest almost perpetually plot core. So, these are a combination these two pushes your composite to the growthy side. Gerard Cruz: Okay, so you're saying the value needs to be further left? Maggie Ralbovsky: Yeah I think you probably need a deeper value manager or consider something of a more core kind of design like the active core design. Gerard Cruz: We did have an active core. Maggie Ralbovsky: Yeah, but they were professionally growthy. You were even more growthy before we did that switch to the index fund. But anyway this is a design issue that I want to discuss after the asset allocation issue is done because there's no reason to do a structure design if we have to change the asset allocation. And I do want to discuss asset allocation to be in more efficient in taking risk but first we have to change the law.

Gerard Cruz: Okay. Before we go off on managers, off the managers is there any reason for us to be concerned about Robeco being sold? Maggie Ralbovsky: Well, right now I believe they're already have some suitors they're talking to. Gerard Cruz: I think they already signed. Maggie Ralbovsky: They did. Who did they sign with? Gerard Cruz: Some Japanese group. Maggie Ralbovsky: Okay. Paula Blas: What's the name Gerry? Gerard Cruz: I don't know it's a Japanese equity firm. Maggie Ralbovsky: I need to get back to you on that. Gerard Cruz: It's like 80% ownership they bought 80 or 90%. Wilfred Leon Guerrero: Maggie what is.. Maggie Ralbovsky: I need to get back to you on that. I have not followed that. Before I produced this book I talked to them, they say there are 3 suitors they were negotiating with so something must have happened after that. Okay, yes, Dr. LG. Wilfred Leon Guerrero: Yeah explain to us again what is this you know the ranking status what's the 2.8 is above average what does that mean? Maggie Ralbovsky: This was February 20, it was 2 days ago. So this is today. So this was today. Gerard Cruz: Oh really, no I heard this before. Antolina Leon Guerrero: Well you know we're a day ahead Gerry. Maggie Ralbovsky: ORIX Corporation. Gerard Cruz: You need a consultant? Maggie Ralbovsky: Did you have insider information? Gerard Cruz: Of course I didn't, crazy from Guam. Maggie Ralbovsky: This is I just got this email today. Gerard Cruz: Oh no sorry. Maggie Ralbovsky: February 20th. Rosalia Bordallo: What time because Gerry might have seen it an hour before. Maggie Ralbovsky: 3:56 this morning, 4 o'clock this morning. Yeah 4 o'clock this morning I got the email. Gerard Cruz: What? You got to get up at 2. Maggie Ralbovsky: Yeah, so I probably. Paula Blas: Saipan's Governor resigned? Rosalia Bordallo: Well he better resign before he gets impeached. Gerard Cruz: Who? He resigned? Antolina Leon Guerrero: That's what KUAM said. Maggie Ralbovsky: He did? No right? Paula Blas: Just this morning today. Maggie Ralbovsky: He did? Gerard Cruz: See you need a consultant. Maggie Ralbovsky: I do because yesterday I was on Saipan they were saying they were submitting the trial to the Senate. Antolina Leon Guerrero: That's probably why. Rosalia Bordallo: That's because it wasn't a guarantee that it was going to pass so now cut your losses, resign. Gerard Cruz: Might as well cause it would have been ugly. Maggie Ralbovsky: Oh my gosh he did? Oh my gosh. So Inos is now the governor? Oh my gosh. Gerard Cruz: That's terrible. Maggie Ralbovsky: Do you not like him? Or do you like him, Inos? Gerard Cruz: I don't like him. Rosalia Bordallo: I don't know, I don't know Saipan. It doesn't matter to me. Gerard Cruz: He is worse than Fitiao. Maggie Ralbovsky: I don't know Fitiao but I know Inos and he was the guy. Rosalia Bordallo: He is more corrupt?

Maggie Ralbovsky: He is a liar. He is a liar on my books. Gerard Cruz: Who Inos or both or Fitiao? Wilfred Leon Guerrero: I think you should watch. Paula Blas: That's okay we'll just totally strike that. Maggie Ralbovsky: He passed this law derivative law the year before they passed the law that says anybody can sue the providers the derivative law and we resigned before the day before he signed the law, the weekend before he signed the law I met him and he told me. Gerard Cruz: You met who? Maggie Ralbovsky: I met Inos because Fitiao was off island and he said he was going to veto it. And Inos and that was pushing. So, I met Inos on Friday and he said don't worry I am not signing that law and on Monday he signed that law. It was 3 before he told 3 days after he told me that he was not going to sign that law. So he's you know what.

Maggie Ralbovsky: Okay, I need to follow up on the Robeco transaction since it just happened. And when I prepared this I talked to them they were considering 3 different strategies and 3 different buyers sounds like this is probably going to be benign because Robeco had been in the past been sold from Boston Partners right so after they sold to Robeco it used to be Boston Partners that group actually did not change at all they are very, they were very autonomous before and after so hopefully this culture can continue but we don't know, I need to follow up on that. Wilfred Leon Guerrero: Maggie on this ranking remind us how does this read again. Maggie Ralbovsky: 5 is the maximum, 2.5 is the average. Wilfred Leon Guerrero: Okay. Maggie Ralbovsky: And any manager ranked above 3 is considered excellent managers. Somewhere between 2.5 and 3 are acceptable and below 2.5 we would you know recommend people not hire those managers. Right now we are all fine with a few above 3 actually 2 are on focus list. Focus list is really hard to get to because every asset category we have 10 managers on focus list. Very hard to get.

Maggie Ralbovsky: Okay. So I'm going to move to international equity in the interest of time. That's after now U.S. Equity composite page 46. This quarter we have all our managers out performed every one of them. The total composite I think it meant to say outperformed. Yeah it's supposed to say out performed by 60 basis points not under. Gerard Cruz: Which, where are you? Antolina Leon Guerrero: Down in the bottom everybody outperformed. Gerard Cruz: Okay everybody outperformed. Wilfred Leon Guerrero: Back to Guardian is Capital International? Gerard Cruz: Yes, are you guys okay with Capital? Maggie Ralbovsky: Well we it's too bit we our only thing is that we have too much money in a very in a category where they can underperform international emerging markets small cap outperformed because they tend to hold larger emerging market which gives you a bias towards large cap. Most of the time large cap do outperform but there are times that small cap may outperform so some people balance them out with an emerging market small cap manager. Gerard Cruz: Emerging market small cap manager. Maggie Ralbovsky: Yes so some people balance them out with that because that's portions they are not covering. You currently have an international small cap manager which has some emerging marketing coverage but it's not a dedicated international emerging market small cap manager. It's a very small category so I'm not counseling adding them right now but small cap managing emerging market but bias is recognized that Cap Guardian is large cap bias. Gerard Cruz: Okay. Wilfred Leon Guerrero: Is this one of our non U.S. equity managers that aren't doing well. Maggie Ralbovsky: Yes. This quarter and the style map we plotted you can see we plotted on 49. Page 49 is the style you know the zero the middle line zero is actually not in the center of the universe. The center of the universe is the cross so that's the acuity XUSIMI index. You see the cross, that's the benchmark we're trying to match and your football the gold football is your total composite. The total composite has a little bit small cap bias. You know in the international space that's actually supported by historical empirical data to say if you have a small cap bias you outperform. So it's actually supportive we support people who have a small cap bias in international just because the index is driven by 3 or 4 very large companies you know Samsung and the big one. Gerard Cruz: LG. Maggie Ralbovsky: Yeah so some very big companies dominate that index which is kind of not fair if you have a large cap bias you just hold those big companies.

Maggie Ralbovsky: Okay. This composite recent performance you see the quarter, next page 51. You see historically they actually underperformed. I'm sure there's some legacy managers that did poorly who are no longer here. Gerard Cruz: No, we have not changed out international. Maggie Ralbovsky: No? Rosalia Bordallo: No. Maggie Ralbovsky: So how can, no you definitely changed it. Otherwise how can you have a history of since 2002 but your managers don't have to since 2000, only 5 year record. Rosalia Bordallo: The Fisher was the first. Fisher's always been with us, DFA is the first. Gerard Cruz: Capital is the first. Rosalia Bordallo: We just got rid of AXA. Gerard Cruz: Yeah. Maggie Ralbovsky: Okay. AXA okay so that must be the reason you had a historical performance that no manager for that long. Gerard Cruz: Yeah AXA was a mutual fund. No we hired AXA. We didn't have an international. Rosalia Bordallo: Fisher was always here. Gerard Cruz: Who did we have as, we didn't have international exposure we had ADR's. Rosalia Bordallo: Fisher it was always Fisher. Maggie Ralbovsky: ADR's. Rosalia Bordallo: Fisher was the first and only and then we started adding. Maggie Ralbovsky: Then why Fisher only started since 2006 I don't understand this. Gerard Cruz: Yeah, Fisher we added Fisher. Rosalia Bordallo: I don't know that's your report. Gerard Cruz: No we added Fisher we added Fisher we hired Fisher. Rosalia Bordallo: Fisher goes back beyond 2006. Paula Blas: It was 2002 I think. Gerard Cruz: No we are Fisher we are the entire international mandate remember. Rosalia Bordallo: No there was somebody before the ADR's. Gerard Cruz: No what's his name was doing ADR's MetWest. Maggie Ralbovsky: Okay, then that must explain this that their record but no managers go that long. Rosalia Bordallo: 2006 with Fisher? Wilfred Leon Guerrero: How is the, Maggie this report is December 31 right? How is the international market doing now? Maggie Ralbovsky: It's doing okay. This year was okay, so far. So page 51 has the history. Historically the composite has underperformed since 5 years ago only margin we underperformed most recent time they are actually doing better. Your managers are all fairly high ranked. Paula Blas: Oh we did add Fisher in 2006. Gerard Cruz: We added in 2006? Paula Blas: I mean we funded them. Maggie Ralbovsky: March 31, 2006 according to this record. Gerard Cruz: Yeah we hired Fisher. Paula Blas: We had Lazard. Gerard Cruz: I remember, I remember because it was that guy Jeffrey, Jeff. Paula Blas: Aberdeen. Rosalia Bordallo: There we go its Aberdeen. Gerard Cruz: It was Aberdeen. Rosalia Bordallo: Aberdeen, Murray Johnstone. Gerard Cruz: There you go it was Aberdeen. Rosalia Bordallo: Murray Johnstone. Gerard Cruz: Aberdeen, yeah it was Aberdeen. Maggie Ralbovsky: They have done very well recently. Gerard Cruz: Aberdeen? Maggie Ralbovsky: Very well. I think they outperformed by 8% last year or something but historically they had issues. I think they purchased somebody Scudder or somebody. Rosalia Bordallo: We started out with Murray Johnstone and then they got bought out by Aberdeen. Maggie Ralbovsky: Okay, oh yeah so they had some issues historically. Gerard Cruz: And Aberdeen to what? Deutche? Maggie Ralbovsky: Deutche that's right Deutche. That was the period they had a lot of issues yes.

Maggie Ralbovsky: Okay, so fixed income page 53 and this quarter is a great quarter for them too. Gerard Cruz: We have fixed income. Maggie Ralbovsky: You see Franklin Templeton outperformed by 1 basis point. Gerard Cruz: A wins a win. 1 basis point. Maggie Ralbovsky: So total composite comes out to 22 basis points. Yeah I know cause here it's very concentrated. Gerard Cruz: They are very treasury plain vanilla, they're in trouble if the market moves. Maggie Ralbovsky: If it moves they will really have little to compensate that. Wilfred Leon Guerrero: You know this ranking that you have, doesn't make sense. The scoring 3 points but you keeping them on watch. Maggie Ralbovsky: Well we keep them on watch for this particular mandate right, with this manager is ranked pretty high actually for their global. Gerard Cruz: Global total. Maggie Ralbovsky: Global total platform and you are only using them for their core which is not how they add value. The manager tends to add value with the other sectors. They have a very extensive global platform. Their global bonds is great. Wilfred Leon Guerrero: The ranking does not make sense to us. Maggie Ralbovsky: No, no, no this ranking makes perfect sense. The manager is a good manager the particular mandate that we're using think is a small portion. Wilfred Leon Guerrero: I know but their ranking is for something else. Maggie Ralbovsky: No we're ranking the team we're ranking the team. Antolina Leon Guerrero: For their total performance. Maggie Ralbovsky: Yeah for their total performance. Antolina Leon Guerrero: Not just for their performance here at the fund as a manager. Maggie Ralbovsky: Not just performance it's for the platform. The entire global bond yeah. Antolina Leon Guerrero: For how well they. Maggie Ralbovsky: That's why we put them on watch here.

Wilfred Leon Guerrero: What you're telling us is that look guys when I give you the ranking you need to keep in mind that there's a big platform here and you guys may not. Maggie Ralbovsky: Benefiting from it. Yeah. It's partially true you are not utilizing the entire infrastructure there. Wilfred Leon Guerrero: Right. Okay. Maggie Ralbovsky: But we put them on watch because since inception they underperformed we'll take it off once they correct that. They have not yet. But Gerry is right that Hamilton they are focused on the very high quality portion of the segment. They may give them limited magnitude limited ways to maneuver next phase when you know interest rate is going to go up, treasury sector suffer, high grade sector will suffer and they are very concentrated. That is the manager that may have limited ways to diffuse that. Anyway.

Rosalia Bordallo: Can you comment on IRM? I mean I know you comment on Franklin where, but IRM is at 2.46 inception. Maggie Ralbovsky: Yeah. That's right that has something to do with the legacy you give them the portfolio from Aberdeen. Was it Aberdeen? Rosalia Bordallo: Deutche. Maggie Ralbovsky: Deutche, yeah. So the negative a lot of that majority of that was that. So I think you probably have to look at the 3 year with the recent history you give them more weight than this since inception because it took them a while to get rid of the legacy portfolio. Paula Blas: The transition. Maggie Ralbovsky: Okay, so the recommendation is to keep Franklin Templeton on watch and see if they can correct the historical underperformance since inception.

Maggie Ralbovsky: Okay, REITS 59. This we have one manager out performed one underperformed. I'm sorry. Wilfred Leon Guerrero: So far for this quarter how is this sector doing? Maggie Ralbovsky: REITS? Antolina Leon Guerrero: Fixed income. Maggie Ralbovsky: Oh, Fixed income. It went down. Core bonds so far is down. Treasury went to 2%. Treasury started the year in 1.7 something. Gerard Cruz: Six, well 1.7. Maggie Ralbovsky: Yes, so now it went to north of 2% has not been over 2% for years. 10 year treasury so the core bond sector has lost value so far this year but not significant. It wasn't like significant down. Gerard Cruz: That's the 10 year right? That's the 10 year. Maggie Ralbovsky: Yes. Gerard Cruz: These bonds are have the 4 year duration. Maggie Ralbovsky: Duration. 10 year has a 4 year duration. 10 year bonds 10 year treasury. No 10 year treasury has a 7 year duration. Gerard Cruz: Yes. Maggie Ralbovsky: That might be the case low interest rate. 7 not 7. 7 really. Supposed to be around 5 yeah. Could be because interest rates are so low. Gerard Cruz: Are so low. Maggie Ralbovsky: Yeah. Gerard Cruz: At 1%, 1.5%. Maggie Ralbovsky: That's right. You really extend that. Gerard Cruz: You need a consultant I can get a card. Maggie Ralbovsky: It's so positively complex you're right.

Okay, so the real estate composite we the total composite underperformed. One manager out performed one manager underperformed however the underperformance is actually quite not significant. So we are not recommending any. Gerard Cruz: Oh Security Capital underperformed. Maggie Ralbovsky: Yeah. Gerard Cruz: They are the plain vanilla out of the two, right. I mean they're the least. Maggie Ralbovsky: They are actually the one we highly ranked they are on focus list yeah but they underperformed. Gerard Cruz: Wow, that's interesting. Not by much but. Maggie Ralbovsky: Yeah. The Cornerstone we downgraded this quarter and now they're ranking their score is at 2.7 very close to 2.5 so I'm watching it although I am not recommending any changes. We downgraded it because they had not found any replacement for the two people who left in July. And for all this time they were trying to hire replacement and they have not. Gerard Cruz: Been able to. Maggie Ralbovsky: Been able to. Gerard Cruz: The replacement is I'm sorry for who the 2 analyst I mean stateside? Maggie Ralbovsky: Yeah, North American analyst. So they basically had the other people assume a lot more names to cover these two peoples I guess capacity. It can not last forever. Wilfred Leon Guerrero: Yeah but this quarter, how's the REITS doing? Is it still it's down right? It was down in December. Maggie Ralbovsky: I don't know. Gerard Cruz: REITS did for the quarter did 2 but 2.2 and 2 point or the composite is 2.2? So that's us? Maggie Ralbovsky: He was asking this month. Gerard Cruz: Oh this month I'm sorry, I'm sorry. Maggie Ralbovsky: I don't know right now. So the underperformance is marginal although this actual performance has been tremendous. You can see since inception we made 20% annualized return. This is a tremendous run. Gerard Cruz: Yeah. Maggie Ralbovsky: For the REITS. Gerard Cruz: We got in that's why. Maggie Ralbovsky: Timing was perfect. Timing was perfect. Right after Aberdeen was bought. Gerard Cruz: Yup, Yup. Antolina Leon Guerrero: It's a good strategy. Gerard Cruz: Oh good job. Wilfred Leon Guerrero: You don't want to fire anybody now? Maggie Ralbovsky: Not firing anybody I want to pass the law. Pass the law. Antolina Leon Guerrero: Maggie what's this 3/15 thing? Actual GGR is that you? Maggie Ralbovsky: 3/15? Oh yeah this was a question, I prepared a little answer to a question that was posed. So that's the 3/15 okay. Antolina Leon Guerrero: If lunch is late can we do the 3/15 now? While we wait? Maggie Ralbovsky: Yeah sure it's just a few sentences just a few pages very few pages of questions. You want me to do that?

Antolina Leon Guerrero: Yeah. The investment update the review from history is that what that is? Maggie Ralbovsky: Yeah, yeah, yeah. Antolina Leon Guerrero: Asking that, I asked the chair if we could do this now since we're waiting for lunch instead of the 3/15. Maggie Ralbovsky: You want to do it now? Antolina Leon Guerrero: Is that okay? Wilfred Leon Guerrero: Yeah. That's fine.

Maggie Ralbovsky: Okay. So there is a mutual fund out there it's called permanent fund. And here's a ticker on page oh gosh there's no page number it says summary of summary of findings. Yes. Wilfred Leon Guerrero: What is derivative contrast? Maggie Ralbovsky: A features, features. So derivatives are instruments that does not have it at the return of itself its return is derived from something else. That's the general definition of derivative. It usually includes features, auctions, forward contracts, these are over the counter contracts those are derivatives. Okay, so most commonly used derivatives are features. Features are for example I want to buy S&P500 in this case I want to buy gold right. But instead of buying gold, solid gold I have to put somewhere in the volt. I don't want that but I want gold return. I want return the gold but I don't want the hold gold. Gerard Cruz: Physical access. Maggie Ralbovsky: That's right. So what I do is I enter into a contract. Somebody else holds the gold for me and I just get a return for that gold. And we net the differential everyday and its being traded on and exchanged, that's called the features contract. And that's one kind of derivative. Derivatives are. Gerard Cruz: That's the forward no its features sorry. Maggie Ralbovsky: Yeah its features. Forward is similar to features but does not trade on exchanges. Gerard Cruz: Not a physical asset. Maggie Ralbovsky: Yeah so all these derivatives are just contracts. Derivatives are contracts that its return is derived from something else. That's general definition of derivatives okay. So the reason why I want to provide this was because of the question being asked about why that somebody I guess came to said hey look at you guys you spend all of this time investing your money and have spend money to hire consultant, hire managers and guess what the past 10 years your return underperformed this permanent fund by huge deal. Look at this past 10 years, this is the chart I show you right. The permanent fund for the past 10 years, growth of a dollar, $1 went to $17 and GGRF oh no I'm sorry.

Gerard Cruz: It's the opposite you don't have that one. Maggie Ralbovsky: It's the other one, this one. This one the next page. So for the past 20 years I think this was the chart they gave you. Gerard Cruz: They gave us the last 10. Maggie Ralbovsky: Oh they gave you last 10. Antolina Leon Guerrero: They gave us both. Gerard Cruz: This one. Maggie Ralbovsky: They give you the last 10 okay. Sorry. The last 10 look at how badly they done compared to the permanent fund. What I'm trying to tell you that. Gerard Cruz: That's your copy right? Is that your copy? Maggie Ralbovsky: Okay, so what I'm trying to tell you that that's only part of the story. Gerard Cruz: Yeah, I know I agree. Antolina Leon Guerrero: Well, I didn't even understand that part, I'm sorry what's the story? Maggie Ralbovsky: Okay for the past 10 years Gerard Cruz: Okay we'll go with that. Maggie Ralbovsky: This mutual fund out performed GGRF by a huge margin but that really is part of the story only part of the story because if you look at the past, since 1983 this is when this mutual fund was launched and versus our policy versus GGRF current policy, even though I recognize this is not the actual history I don't have actual history to '83 but had we have our current policy since '83 we would have had $17 today with $1 invested then and the permanent fund would only have $7, and as you can see for the longest time permanent fund did nothing and the only times permanent fund really took off was last 10 years, see that? Last 10 was took off and so this person has presented this particular sales pitch with only part of the story. And if you just look at the actual this is the actual return this is not the policy, this is the actual GGRF return versus the permanent fund for the past 20 years and you can see the only time we started to underperform was actually after 2008 drop you know the most recent period. And in total 20 years we underperformed by a small margin. So, what is in this permanent fund? Permanent fund, here's the regression. What is the regression? Regression is trying to understand where the sources of return is from the permanent fund. The permanent fund basically is about 50% in stocks and 50% in commodities. And the commodities are they use the features contract to replicate. So if I gold it's gold.

Wilfred Leon Guerrero: Does it make sense to make this comparison the Retirement Fund versus permanent fund? Gerard Cruz: Not really. I don't think it's a fair comparison notwithstanding just looking at the absolute return figures because the components of the portfolio that we're being compared to includes securities and instruments that we cannot invest in as a Fund. We don't have the ability to do derivatives invest in derivatives. So we're so that's one component where I think is an unfair comparison. The other component where I think it's unfair, is that these are mutual funds that have its own set of components that active managers can't do for example, we're a long only. So I don't know if there is if shorting is an option here or not but as a mutual fund there is just some components that are different from actively managed portfolio and I don't think anyone is suggesting that we should be a passively managed fund. So.

Maggie Ralbovsky: Well I think the most the biggest bias this particular chart they are presenting to you is the fact that the parts of the story it's not the whole story. Gerard Cruz: And that's the other part. Maggie Ralbovsky: If you look at the whole story we did so much better than they did. Wilfred Leon Guerrero: Right, right, right no I understand. Maggie Ralbovsky; Do you know what if they craft a core bond portfolio in this if even much even better for bond out performed permanent fund by a huge margin this is specific period in time. Wilfred Leon Guerrero: Let's see if I understand this correctly. Maggie Ralbovsky: Okay. Wilfred Leon Guerrero: This where it says $17.62 okay you start out with $1 and April 2012 that $1 is $17.62 as opposed to. Maggie Ralbovsky: Not April this is end of 2012. Gerard Cruz: 2011. Antolina Leon Guerrero: 2012. Maggie Ralbovsky: End of 2012. December 31, 2012. Gerard Cruz: Oh 2012. Wilfred Leon Guerrero: No you got April 2012. Maggie Ralbovsky: No that's just that's just a little legend no this chart goes to December 31, 2012. I'm just, I'm out of room to write that down there. Gerard Cruz: They couldn't fit the letters in. Wilfred Leon Guerrero: Oh okay. Maggie Ralbovsky: You see the chart is to December 31, 2012 yeah. Wilfred Leon Guerrero: Okay. So that what it's you start off with $1 and December 31, 2012 it was worth $17.62 where the permanent fund started off with $1 in 1983 and as of December 31st $7.04. Maggie Ralbovsky: Correct. Wilfred Leon Guerrero: Okay this other one the one that doesn't tell the complete picture, it's the same thing only it started now. Maggie Ralbovsky: It started December 1, 1992. Wilfred Leon Guerrero: 1992. Maggie Ralbovsky: That's your inception. Inception of the fund for the data we have. Permanent fund data. Gerard Cruz: $4 one? Maggie Ralbovsky: Yeah. Wilfred Leon Guerrero: Okay, so I see. Maggie Ralbovsky: So the next. Wilfred Leon Guerrero: Yeah it really if you do want to be objective about it you should start in 1983 book because both funds were in existence of that time. Maggie Ralbovsky: Because that fund was in existence your fund in existence too I just don't have that. Wilfred Leon Guerrero: Yeah that's what I mean. Maggie Ralbovsky: That's right so. That's right. so you see this permanent fund did nothing for the longest time because gold did nothing it holds 50% gold and gold only had arrived for the last 10 years and they hold another 50% in stocks. So here's a reduction I have done if I just use gold and stocks I explain 87% of its return. So 87%.

Wilfred Leon Guerrero: I don't know what that means Maggie. Gerard Cruz: So basically what this what this did was it took a look at the last 10 years and the last. Wilfred Leon Guerrero: .87 is 87% correlation is that what you are saying? Maggie Ralbovsky: The multiple R square is a statistical term that measures how well this model explains the actual performance. So I regress the permanent fund return versus 50% stock 50% gold. Okay. So I'm saying okay how well can I understand permanent fund return if I assume the whole 50% stock 50% gold and my conclusion is 87% of their performance can be explained by these two things which is a very good fit model. The model has a significance of over 76%. So which gives us a conclusion that majority of this fund hold is basically 50% stock 50% gold. So I graphed how well gold explains their return and you can see their predictive the red one and the blue is their actual performance. All these blue dots versus the red dots are very well fitting. If you combine these two explains 87% of time. That's basically what this fund is actually should not say just gold, its precious metal. I use the precious metal also includes silver and platinum. Gold, silver, platinum and gold that are stocks use the 4 things it holds. Gerard Cruz: But we can't hold those. Maggie Ralbovsky: Yet. Gerard Cruz: Well even during this time period. Maggie Ralbovsky: Yeah, no this is totally bias comparison its very bias pitch you know sales pitch. Wilfred Leon Guerrero: Okay. The other thing is in terms of like making a comparison one of them Gerry had mentioned that they constrained in one fund because of the law and the Permanent Fund can do whatever what it wants to do. What other differences how about the objective of the do you know what the objective of the permanent fund? Maggie Ralbovsky: The permanent fund is being sold based on the theory that as a long term investor you should hold actual things like its permanent right so if you hold gold, gold is permanent right. Inflation so the gold from this fund is to beat inflation but I can tell you it didn't do very well if you graphed this since '83.

Wilfred Leon Guerrero: How about expenses? Maggie Ralbovsky: Well expenses is actually very comparable. I think this fund has a 70 basis point expense ratio. I think our fund pays less than that but if you add, it's comparable I think we are a little less. Maybe 50 basis points all in including the operation expenses and all that. They are a little bit higher but not by much. So bottom line this is not this is the sales pitch. Wilfred Leon Guerrero: No, I understand that I just want to know more about it because I. Gerard Cruz: You better explain it. Maggie Ralbovsky: Explain it okay so. Gerard Cruz: They just took a picture of the best 10 years of its life. Maggie Ralbovsky: That's right. Gerard Cruz: And said look at how much better. Maggie Ralbovsky: That's right and Dr. LG you can ask him what if you graph Treasury bond return you know you graph the core bond return years much better than them too. Wilfred Leon Guerrero: They what? Maggie Ralbovsky: The past 10 years the best performing asset class is core bonds. Gerard Cruz: Yeah. Wilfred Leon Guerrero: Core bonds? Maggie Ralbovsky: That's right. If you graph core bonds here you use the permanent fund. Gerard Cruz: Past 10 years. Maggie Ralbovsky: That's right for the past 10 years it's a very small. Wilfred Leon Guerrero: What is core bonds?

Gerard Cruz: Core bonds would be like treasury. So if you take our fixed income manager like let's look at. Maggie Ralbovsky: Garcia. Gerard Cruz: Garcia Hamilton, who invests primarily in treasuries and high rated bonds. If you graph their performance over that same year 10 year period their returns could be pretty significant because interest rates over the last 10 years have come down tremendously so the value of those fixed income securities have gone up tremendously. So we don't have the luxury of being able to say okay we want to invest at the best time of a funds life. You know I mean if we knew that in 19 or 2000 we could invest our money in this fund and it would return a rate better than what we are getting, then we can, but we don't invest looking back, we invest looking forward we just don't know what the future is going to hold. This is a high inside comparison something that has already happened and its predictive nature going forward is less than unknown. Wilfred Leon Guerrero: Okay, thank you for that. Maggie Ralbovsky: Okay, great. Gerard Cruz: Good. Lunch time.

Capital International

Takashi Takamura: I was here. Wilfred Leon Guerrero: The format is the same, you have 45 minutes of we'd like to think that you'd lead us on discussion, review the portfolio and we'll let you go ahead and get started. I think did you say asking these guys exactly what is it that we are looking for. Diana Bernardo: Oh they have an idea of what we need to go over right. Takashi Takamura: Yes we got the agenda from 1 to 8. Wilfred Leon Guerrero: We ask you to help us in reading our fiduciary responsibility by responding to questions. We turn it over to you and we'll just interrupt whenever we feel like doing. Takashi Takamura: Okay. Wilfred Leon Guerrero: But we need to introduce everybody. Trustee, James Duenas he is new this is I think first meeting. James Duenas: My first meeting. Wilfred Leon Guerrero: So he's going to ask a lot of questions cause he doesn't know and of course our Director Paula Blas and we have trustee Antolina Leon Guerrero, trustee Gerry Cruz and Diane I guess you've communicated with and I'm Fred Leon Guerrero. Okay so we turn it over to you.

Takashi Takamura: Thank you very much we will start. We really appreciate your time and pretty much honored to be here my name is Takashi Takamura I am the district manager and sales head of Japan and based in Tokyo and here's my colleague, Akira Fuse investment specialist also based in Tokyo office and he is out of the Investment Group so therefore he is the person who knows the portfolio in detail and also in explaining those details of the portfolio and they how I should report the managers thinking to our clients. You may wonder why the two Japanese people come here instead of the American tall guy in the past. The reason is I think that as you know Guam is pretty much familiar place for Japanese people that's one thing of course. Wilfred Leon Guerrero: Did you bring your family? Takashi Takamura: Not yet. Wilfred Leon Guerrero: We expect you to bring your family. Takashi Takamura: Next time I will. Wilfred Leon Guerrero: Support the industry down there.

Takashi Takamura: Actually, Capital is taking the sort of regional global approach in terms of the transhousing as well and now we are part of Asia Pacific Citizen of the marketing team. So we actually some point a particular often times fly to the Mid West to clients outside of Japan as well, so that's why we come here. Gerard Cruz: Do you still have the Singapore office? No more? Takashi Takamura: Yes we do. We have the regional managers when the market moved out there. Gerard Cruz: Okay. But our region is being covered by Japan now? Takashi Takamura: Not Japan, part by Asia pacific teams, so Singapore, Tokyo and also New Zealand. Gerard Cruz: Oh part of the team, okay. I see. So but our contact is with you, okay. Takashi Takamura: I have been with Capital for 11 years and Akira has been with the company for 5 years so therefore we know our contract I think and can take care of you. With that I think you'll be much more interested in the investment results and so we will go through this up on the agenda you got starting from the results since inception and the period of annually which is the one year ended September end. And the recent one is first quarter last year plus the last month January. And after that we are going to cover our investment outlook and the portfolio review for future so that's of course that's what we'll go through. And then I will ask Akira because he knows the book for you.

Akira Fuse: Before starting this my presentation I will include a point 5 impact of current market volatilities on the portfolio into the market outlook that is located in tab 5 of this paper, so I will touch on that later. Gerard Cruz: Okay. Akira Fuse: Let's review in line with the agenda the first tab is portfolio review for the since inception. If you open to page 4 you can see the investment results since inception. Since the August 2006, as you see after 3 basis the portfolio make 7.1% versus benchmark 7.2% so excess return is behind at this moment. If you look into the forward page, page 5. Wilfred Leon Guerrero: I'm sorry why are you, why is the date on this September 30 2012, you don't have December? Akira Fuse: We do. We do but you know we assigned to review the result up to September, that the first agenda from you guys. Wilfred Leon Guerrero: Okay.

Gerard Cruz: Is this number, I'm sorry may I ask a question, this $77 million dollars as of September is that pure market changes, have we given you more money through inception? Akira Fuse: Yes. Gerard Cruz: I know we started at 36. How much additional funding did we provide? Do you have an approximate? Akira Fuse: Last year we got you know I'm sorry I lost. Gerard Cruz: That's okay I'm just curious. Okay. Diana Bernardo: We did a rebalancing and we gave some money. Akira Fuse: I will check that $15 million dollars from last year. Gerard Cruz: Okay. You are also on an annual basis pay we've come to what I've come to remember as what capital gains right around Decemberish or something. I remember seeing that number. I don't remember how much it is over the years but. Akira Fuse: You mean a fee? I'm sorry. Gerard Cruz: No it was called a capital gains it was almost like a big dividend of sorts. Akira Fuse: Right from the fund. Gerard Cruz: Right that you that was part of the increase in our values right? Akira Fuse: Right. Gerard Cruz: Could you explain where that comes from how thats calculated and if you. Akira Fuse: Fund dividend. In my understanding based on the dividend that is coming from the actual dividend received from the equity investment. Gerard Cruz: Okay. Akira Fuse: Under the fund so we do not pay out any capital gain from the Fund that's to my understanding. Gerard Cruz: I see. I see. Maggie Ralbovsky: This mutual fund distribution once a year so instead of you holding a security directly every time they pay a dividend you get it, mutual fund accumulates in the NAV until the end of the year. They probably will also distribute capital gains because if there's trading and during the year if people redeem and stuff like that and they also accumulate that and eventually divide it all up to all the holders. Gerard Cruz: So that's done once a year. Maggie Ralbovsky: That's done once a year. Gerard Cruz: Okay, thank you. Cause it's you know pretty substantial amounts. Maggie Ralbovsky: Do you get that reinvested or do you get. Gerard Cruz: It's reinvested. We took some. We took 10 of the 16 and since then we reinvest. So I'm curious to know how much of that is that and then how much of this 77 is actual new contributions. Akira Fuse: Right. Can I come back to you with the answer. Gerard Cruz: Sure, absolutely.

Akira Fuse: Let me come back to the page 5. Page 5 showed since inception year by year result but you know I'd like to highlight on the middle column, the annualized lifetime return. The portfolio made a 7.8% and the after fee portfolio made a 7.1% and benchmark is 7.2. Before fee we made excess returns still but after fee we are still behind at this moment. But annual basis you invested since 6 year you know 6 years ago and you made around 8%. That's a really good investment as for the committee before that. Move on to the a little more in detail. Page 6 looks like a similar page beforehand but this is compare with this standard index MSCI Emerging Markets standard Index which is including around you know 800 companies and in this index but in a previous page using the index called MSCI Emerging Market, Investable Market IMI, yes investable market index. Investable means you know they have a wide universe so standard they have around 800 companies but investable universe has more than more maybe adding on hundred thousand hundred companies.

Maggie Ralbovsky: So the IMI is inclusive small cap? Akira Fuse: Yeah small cap. Gerard Cruz: But the ones that we measure you against is just the MSCI emerging market? Akira Fuse: That's right. So in such a case, page 6. Gerard Cruz: Do you think it's a better measure to use the larger the broader index with smaller caps? Is it more consistent with. Akira Fuse: As a standard answer you know we are using IMI because you know we are skilled towards the mid cap and small cap and under the portfolio so that's why we like to measure ourselves against the broader universe. Gerard Cruz: And that's reflected in benchmark number this one on the bottom page or the top one? Akira Fuse: The bottom one page, I'm sorry. Maggie Ralbovsky: The top one's IMI, this is. Gerard Cruz: Okay the top one. So the 7.2 so the benchmark is 7.2 okay I see.

Akira Fuse: But we understand the mid cap and small cap are really vulnerable in broader market such as Lehman Shark up market, down market so that's why your investment year is 6 years so actually absolute return of the IMI is slightly up but since especially recent years I think standard index has a better number. So because of the IMI has a lot of name but their market cap is really small so the investment result and the actual performance result doesn't change a lot. Maggie Ralbovsky: Do you have any comment on the fact that most of the out performance was in the earlier first 3 years and later on every year have been underperforming? Akira Fuse: We could prepare the summary of the analysis on that but basically the first several year was really good environment particularly the market participant has the risk update so buying on the growth company was the fair evaluation but since Lehman Shark finished market skyrocketed and people both really inexpensive value deep value type of stocks but our approach is you know purchasing really good company with the gross prospect with the really inexpensive share price. So in that environment we are having a tough time in the past several years.

Gerard Cruz: Do you see that changing do you see a point where there's a reflection where that changes? Is it still in the really low inexpensive stocks or in the higher valued ones? Akira Fuse: I think in the past several years you know people are really worried about euro crisis and that's why people are paying high premium to the very steady type of company so that's why the evaluation of this steady company is really high at this moment but the market has been gradually changing now people are looking at the variation of the good company with the cheap evaluation of the stock. Gerard Cruz: Do you see the emerging market growing as a market in general? Akira Fuse: Yeah sure. Gerard Cruz: There's been comments about Capital and specifically in how it is that you guys have gotten pretty substantial in terms of your assets under management. And I guess our concern is you probably have heard maybe from your other clients is there's still value to add is there's still a reason for us to be engaged given your size and do you plan it at some point to close your fund to new money? Akira Fuse: We are monitoring our fund size but actually the fund size itself doesn't mean anything because the market itself is growing, so if you look into the year 2002, our fund size is around $23 billion dollars but our market share. Gerard Cruz: $23 billion? Akira Fuse: $23 billion dollars in 2002 and our market size compared to the tradable float cap was around 4.4%. So that's a pretty big. That was a maximum percentage. Gerard Cruz: Where are we today? Akira Fuse: We are around $18, $19 billion dollars but our market share is below 0.5% in the standard index float cap. So that's why we are monitoring all of that kind of a float cap and we set a certain threshold that would be 1.5%. Gerard Cruz: 1.5% of? Akira Fuse: So that's. Gerard Cruz: Of the broad cap market. Okay. Akira Fuse: Float cap. So tradable security market and our market size is below 0.5% now and we are monitoring every month and if we reach up to 1.5% of the float cap that would be kind of a fast area to review our capacity. So that is it clear to you? Gerard Cruz: Yes it is thank you.

Takashi Takamura: So 2002 is a peak and I think in terms of insurance, is part I think 2006 has the highest number. Akira Fuse: Yeah, I don't have an exact number I think 1.567 percentage still far lower than the portfolio. As a strategy you know we used to have a more certified billion dollar percentile management but you know we would rather focusing on the percentage of the float cap because that exact measure compared to the total size of the market. So as an answer we do not have any issue of the liquidity and some stocks require some days to liquidate or sell in the market but you know we have a very experienced traders in the global market so that's why we don't think any issue regarding to the liquidity at this moment. Gerard Cruz: Okay. Good. Akira: Is that clear answer to you? Gerard Cruz: Yes I'm okay.

Akira Fuse: Let's look at page 7 please. This is a country by country analysis since inception. As you can see on the top Taiwan, China, Russia and Korea were really big contributor to the portfolio while on the bottom, India, South Africa and some United States and UK company contributed negatively to the portfolio reserve since inception basis. And your question this is investment into the emerging market but then we have several companies who have a significant business in the emerging market countries. Gerard Cruz: I see. So that would be okay so that would is that's why you have a country like the U.S. and U.K? Akira Fuse: Yes. Gerard Cruz: What would be an example of a company from a name that you would have that's from the U.S. or U.K. that's in your portfolio?

Akira Fuse: Particularly as you understand the historical reason U.K. has a very strong relationship with South Africa, so U.K. base company has lots of mines and some of the mining operations in Africa. So we invested into the some of the companies who has mines outside of U.K. of course and Africa or oil companies. That companies, you know we have a process to see the companies eligible to this process this strategy and if the company has more than 50% of the sales or revenue or assets, in the emerging market country we put. Gerard Cruz: But do they trade on the emerging market exchange or they trade in the U.K.? Akira Fuse: They trade in the U.K. Gerard Cruz: And it's a U.K. domicile.

Akira Fuse: U.K. domicile. But the operation is more than 50%. Gerard Cruz: But listed on the MSCI not listed on the MSCI not part of the index obviously right? Akira Fuse: It's a non index. Out of index. Gerard Cruz: How much of your portfolio exist that don't have names in the index? Akira Fuse: Around 10%. You know I have a data here in a packet, page 35. Gerard Cruz: Okay sorry. I know we're deviating right? Akira Fuse: Gerry, we actually at the end of December we have a 5.7% as other. Gerard Cruz: Okay, okay. Akira Fuse: Page 35. Gerard Cruz: Great. 35.

Akira Fuse: Yes, if you look into the pie chart. Gerard Cruz: Oh so about 1.4%? Akira Fuse: No other it's a tan color. Gerard Cruz: Oh tan color, oh other 5.7. Akira Fuse: This is the DM developed country listed companies particularly U.K., U.S. and Canada and Australia. Gerard Cruz: But they represent a small part of your overall portfolio? Akira Fuse: That's right. Gerard Cruz: They were detractors, did they help or hurt your portfolio. Akira Fuse: In the past since inception it was detractor because of the emerging market stocks were making better results compared to the DM names "developed markets". But we understand those company even if they are listed in developed market they're fundamentals are driven by the operation in the emerging market countries. That's why gross prospect is really high that's why we kept investment into that. Gerard Cruz: I see, okay.

Akira Fuse: Let's jump into the page 10. This is a historical result of emerging market growth fund. In the long run we'd like to say the active investment made a difference compared to the index particularly in RES we made double digit excess return in the past. As you can see in the recent years we had a tough time in 2009 we are behind to the benchmark or index in 4 years consecutively. But if you look into the year 2002 to 2004 we had a similar experience at that time and the year 2004 we made a change of the investment team and the research team. Since then the investment result revived and we made a pretty good return. So I'd like to touch on that but we are now reviewing the research team. Portfolio manager is doing a good job at this moment but you know we found some mistakes and you know the lack of clarity on the research process in some countries and we reviewed all of the professionals and we reassigned the coverage of the country, industry and also adding on the new resources in several countries. So I'll talk about that.

Gerard Cruz: Those changes already been implemented? Akira Fuse: Yes. Gerard Cruz: Since when? Akira Fuse: Since the middle of last year. Gerard Cruz: Middle of last year. Are you seeing the results? Akira Fuse: Not yet. Gerard Cruz: Too early? Okay. Akira Fuse: Results in past 4 months is improving gradually and I could not say that's you know result of the people change but you know gradually market has been changing and our team is more engaged and people are you know we are fine tuning the coverage of sectors, so that's a gradually contributed to the result of this moment. Let's see the 12 months result page 12, yes. 12 months result is really difficult at this moment we are behind by 4.9% and if you look into the page 13, you can see country contributor and their track record. As you can see the contributor was Brazil, Taiwan, Indonesia and Saudi Arabia and Mexico made a positive return to the portfolio. But on the other hand India, South Africa, China, U.K. and Malaysia made the negative return to the portfolio result.

Particularly we are looking into the 3 countries, India, South Africa and China, that is really caught on to the since inception results and we found some mistakes in the stock picking in these countries so that's why we decided to change the analyst in this country particularly two analysts cover China and South Africa left our company and we redistributed those countries companies and universe into some other analyst who can cover those sectors. And also we added new analyst to India, he is an India guy. Gerard Cruz: I see. Akira Fuse: And he is going to look after the infrastructure sector in India that's a starting point. Gerard Cruz: Are you still, do you still maintain in China for example a similar exposure? Akira Fuse: Yes. Gerard Cruz: So you're contention is that the issue was stock picking rather than country, countries still conviction. Akira Fuse: Countries high conviction and the stock picking is also high conviction now, Gerard Cruz: Okay. Akira: But in the past we had several mistakes in picking some of the consumer's staple companies and some other you know sportswear good companies sold those things. Gerard Cruz: I understand. India now you're looking at infrastructure you said? Akira Fuse: Yes we have a new guy already and he is looking at the infrastructure and utilities and such kind of the background of the countries now. And also we added new analyst to Russia. Gerard Cruz: Russia? Akira Fuse: Yes. And also we gradually expanding the coverage of deferral market analyst into the emerging market such as you know the guy who is covering U.S. bank is now expanding coverage to the Bank of America and.

Gerard Cruz: Is that because he is good at it or is it because it makes sense for what he is covering in the U.S. to be covering Latin America? Akira Fuse: Yeah both, he is a survivor after the Lehman Shark, and he made a good decision to stock picking at that time in the past several years. And we have a high conviction on him so that's why I ask of him to expand his coverage to Latin America such as Brazil, Mexico. That's the first expansion at this moment and he is gradually expanding that. He is based in Los Angeles but he has traveled to New York a lot. And that's why you know he can move to the Bharti direction to see these South America countries. We have also some expansion or mixture of the coverage in Asia particularly some analyst who is covering Japan expanding the coverage to China and technology analyst is now covering Taiwan, Korea and Japan together because those industries are always competing I guess head to head so that's why the coverage has a Asian region is much more making sense rather than assign each of the analyst into the country. Gerard Cruz: I see. And that's a new thesis I mean that's a new process that you?

Akira Fuse: It's not new I think we have been doing that for the past. Takashi Takamura: Enforcing regional eyes global eyes coverage. Gerard Cruz: And it's just one analyst that does this? Akira Fuse: No many. So regional in case of Asia the energy analyst is covering all of the region. So China, Australia. Gerard Cruz: But several analysts covering energy in Asia? Akira Fuse: No the one lady is taking care of the energy in Asia. Gerard Cruz: So how are you so in terms of redundancy and legacy, what happens if she gets hit by a bus? Akira Fuse: If we expand one guy or one lady to take care of industry we will change the other people covering other area. So we do not do many redundancy in the past but I mentioned two analyst already left us because of some reasons. Gerard Cruz: I see no problem, understand. Akira Fuse: But you know we keep adding on resources in the team and also we are expanding the DM team developed market team covering EM so the result wise we keep adding on resources in the team. So that is basic message to you to improve our result. Gerard Cruz: Okay. Good news. Takashi Takamura: If something happens then we have to deploy other analyst from other markets. Gerard Cruz: I see. I see. Good.

Akira Fuse: Moving on quickly look onto the page 15, key contributors by stock names. The best contributor names are 5 names, particularly the CVRD this is the Brazilian or corks company. This company is actually, we are underweighting. That's contributed to us 0.5% but other than that, Delta Electronics, this is a Taiwanese electric power supply machine company and Hypermarcas consumer staple retail on household product company in Brazil and Grupo Financiero Inbursa this is a Mexican bank and Bank of China the bank contributed a lot. On the other hand, the negative contributor the top negative contributor is Bharti Airtel, this is an Indian mobil telecom operator and Adani Enterprise this is an energy congolomerate in India, and also Jain Irrigation this is agriculture system supplier to the India contributed negatively to the portfolio. Part of the reason is the political policies we are expecting a change or improving investment in public investment in India. But, India political is really slow and that the moving action is behind the expectation so that's why those stocks are heavily involved in the public investment and that's why. Gerard Cruz: So that's why I'm wondering if so if infrastructure development and investment in India's infrastructure is going to suffer the same or similar scenario as maybe these did because of the government beauracracy that exist.

Akira Fuse: That's right. So we are bottom of stock picker so that's why we are finding the value in those companies but you know at the market actually had some pressure from the concern or the government or macroeconomic environment so that's why we are actually doing the onsite research on the politics side and economic side. We have a chart for you on page 47. Gerard Cruz: 47? Akira Fuse: Yeah 47. As I discuss the important factor for India stock market is reformed effect and that's why as I said we are stock picker so we are marketing macro and politics as a supplementary formation but in the case of India it is really important at this moment. So that's why we decided to make a caravan to visit India with our macro economist. Gerard Cruz: Really who's going? Akira Fuse: I'm sorry. Gerard Cruz: Can we go?

Akira Fuse: Well you know the important thing that Capital is always working together. Gerard Cruz: Do you actually go and visit these companies? The companies that you pick some, some you do, some of the stuff? Akira Fuse: Yes, particularly I am visiting Korea, Taiwan and particularly I frequently visit to Japanese companies. Gerard Cruz: So the companies you invest in you actually visited? Akira Fuse: All of the companies are visited by someone. Analyst and portfolio managers should visit them and also they have to confirm the balance sheet and PL always with the CFO. So that's the kind of discipline for us. So we do not invest the company without visiting them. Gerard Cruz: Good, especially in emerging markets. Akira Fuse: That's right. You know confirming asset, confirming balance sheet, confirming the people and management that's a critical factor for us. So in case of India, the macro economist and our team visited and found some change of the politics particularly the physical conservation some of the minister already you know mention they would do some measurement to reduce the physical deficit, so that is a very important to keep the Indian groupie to stabilize. And secondly, the important thing is the unfreezing of our policies of the system as we understand India has some beauracratics so that's why governmental company applied some KPEX in the government but in our approval extended more than 1 year so that's why they cannot invest into the actual operations. So that's why the government set some cabinet committee over the investment and if they approve or extend us 3 months they will check what's happened over there. So that's the kind of acceleration of the KPEX in the public companies. And foreign public companies, the private company will start invested into their operations. As we understand the concern and the issue of the Indian country compared to China and some other countries are really weak infrastructure. So the investment into the power of the infra such as electricity generation and communication and water supply does really important for them. So I think second point on research result will be helping a change of the sentiment for the

India countries or India company investment so those are really important point. Gerard Cruz: Yes that is that's been the hold up.

Akira Fuse: So our key holdings on the right Adani Enterprise and Bharti Airtel. Adani Enterprise is a kind of conglomerate of the energy and port every single India for infrastructure basis. And this company really important for growth of the India. Bharti Airtel this company is supplying telecom service to this country but at the same time this company has exported to some other south East Asia growing countries so we are expecting a lot of growth going forward. Is that answer to you? Gerard Cruz: Yes. Are there protections for investors who invest in India to, against things like I'm sure they exist but just like governments nationalizing certain industries or companies, are there certain protections that you guys look for in countries like India? Akira Fuse: I don't have a great answer to the protection but on the same page you know we visited several authority companies and actually we're looking at deregulation on the public owned companies as I understand India has some limitation to investing into the important industry such as aviation sector. Gerard Cruz: Oh you're not able to there are limitation on how much you can invest into aviation? Akira Fuse: Retail companies we can invest into the 51%, foreign capital can invest into retail sector by 51% and aviation 49% but you know we observing Indian government wants to accelerate fixed asset investment to India so they will relax their limit on those of important infrastructures. Is that answer to you? It is not the protection. Gerard Cruz: No, I understand. Akira Fuse: But India is gradually moving towards deregulation so that's important. Gerard Cruz: That's good. No I hope they do I hope they continue on that pace or on that path on a quicker pace.

Akira Fuse: So conscious of time, I'd like to check page 20, this is a 3 months result ending December. Mr. Leon Guerrero's has a concern on this but recent 3 months we had a strong market, the benchmark made 5.5% but portfolio made a 6.1 so gradually our strategy and market is coming our way I think. And structure is started working at this moment. So let's see. Gerard Cruz: This is net of fees? Akira Fuse: This is net of fee. Let's check the 1 month result as well, page. Gerard Cruz: I think you're at $84 million right, today, you're at $84 million as of today? or as of end of January? Akira Fuse: End of January you have $81 million. On page 29 you can see one month result. But you know we made another excess of 0.2. So end of January $81 million. Gerard Cruz: That's good so that's about 20% return annualized? So that's what we're looking for Mr. Chairman. Wilfred Leon Guerrero: Are you going to do the same thing next year? Akira Fuse: I hope so. Gerard Cruz: That's the bottom line question. Akira Fuse: Let me touch on page 33. This is a special question coming from committee to see the impact of the current market volatilities on the portfolio. As you can see on the top chart this is a volatility chart 6 days market volatility as you can see the volatility was shot up in great financial crisis and then coming down gradually but we had 2 sharp increase over the volatility this is driven by the concern on the European debt crisis. Gerard Cruz: You are looking at November, December 2008 or 11? Akira Fuse: Yeah both. Gerard Cruz: Oh both 2010, 2011. Akira Fuse: Particularly end of year 2011 was totally driven by the European debt crisis and also as you can see in the middle of last year we had a slight upturn of the volatility that's driven by the concern on some of the bench risk such as you know handled by the leadership in China and dissemination of the economic growth in China together with the Euro president election, so that eventually is coming on the late half of this year. So that's why the volatility made a slight upturn. Gerard Cruz: You're right, there were really low levels right? Akira Fuse: Yes. Gerard Cruz: You think that's temporary I mean are we, should we get comfortable at that level or should we be worried at that level? Akira Fuse: That's good question but you know from my point of view the biggest concern the emerging market was mishandle of Chinese leadership. And the Chinese economic growth is gradually stabilized. And people are concerning on the middle of last year, people are concerning on the China economic growth coming down to lower single digit but it wasn't appeared and that's your annual GDP growth is about 7%, so that's a really stable growth at this moment. So that's why U.S. economy is gradually moving up to the higher trend now and European is still so, so, but Asia and Japan is a gradually moving up.

Gerard Cruz: Do you think Japan is going to make it out of this? Akira Fuse: I think so. Gerard Cruz: Good. It's more expensive for you to come here now though. It's cheaper for us to go there now. Akira Fuse: Yeah, well you know the environment has been changing gradually in Japan. Gerard Cruz: I think so. Akira Fuse: It's only 3 months ago we had a change of administration, change of our prime minister. And prime minister made a very strong statement on his view, and economic policy that's helped a sentiment of the people, market and management. So that's why share price went up and people start spending. Gerard Cruz: There's more spending now in Japan? Akira Fuse: Gradually. If you look into the month by month sales gross in the department store it's really strong now. Wilfred Leon Guerrero: So do you think the new prime minister is heading in the right direction? Akira Fuse: I think so. Wilfred Leon Guerrero: In terms of Japanese economy? Gerard Cruz: Yeah, look at it now 94? 94 to the dollar right. When I was there in July it was 75 you get the exchange at the hotel its 68 to the dollar.

Wilfred Leon Guerrero: You know the incident that we had here, what are you hearing about it? Takashi Takamura: We are hearing the news almost each and every day it's sad because the girl was popular in baseball almost every Japanese and the peoples mindset is Guam is safe. Actually in my case I visited first time I came over here particularly when my son and daughter were little. This is safe and closer to Japan so that's how I came aboard. Those are emotions. So therefore the incident that happened in a place was popular for the Japanese people but really we are hearing some news about the Guam people had a ceremony that would sure help people calm down. My personal opinion the Governor should put more security in those area and even though it's a pretty much safe place I think, but still the people would like to see some changes or improvement.

Wilfred Leon Guerrero: We still don't know what's wrong with that guy, why he did it. Takashi Takamura: That happens all the time, similar incident happened in Tokyo. Akira Fuse: One guy drove a big truck and hit the people and also he use a knife. Wilfred Leon Guerrero: Oh so he used a knife in Tokyo, wow, when was this? Takashi Takamura: 3 or 4 years ago. Gerard Cruz: Yeah it's terrible. Wilfred Leon Guerrero: Maggie we had something like 300 reporters here. Paula Blas: Yeah the Japanese paparazzi. Gerard Cruz: They just came in. Wilfred Leon Guerrero: It was a major story in Japan. Akira Fuse: It's really weird. The media have some issue I think they are focusing on that kind of dramatic story kind of things but that killed peoples motivation to come here right. This is a really safe place, nice people, nice weather and relax. Gerard Cruz: Right I know that's so unfortunate. Akira Fuse: If you go to America or Los Angeles it happens everyday. We should not worry about too much on that one incident.

Wilfred Leon Guerrero: My daughter is in charge of the Japanese market with Guam Visitors Bureau. She's been staying up all night trying to. Gerard Cruz: Of course that's a big market. Akira Fuse: The aircraft yesterday was full. No vacancy. Gerard Cruz: What time did you arrive? Akira Fuse: 10 evening. Gerard Cruz: Wow really? Out of Narita. Akira Fuse: So business class and economy everything is packed really packed. Paula Blas: I don't think it's going to have an impact, it was an isolated incident. Gerard Cruz: Yeah that's good. Wilfred Leon Guerrero: I think there's two more questions. One changes, any major changes to personnel? Takashi Takamura: No changes at all. Wilfred Leon Guerrero: And regulatory issue? Takashi Takamura: We only do one business that we are managing for our clients and don't have any issues. Wilfred Leon Guerrero: Okay, next year we. Akira Fuse: May I ask, may I. Antolina Leon Guerrero: There's one more thing he wanted to say, I could see it. Akira Fuse: Page 37, our country allocation has a heavy weight on India, China and Russia, you know we discussed already. But if you look into the valuation India, China, Russia is still below 10 year average, but if you look into Taiwan, Korea, South Africa, Brazil it is above 10 year average. So it is aggregated in market index but generally speaking Taiwan, Korea, South Africa and Brazil is very expensive in terms of variation so that's why we found some good companies over there but we are very conscious on the valuation and rather we are investing to China since last year. It was kind of a little bit of timing, that's why we are behind the index. But you know Chinese stock is really cheap at this moment. Gerard Cruz: Oh you were early you said to get into China?

Akira Fuse: Yes, Almost one year ago you know we get into the China machinery and that's the cause of the negative return but as you can see the valuation is gradually coming back and we are seeing China has a really steady growth going forward and then Chinese company will make a profit you know going forward and sentiment is also improving in China so the valuation will come back at least to 10 year average. In such a case our strategy will work. Gerard Cruz: How about Russia? Akira Fuse: It's a difficult point, Russia industries really heavily skewed towards the energy industry. As we understand and global market is now looking at the shell gas evolution coming from U.S. so that's why share price and also oil price is pretty much for sure that's why share price is weak but you know we are rather invested into the Russian consumer realtor things such as banks and retail companies and some internet realtor companies. And also we have several really inexpensive oil companies and gas company over there. So if you look into the Gazprom which is the biggest gas supplier in the world it is PAR price awning ratio is 3 or 4 times 3 and 4 times, that's a really cheap. Gerard Cruz: Really, that is cheap 3 or 4 times. Akira Fuse: Because Gazprom is owned by the government and government direction is a little bit uncertain at this moment and we discussed with Paula last year regarding Mr. Pruten's direction and she was right you know. Gerard Cruz: Paula. Paula is always right. Akira Fuse: Improving Capital is administration but we are seeing the strong move of the economies and you know their economy is really dependent on the foreign demand of the oil and minings so that's why they need some change of economic system I think. So we are looking at the consumer side in Russia. Gerard Cruz: Okay. Wow. Good.

Akira Fuse: We are seeing a very good outlook. You open the page 41 on right hand side you can see the EPS growth. Gerard Cruz: I can see plus 16. Akira: Yeah that's right. Gerard Cruz: Oh that's last year. Akira Fuse: Last year. Gerard Cruz: I thought this year. I thought you're forecasting a plus 16. Akira Fuse: You're looking to the EPS growth you know. Earnings growth per share as you can see emerging market is expected to be growing 26%. 26% in earnings right. So earnings will definitely grow the share price was driven by earnings growth and price earnings ratio so that's a sentiment, so sentiment measuring improving and if you are assuming that kind of variation will be kept, we can see some growth of the earnings that will drive the share price. So that's why we are seeing positive trend in the emerging market. Gerard Cruz: Wow, we're good. Akira Fuse: Is that clear? Gerard Cruz: Yes, very nice. Akira Fuse: I'm sorry one question, page 40. Gerard Cruz: Okay. Akira Fuse: Our strategy is keeping a heavy weight on the industrial consumer discretionaries and if you look into the top right hand side, this is a 12 months forward price-to-earning ratio and as you can see consumer staple is staying on top of the 5 year historical variation. So those sectors are really expensive now so that's why we are staying away from those sectors and rather invested into the inexpensive priced sectors such as you know energy, material, industrial, consumer discretionary. If you look into the bottom right hand side, this is ROE return on equity range in the past 5 years, as you can see consumer discretionary is absolutely top of the range of the 5 years. So this is a really attractive investment at this moment. Gerard Cruz: Wow. Akira Fuse: This gave you some clarity of the view of the sector by sector analysis. Gerard Cruz: I see. And you guys invest your rate close to the sector? Or is that in. Akira Fuse: Our approach is a step by step borderline investment, so that's why the sector allocation is kind of a result of this topic so we don't take up too much overweight and underweight. Gerard Cruz: Yeah it didn't sound like in the beginning that you are much weighted against the sector deliberately it's more of a consequence of your stock. Takashi Takamura: That's right we did not make any top down asset allocation, top down sector allocation, our investment strategies is driven by stock by stock analysis stock by stock. Gerard Cruz: That's what it sounds like. Good for me. So now you can enjoy the beach. Oh you leave this evening?

Dimensional Fund Advisors

Ted Simpson: First of all thank you very much for the relationship that's gone on as many years as it has, Dimensional very much appreciates the relationship we have with you, and certainly a very important one for us so I want to start by saying thank you for that. I want to make sure just to hit some of the housekeeping items that you guys would like me to cover up on. In terms of any legal issues, litigation issues, FCC issues, none in the last year. So nothing really there. And then in terms of organization issues, I guess just an update, I think I actually mentioned some of this, it was really just kind of getting going last year but Dimensional in 2012 and 2013, has started to open some offices in East Asia so we had someone I think just a year ago who we hired from Fidelity there in Hong Kong. He's actually opened up a Singapore office for us. Since then we also hired a gentleman by the name of Pung Chan who was running Ibbotson Associates for Roger Ibbotson who is on our fund board and a good friend of our firm. And then when Ibbotson was bought by Morningstar, Pung was running a good section of Morningstar and then he wanted his family is in East Asia so he headed back there until we hired him up, he was a great hire for Dimensional, really a great guy. So he's our CEO of Asia Japan and then the newer news is that we actually are in the process of opening a Tokyo office as well. So as far as organizational changes, that's probably the most interesting exciting ones that we have. We have a very long standing kind of senior management transition which has been going on for 5 or 6 years now with David Booth our co-founder and co-CEO, who I guess we have later this year of 2013 is still going to be around but is going to the plan at least is to have him change his title to Chairman, my guess is he'll stay as involved as he wants to be in the things that he wants to be involved in, and those day to day things that he doesn't really want to be involved in he's now has the privilege of being less involved in some of those but on certain projects he's gotten very excited about over in fact even in the dozen years I've been around I'm not sure I've seen him this excited about some of the things that he gets to work at on a daily basis so I guess since he's going nowhere anytime soon. Gerard Cruz: Nice. Nice.

Ted Simpson: See as from an organizational level that's kind of it in terms of any organizational changes, Gerry was just looking at what are we now over 700 employees. The bulk of those are in our Austin, Texas office. Still about 100 of us in Santa Monica and then about 100 each in our Sydney and London offices. And you can see John Alkire from Morgan Stanley joined us as CEO of our Japan firm. Firms just up over still up over 250 billion, 260 maybe a little more than that billion in assets. And you know past year was a certainly a better year for our clients and a better year for us in some and certainly in the prior years. I'd be happy to talk about that. In terms of some of the, I keep coming here right after our client conference, which just happened about 10 days ago, but that's something hopefully I believe it's a long way to come but if you have reason to come over and visit Maggie or be in stateside in February, probably not the best time to make it to this.

Gerard Cruz: Has it always been in Texas? Ted Simpson: It has been the last couple of years and probably will be on a go forward basis. We have a great facility there, Maggie is familiar with the facility we have in the building in Santa Monica which is about 75, 80 person auditorium there. We have very much an academic focus to the firm. I'd like to both in terms of instructing the way that we think about investing and even in the process we use to invest with academics but we also enjoy sharing that with our clients and consultants and so we do that through this auditorium we have in Santa Monica, we will have an event I know in June. Kind of a one day event then we have 2 day events, 2 session day events in February and in Texas where we have 130 person auditorium actually another one which is 190 people just right next to it. So yes that's a big focus of the firm. And yes some others there you can see coming up. And then I'll touch up on this maybe at the end but profitability in terms of that's actually kind of an interesting new bid of research for us that will instruct. I know we shared it with some fine folks at Wilshire I don't know if it made it in to notes that you had a chance to see. Maggie Ralbovsky: I have nothing. Ted Simpson: So I'll give you kind of a snip on it and tell you some more, it's not really going to impact, well it hasn't impacted the way that we manage the international small caps strategy, certainly yet in fact actually as I'm getting ahead of myself here but even the way that we started thinking about this additional new piece of research was very much around the changes that we already kind of mentioned that we implemented in the US small cap and the international small cap strategies in terms of and I'll remind you of that at some of the extreme small growth companies that we exclude from the strategy we run for you. That kind of constructed some of this new research. So I'll come back to that after we touch a little bit more on some of the items that is on the agenda.

I know that you get to see us just kind of once a year, but so for that reason I don't know if you would like me to last year was my first year so I wanted to make sure to get a chance to kind of share with you just a quick refresher of kind of Dimensional's overall investment philosophy and kind of our 3 prong process. I don't know this year if it makes any sense to touch on that at high level as a refresher or just kind of jump more in to some of the performance and maybe come back to how the process. Wilfred Leon Guerrero: Let's go with the performance. Ted Simpson: Performance, sure. Gerard Cruz: Yeah, you guys have been with us for long, we know how you invest. Ted Simpson: Exactly I figured as much. So if you look back at the account review, this breaks down to the performance over the kind of the periods that had shared with you in terms of the way that you guys like to look at managers who come in February and so certainly compared to last year, these are especially the calendar year 2012 is a much larger absolute number that had been in prior years and that's special obviously 2011. So that being a certainly very much of a positive thing as well as you can see the relative performance of Dimensional versus our international small cap strategy versus the benchmark that we have in our perspective again this is a reminder we don't really manage the portfolio to any benchmark but obviously we put one in the perspective since it does include Canada. Our strategy includes Canada, we tend to use World ex US Small Cap. I noticed I think even before last year, that Eaton was in some of the notes, I put that in there as well. Are you guys currently like in your materials Maggie, do you intend to show us against Eaton, you showed us against? Maggie Ralbovsky: Small Cap. Ted Simpson: But its Eaton small or it World ex US Small. Really only difference is Canada.

Gerard Cruz: Eaton small. Maggie Ralbovsky: I think it's Eaton small. Ted Simpson: Okay. So the one thing you'll see certainly to the extent that you see differences here just eyeballing it or as I talk about it in more detail, differences between the Eaton small and the World ex US Small really the main difference there is Canada. And since we half dozen years ago or so added Canada to our international small caps strategy we change our benchmark to the World ex US Small. Gerard Cruz: Okay. Ted Simpson: So that would be the main difference there. And sometimes it could be you know sometimes it's a large and sometimes it can be a little more significant. Gerard Cruz: Right. Ted Simpson: But if you look over these periods then you can see through January 31, if you start back since the inception of the account back in '06. Maggie Ralbovsky: How much was Canada investment? Ted Simpson: What percentage? Maggie Ralbovsky: Yeah. Ted Simpson: Is it. Maggie Ralbovsky: Pretty small less than 5? Ted Simpson: That sounds about right, if I go back and cheat here on page 24 tells me that Canada 10%. Maggie Ralbovsky: Oh maybe we should change our benchmark. Yeah we should probably change it. Gerard Cruz: It's going to require change in. Maggie Ralbovsky: Guidelines? Gerard Cruz: Not the guidelines but the IP and yeah. Paula Blas: IPS. Gerard Cruz: No. Maggie Ralbovsky: The guidelines. Ted Simpson: What this is just a mutual fund, I don't think we have a guideline. Maggie Ralbovsky: Oh you don't have a guideline so we, I just have to change it in our system. I will do that. Ted Simpson: It might make it easier yeah. I was going to say otherwise it includes getting lawyers involved, this is fine. Maggie Ralbovsky: Yeah their only mutual funds. So, I need to change that because of this 10% we need to change that. Gerard Cruz: Okay.

Ted Simpson: But you can see so for, you know since 2006, kind of in the neighborhood of 130 odd basis points versus the upper. Maggie Ralbovsky: That's pretty high. Ted Simpson: Yeah and that's kind of in the range with this strategy is likely to do, you can see for some of the because especially 2009 which we talked about the past years which was where we did not rebound quite as quick as the benchmark did. You can see for some of these periods, especially for 5 year that still out performance but not much below kind of that longer trend average but you can see through the 1 year through January 60 basis points. You can see down at the lower at the bottom of the page it's the one place you can see through December of 2012, a slightly larger number there. One thing I will caution you is that one of the reasons there is a slightly larger number there its same reason there is actually a reversal in the lets say year to date which is really just the month of January. My guess since I've, I can't remember if it was an issue and I brought it up last year, maybe if Kevin Height brought it up in years before but fair value pricing if that I'm not sure Maggie if you heard all about that from other managers but I am happy to give just a quick reminder of what fair value pricing means and how that impacted us. It actually was a help. You can see even like the 4th quarter we were up by 166 basis points versus the benchmark. Roughly 100 basis points of that actually came from "fair value pricing". What that means is that the last day of the year December 31 I guess probably this past year, the market in the US was up nearly 2% and so what that means is that we fair value price our international equity portfolios, we don't actually don't do it ourselves we have a third party that helps us out with this. And so the market is way up we want to make sure the clients can't kind of gain the pricing around what would happen to the international strategies and so we actually adjust the price that we quote and that we calculate for our funds based on where the US market went since we're using Japan which closed 18 hours earlier, since we're using Europe which closed 7 hours earlier, people might be able to look at that and say oh wait a second the US market was up by 2% I want to get into this right now, I want to benefit from that. No, no, no what we do is we use a 3rd party to help us. Not exactly one to one but it shows good job bring the market up a little bit. So part of that is we did well in the 4th quarter we were actually up by 66 odd basis points, but we weren't up by the full 166. Same thing then with the year to date in January. You know just for that 1 month, because the starting point was artificially inflated we were you know we probably actually did actually better than the benchmark except for the fair value readjustment because the fair values stuff kind of washes out in the end of the long term.

So with that we look at some of the performance for the year you know REITs is something you may recall that we exclude, you know we have a whole list of exclusion roles in the presentation. You know REITs is something we exclude. REITs had a very good year, we excluded them so had roughly 50 basis points of underperformance due to that. Gerard Cruz: Really? Wow that good of a year. Global REITs. Ted Simpson: Well REITs in international developed markets. Gerard Cruz: Okay. We don't have exposure to global, right? Ted Simpson: As you may remember Dimensional just based on some research by Don Kine, at the warden schools as well as others and our own view is that there's nothing wrong with REITs they actually run a US REIT International REIT as well as a Global REIT strategy. But we think of them as being a separate asset class. One that tracks more real estate, one that and the total market REITs probably do maybe as well as the total market but frankly we see them a lot in small cap and we definitely see them in value strategies you know in the US, Russell 2000 value probably has a 10, 12% in REITs, so there that becomes a big exclusion and if we look back at sheet here, let's see REITs was say 5, 6% in the benchmark, we're down at almost 0. Gerard Cruz: You're I'm sorry. Ted Simpson: I'm sorry I'm back on page 26. Gerard Cruz: Okay. Ted Simpson: Just the prior section take a look over at, I didn't fill the appendix with these attributions this time. Gerard Cruz: Oh no that's fine. That's fine. Ted Simpson: I certainly have something here people have any interest in grabbing it but what it shows is that about 50 basis points actually hurt us so even despite that we did actually outperform for the year. Some of the other things that did help us we exclude certain exchanges. Some of the exchanges like you know Jazz Acker or some of the pink sheet type exchanges around the world that we exclude that are in the benchmark. We didn't hold on to them so that actually helped us by 40, 50 basis points as well. Other than that, the small cap there was a return to risk a bit in 2012, frankly it was more on the value side of risk rather than the just the small cap side. So there really wasn't a real big small cap premium and frankly the micro cap part of a small cap which eventually gives you fairly unique deep exposure to it that didn't do well in 2012. So that part didn't help us so much. But our international small value strategy but we do run one of those and that one.

Respectfully submitted,

Angelina Castro/Marilyn Aguon
Recording Secretary

Affirmed:

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