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Quarter Ended June 30, 2013 Performance Meetings & Annual Investment Manager Reviews

August 28, 2013
Retirement Fund Conference Room

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

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

Other Present:
Doris Flores-Brooks, Public Auditor, Office of Public Accountability
Maggie Ralbovsky, Wilshire Associates
Kenneth D. Statz, Security Capital
Dave Wharmby, Cornerstone
Scott Westphal, Cornerstone

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Economic & Capital Market Environment & DB Plan Performance

Maggie Ralbovsky: The second quarter was a very interesting quarter for all the different risky asset classes. It all started in May when Ben Bernanke started to guide the market in a somewhat different way. So ever since 2008 the Fed was very accommodative in injecting liquidity in the market place. And had for every Fed meeting in the past 5 years he would say that the Fed is going to keep the interest rate low for the foreseeable future and he dropped that phrase in this quarter. Many people think he would just trying to test to see what the markets reaction would be and the market was so everything else he said was exactly the same with the exception he would drop the phrase which was very important for the market. The market really reacted violently. And if you look on page 3, the bottom line that says May 2, 2013 that line was the euro dollar futures interest rate line and this is the line that basically discounts in what the market thinks interest rate will be in the future. So if you look at this line the interest rate was priced to be zero until you know some time in the mid 2015 the market thinks sometime you know close to maybe September mid September of 2015 interest rate will go up 25 basis points. That was what the market thought would happen on May 2, 2013.

Now if you look at June that was right before Bernanke started talking officially and that line has moved ahead by about a year so the market at that time was actually pricing into an interest rate movement a year ahead of time and July 2 you see that after the quarter just after the quarter end they moved even further. The market at that time was actually pricing into a 25 basis point rate hike in next year, early next year. Now that is very significant because every risky asset class is priced off the risk free rate. What does that mean? So the pricing of every asset class is the present value of all future income. And the present value, to calculate present value you have to take all future income and divide it by the discount rate.

The discount rate is the expected return so to speak and when risk free interest rate is very low that discount rate is very low because investors will just demand a little bit higher return above the risky free rate to take some risk. Now when the interest rate for risk free asset moves up, everything basically moves up, the discount rate moves up. So every asset class sold off in May and June. Some more violently than others and we'll see later more smaller economies in the world that relies more on foreign investment sold off really violently and actually as we speak today there are some crisis developing in India, Indonesia, Brazil. These economies are now experiencing huge capital out flows because when during those low interest rate years in the U.S. people basically think of Bernanke's protection as a port option meaning you don't have any risk by borrowing in the U.S. and investing in emerging market, because you know that you borrowing already zero, so you can just go somewhere else to buy emerging market debt which pays you 5%, then you're actually pretty good you're making out pretty well with this really low borrowing rate.

Now when the borrowing rate started to rise, people think it will start to rise, people started to sell those assets they have bought in the emerging markets and now if you are small emerging market like Indonesia, like Malaysia, even India today you are so dependent on the foreign investment to be steady and now all of a sudden everybody pulls money out, you are experiencing a drought of capital. And that is what happened in India, Indian ropy dropped 25% since May in the past 2 months. So India has this right now has a pretty severe crisis of being ruined and it is considered contagious to the other small economies. So as we speak the situation is developing so that's the portion that was impacted most but other places have also been impacted, we'll see later. So Bernanke actually.

Joe T. San Agustin: You see similarity with Greece? India? Maggie Ralbovsky: Greece yes you know there's issues in Greece as well. Greece will need another third round of. Joe T. San Agustin: Same trend. Maggie Ralbovsky: So since you asked that so Europe also has this pending issue because after 2008 the European Union actually initiated two rounds of bail out of Greece. The first round was basically give them a very ounce acceptable like prohibitively expensive loan to give them a 5% loan at really prohibitive interest rate and ask them to cut their government spending by huge amount and that loan was not sustainable so in 2011 I think, they had to redo that loan so they basically forgive a portion of that loan, give them a second bail out, give them a better term.

Now that second round of bailout is coming due pretty much next year and Greece is still in really bad shape. They have 25% unemployment rate. Pretty much they cannot fulfill the terms of the second round. Now there is this need for third round of bailout and in the meantime Italy, Spain also are entering the phase that they will need the second round of loan from you know to replace the first round of loan. So this whole thing will start to our first in 2014 so now it's sort of a period of time people are anticipating what ECB is going to do. The ECB has done two different things in the past bailout packages.

The first thing they have done is for the second round of Greek Greece bailout they forgive a lot of the loan basically they just wrote it off. The second thing they have done however was different from the first thing they had done. Second thing they have done was Cypress what they did is that they actually confiscated a bunch of the depositor, not really confiscated they turned them into equity. So if you're a depositor in the Cypress bank at the time, ECB came in to say you know what since you have a lot of money with the bank, we're going to take 20% of your deposit, deposited money is no longer yours but you get a claim to the banks residual income in the future, sort of turned you into a equity holder in some. If that was going to be the model for Italy and Spain, you can imagine the depositors that are going to flee. So that they were able to back stop the fleeing capital for Cypress because it was a pretty small economy. Well if this happens to Italy and Spain then probably is going to be a huge crisis. So the market is really a little bit unsettled that's why the European even though European equity is cheap by historical standard nobody is buying it. Nobody is buying it in a big way because it was all these uncertainties. Joe T. San Agustin: Maggie what was happening in Europe is now happening in the brick countries. Maggie Ralbovsky: The brick countries. Yes that was the emerging market. Joe T. San Agustin: That's what I said that what happened is not being brick. Maggie Ralbovsky: They are different, they are actually different in the brick countries it's not actually brick because China is not included. China still has capital control, you can't really take money.

Joe T. San Agustin: Germany was strong. The brick is China is a strong brick in the European country. Germany was strong. Maggie Ralbovsky: Right, Germany. There were issues in both emerging market and European Union but for different reasons but they both have issues. That's why the U.S. becomes a safe haven for this past quarter even though we sold off in June. U.S. equity sold off in June but because it relatively speaking April was very strong for the quarter U.S. was still positive. So that's a very quick nutshell as to the central bank's policy, central banks decision power what has done to the global economy for the past quarter.

So, Wilshire we do other just our expected return for asset classes every quarter and usually the adjustment was relatively small but you can see this quarter is actually relatively big. We actually downgraded equities by 50 basis points pretty much across the world. You can see the change column we downgraded the equity return, we upgraded fixed income return and we downgraded real estate securities return and commodities the real assets because commodities and real assets are very much thought of as inflation hedge and if the Fed started to raise interest rates that's going to be good for controlling inflation because then it withdraw liquidity from the market which controls inflation which makes these asset classes less attractive, so that's why we downgraded them.

Maggie Ralbovsky: Inflation is also downgraded by 50 basis points. Gerard Cruz: This is as of the 2nd quarter? Maggie Ralbovsky: That's right. Gerard Cruz: As of today basically? Maggie Ralbovsky Ralbovsky: As of yes so we adjust this once a quarter but usually adjustment is small, we only make a big deal when it's significant. Gerard Cruz: But do you think the moves in the market are over reaction to the news? Do you think it's going to revert back to the mean? Maggie Ralbovsky: You know I think for the period after this talk it was over reacting but then after that the market actually adjusted to reality. I think now the pricing is actually correct although I don't think the Fed is going to rate great next year. I do think they're going to withdraw liquidity. So they are going to stop buying those 85 billion dollars a month which by itself is a tightening move.

They're probably going to stop buying before the end of this year especially if we get Larry Summers as the Fed chairman. So the Fed chairman term is expiring in January. So now we have 2 major candidates for that role, one is Janet Yennen and she is definitely going to pursue the same policy as Bernanke, she is on the same camp. And another contender would be Larry Summers and he is less of a same school soft kind of person. Joe T. San Agustin: He was treasury. Maggie Ralbovsky: Yeah he was. We don't know who is going to be selected yet. Antolina Leon Guerrero: Those are the two top?

Maggie Ralbovsky Ralbovsky: Those are the two top although there's a few others out there but I think most people expect it's going to be one of these two. So. Doris Flores-Brooks Flores-Brooks: And when will that take place? Maggie Ralbovsky: January is the term often in January. People think the last meeting after September. Okay. So is that. Page 5 is the economic data. The economic data is actually not very different from the previous quarters. You can see the bottom right hand chart of unemployment rate and job growth still very anemic. It's not really very strong especially many people cite the uncertainty in the health care law in the U.S. for being the reason that the employment growth is not very strong because the law actually defines for employment at 30 hours.

So if you hire somebody for 30 hours you have to provide health care. So that makes a lot of people downgrade their employees into 29 hours, make them to be part time employees so you don't have to pay for that. And also it defines a business that has to buy health care the size of the business at 50 people. So if you hire 49 people you don't have to buy insurance so it makes all these little things that create a lot of uncertainty for the employer mandate makes people wait and see.

So that's part of the reason I don't think it's the full reason but it is part of the reason why employment picture is still very slow. Other than that the manufacturing data has been okay. You see right around 50 which is a good number. And consumer sentiment is very strong. Consumer sentiment you see in that table on the top left hand side, the June number was June and May both are above 84, that is almost close to like all time high. I think all time high was 87 or something. So you see 10 year average of 78 and during the crisis this number dropped to 50, just as a comparison. So the reason consumer sentiment is a very important number is because all these other numbers are lagging indicators meaning they already happened.

Doris Flores-Brooks: So why would consumers be so optimistic? What's there to be optimistic about? Maggie Ralbovsky: Ok so you can speculate about that right I think equity market and housing market recovery is a huge matter because peoples wealth they felt they're wealthier when they feel they're wealthier they're more willing to spend money. So that's why consumer sentiment is the leading indicator all the others are lagging indicators which tells you what had happened.

Maggie Ralbovsky: Consumer sentiment is the leading indicator because when their when consumers more happy they spend more money which makes the other numbers look better in the futures. So that's a very good number to be looking at. Now inflation, this is also very important inflection point for this quarter, page 6. There is a chart on the top that says effective tips pricing. Now this is the blue line is something called break even inflation. This is the markets consensus as where inflation will be 10 years from today. So 10 years is a long time but this is an indication as to where the market thinks inflation will be.

And you can see at some point during the 2nd quarter it was at 2.75%. The market was actually expecting inflation to be 2.75% in 10 years from today. After Bernanke started talking or after May you can see that number dropped even below 2%. So that was a huge matter for tips pricing. Tips was the worst performing asset class in the high grade sector, high grade bond sector because when people think inflation is going to be lower, tips becomes less attractive and they sold off you see that tips on the bottom. The 10 year real yield for tips was a negative .6 sometime in April. And that has gone up to .5 so it was almost a 1% change. A 1% change on the very small yield was almost 100% change in terms of the rate by itself.

So TIPS sold off by more than 7% in this quarter alone. That was a treasury security and it wasn't super long in duration sold off 7% in quarter alone because of this change of sentiment. It was pretty violent. I think Bernanke in the beginning of the year has said he doesn't want 1994 to happen. 1994 was a terrible year for bonds, basically bonds sold off because the Fed was surprised the market and he actually wasn't able to maintain that promise. I think pretty much the bond market experienced similar magnitude the sell off as 1994. So that's on the TIPS pricing and gold pricing, look at gold, gold was down 23%

this quarter 23% that was very violent sell off and the commodity index as a whole was down 10%.

So this you know I think that's that made gold actually quite attractive at the end of the quarter a lot of the central banks came in to buy gold. Wilfred Leon Guerrero: Why do they drop? Maggie Ralbovsky: Because of the inflation expectation and gold is a double whammy in certain aspect because gold is mainly purchased via derivative instrument. If you just want to check GLB is the ETM. Wilfred Leon Guerrero: But do people buy gold to protect against inflation? Maggie Ralbovsky: Inflation yes but they also bought it on derivative which is levered so it's a levered instrument to buy gold for the future so if interest rate is going up the borrowing cost is going up makes people want to sell because that's a natural reaction if borrowing cost goes up, you have to reduce your leverage. At the same time gold by itself if viewed as inflation hedge so there's two things working to this one trade that made gold to be the worst. It was down 23% part of that was because of the leverage effect.

Wilfred Leon Guerrero: Before you go on you talked about India and other places what's happening in Japan? Maggie Ralbovsky: What's happening in Japan, so Japan is really also entering a very critical phase. If you think at the beginning of this year the abenomics was very stimulative so he basically started this very liberal printing money program to spur growth which was successful for the time being until this program however has an expiration date, I think its end of this year. And also, in the meantime there's a sales tax increase of 2%, in Japan that's going to start January of next year.

Maggie Ralbovsky: So if those two if they let the stimulus program expire end of this year and let the sales tax increase take into effect, the calculation is that the drag on GDP is going to be 7 percentage point. So it's going to be really, really bad there's no way I think they are going to let that happen so it depends on what kind of patchwork they do, Japan is very uncertain next year because of these two policy changes. So it's the lack of consistency I think in Japan that is you know the market likes certainty, if you give them something uncertain to think about market doesn't like it. It just doesn't like uncertainty. So, Japan I think is entering some critical decision points for policy makers. Same thing for Europe, same thing for Asia. That's why U.S. was the safe haven for this quarter.

Okay, let's look at the U.S. market, page 8. Wilshire 5000 was at the total market index was up 2.8% for the quarter, year to date as of June was 14%. I think July was a positive month for U.S. equity I think was up 5% but August so far was negative, I think August equity was down about 3% so far. So, U.S. equity compared to the rest of the world benefited from the fact that U.S. is much more stable in terms of policy, visibility, number 1. Number 2, U.S. was also the first one that entered into the huge crisis in 2008 but was also the first one that got out.

So if you think of the cycle of getting out of recession, U.S. leads the rest of the world. And the emerging market seems to have just entered into that crisis phase so it's like there was a staggering effect that had different phase of this whole cycle, so U.S. benefited from those several things also including the recovering of the housing market. I think the housing market also was very strong. Doris Flores-Brooks: Now the fact that mortgage rates have gone up slightly has that dampened? Maggie Ralbovsky: The thing is that in the U.S., a lot of the property are sold to foreigners. Doris Flores-Brooks: Oh so it doesn't matter, they got money they just pay cash. Maggie Ralbovsky: A lot of people are paying cash which actually made the housing market you know like in markets like west coast, like where we live.

Doris Flores-Brooks: That's at the high end of things, how about for instance. Maggie Ralbovsky: Everywhere. Everywhere so if you even though housing market has recovered somewhat compared to the other markets, U.S. is still very cheap. So a lot of foreign money is flowing into U.S. to buy that and mortgage rate went up and made entry level houses obtainable for some people but I think the housing they did not housing market yet in terms of pricing. Doris Flores-Brooks: Have the rates gone up? Gerard Cruz: Rates have gone up 75 basis points three quarters. 4 6 5, 4, 7, yeah it's gone up a lot. Maggie Ralbovsky: It's probably not going to come back to the lows. Gerard Cruz: No way, those are gone. But four historically is still low. Doris Flores-Brooks: I can remember when it was seven for the longest time.

Maggie Ralbovsky: I had my first house I bought I paid 8½. Gerard Cruz: So if you have 4 it's still good, still low. Maggie Ralbovsky: But my mortgage was 2 and three quarters. So I like you. Doris Flores-Brooks: Mine was 3. Maggie Ralbovsky: That's unheard of. Gerard Cruz: Yeah. That's unheard of. And it will be unheard of. Maggie Ralbovsky: Yeah I know it is so amazing. Gerard Cruz: The problem though is that prepayment speeds are going to be extraordinary low so everybody is going to pay their term now because nobody is going to want to refinance out of a 2, 3% rate so the next big boom is going to be equity loan the second. Maggie Ralbovsky: They are going to restart the mortgage back securities market because that market basically died. No new issues after 2008. Gerard Cruz: Yeah no private. Maggie Ralbovsky: Yeah, you have to sell to Fannie Mae, Freddie Mac basically and home equity loan does not qualify so they have to restart the market and there was a few proposals out there and I think definitely is going to restart again for that home loan. Gerard Cruz: But you need the equity. You need appraised values to go up. Maggie Ralbovsky: And the banks need some residue put on their books so they're participating in the risk taking not like in the past, banks basically off loaded to whomever wants to buy it. Gerard Cruz: Yeah that's the big problem.

Maggie Ralbovsky: Okay. Now U.S. equity market look at emerging market, page 9. Emerging market was down 8% for the quarter and you see across to 10 years. Emerging market was up 14% year over year for the past 10 years, so that beat every market however you see how violent the recent drop was, it was down 9.4% for this year, it was down 8% alone for this quarter. Think about U.S. was up 2%. So that was very severe sell off. Gerard Cruz: Is this the troth or is it just the beginning? Maggie Ralbovsky: I think the beginning. I think the sell off continues especially when these countries now don't have a plan to save themselves. Like India doesn't have a plan has this guy called Mohammad Sin, he keeps misjudging the situation, he keeps he's the central banker in India. He keeps coming up with theories that is entirely wrong you know like so far he has been wrong for everything.

Doris Flores-Brooks: And they still keep him around? Maggie Ralbovsky: Well he was actually like an economist that was celebrated. He actually saved India from the crisis in 1981 but that was because the IMF came in to save them but he was the one who took the credit basically to save them from the previous crisis in 1981. But so far it is viewed that he doesn't have a plan he doesn't understand what had happened in India. So I think these numbers emerging market is in trouble for a while yet.

Wilfred Leon Guerrero: Who is the frontier market? Maggie Ralbovsky: That's a good question. Look at how gray. Wilfred Leon Guerrero: Who are they? Maggie Ralbovsky: Okay, so Mongolia, Nigeria, Vietnam is a good market, then there's Nipo there's frontier market. So it's still very small in liquid markets that you know therefore any money that flows into it makes it really great. I think for example Nipo I think I said this before but Nipo is a market there it's very liquid it only trades once a week on Wednesday afternoon I think, there's one broker part time broker and you traded and settled in 3 weeks kind of places. So you know these market pricing probably hasn't really adjusted if you think about the cycle you know trading.

Maggie Ralbovsky: It really is not a mainstream market at all right now. So that's. Gerard Cruz: But the emerging markets though this one's because we're going to the Legislature this Friday, we're going to talk about emerging markets? Maggie Ralbovsky: We're talking about non U.S. equity as a whole not emerging market per say. Gerard Cruz: Okay and we're going to ask them to change the law to do what? Maggie Ralbovsky: To allow more investment in international equity. That's not to say we take that option right? Gerard Cruz: I know but that's going to come up as a discussion. Maggie Ralbovsky: Yeah sure definitely we can discuss that. I actually have some slides I want to; I have some slides that support diversification.

Maggie Ralbovsky: Okay. Fixed income. Look at the treasury curve on the bottom right hand corner; you can see how much went up. Now just by sheer magnitude it went up like you know since a year ago the green line about a percent. But think about percentage terms, you know it's a percent of you know 2% a 100% movement. Gerard Cruz: Wow 10 years high. Maggie Ralbovsky: It's really, really violent. And look at the quarter performance for fixed income sectors, not surprisingly a long term government related was the worst, was down 8% but surprisingly TIPS were down 7% because of the adjustment of inflation expectation.

Now high yield is the most resilient was down about 1.4% for this quarter but if you look across for the other periods has done a lot better than the other sectors. And high yield also have recovered since the 2nd quarter. Now high yield is also one of the topic things in our legislative. Gerard Cruz: Domestic high yield or just high yield in general? Maggie Ralbovsky: High yield in general most of high yield is issued by the U.S. The bond market for corporates are not very developed elsewhere. So if you look elsewhere most of the bonds are issued by government sovereign bonds so corporate high yield is mostly U.S. there are some German, UK ones mostly developed markets. Doris Flores-Brooks: And the reason for the fixed market decline is due to what again? Maggie Ralbovsky: Due to the interest rate movement. Doris Flores-Brooks: Interest rate going up therefore bonds are going down. Maggie Ralbovsky: That's right. Because it has much less insulation in yield it's pretty much connected. Doris Flores-Brooks: Could you go for a moment to the above on the EAFE all the other countries with fixed. Maggie Ralbovsky: EAFE you mean? Doris Flores-Brooks: Yea EAFE, how come Australia is having problems?

Maggie Ralbovsky: Australia if you think of 2008, was the least impacted it is so connected with Asia it has a lot of money came from I guess China and it is very connected with Asia. Doris Flores-Brooks: I see. Maggie Ralbovsky: So even though EAFE it's cycle is different. Cycle it just entered into a place where their real estate is considered over heating while the rest of the place have come out of the. Doris Flores-Brooks: Where is New Zealand in here? Is New Zealand where would New Zealand. Maggie Ralbovsky: New Zealand is in the EAFE index but it is a very small country. So it's not listed here as the largest. Doris Flores-Brooks: I see okay. Because everybody else seem to be you were asking about Japan, look at Japan?

Maggie Ralbovsky: Japan yeah this year Japan, UK was doing great. Doris Flores-Brooks: Why is Switzerland doing so well? Maggie Ralbovsky: Well Switzerland in the European nation, it's not a euro country. It doesn't use the euro. Doris Flores-Brooks: It's not? Maggie Ralbovsky: It's not. It doesn't use the euro and when euro has problems everybody flushed to Switzerland. Doris Flores-Brooks: I didn't know that. I thought all the countries in Europe. Maggie Ralbovsky: No, UK is not. Doris Flores-Brooks: Well I know UK but I didn't realize Switzerland that's right in the heart of Europe. Maggie Ralbovsky: They had to like push down their currency because everybody is flushing towards Switzerland.

Maggie Ralbovsky: Okay, fixed income market elsewhere, page 11 was also pretty ugly picture, you can see across the board pretty negative and emerging market debt. If you look at local currency debt was down 6% and that has went down further because not only it's impacted by US interest rate but also their currency are losing value. As I said earlier India currency dropped 25% in this quarter alone. A lot of the places like Brazil very large emerging market debt issuers Brazil, Argentina is all almost in mode of crisis because of the foreign capital withdraw. China is doing better but it's not in this index because China doesn't issue foreign debt that's why it's doing better because it has capital control.

Doris Flores-Brooks: Going back to the bond thing, I know that the fund has a relatively high percentage in fixed income. Maggie Ralbovsky: No, we don't. Compared to the rest of the world. Doris Flores-Brooks: No? Gerard Cruz: Up 30, 35. Wilfred Leon Guerrero: No she's right. Doris Flores-Brooks: Relatively speaking right? What is your percentage? Maggie Ralbovsky: It's 25% allocation. Doris Flores-Brooks: Okay. Oh so it's come down? Maggie Ralbovsky: It has a 30% target, right now. Doris Flores-Brooks: The only reason I want to say that is because I just came back from a conference and pensions was the biggest thing on everybody's mind. Pension and health care and I was really shocked and I can't remember now which state it is, they don't even invest in equities they are so. Gerard Cruz: All Bonds. Doris Flores-Brooks: All bonds. So conservative, it really shocked me.

Maggie Ralbovsky: There's some off the chart out buyers out there. Doris Flores-Brooks: I can't remember what state. Maggie Ralbovsky: Could it be Virginia? Gerard Cruz: I think it is. One of those. Doris Flores-Brooks: One of those but it really shocked me. Gerard Cruz: But fully funded, they are close to fully funded right? Doris Flores-Brooks: But she said we're ultra conservative, ultra is the word she used we don't you know all we have bonds. Maggie Ralbovsky: The thing is though public funds there's no way you can be fully funded. You can only be fully funded counting no future people like. Antolina

Leon Guerrero: It's closed. Maggie Ralbovsky: That' right but no public fund is closed, well CNMI is one thing. So if you don't count future people you can say you're fully funded but if you count yourself as a growing concern it is you know I think using 100% equity fixed income is totally powerful. Doris Flores-Brooks: It just shocked me. Maggie Ralbovsky: There's also a state that uses all levered TIPS to fund everything and that was a huge, huge quarter for them. If you levered TIPS was down 7% if you levered it, think about it. Doris Flores-Brooks: That was just one of the things that's why I mentioned this let me remind you, so we used to be higher like 60, 40 right, so now closer to 25, oh okay. Maggie Ralbovsky: You know I think the fixed income cycle was still. Doris Flores-Brooks: But then during the bust, I mean that's the reason why the decline wasn't as bad because you had better bonds. Maggie Ralbovsky: We actually compared to the public funds, we're sort of medium. But if you compare to including corporate endowments, this fund has done really well. Public funds tend to have less bonds than corporates. Corporates when interest rate goes up it loads up on bonds because it's a hedging instrument. For public funds they tend to hold less bonds than I think the interest rate cycle is going to be quite hostile for a while if you think about the past 15 years it's been just drop and drop and drop there's pretty much nowhere to drop and if you have 15 year up and up and up then it's you know pretty worry some for any sort of a high grade fixed income. I do think the lower grade is much better position for this environment like high yield you know like distress actually even.

Gerard Cruz: Yeah but I think the wild card is going to remain inflation and how successful we are in growing productivity because if we're able to contain inflation, if the country is able to contain inflation then you don't need those violent interest rate moves to contain inflation. Maggie Ralbovsky: It depends if you have high growth because of the productivity gain because of low inflation, bonds are going to become very unattractive and if you think of this country you know with all the debt out there. Doris Flores-Brooks: Really? Why continue to issue more debt raise the debt ceiling. Gerard Cruz: If we our GDP is able to grow I mean it's exactly what happened in the Clinton years, where you had high growth, you had huge productivity gains, and you had low interest rates because of the huge productivity gains, so.

Maggie Ralbovsky: The difference in Clinton years is because emergence of the emerging market and if you think of. Gerard Cruz: But the emerging markets haven't really taken off yet we're still I think at the beginning phase of the emerging market. Maggie Ralbovsky: Right, that's why labor costs can be very, very low in those countries and now if you think of emerging market inflation like India has a huge problem. Doris Flores-Brooks: What I'm hearing is that people are moving away from China because China is no longer the low growth the low. Maggie Ralbovsky: That's right so I think the wage cycle is changing in the emerging market. The goldilocks situation of Clinton years is not there, I don't think it is there. But there is a risk to this growing interest rate kind of possibility the risk for that is the fact that treasuries is not in a league by itself. It really is being arbricharge against German bond for example. And if Europe is going to be this bad then it's going to be getting worse. You can U.S. interest rate cannot just go up by itself without being arbricharged by somebody you know. So there is that it's not in a league by itself kind of situation.

Doris Flores-Brooks: But still relative to the world it's still the safest. Maggie Ralbovsky: Yeah that is definitely true but given the fact we are paid to worry right we have to diversification is always there. Gerard Cruz: I don't think it's going to be that bad. Cannot be that bad. Doris Flores-Brooks: I don't know but I mean we've been talking about inflation for years, will we ever revert to the time during the Carter years? Maggie Ralbovsky: No. We will not. Doris Flores-Brooks: I doubt it. Gerard Cruz: It takes something pretty extraordinary for that to happen. Maggie Ralbovsky: That was the energy. Think about U.S. it's going to be independent by 2020 and we are going to be the biggest exporter of energy in another 15 years that is huge. U.S. is going to be so attractive. Forget about China.

Gerard Cruz: The Middle East influence won't matter anymore. Maggie Ralbovsky: That's right we basically forget Middle East. Doris Flores-Brooks: The price won't come down right? Maggie Ralbovsky: It will. If we start the Alaska what was the. Gerard Cruz: No, no, no I think you'll see the bulk. Doris Flores-Brooks: We've gotten accustomed I'm sorry to say a paying over 4 bucks a gallon Maggie Ralbovsky: Think in this way, energy cost in the U.S. is half than in the emerging market. It's 2/3 than in Europe, that's why U.S. is so attractive for manufacturing to relocate if the labor cost becomes more evenly because it's so cheap in terms of energy. And that's getting cheaper too because U.S. comparatively speaking because of these new Shell gas. Doris Flores-Brooks: That's probably why we can't have manufacturing here because it's so expensive. Power is so expensive, energy. Gerard Cruz: Anything petroleum basically. Antolina Leon Guerrero: GPA. Gerard Cruz: Right but once you move out of the petroleum and into the alternatives and I think it's going to become a lot more reasonable and once that starts to happen then the oligopoly of OPEC has less influence and they have to bring their prices down in order to compete with alternative sources. Antolina Leon Guerrero: The demand is going to drop. Maggie Ralbovsky: That will be great thing. Yeah you know. Gerard Cruz: I think it's just the issue of economics, they have the ability to price where they want. I don't suspect the prices of gas is nearly what we pay here in the U.S. or anywhere else in the world in countries in the Middle East.

Maggie Ralbovsky: Oh yeah no. 25 cents a gallon in Saudi. Gerard Cruz: So it's not supply it's just the ability to price where they want. Paula Blas: 25 cents a gallon in Saudi. Antolina Leon Guerrero: $8 in Australia? Paula Blas: $8 dollars in Australia. Joe T. San Agustin: Australian dollars. Antolina Leon Guerrero: The equivalent of our 8 dollars, that's what it cost for gas there. Joe T. San Agustin: What's the rate of exchange in Australia dollar? Maggie Ralbovsky: You mean West Coast? Joe T. San Agustin: 8 bucks. We pay what $5 dollars a gallon. Rosalia Bordallo: That's why Europeans are fit because they walk a lot. Gerard Cruz: And Asia too, everybody walks in Asia, Japan. Doris Flores-Brooks: Nobody walks in Guam, not even to DOA. Maggie Ralbovsky: It's hot. Antolina Leon Guerrero: We'll walk if we wouldn't sweat by the time we get to the meeting. Joe T. San Agustin: That's for sure. Doris Flores-Brooks: From my office to DOA before they moved my staff are we going to take the car? Huh this is Guam, never walking. Let me call that's the only time come and get us when it's raining.

Maggie Ralbovsky: Okay. Gerard Cruz: So this year is looking how, how is it looking for the rest of this year? Doris Flores-Brooks: What is your prediction, what is your crystal ball? Maggie Ralbovsky: I think we're going to be probably flat for the rest of the year, I think we're going to be flat because we're waiting for things to happen because you know lot of uncertainty. Wilfred Leon Guerrero: What did you say? Maggie Ralbovsky: Flat. Gerard Cruz: As of today we're up? Maggie Ralbovsky: 20%. Gerard Cruz: You said 20 right, you heard that. Wilfred Leon Guerrero: Yeah 20%. Paula Blas: Yeah but we're going to stay flat. Maggie Ralbovsky: We're going to stay flat. I'm saying like for the rest of the year because so many. Antolina Leon Guerrero: Geez so we're going to stay at 20. Doris Flores-Brooks: Stay at 20 or stay flat?

Maggie Ralbovsky: Stay flat from now on. Gerard Cruz: Oh, where are we as of now? Maggie Ralbovsky: Okay, so it is year to date U.S. market was up at June was 14, then July was up another 5%, August was down about 3%, so we're what 18? 18%. Gerard Cruz: So we're up 18? Maggie Ralbovsky: Yes, U.S. not Guam, U.S. Gerard Cruz: How did Guam do? Maggie Ralbovsky: Guam we have that later but before I make a pitch on it diversification. Gerard Cruz: Who took that page out of mine? Doris Flores-Brooks: What does this mean? Maggie Ralbovsky: This means diversification really is the key because you don't see it consistent winner or loser of any. Joe T. San Agustin: This is your target? Maggie Ralbovsky: This is a picture for the Legislature to buy into diversification. Antolina Leon Guerrero: Can I just tell you that that's not a very clear picture, I mean it right it's not meaningful. Naturally the point is its very clear to you but it's a bunch of pretty boxes.

Maggie Ralbovsky: Okay, let me explain this chart which I thought was very clear. The different colors. Antolina Leon Guerrero: Know your audience. Maggie Ralbovsky: Ok the difference. Doris Flores-Brooks: But how do we compare to this? Maggie Ralbovsky: We'll look into that later okay. Antolina Leon Guerrero: She's going to clarify the clear picture. Doris Flores-Brooks: Well that's what I want to know. Joe T. San Agustin: Put Guam in there. Maggie Ralbovsky: Ok so the different colors represent different asset classes and the top for every of those columns are the best performing asset class for that particular time period. Doris Flores-Brooks: That means somebody is always on top. Maggie Ralbovsky: That's right and you see many times the top one for one year will become the bottom one for the next which is to say that you really can't invest by looking backwards, you have to diversify. Ok that's my pitch.

Doris Flores-Brooks: Can we go back to this, high yield, when you annualize this, this is on a 5 year basis right? Maggie Ralbovsky: High yield was the best performing for the past 5 years. Doris Flores-Brooks: And High yield is what again? Maggie Ralbovsky: High yield is junk bonds. Doris Flores-Brooks: And that's the one you're not in. Maggie Ralbovsky: That's right. Doris Flores-Brooks: That's the one you are trying to get in right? Joe T. San Agustin: We're junk money? Maggie Ralbovsky: That's junk bonds. Doris Flores-Brooks: I asked. I'm sorry. Paula Blas: That is what Maggie is putting on the table. Doris Flores-Brooks: Is that correct, that's the one you want to get into right? Maggie Ralbovsky: Yeah. Joe T. San Agustin: Not really. Antolina Leon Guerrero: We want the option to. Maggie Ralbovsky: We want the option. Antolina Leon Guerrero: We don't know if we want to get into it but we want the option to get into it. Joe T. San Agustin: Junk bonds. Wilfred Leon Guerrero: If the law allows us to invest in companies that issue junk bonds, this is one of the arguments that we had. Paula Blas: Non investment grade bonds. Joe T. San Agustin: But you don't want to say that politically, we'll get killed. Paula Blas: Just say non investment. Wilfred Leon Guerrero: You know but the law allows us to buy companies that issue junk bonds. Joe T. San Agustin: I know that we are allowing it but we don't publicly say that. Wilfred Leon Guerrero: I know that's one of the things that. Joe T. San Agustin: There's a polite way, high yield. Doris Flores-Brooks: And then U.S. equities of the market right?

Maggie Ralbovsky: Everything was because of the market. U.S. equities yeah it was in the middle of the past 5 years. Paula Blas: Commodities. Antolina Leon Guerrero: And will this new legislation allow for us to buy these as well? Paula Blas: The changes to the statute. Maggie Ralbovsky: It's a Non investment grade. Joe T. San Agustin: High yield, the risk is there too. Maggie Ralbovsky: There's risk but it depends on how much they pay you, everything there is a price right? Pay me enough I'll take that risk. Joe T. San Agustin: Compensating risk. Maggie Ralbovsky: Get it done. 2 years incoming. Joe T. San Agustin: You got to change the vocabulary right. You drop the junk bond. Gerard Cruz: We're not slow, we're just deliberate.

Joe T. San Agustin: High yield. Doris Flores-Brooks: But don't tell that state that is all bonds. Gerard Cruz: I think it is Virginia. Doris Flores-Brooks: Might have been. Joe T. San Agustin: That's not the target to be all bonds. Maggie Ralbovsky: I think it is Virginia, it was down like 30% or something because it is levered. Not only bonds but also levered. Gerard Cruz: But then there's so many that are pitching liability driven investment. Maggie Ralbovsky: That's for corporation really, I know but they shouldn't I know that's the pitch of the industry because if you think you are bond manager in this cycle what do you do? You tell people bonds are good for you, right? Why do bonds good for you? Because hedging your liability.

Gerard Cruz: Because see that's the concern though because you get that same different products same argument from different. Maggie Ralbovsky: That's why you need me. Gerard Cruz: Some of them come from consultants though. Some of those pitches come from consultants. Maggie Ralbovsky: Well consultants should not pitch LDI to public funds. It should not. Doris Flores-Brooks: What is LDI? Maggie Ralbovsky: Liability driven investments. It is very rare for corporations because the Pension Protection Act of 2006 said that corporations have to reach 80% funding based on particular measure if you are not at 80% funding you're immediately due to putting that 20% within 3 years. But if you are at 80% funding you have the liberty as to when you fund it. And the particular measure measures your liability based on a long term fixed income curve which is to say that your risk less you can lock in your funded ratio by investing in that curve. And most corporations are also frozen in their liability, you don't give any new workers pension any more.

Maggie Ralbovsky: Not only that. Doris Flores-Brooks: Yes no more. Maggie Ralbovsky: The existing people don't earn anymore. I know Guam does not have any future new entrants, but existing people still earning it. In corporations, most corporations are frozen meaning you don't even if you're still working for the corporation you don't have any right, that's right everything is set is done. The only uncertainties are the mortality. So if you live to 150 years end of story it's not really hedge. Doris Flores-Brooks: That was one of the things that was very evident in one of the seminars I went is that from the private sector, defined benefit is almost nonexistent now but it is still very prevalent in government and local government. Still the main thing compared so and it had a graph before because one of the comments that it said was that one of the reasons for having the defined benefit was because the salaries of government workers were in general lower however that now has reversed.

Doris Flores-Brooks: The salaries of government employees are not as despaired, not for the high end you know I'm just talking you know more like the rank in file and the government is now much more attractive because of the defined benefit. And there's no movement of foot. There are certain states like, they name 5, Illinois, Connecticut, Kentucky, I kept having to look at are the ones of major concern okay as to the function liability, but most of the other states are okay but there are 5 and those were the 3 I remember. And of course Illinois is the poster child right now, more so than Detroit and everybody is waiting to see what's going to happen with Detroit. Maggie Ralbovsky: Nothing is going it's protected by the constitution. Doris Flores-Brooks: That's going to be the argument, that's the argument of the people back down there. But it's hard to say because that's going to have a rippling effect because what is happening which is different from Guam is that a lot of these local governments they're not tied to the state, only a handful of local governments are tied to the state, so where the states are doing well it's the local government that have gone pardon the expression on a muck you know and given all these very generous because you know local politics and stuff, that's going to be the key. Well the states now have to bail out the local governments and is that how going to affect GovGuam is state and local. So that's the issue now. That and health care, Obamacare only 18 states had opted to do exchanges. Everybody is in a wait and see. They still haven't made a decision. But that's going to be interesting, I'd like to hear what you how you're following local government pensions besides the states.

Maggie Ralbovsky: Yeah, actually I think we published a survey every year and depends on different states, different. Doris Flores-Brooks: But states are different from local government. There's only a handful of states bring in the local government. The majority of local governments are on their own. They are not tied to the state. Maggie Ralbovsky: State Illinois has like hundreds of public funds. Doris Flores-Brooks: Yeah there are a lot, the fire like in Texas. Texas has I think like a thousand different local government. A thousand in Texas separate from the state. That's why the GFOA has right now has over 6,000 members 6,000, different local government. Gerard Cruz: Really? Wow. Doris Flores-Brooks: Over 6,000. A fire district, a water district, teachers you know not counting cities and counties. They call them special purpose in Texas their called MUD, municipal utility district they call them Mud. Anyways sorry to.

Maggie Ralbovsky: No problem. Gerard Cruz: Good conference. Doris Flores-Brooks: That is the main topic right now, Obamacare and pension. Maggie Ralbovsky: So going back to Gerry earlier about SDI it is not relevant for most public funds the reasons it is very relevant out of corporation is because of definition by PPA 2006. Gerard Cruz: I agree you just hear that all the time. All of the time. Maggie Ralbovsky: I know that's why we need to be able to tell that it's wrong. Okay. So we actually had a positive quarter, page 15. We were up 10 basis points. And you can see it's mainly it's actually mostly, it's all from U.S. equity. U.S. equity was up 3.47% every other composite was negative but U.S. has done so much better to make the whole total fund better. Antolina Leon Guerrero: So diversification. Good job. Maggie Ralbovsky: So we did make two changes of managers. Gerard Cruz: It's our chairman, good job Mr. Chairman.

Maggie Ralbovsky: Our remaining manager. Antolina Leon Guerrero: Our performance. Wilfred Leon Guerrero: For last quarter. Gerard Cruz: Even where we're at this quarter. Maggie Ralbovsky: Yeah we are we have a flash report somewhere. Antolina Leon Guerrero: You're doing very well sir. Gerard Cruz: Keep up the good work, you get a raise, double your salary. Antolina Leon Guerrero: We're going to get you a good lunch on Friday. Maggie Ralbovsky: If we pass that law. Okay so. Antolina Leon Guerrero: That's for the evening. Gerard Cruz: Evening? Antolina Leon Guerrero: 5:30 on a Friday. Joe T. San Agustin: We're going to have a hearing? Maggie Ralbovsky: I'm sure to attract a lot of people. Antolina Leon Guerrero: I'll be cheering for you from.

Maggie Ralbovsky: Page 16 has our managers, remaining managers. We did make two manager changes during this quarter. I'll give everybody an update for that change which turned out to be great because I checked those both of those managers has underperformed. Gerard Cruz: Are you sure? Maggie Ralbovsky: Yeah I checked. Antolina Leon Guerrero: Who did we change to? Gerard Cruz: Metwest and Winslow. Wilfred Leon Guerrero: You started to say that we did better than a lot of the other plans, how is controlled different from them? Maggie Ralbovsky: Oh we have more U.S. equity. You see I have a chart to show you. Gerard Cruz: More U.S. equity, we don't have an allocation to alternatives TIPS, high yield debt, we have no alternatives. Maggie Ralbovsky: Only that permanent fund, check on that one. That fund is like 90% coated with gold.

Antolina Leon Guerrero: Oh that perma fund the one that, yeah we should get an update. Gerard Cruz: Why don't you give us that and give it back to Mr. John. Antolina Leon Guerrero: Ask him for an update. Get an update. Wilfred Leon Guerrero: He's taking me golfing now to try and calm me down. Gerard Cruz: He's trying to calm you down? Maggie Ralbovsky: You invest in that fund? You did? Antolina Leon Guerrero: You took one for the team. Wilfred Leon Guerrero: I think I want a discussion, these other funds that you're advising us, my sense is that it's pretty different from our proposals right? Maggie Ralbovsky: No. Actually if you think of their people are very different on both sides, you think of a curve like their out layers. Guam is sort of in the middle of the road although Guam is less diversified than most public funds. Wilfred Leon Guerrero: More diversified? Maggie Ralbovsky: Less diversified. Wilfred Leon Guerrero: Okay. Maggie Ralbovsky: In terms of total risk level you are taking it is middle of the road, I actually have a universe comparison actually why don't we see it, here page 20.

Joe T. San Agustin: Okay. You have a whole bunch. Maggie Ralbovsky: Page 20. Gerard Cruz: I'm still thinking about that placement bond the one we were being compared to. Joe T. San Agustin: Where are we? Maggie Ralbovsky: Placement bond? Permanent fund? The permanent fund? Yeah. Gerard Cruz: That one. Wilfred Leon Guerrero: Lets. Joe T. San Agustin: What are you talking about? Maggie Ralbovsky: Page 20. Antolina Leon Guerrero: Page 20. Paula Blas: What was that permanent? You did a graph on it and we showed it to them. How, over the last 20 years. Maggie Ralbovsky: Yeah they under performed. They selected the period that they outperformed because gold run in that, that funded 89%. Antolina Leon Guerrero: But when you looked at it in the long run.

Maggie Ralbovsky: Okay, so page 20 is the universe comparison on Guam versus the other public fund. So these are all public funds and the X excess is risk Y excess is return and you can see the return over this 10 year, this is 10 year comparison that's all we have for data in terms so I guess it didn't say so this is 10 year comparison. So for this past 10 years, Guam total netted fees of return this is all netted fees was 49 percentile which is right above median and the risk we're taking however is in the third, in the top third. The reason risk is a little higher is because we are less diversified. If you look at asset allocation for the funds that has lower risk, it is more diversified. However more diversification does not necessarily translate into higher return and you can see the return pretty much doesn't matter. Return doesn't matter risk you're taking its sort of. So there is definitely a thing to be said on how to take that risk. However it is definitely the case lower risk fund has more asset classes. Diversification definitely lowers the risk and if you take the diversification the right way you translate into higher return and lower risk. If you don't take it right way then lower return and lower risk. So that's what this chart is saying to compare to others.

Doris Flores-Brooks: So let me justify hearing you correctly, Guam's average return was 7 almost 6.95 and the medium, medium is not the average, medium is the above us and below us, correct. Maggie Ralbovsky: It's the middle fund. Doris Flores-Brooks: The middle fund. So we're just one above the average. Antolina Leon Guerrero: The medium. Wilfred Leon Guerrero: If you want to be in the upper. Maggie Ralbovsky: You want to be the North West quad rum. Doris Flores-Brooks: Right. Who is that one that's earning 13%? Antolina Leon Guerrero: Nobody is earning 13. That's risk. Maggie Ralbovsky: Who is that one that's earning yeah that's risk. Highest alternative is 8. Doris Flores-Brooks: 8 something. Okay. Gerard Cruz: But you know they probably have. Doris Flores-Brooks: This is a 10 year average? Maggie Ralbovsky: This is a 10 year annualized not average. Doris Flores-Brooks: Annualized, I'm sorry, annualized. Wilfred Leon Guerrero: 10 year? The figure that I saw was 5½ wasn't 6.95.

Maggie Ralbovsky: 6.95 is your 10 year return. Where did you get 5½? Wilfred Leon Guerrero: The permanent funds remember. Maggie Ralbovsky: Oh no this is the Guam. Wilfred Leon Guerrero: Yeah I know this has the permanent fund showing that Government of Guam Retirement Fund was earning 5½. Gerard Cruz: That was a spotted time that was I think either 20, I don't think it was 2012, that was a different period. So I think that period. Wilfred Leon Guerrero: I thought it was 10 years. Gerard Cruz: It was 10 years but they used this is to date. The one that you are looking at this is as of June 30, 2013 I think the one that you are looking at that time is December 2012 so it didn't include this year. Maggie Ralbovsky: Okay. So, I'm sorry go ahead.

Wilfred Leon Guerrero: Because I think I'm trying to prepare you for the legislature. This is what they want to do is because right now we're taking more risk than you like us to do and so that you want us to take less risk. Maggie Ralbovsky: And more return. Wilfred Leon Guerrero: More return. Doris Flores-Brooks: That sounds good. Maggie Ralbovsky: That's the goal. Doris Flores-Brooks: Less risk more money. Maggie Ralbovsky: That's the goal. We need to ability to diversify. Okay. Joe T. San Agustin: Are we going to rely on that chart for presentation? Maggie Ralbovsky: I have a few others. Joe T. San Agustin: You don't project that 6.95 for the last 10 years. Maggie Ralbovsky: There's other charts. Wilfred Leon Guerrero: I'm concerned Chair that if we go down there this

6.95 medium which says that. Joe T. San Agustin: We're just the same as the other group basically. Wilfred Leon Guerrero: Yeah, so why change? Doris Flores-Brooks: Why tinker? Joe T. San Agustin: That's right I'm following you. Maggie Ralbovsky: Can we save that discussion for some. Joe T. San Agustin: What do you ask us to do. Maggie Ralbovsky: Chairman, I have good answers to that question but it's not for now, can we finish this?

Joe T. San Agustin: If you look at this it, goodbye gentleman. Doris Flores-Brooks: Hayi? Is this the public hearing or closed door? Joe T. San Agustin: Public hearing. I don't know whose, Ben Pangelinan. Paula Blas: Yeah. Maggie Ralbovsky: Okay so, I think we can Joe T. San Agustin: We don't have closed hearings. Maggie Ralbovsky: We can move on to. Doris Flores-Brooks: Let me rephrase, an informative meeting. Joe T. San Agustin: Yes okay, okay I take that, yes we have. We like to encourage more informative meeting. Maggie Ralbovsky: Shall we, so page 22 is our asset allocation compared to the policy as you can see we are a little bit over weighted in U.S. equity which actually helped in this quarter. And we underweight in U.S. fixed income. That's part of the reason that we actually done a lot better than our policy. And the policy was actually down 50 basis points and we were up 2010 I think.

Joe T. San Agustin: We were down 25 actual. Antolina Leon Guerrero: But the actual allocation is really a reflection also of how well they did right? That's. Maggie Ralbovsky: Yeah that's part of the reason. Antolina Leon Guerrero: It's nothing we did, we just have to deal with the results of the market. Doris Flores-Brooks: Market was up and it's not because you put more in, it's because the. Antolina Leon Guerrero: They performed better right. Doris Flores-Brooks: Because there is some that this is your guide and you don't make sudden changes. Maggie Ralbovsky: Oh yeah no there's no way you can make sudden changes. We only meet once a quarter. Doris Flores-Brooks: Just because you're out of you don't necessary need to. Maggie Ralbovsky: Oh no you need to rebalance so when we withdraw. Doris Flores-Brooks: The question is when do you rebalance?

Antolina Leon Guerrero: It's when you go past your range. We have a range for every. Doris Flores-Brooks: So what is the range? US. Maggie Ralbovsky: Range is 5% over I believe. No actually range is for every manager, there's a chart that Diana. Gerard Cruz: Every mandate. Maggie Ralbovsky: Yeah every mandate, so Diane actually monitors this every month where you have to pay benefit you withdraw from the one that's most over rated. We have the mechanism to, the whole process is established. Doris Flores-Brooks: Okay, so because you are withdrawing every month to meet benefits, correct. So you're withdrawing in your classes that are over which you don't do anything to the classes that are under, right? Maggie Ralbovsky: That's right that's the established process.

Wilfred Leon Guerrero: She's taking from the winners and leaving the losers. Doris Flores-Brooks: That's right. Antolina Leon Guerrero: Giving them a chance to earn their keep. Maggie Ralbovsky: Okay, so if we are ready. Doris Flores-Brooks: Which sounds counter intuitive right? That's counter intuitive. Maggie Ralbovsky: No buy low sell high. Maggie Ralbovsky: But it's counter intuitive when you think about it. Rosalia Bordallo: That's looking at it from your point, my point I don't think so, I'd rather sell my house when it's at its highest versus me waiting until it goes down in value.

Maggie Ralbovsky: Okay, so let's look at U.S. equity, page 31. Gerard Cruz: Really? Maggie Ralbovsky: Really. So, this is as of June and since June we did make two changes. The transition was performed the first week of July so I'm going to give you an update on the transition. It was performed very successfully. Gerard Cruz: Everything is done? Maggie Ralbovsky: Everything is done. It was performed very successfully when I prepared everyone transition I think I estimated the transition cost to be somewhere around 10-15 basis points. It turned out to be much less it turned out to be something like 75 thousand dollars. Gerard Cruz: That's off the top right? Maggie Ralbovsky: So I'll show you that. Gerard Cruz: That's fine. Maggie Ralbovsky: That's fine okay.

Maggie Ralbovsky: So there's two documents that's transition management, one is pre-trade one is post trade. So the one that's dated June 10th is the pre-trade. Pre-trade is the guess, I guess the educated guess when the transition manager sets up the model to compare your legacy portfolio versus the target portfolio based on the market condition it considers how this in one day how it transformed from one portfolio to another portfolio, it calculates the cost to the market because when you sell you actually will have some slippage right because when you sell you buy the fact you are selling your pushing the market down, so the more you sell you take less of a price. And by the effect you are buying you push the market up. So there is a thing called market impact and if you compare the performance of the target portfolio versus the performance of the legacy portfolio that's called implementation shortfall. That's how you actually determine your transition cost.

Maggie Ralbovsky: So the manager set up the model Blackrock was the chosen manager, set up a model and they calculated the cost on page 4 of 9, page number is on the top right hand corner it says page 4 of 9. Wilfred Leon Guerrero: Maggie explain again what does focus list mean is that the better one. Maggie Ralbovsky: Oh yeah focus list is our conviction list risk managers. Paula Blas: Maggie he's on the report. Maggie Ralbovsky: Oh, I'm sorry. Antolina Leon Guerrero: She was answering a question about the transition. Maggie Ralbovsky: I was talking about the transition management. Antolina Leon Guerrero: From Winslow and Metwest termination so that's why. Doris Flores-Brooks: She's talking about how the transition was. Maggie Ralbovsky: There was a file. Wilfred Leon Guerrero: Go slow. Maggie Ralbovsky: I'm sorry. Wilfred Leon Guerrero: Can't keep up with you. Maggie Ralbovsky: There's a file by Blackrock it's dated June 10, 2013. And I want to compare page 4 of 9 of this file versus the other one that's dated August 13, 2013. There is also page 4 of 9, 4 of 6. Wilfred Leon Guerrero: Okay, I have a question about this and I guess I can direct it to all, how are we able to get a transition manager without?

Paula Blas: We gave you legal's memo on it with regards to the transition of these assets prior to even, prior to it being implemented we went to legal, we gave you a memo from legal as to why we should go ahead and go this route. Wilfred Leon Guerrero: I'm just surprised that the lawyer is saying that we can do it. Maggie Ralbovsky: Yeah because if you think about the goal of transition is to limit cost, if you advertise the whole world, you defeat your goal. Wilfred Leon Guerrero: I understand that, I don't have a problem with it I'm just. Maggie Ralbovsky: Then why do you have a question if you have no problem with that? Wilfred Leon Guerrero: I'm surprised that we can go out and hire people without bidding.

Doris Flores-Brooks: Yeah well the one thing, there was one comment, negotiators bids are better than. Maggie Ralbovsky: We solicit 3 bids, what do you mean without, we solicit 3 bids. We did. There was a memo circulated. Wilfred Leon Guerrero: It takes us at least 6 months to hire somebody because we have to put out ads and. Maggie Ralbovsky: This is a different mandate, it's not a money management it's a one day mandate and there's only like 5 people out there who does this. Wilfred Leon Guerrero: I guess my issue is not with you I want to go legal counsel. Maggie Ralbovsky: There is a memo legal counsel served. Wilfred Leon Guerrero: I know that. It just surprised me, you're saving money and all this sort of thing. Maggie Ralbovsky: Isn't that the goal to save money. Rosalia Bordallo: Maggie what he's looking at is the legal issues he's not looking at the financial, he's looking at the procurement law and what it saying that you have to go out and advertise it. Doris Flores-Brooks: Is she saying that the advertisement covered everything even though you had to hire somebody separately, is that what.

Paula Blas: We only needed to do that one service and that was transitioning these particular assets. Maggie Ralbovsky: So we should have many public funds have standing transition managers because you do not go out to transition management every RFP because that defeats your purpose. Transition management needs to happen fast, needs to happen secretly. If you advertise to the whole world it defeats both purposes, so most public funds has extending transition managers. Doris Flores-Brooks: So whose Retirement's standing transition manager? Maggie Ralbovsky: We need to, next time we will create. Paula Blas: We actually created EFT remember as ETF's as a way to use. Maggie Ralbovsky: Which is not ideal at all because you liquidated the whole portfolio to buy ETF's, it's totally the wrong thing to do. Wilfred Leon Guerrero: I don't understand that Maggie. Maggie Ralbovsky: I understand where you're coming from I'm just saying most public funds have a standing and we stuck to the 3 bids and the lawyer believes that we are within the definition.

Wilfred Leon Guerrero: Because I know in the past, we've looked at this thing and we had to suffer because let alone we had to go through the procurement process. Maggie Ralbovsky: We'll fix that in the future. So as of now can we take a look at. Antolina Leon Guerrero: No, okay so Diana maybe you could help us with this just to satisfy this. So your question is, what's the procurement process for us to get this transition manager and how do we comply? So if Diana or Paula Blas could tell us. Diana Bernardo: One thing is that in the last board meeting the issue did come about and the decision was made. Paula Blas: 2 board meetings ago. Diana Bernardo: 2 board meetings or even the last one I'm not sure but a couple of board meetings ago, there was a decision by the Board to go ahead and go out on an RFP for transition managers, so that answered one question. And then inso far as getting Blackrock on board, we did not get Blackrock on board as transition manager because they were an existing manager. As Maggie indicated 3 quotes were obtained and then I believe she did a write up which legal counsel reviewed. Basically Joanne Grimes said that it was not contrary to public procurement to go out or to hire Blackrock as a transition manager, in this case Blackrock I guess had the lowest fees estimated. And she did say it would be risky to go out on a public announcement and say okay we're going to hire transition manager to terminate two managers. You know you're giving public notice. She said it was contrary to public procurement on that case so basically legal opinion was obtained.

Wilfred Leon Guerrero: Yeah I know. Doris Flores-Brooks: This is not the first time you have. How have you done it in the past and what makes it different this time? Gerard Cruz: The way we have done it in the past was we've actually used an existing manager to run the transition, which wasn't efficient. Was not. At the time we used Metwest as a transition manager to transfer out assets but that wasn't efficient because they just did it as a almost as a favor to us, this was more efficient. Diana Bernardo: Right but also, when the issue arose and Dr. LG indicated to go out on an RFP for transition manager, one of the recommendations Terry had made was in lieu of getting a transition manager is to utilize ETF's.

Gerard Cruz: You can use an ETF but that also is not an efficient way because they don't do the you know the existing, the reason why my understanding is we went with Blackrock the way we did was because of what you mentioned but it was also an issue of timing. It was a run off process that we were going to do it and it was going to be done and the timing of terminating these managers coz we were going to terminate them one way or the other so we needed to do this immediately we needed to have the transition manager because it was the most efficient and going through a long RFP process would have not been in the public interest. I think that's why Joanne applied the way she did.

Maggie Ralbovsky: Another difference is at this time we have two legacy managers and three target managers. It wasn't one to one kind of transition so if you do not have a transition manager to do the crossing and to do the optimization we calculated the cost could be a million dollars. So, eventually we only the whole cost would be 75 thousand dollars. Gerard Cruz: And the universe of those who are able to do it are so small, it's a handful and we looked at the top 3. Antolina Leon Guerrero: So we did get quotes. We got quotes for. Wilfred Leon Guerrero: Yeah I understand that I need to recall but what amaze me was the legal counsels opinion it's perfectly fine to do it. Joe T. San Agustin: Let's look at that thing because I think what happened is just a transfer of account. An existing manager usually transfers from one account to another account, so you're not hiring new people. If you hire a new manager.

Antolina Leon Guerrero: But we might have. I mean if it wasn't for the, they were the lowest it was the lowest fees. Joe T. San Agustin: But you have existing managers, no more than transfer one person to another person, I don't have to hire a new employee, see that's the whole point if you and I new employee then you have to go out on RFP. We have an existing manager and the Board or you just move it out. Paula Blas: There's only like 5 transition managers out there that you can actually solicit from. Joe T. San Agustin: I mean we use existing managers for transition like Metwest. Metwest did it before. Gerard Cruz: Yeah but they were a little more costly. Joe T. San Agustin: Which is a side job of the regular investment manager. It's only a temporary role. Gerard Cruz: That's right. It's not even a whole, it's just a traffic director.

Joe T. San Agustin: Every manager has that capability. I mean we did that remember we be selecting which one we want, what was the one that we fired, Aberdeen and we took some of them and you said you took the best one. Maggie Ralbovsky: That is also different in the case of fixed income. Joe T. San Agustin: You have to do that. Paula Blas: Because you can do that, the index fund you can't do that. Maggie Ralbovsky: Index fund so for this transition is a one day process, you need to optimize that one day process instead of disturbing everything. And that Aberdeen transition was a drawn out transition because you don't have a readily available market for certain securities that wait to be patient. Joe T. San Agustin: That is a long transition. Maggie Ralbovsky: That's right. So that is very appropriate to give to IRM, a great way to do it. This would not be a great way to do it if you. Joe T. San Agustin: I don't think we would be too prudent to go out on RFP for that as you said. Gerard Cruz: Everybody would know, the managers would know. Antolina Leon Guerrero: The efficient manager complied with the procurement so I'm not sure.

Wilfred Leon Guerrero: The point is Mr. Chairman is that. Joe T. San Agustin: I know but there's a legal opinion. Wilfred Leon Guerrero: In a similar situation and we reacted different, I just want to know and I think we should be consistent. Joe T. San Agustin: You're right but I think we should pull the legal opinion that made that justifiable. Wilfred Leon Guerrero: That Aberdeen is a good example. Antolina Leon Guerrero: It's not, it's not comparable. Maggie Ralbovsky: It is not comparable at all, the Aberdeen is a fixed income security manager that during the crisis period there was no market for those securities, number 1.

Maggie Ralbovsky: Number 2, fixed income does not trade on exchanges. You do not have a New York Stock exchange or any exchanges. Wilfred Leon Guerrero: That has nothing to do with the procurement process Maggie I'm sorry to tell you that. Antolina Leon Guerrero: No but Mr. Chair she's trying to answer, you're comparing the two situations when they are not comparable. And so what we have to do as the Board I think, is to address what's the most efficient way within the procurement rules and we looked for the most efficient way to handle these funds and we sought legal counsel and we got legal counsel which said we can go out this is the most prudent way to proceed, we got 3 quotes, I mean I don't know why it doesn't satisfy procurement rules for you, I mean it seemed to make sense to me, legal counsel said it was fine and so that's why we ruled on it. Joe T. San Agustin: Well if there is going to be a doubt maybe we should put some legislation. Antolina Leon Guerrero: You could advertise it. Gerard Cruz: We could advertise but the risk of advertising though is that everybody knows and once these managers know they are about to be terminated then.

Paula Blas: The liquidation on their side starts to happen. Antolina Leon Guerrero: Right and it hurts. Paula Blas: It becomes more harmful. Gerard Cruz: It hurts the value of the portfolio. Antolina Leon Guerrero: So we had to do what's best for the fund and we did it within the rules. Doris Flores-Brooks: How did we notify the manager? Wilfred Leon Guerrero: I am not disagreeing with what's taking place. Antolina Leon Guerrero: You're just surprised that legal counsel replied that way. Wilfred Leon Guerrero: We can be efficient. Antolina Leon Guerrero: Surprise. Joe T. San Agustin: We didn't break the law we just bend it. And we ask Joanne to bend it. I know what you're talking about.

Maggie Ralbovsky: Okay, so shall we. Wilfred Leon Guerrero: Yeah. There is a. Gerard Cruz: So we have an RFP out. Wilfred Leon Guerrero: Yeah there is an RFP out. Gerard Cruz: For standing transition manager. Joe T. San Agustin: For what? What RFP we have? Gerard Cruz: Just to put them on bench. Antolina Leon Guerrero: To be readily available. Joe T. San Agustin: Oh yeah. Maggie Ralbovsky: Next time we RFP we'll have a transition manager. Gerard Cruz: But they are just on standby right? Antolina Leon Guerrero: Not in the middle of the transition. Gerard Cruz: So we have one on standby its okay, but this one is just a one off, one time.

Maggie Ralbovsky: Okay, so I was going to report that the transition was fulfilled very successfully, the estimate was 9 basis points it turned out to be only 3 basis points. Gerard Cruz: Wow. That's because the market was strong right? Maggie Ralbovsky: Well the market was calm, it doesn't have to be it just has to be calm, it cannot be volatile. We actually got lucky with that. And also Blackrock in my view is the best in equity transition out there because you need optimization model to determine how to trade and when to trade, who to trade with. So they have this model set up which worked out, actually was less than 70 thousand dollars, 69 yeah. Wilfred Leon Guerrero: You said less than 70? We're talking about how much?

Gerard Cruz: A couple hundred. Wilfred Leon Guerrero: Couple hundred million? Maggie Ralbovsky: Yeah the total round trip is 200 million. Doris Flores-Brooks: Oh 200, oh but what did you transfer 200? That's 20% of your portfolio, that was a big portion. Maggie Ralbovsky: And we transitioned also half into index funds which makes future deployment much more efficient because if you take money out of index fund you have no. Antolina Leon Guerrero: No fee. Maggie Ralbovsky: No Fee. Yeah. So it because I if we didn't go further diversification we would need liquidity. So we don't have to another transition. Wilfred Leon Guerrero: Okay, Maggie good job. Gerard Cruz: Good job. Joe T. San Agustin: So what's next after this? Paula Blas: Now we have to pass the law. Maggie Ralbovsky: There are a couple of manager issues to discuss. Gerard Cruz: Eaton Vance is the only one the other ones have been discussed. Maggie Ralbovsky: The other ones have been discussed and Intech and Robeco have done tremendous jobs this quarter. Gerard Cruz: Intech? Maggie Ralbovsky: Intech and Robeco was the 2 managers we transitioned our legacy portfolio into. Gerard Cruz: Yeah I'm surprised Intech. Maggie Ralbovsky: Did so well? Antolina Leon Guerrero: You mean you're surprised you're right about selecting them, I'm surprised too, if you put it that way.

Maggie Ralbovsky: Okay, so our underperforming manager is Eaton Vance. So I actually prepared a few discussions on page 34 and 35 just to take a deeper dive on Eaton Vance. If you look at Eaton Vance on page 34, I'm sticking on the write up because you know I think. Gerard Cruz: Nancy, Nancy, Nancy and Christine right? Whose our client services rep? Maggie Ralbovsky: Kristen. Paula Blas: Kristen, but Nancy is your portfolio manager. Maggie Ralbovsky: So the style for this portfolio manager is to pick profitable companies ok. And that doesn't. Antolina Leon Guerrero: Novel liking. I like it. Maggie Ralbovsky: And guess what. Gerard Cruz: She does, she picks them. Once she picks them they are profitable.

Maggie Ralbovsky: Who wants to pick companies that have lower debt and have more profitability. And sometimes those companies actually don't do well and this past 24 months, if you look at page 34, I have a chart on the bottom. This chart compares two groups of managers in Russell 2000. Russell 2000 is the benchmark for Eaton Vance which is the small cap after the top 1000 stocks. So if you just line up the profitability of debt leverage, leverage and profitability from the worst to the best and you cut in the middle okay these group are sort of high quality, this group is lower quality. Quality is defined as lower debt to equity ratio and higher profitability. And if you compare their performance the red line is higher debt to equity ratio. The blue line is lowest P/E which is basically the 2 groups. The good group actually underperformed severely to the knock I shouldn't say good but they lower quality group did significantly better than high quality for the past 24 months.

And that is part of reason is because of the Fed "put". We talked about the Fed "put" which means the Fed tells you interest rate is going to be zero. If you know that you just going to basically lever it up right where ever you can lever it up. Gerard Cruz: So you think that's the reason why? Maggie Ralbovsky: That's part of the reason. Junk rally, this is the junk rally although not every manager gets impacted by junk rally. Because just because you're junk doesn't mean I cannot pay you enough to take that junk, so junk doesn't necessarily mean it's something you shouldn't hold, it just means that you. Gerard Cruz: But that's what Eaton Vance is saying she's only investing in high quality, so go ahead. Maggie Ralbovsky: That's exactly why she under performed. And our other manager Numeric did not under perform because Numeric doesn't care, you pay me enough I'll take junk. Nancy does not take junk, so I guess that explains she never changes her strides, this is the way she is and she has been pretty much out of favor in this kind of market cycle.

Maggie Ralbovsky: I also want to show you the historical performance on rolling 3 year basis, page 35. Gerard Cruz: For her? Maggie Ralbovsky: For her, so let me explain what this chart is. This chart is something that we call universe comparison. Gerard Cruz: So she was doing well. Maggie Ralbovsky: She was doing very well, so on the access on the vertical access, this is the universe comparison, a small number is better than a big number. So 5 means fifth percentile means you beat 95% of the managers, a hundred means you're the bottom manager and the. Antolina Leon Guerrero: It's almost the bottom. Maggie Ralbovsky: So all the dots are rolling 3 year numbers so these are not quarterly number these are long term numbers. And you can see red across is Russell 2000, the reason we want active management in small cap is because of this.

Gerard Cruz: Right. So what economic conditions need to exist in order for quality to return. Maggie Ralbovsky: You do not want this kind of junk liquidity floating kind of market. You want fundamental market. Fundamental eventually should prevail but this kind of a liquidity market. Gerard Cruz: Flood. Maggie Ralbovsky: Liquidity flood market junk rally market does happen once in a while. 2003 was the last time that happened, I didn't show you 2003 was because Nancy wasn't there since 2000. She started in 2006 with the strategy. Antolina Leon Guerrero: Yeah but given that, I mean isn't this going this manager going to be her model going to be in favor over time? Maggie Ralbovsky: If this condition continues she is still going to be here but it's not going to forever continue because fundamentals eventually have to prevail and I do believe this cycle right now is turning and she should. Antolina Leon Guerrero: Start to improve. Maggie Ralbovsky: Start to turn. Yeah, we really don't want to pull the plug right now.

Gerard Cruz: So her or her I'm not going to call it competitor but the other person in this mandate is Numeric? Numeric is a quant shop though right? Maggie Ralbovsky: Is a quant shop. Gerard Cruz: So are they conflicts. Maggie Ralbovsky: Very complimentary to each other. Numeric actually has done recently two things that helped this because one of the huge low quality supposedly low quality sector is Biotech because Biotech can't really count whatever their earnings are. It's not you cannot use the earnings as indicator, and Nancy holds no Biotech because they don't know how to analyze and Numeric recently introduced a very good model in that. They basically was able to pick the right winners I guess in that sector which helped tremendously and another model introduced was retail models. Small retail companies they also have been very successful. So answer your question, yes they were very complimentary to each other.

Gerard Cruz: Okay. Good so we should. Antolina Leon Guerrero: Yeah because I don't know if I want somebody to switch models and just because their model is not working in this market they'll be like okay well that sort of chasing the dollar. Maggie Ralbovsky: So I do want to keep them on watch because we obviously want them to keep doing what they are doing and when the market turns they're there instead of getting impatient and sort of change strides. So recommendation is to keep them on watch. Gerard Cruz: Do you think that there are better fundamental small cap managers? Maggie Ralbovsky: Yes there are and you know like Kennedy for example will be the ones totally compliment but that doesn't mean that we. Antolina Leon Guerrero: Should switch. Maggie Ralbovsky: And that we can't switch just like that we have to advertise. So for now let's stay put and we put them on watch.

Gerard Cruz: So overall how did we finish compared to the universe? About 50%? Maggie Ralbovsky: About 50% yes, and all the detail manager comparison. Gerard Cruz: But most of that most of that gain was made up in the second quarter? Most of that gain for the year for us is in the second quarter or just overall? Maggie Ralbovsky: It's overall. Actually, second quarter wasn't the best year. So does that mean you want to wrap up? Antolina Leon Guerrero: Well we can't wrap up because there's no food. Where's lunch Gerry? Wilfred Leon Guerrero: Your page 31 is U.S. equity and where's the next one on your. Maggie Ralbovsky: International. Let's look at International equity page 41. Page 41, there you see International equity has done very well. The underperforming manager is Earnest. Paula Blas: They made focus. Maggie Ralbovsky: They what? They are on focus list, yeah. So really it's a concentrated manager sort of a little bit like Nancy's style you know fundamental driven, concentrated, isn't doing well this environment, but I'm talking about Earnest. It's also complimentary with Fisher because Fisher is a top down manager so sort of like a Macro.

Maggie Ralbovsky: Fisher has done well. You know. Gerard Cruz: Fisher just does well when the tide is high. Maggie Ralbovsky: They're Macro manager you know sort of top down manager, if they call the tides right then they do well, if they don't call the tides right. Didn't the guy tell us it's going to be 20% a year. Gerard Cruz: Last year. Maggie Ralbovsky: Not this year? Gerard Cruz: No. Maggie Ralbovsky: Oh yeah that's right last year. Last year was flat they didn't do too well. Wilfred Leon Guerrero: Okay Maggie on page 48 you have recommendations to. Maggie Ralbovsky: Keep Franklin on watch, yes. You know I think your fixed income portfolio really needs work although I understand why it is the way it is because the constraints of the law. So after the law is passed, this is the first place we are going to start looking. Gerard Cruz: What are you going to do here? Maggie Ralbovsky: I have things I want to do. Gerard Cruz: We all do. Antolina Leon Guerrero: Which way are you going to try and move in this group Maggie? Paula Blas: Maggie going to start her journey but you guys are the drivers. Joe T. San Agustin: I don't want surprises. Maggie, I don't like surprises okay. Gerard Cruz: We don't like surprises. Joe T. San Agustin: I don't like surprises so if you are planning something then let's go. Maggie Ralbovsky: So ideally one of the managers needs to go. Joe T. San Agustin: Okay, fine. Gerard Cruz: One third of the portfolio needs to be liquidated. Maggie Ralbovsky: To have a high yield manager. Couple high yield managers. Joe T. San Agustin: What are you talking about? Maggie Ralbovsky: I want to diversify it there. Gerard Cruz: No surprise there. Wilfred Leon Guerrero: Before you get into discussion on 48, where's the next recommendation? What page?

Maggie Ralbovsky: The next recommendation is to keep Franklin on watch, page 48. Wilfred Leon Guerrero: Yeah but okay. Maggie Ralbovsky: I want to show you Franklin's track record just like I showed you Eaton Vance on page 50. So you know this is not a manager like Eaton Vance as I see. Eaton Vance most of the time was on the top, Franklin most of the time was on the bottom. And this is all. Antolina Leon Guerrero: I was just going to say Gerry selected this group didn't he? Gerard Cruz: The Chairman, you signed this contract when you were the director, this Scudder. It started out as Scudder. Joe T. San Agustin: Where? Franklin? Gerard Cruz: Franklin. And then it became Fiduciary Trust. Rosalia Bordallo: No. This is fiduciary trust. Scudder was a different manager. Gerard Cruz: Oh sorry. Rosalia Bordallo: This is still Fiduciary Trust. Gerard Cruz: Is it? Rosalia Bordallo: Yes.

Wilfred Leon Guerrero: Okay and the next one is page 56. You and. Maggie Ralbovsky: And I have a universe comparison of the other two managers. You can see that they're a lot better. Gerard Cruz: Hey this looks like a camel. Maggie Ralbovsky: Those two other managers are a lot better than Franklin. Wilfred Leon Guerrero: Maggie, we're running out of time lets concentrate on the recommendations. Maggie Ralbovsky: I just told you the recommendations. Joe T. San Agustin: Where are we at now, page 56? Maggie Ralbovsky: That's it. That's it. Wilfred Leon Guerrero: No changes on REITs. Gerard Cruz: REITs are good. Maggie Ralbovsky: REITs asset class not very good right now, that asset class but these two managers are still good. Gerard Cruz: But they're also complimentary. Maggie Ralbovsky: It's complimentary to some extent even though it's a smaller universe. Gerard Cruz: But, Cornerstone takes bigger bets. Maggie Ralbovsky: Yeah. Wilfred Leon Guerrero: What does it mean when you say performance will be closely monitored? Maggie Ralbovsky: Means that this sector I have total doubt that we should keep the way it is even 10% in the sector. Gerard Cruz: Should we push it up more? Maggie Ralbovsky: No. Antolina Leon Guerrero: But we just started with them, two new kids on the block. Maggie Ralbovsky: This is a sector with a total selection in the hundred securities and you have two managers trying to fish in the hundred securities pond. I want to expand it to the world. So there's a global real estate. Gerard Cruz: Yeah global REITS. That's the one the Chairman wants us to go to in China. That global REITs conference. Paula Blas: They got to change the law. Joe T. San Agustin: No. Antolina Leon Guerrero: Is that part of this legislation? Maggie Ralbovsky: China, Hong Kong. Joe T. San Agustin: Hong Kong can be the outreach.

Maggie Ralbovsky: I think today we're going to hear from tomorrow, today right. Yeah so these managers may make a pitch. Gerard Cruz: Cornerstone and Security Capital. No, I think REITs I think we need to go global. Maggie Ralbovsky: Okay, so that concludes my prepared remarks right on the dot. Wilfred Leon Guerrero: You didn't answer my question about REITs. Maggie Ralbovsky: What is your question? Wilfred Leon Guerrero: I still don't understand about closely monitored. Maggie Ralbovsky: The reason I made that comment is because the pending change of the law, once the law is changed this composite will be. Wilfred Leon Guerrero: So it's got nothing to do with the performance. Maggie Ralbovsky: I want to expand the universe to include international global real estate. Doris Flores-Brooks: But you're assuming the law is going to get passed. Wilfred Leon Guerrero: Maggie you're saying performance. Maggie Ralbovsky: Because this sector is terrible right now. Wilfred Leon Guerrero: Oh, okay. Maggie Ralbovsky: Because it's a small sector. It's a small cap value sector that had huge runs. That's why I said the performance. Wilfred Leon Guerrero: You like to expand to other places other than U.S. What about the allocation are we going to keep it the same? Gerard Cruz: Yeah if you expand the universe. Maggie Ralbovsky: You mean the total, I want to reduce the U.S. Gerard Cruz: The 10% of the.

Maggie Ralbovsky: Yeah, in real estate sector I want to keep the same but not all in U.S. securities. We may expand to international we may also include some Comingle funds which are sort of a stable rent collectors you know instead of security. So what we have right now is levered real estate. You could go to unlevered real estate. Levered real estate is very volatile. REITs are 76% levered. So if you just buy a property and collect rent you're unlevered and you probably can collect 6% rent that's more stable than if you invest in REITs because REITs are 70% levered therefore it goes with the Capital markets arrayed violently so to diversify the allocation to real estate including expanding the universe into non U.S. REITs also including consideration in Comingle funds.

Wilfred Leon Guerrero: What do you mean by levered? Gerard Cruz: Borrow, they finance their purchase. Maggie Ralbovsky: REITs are actually financing company, they issue all kinds of securities including debt and equity. And what they do is, they go out to buy these properties levered. Wilfred Leon Guerrero: They buy the property. Maggie Ralbovsky: With debt. They have mortgage on their property so you are participating in the equity piece and on top of it there is debt piece. On average REITs companies are 76% levered meaning you are holding the 23% residual value which makes it very volatile the reason REITs are volatile. Wilfred Leon Guerrero: You're speaking too fast for me. Maggie Ralbovsky: Like you buy your house, you borrow from Gerry, for 76% you put 23% of your own money. Wilfred Leon Guerrero: I remember that there was like the companies that were making money for those who are managing the property as opposed to those that own the property. Maggie Ralbovsky: There are different REITs companies actually are mixed. They don't just do one thing they're mixed. Most REIT companies own properties too and REITs are basically financed.

Wilfred Leon Guerrero: I remember that. Doris Flores-Brooks: I remember that too. Maggie Ralbovsky: They have those companies but not only those companies. Doris Flores-Brooks: So what kind of companies are these? Maggie Ralbovsky: These are managers that buy. They have everything in the U.S. Doris Flores-Brooks: Levered, unlevered? Maggie Ralbovsky: REITs are all levered because that's the purpose of REITs is to lever because they don't pay taxes so they wanted to borrow from Gerry at 3% and then when. Doris Flores-Brooks: And this is due to. Wilfred Leon Guerrero: 3% from Gerry? Gerard Cruz: Yes. Doris Flores-Brooks: And this is due to the depreciation. Maggie Ralbovsky: When you lever you're more volatile right. Doris Flores-Brooks: But the write off is due also not just because you can only the interest but also due to the depreciation right? Maggie Ralbovsky: Well the volatility. Doris Flores-Brooks: When you say they don't pay taxes. Maggie Ralbovsky: Not like a corporation, you have to pay 35% on your profit, REITs pay no taxes but they promise to distribute their rent 90% to the investor. So it's a structure. REITs is a structure, there's a REIT law out there in most of the countries not most but many countries there's a REIT law that basically says okay you're just a distribute most of the rent to the investors you don't pay corporate taxes which is viewed as a advantage that's why REIT has a place in the portfolio but REIT is not the only way to invest in real estate.

Doris Flores-Brooks: So was it good or bad to invest in REITs? Gerard Cruz: Oh no REITs we made a lot of money. We made quite a bit of money on REITs. I think what she's saying is that right now we are pretty concentrated on just the U.S. and which makes up only 100 securities and there are other vehicles beyond what these guys are investing. We're using the same allocation just expand the reach. Maggie Ralbovsky: I would like to expand this to include international securities and Comingle funds. Doris Flores-Brooks: So which ones? Maggie Ralbovsky: Oh which one okay. Comingle fund there's the biggest one out there it's called Lion Value Fund which is run by ING. It's called Lion Value funds. It buys stable properties, no leverage and just collects rents and they just give you the rent. Gerard Cruz: But it's Comingle fund. Maggie Ralbovsky: It's a Comingle Fund. Doris Flores-Brooks: What's a Comingle Fund? Gerard Cruz: It's like a mutual fund. Maggie Ralbovsky: Yeah, you don't right now have the capacity. Rosalia Bordallo: You're limited, you can't buy it.

Joe T. San Agustin: How is that structure? Maggie Ralbovsky: How is that Comingle fund? Joe T. San Agustin: Yeah, how are you going to structure that with real estate? Maggie Ralbovsky: I'd like to. Joe T. San Agustin: No you buy share on a corporation and you buy individual properties. Maggie Ralbovsky: I'd like to convert your REITs into global and then 50% into Comingle funds. Joe T. San Agustin: Then you go to various corporations. So how is the money going to flow? Maggie Ralbovsky: Okay, how I would like the structure. I'd like to convert your REITs into 50% Global REITs and 50% Comingle funds. Joe T. San Agustin: But how is that going to structure on the global REITs you going to have a one company or one firm and the challenge will be very difficult. Maggie Ralbovsky: Oh one or two. I may want two managers, yeah I want two managers. Joe T San Agustin: We've got to have a structure like that. Gerard Cruz: I've got to go to China Mr. Chairman to research this. Joe T. San Agustin: Yeah, why not? Hey the only problem in China. Gerard Cruz: At least 6 months. I need to learn the language first. Joe T. San Agustin: The only problem in China is that you know what the visa is so expensive. Gerard Cruz: It's $200. Joe T. San Agustin: No, $300 bucks. Gerard Cruz: For 2 years though. Joe T. San Agustin: I don't want to go for 2 years, $200 bucks for Visa. Yeah unless you're multiple. Gerard Cruz: So you went? When did you go? Joe T. San Agustin: 2 years ago.

Security Capital

Kenneth Statz: Again we are real estate people so page 5, we'll have pretty pictures of real estate that's mandatory for any real estate manager. But I think this is a very important thought page again because even though as we discuss your portfolio we'll talk about who owns stock in companies. What you really own is the cash flow from commercial real estate owned by these companies? And in the public market last year was very important because the size of the U.S. commercial real estate market in the stock market which is where we invest for you went through 1 trillion dollars in value. It's now 1.1 trillion dollars of real estate over 23 thousand high quality properties and we showed you 48 pictures here. These are the kind of quality of real estate that's available in the public market.

And so that's very important and as we talk today about the future of your portfolio, it's all about the cash flow and the quality of the cash flow which is in turn just a function of how good of a real estate, how good are your locations that you own. Public real estate market owns in many cases the best commercial real estate in the United States. And the depth of the market, the breath of the market gives your cash flow incredible quality because when we own a portfolio of 25 stocks of REITs, you're going to own 14 to 15 thousand properties in the United States the cash flow from that. So when we talk today about the future of your portfolio, it's really the future of the U.S. Commercial real estate market because this is the size and breath of the U.S. commercial real estate market, so that's important.

Now the firm, we have about 4½ billion dollars under management, we are still wholly owned by JP Morgan, those are our parents. We continue to have the same keen people although briefly there's been no change on that. And I guess the only thing that's been happening in our system if you look on page 7 and 8, is page 7 is back to overview the size of the public real estate market, that's the stack to your left. That's at 1.1 trillion dollars worth of value up there. When we talk today about what's happening in your portfolio, our franchise is investing in everything that's publicly traded in the public REITs stacks. So we buy the equity for you that's what your focus is but some of my comments today will be reflecting on where risk could be coming into the market that could threaten your values. We look to the preferred of REITs preferred stock and the debt of REITs because that's where we'll see signs if there's problems because what happens in those safer markets is that there's problems in the markets view point on the value commercial real estate you'll see the bond yield starting to go up because people are getting frightened about commercial real estate. And so I'll talk about that a bit because that's not happening at all.

Kenneth Statz: Right now the bonds of REITs are indicating that people have great comfort in the value commercial real estate. And last cycle, we'll look at a really important picture when you started investing was at the bottom of this market. Last cycle when things started to get risky in real estate, the bonds of REITs spreads were starting to widen and gave a very good indication to be concern. That's our specialty in the equity and that's not happening at all right now. So that'll be an important comment I'll be making and that's why I wanted to focus you on the entire capital structure of REITs.

Now in our platform then we continue about 4½, 5 billion dollars worth of money under management but the only thing that's really happening in our platform that you have participated in is recently you gave us the opportunity to strategically add cash to your portfolio if we wish if we started to see commercial real estate values in problems, that is going across our portfolio where people are giving us the opportunity to go into cash and so that's very much like you can see cash on page 8 is part of the that's inching in you are in our top product called growth and income all equity. We're starting to edge into the cash category and that's something that you gave us the ability to do starting in December. We always have a little cash if we're buying and selling but to tactically go into cash right now you are 98% invested, we do not see the need for cash in this portfolio.

So the easiest thing I can tell you about commercial real estate what we really believe since you've given us the ability to own cash, is we think things are very fairly well priced right now. So you gave us that ability, we used it over the last 6 months in a small band which is at a little performance which is good. But right now we are not going up to 15% in cash for you because we think the values in your portfolio are more likely to be going up and down in this environment even with interest rate rising. So across. Gerard Cruz: You would go up to 15. Did we put a cap on that? I don't remember. Kenneth Statz: Yes 15% is the cap. So it's meant to be able to really kind of draw back a little bit from the market. Now I think if we go to 15% in cash, you probably would also want a call from us because I think the next level is just take money out you know that and this is I think the easiest way for us to signal clearly to you all. You know they always say sometimes people can talk about things but watch their action. If we go to 15% in cash, take money, you know just take it out okay. And that's part of our franchise, we like to tell people when we think commercial real estate values are sound and when they are in trouble. So we are not doing that right now. We have moved your cash around admirable value but the big story right now is we think what you own will withstand arising interest rate environment because bottom line the cash flow growth is so strong.

So what's happening in our entire platform is people like yourselves are making the choice to give us more tools to express what we think is happening in real estate. We also are getting a lot of money in a new product called liquid core which does exactly what you do but has preferred in debt to the mix to have more income. So people are going two ways, they are getting us more ability to get conservative or two they are giving us the ability to buy the full capital structure of REITs because it's a lower volatility and higher income. So that's a very interesting, we're probably going to go 2 billion in new assets very quickly in that product. So that's something that's happening in our platform.

Kenneth Statz: So, Security Capital as a franchise same people, same process, same owner JP Morgan but people are pending to come into our system and we are really growing rapidly right now in new accounts because people like our use of cash and they like our ability to be conservative and tell you when you should be conservative that's our franchise I think. So that's really what's happening in our firm. On page 10, just to put a fine point on it, the only change in our personnel since we spoke last was not in terms of our chief investment officer same person, and you can see what's interesting parenthesis by Tony Manno at the top 19 years with the firm, Kevin Bedell if you go to the far left 17 years and myself 18 years. And we continue to be a firm with a long longevity with people. We have added a new client service a new strategy person, Jen Fetzer with 1. But besides her that would be the only change. What we're finding is as we get more complicated in our execution of products adding cash, adding burden, we need more people to help us explain performance and what's going on in portfolios. Other than that same team you hired 5 years ago still in place. Perhaps it's been a record in money management, we're known for that.

Before I go on I'd like to just explain page 12 a little bit just to remind you of our process because now we're going to go into some heavy lifting in terms of what's happening in commercial real estate, how does our process work to give you answers. Just to remind you all we do 3 levels of research to figure out what you should own because we can own regional malls for you, large shopping centers, we can own apartments, multi-family, we can own office building, industrial warehouses. We all start with submarket research Security Capital will figure out what's happening in all the different markets that we can invest in and that forms a couple of things. It forms a basis for us to understand the quality of your properties. And I'll talk about that briefly because this market has changed pretty dramatically on what part of the quality spectrum the stock market is most interested in. There are medium quality properties, very high quality properties, there are companies with a lot of debt on their balance sheets, companies with not so much debt on their balance sheets. What's been happening in our markets is quick the market is shifting from favoring low quality to high quality. In Security Capital we have a unique way of understanding quality because we look at every property in the public market, we figure out what its location advantage is. All 23,000 properties we have in our system. And so we have a real fine sense of how's the market paying for high quality versus low quality and we're going to talk about that in a little bit and that's an important part of our process it's unique to us. We also do a lot of work in part 2, the company's balance sheets. Sometimes you know I always have to remind myself and our investors, we own for you the equity only of these companies which means their balance sheets matter because they run with a lot more debt than average companies that we can invest in the stock market. So we have to watch very carefully how much debt are these companies using, how is their debt structure, is it long term, short term, fixed variable because right now with interest rates going up that's a critical determination of how much cash flow you are going to get as a equity holder and so that's a very important part of our process and we're going to have some comments on that. So we put it all together and I've come up with an answer that I think right now your portfolio is priced that's the 3rd box that's my job on the strategies. I think your portfolio is priced to give you at about 9% rate of return in the next 5 years in pricing, that's what the kind of growth and dividend yield you should get and we call that in the 2% to 2 ½% inflation environments a fair to good rate of return.

Kenneth Statz: So we've studied the quality, the cash flow and the balance sheets of all these companies and I'll talk in a moment in detail about your portfolio. Wilfred Leon Guerrero: That's what you're projecting 9%? Kenneth Statz: About 9%. And now as we'll see you've earned 20% a year but your timing was very, very good. You bought when things were very cheap and things were very depressed. That's not the case as we'll see right now. Things are fair value but I think a 9% rate of return in our system and we have interest rates. Wilfred Leon Guerrero: If you can guarantee that, we'll take it. Kenneth Statz: Well if I would give you a guarantee maybe you'll ask me to leave I don't know. So our process is all about cash flow and the quality the balance sheets and at the end of the day what's a reasonable estimate for your returns. Now let's talk about your portfolio, and let me stop for a second, any questions on our firm? Great. Why don't we jump right in?

Page 22 and you know these numbers. I just like to look at them because it's so terrific to have an investor whose timing was perfect. You know you start in December of '08, again you know that but I think it's always fun to say that you gave us $71 million dollars, you've earned $53 million dollars, we've given you $35.6 back and you still have $88.6 million dollars invested. So that's a 19.6% rate of return. Now the real estate common index has done 20.8. So we're going to talk about that because we just before fees have kind of match that index. I'm going to talk about why did we just matched it and why are we starting to outperform right now and it's that outperformance its started happening in your portfolio versus index, something that we expect to continue or what's happening in the performance side.

A little closer in on page 23, I'm going to focus a bit on the second quarter, and that's the second column to the left if you go in the middle of the page. That's a very important quarter. Why? Because that's the first quarter where interest rates started to go up. And in the environment you can see your portfolio is kind of flat after REITs went up and down it kind of was a flat quarter. It was a quarter where you started to outperform the market. Now the reasons for this I'm going to go into why were you thinking to make money in a rising interest rate environment will be in the structure of your portfolio the kind of equity that we purchased for you in the kind of property place we're invested in for you. So we're starting to see that even though the market was off anywhere from 1.62% in REITs, you were off .8 in the quarter and I think we're starting to finally get the relative out performance because we have been worried about interest rates for a very long time in our system. We have thought that the U.S. Treasury market was unusual, the rates were too low. And those rates had to go up as the market would start gravitating to a more normal market and so what we're looking at is our ability in a rising interest rate environment to a relatively out performed I think we're doing that but can we actually make you money. When you look at your portfolio, we'll talk about that.

So, if you look over for the full year, REITs at the end of June second quarter we're up about 6%, that's what your portfolio was up. There's been more volatility, it was off where it actually went slightly negative a couple of weeks ago it's come back so it's slightly positive. Clearly this market is struggling with this big concept right now in the very short term which is what do you do when you are in a property a group of assets that bond rates are very important because these companies a lot of debt as I mentioned, what do you do if the cost of their debts going to start going up because the treasury market is starting to go up.

Kenneth Statz: And let me just focus to what are theories are in this. If you look page 24, the next page on the bottom. There are 2 areas that we have significant over weights. Over weights your portfolio is blue, that's how much of your portfolio is in every property type and the property type selection right now is critical in a rising interest rate environment because in commercial real estate the length of leases vary dramatically by different property types. If you own very large high rise office buildings New York, San Francisco, those leases can be anywhere from 10 to 15 years and so that's a bond. Your cash flow won't go up or down in those bonds because that's the nature of the leases. In a rising interest rate environment your cash flow is not going to go up but interest rates going up so your values are probably going to wobble, maybe even go down.

But if you take another property type like apartments where leases are 6 to 12 months, as the economy gets better interest rates going up you have a chance of rates increasing your rents. And that means your cash flow can go up even in a rising interest rate environment, in fact if interest rates going up because the economy is doing better that probably means your cash flows going to go up enough to offset the rising interest rates. So we want to be in short term leases. We want to be where your cash flow can respond to a better economy quickly because then in a rising interest rate environment you can offset the rise of interest rates which are the present values. So we have an overweight in your portfolio in apartments. And then we have an overweight over in regional malls, these are the big powerful retail centers in the United States. The reason we have those 2 over weights is we think that's where cash flow will be rising. Multi-family because of the short term leases. Regional malls because they get a percentage of what's happening in their centers so if people are buying things at the mall, rents go up. And when they roll rents they get more rents when they roll it and their rents are like 5 years long. So we like those 2 areas because they're well priced and they can do we believe a very good job, there's a lot of cash flow growth in them they can offset a rising interest rate environment.

Up until the end of the 2nd quarter we also had an overweight in self-storage, that little category in the middle. That has also been a terrific place because their leases are one month and the bottom line is apartments and storage in the 2nd quarter where we saw performance was negative they had positive rates of return. They actually made you money in the 2nd quarter when interest rates were going up. Again very strong fundamentals, high occupancy rates are full and the short term leases are allowing them to raise rents. Gerard Cruz: So, you know in speaking about the rising rates and I understand what you are saying but, so I'm kind of wondering though if the increase in interest rates are truly a function at this point at economic growth in a return to economic expansion or is it just the unwinding of an artificially or a program that artificially depressed rates to try to get the economy started? In other words, is this rise 2 month rise in interest rates, was it because of the discussion and anticipation of rising rates at some time in the future or is it are we really seeing the economy starting to come around?

Kenneth Statz: Great question because in our system this whole concept of interest rates I think has been tricky over the last 2 years because interest rates went very low levels the economy was fine, I mean usually interest rates start going up when the economy starts getting better. This was an unusual action by the Fed. We believe that our system that interest rates will go up and we priced in the interest rates going up about 4½%. Gerard Cruz: By when? The interest rates the treasury. Kenneth Statz: The treasury market. Gerard Cruz: The 10 year. Kenneth Statz: Right because remember here's, so I'm going to answer your questions in 2 forms. First, our process is very important. We figure out what your cash flow is going to be from your portfolio and we do that for 5 years and we look at all the companies, what do they own, what's happening with their rent? And we forecast what's happening with in your cash flow and right now cash flow is growing on from your properties in about the 7% per year range. NOI, Net Operating Income. That's unusually strong, that's a rebound skill from a bad recession. We anticipate we'll probably start going down to the 3 to 4% range as things start leveling off. So we have cash flow fast today slowing down but in our system because we're real estate buyers we got 5 years and we say okay here's the cash flow you're going to own, what will someone pay you for that? In our world we call it a cap rate which is like a multiple, what would somebody pay for your cash flow? So in that we've already banked in at the end of 5 years that our based cap rate starts at a 4½% treasury market. Then we put credit spread you know this is a risky business I mean it's not like the treasuries and then we take that rate and we say whatever the cash flow will be then let's bring it back at that discount rate.

Kenneth Statz: So one of the reasons I think we had some relative underperformance when interest rates were going down is we were already expecting interest rates to go up so when the market was all excited about interest rates going down and paying a lot in the short term for what we thought was poor real estate, we were like well in 5 years interest rates going to go back up and it's poor real estate it's not that valuable I mean the markets perhaps going the wrong way. So we were already baked in so first off we've never believed interest rates when the treasury market was under 2%, that didn't affect our values at all, we didn't pay anymore for a week. We just said no, 5 years out when I have to sell your cash flow I'm not going to sell it to somebody with a 2% treasury. And so there was a lot of lower quality REITs that really went up a lot that we didn't buy but we couldn't make sense 5 years out well that's low quality stuff the credit spread is going to be wide higher we can't make sense of that. So we agree that with interest rates going up its going to change what kind of real estate works. Our belief is it will work for the stuff we own for you and that's what's starting to happen.

And so what happens I would think that there is a very important part of this puzzle because its cash flow discount rates interest rates and cash flow is what everything is. These companies that you own are performing better than we expected. I mean that's just the bottom line. They're producing much more cash flow right now, their operations are strong, their balance sheets are very long term fixed rate balance sheets that are what we want in your portfolio. And they're just producing a lot more cash flow than we thought so that's why we're kind of not using any cash right now because yes we've already baked in higher interest rates but the cash flow is better than we thought. Cash flow is good and so when we're looking at the different property types it's pretty simple. All those equal we want very short term leases with high occupancy rates and very long term fixed rate balance sheets because if your debt is fixed for long periods of time, in the rate you pay even if interest rates is starting to go up you don't have to pay more debt costs. Eventually you will but many years from now. That's what working in the market, that's what's we've been seeing in your portfolio anticipating and I have to tell you it's a relief to us it's starting to happen. So that's part of our belief in your portfolio that we wouldn't own some commercial real estate with long term leases and perhaps balance sheets with very short term debt but if we could buy the stuff that is producing very good cash flow today and has very good balance sheets, we think you actually should make some money in your portfolio. This is not something that we expect you to they'll be volatility when interest rates are starting to go up but we've already anticipated that how we selected what your portfolio is about.

Kenneth Statz: If you look on page 25 and there's a lot on this scale but it is important if you look at the 2nd quarter just to notice that apartments in the middle that gray dot that you see, the fact that it's up in positive that means you've had positive performance in the quarter. That actually made money for you. You can see storage the gray dot. These are important parts of our theory, which is even if interest rates go up you're going to make money in this environment. So I would suggest that this environments very good for our process. We understand I think the effective interest rates and commercial real estate and I think we're starting to get the relative performance for you on top of your decision which was strong which is to go into REITs at the right time. I think our system's starting to work very strongly for you instead of just keeping up with the index we're starting to outperform the index. So this was an important quarter. I was very happy to see it happen before I came back to Guam. Gerard Cruz: So are we. Kenneth Statz: And I think it's indictive of the strength of our system and you should see more of that in the future. So. Gerard Cruz: So higher rates huh. Kenneth Statz: Higher rates.

Kenneth Statz: Before I go onto sort of the outlook, any questions on your portfolio in terms of where it's focused? I mean it's very simple. And there's something I didn't mention is we think the highest quality real estate is relatively attractively priced right now. We think the quality of the cash flow is superb, the ability to produce rents is rising very well in the high quality and the reason for that is it's so expensive to build real estate in the Unites States right now in the best markets. And I'll have a picture on that. The price of concrete and steel and now land is skyrocketing in the United States and interest rates going up make it also more expensive to build. So if you own great real estate in the best markets, your ability to raise rents is going to be superb right now, much better than in low quality. It was kind of fun to see the new hotel going up on the bay there. That's nice to see new product and when you think about that hotel think of you know great location and it's probably pretty expensive. I bet their rates will be fairly high when they open because it cost them a lot of money to build this thing. So they're going to be very high. But that's good over time will be good for that whole market because you want fresh product you'd want good real estate.

So that's your portfolio highly focused on the best balance sheets, the best real estate. Focus in two areas we think do really well when the rise of interest rate environment, large scaled malls retail because for the better economy people buy more in the high quality real estate malls are doing much better than all the other malls. And also multi-family because short leases and big store in the United States is even though the housing market is back the apartment market which we believe would be true is also very strong and remains very strong so that's a great market to be in right now. So before I go into outlook any other questions on your portfolio? Gerard Cruz: No, looks good. Wilfred Leon Guerrero: What kind of health care do you have? Kenneth Statz: That's a good question. Wilfred Leon Guerrero: Do you own a hospital? Kenneth Statz: Yes, but not much. In the United States REIT industry and health care. Those companies now are very large companies, $25 billion dollar companies of trade in the market and they own 4 different kinds of properties. They own nursing homes, long term nursing homes. They used to that's mainly what they own. Now they own about 20% of their portfolios in nursing homes and the good news about nursing homes is its safe business but it doesn't grow a lot and it's also a function of how much the U.S government will give to Medicare and Medicaid for nursing home people. And so it's very it can if Washington is stingy which they are right now, that business suffers because they'll cut reimbursement rates to nursing homes.

Kenneth Statz: What we've been focusing and we like the healthcare business a lot right now is because there's a lot of people getting old and that's nice but there's another part that's much more interesting. Independent living in a system where you're not in a nursing home but you're in a special facility that looks a lot like an apartment. What we like about it is high occupancy rates and its private pay, the government won't pay for assisted living and independent living so these companies have gone dramatically into that part of the business but it's like a multi-family part of the portfolio we like that. They also been a medical office building which are next to hospitals. So it's office but it's medical office and what's happening there is a lot of big doctor groups in the Unites States are all getting affiliated with hospitals and that's making them a better credit and they're able to pay more rent and we kind of like that.

Then finally there's a little bit of hospitals in there but not a lot. And so there's a lot of different parts of this, the healthcare business is usually when you think you're going into a recession, people like to buy the healthcare because of its safe, people still have to get well and things like that. But right now with rising interest rates we emphasize that a bit because their leases tend to be sticky more like bonds and so in a rising interest rate environment that's part that suffered in the REIT market. That's why we future it even though we'd like to say is weak doesn't have enough short term growth. But it's an interesting area these companies now are very, very large. They pay very high dividends, yields of 5½% or so it's very safe as equity. So sometimes we'll own a lot of healthcare for you other times we'll own less, right now we'll because of interest rate rises right now we own less for you. And the hospitals are small, small part of it but the biggest part of it is again independent assisted living some nursing homes and then some medical office space that's what it's all about.

Now I'm going to focus you on the most interesting page here page 31. And of course I would take 2 points. This long blue that went up crashed went back up obviously if you look down at 2009, that's beginning of 2009 just look up that's exactly when you started investing in REITs. So just to be very clear that's when you started, bravo. Wilfred Leon Guerrero: We designed it that way. Kenneth Statz: Yes I know, brilliant. Gerard Cruz: No we didn't, market time. Kenneth Statz: You know what I will tell you a lot of people after the steep declines were ready to go into the REIT market and you did, we have a lot of people who sat at the sidelines and waited, waited, waited, so bravo, but now look at that line that's straight up that's what's called 20% per year, that's terrific. But where are we today?

That's what I'm going to talk about and I'm going to talk about is it possible for this market which has certainly gone up a lot down a lot up a lot, what are the chances that we are in for as interest rates are going up or something unforeseen that you can go back down a lot. And so that's the first thing I'm going to talk about and how you go down a lot. Let's go back from that 2007 and down. Two things were happening at the same time. It was all inter related but the economy in the United States crashed, at the same time credit spreads but people required to own risk sort. So that's what and remember you own the equities so if you look at the black line, that's unlevered real estate in the United States and that went down that's a value of that it's called NCREIF it's an index. It went down 30% peak to troth from where it was. Since you own leverage real estate at 60% leverage that's how much that they had, you went down you didn't but the market went down 75% because that's what happens when you're levered.

Kenneth Statz: So one of the key things I'm going to tell you right now is as we're at this other you know cash flows come back, commercial real estate markets have come back, the REITs themselves have a lot less debt than they did going into '06, '07. Going into '06, '07 they had 60% debt, 40% equity. Right now they have 60% equity, 40% debt so they flipped that accordingly. That's very important right now, the balance sheets on REITs terrific, terrific shape. So that's part 1 and I mentioned bonds before. We will look at the bonds of REITs very carefully because if all of a sudden the price of bonds which traded in public market just like the equity start going down a lot more so than an interest rate rise would indicate, that means the markets starting to worry about that we could have a sharp throb in property values. The credit spread on REIT bonds is the best it's ever been in history and it remains very, very tight. The bonds of REITs are indicating, number 1 that the recapital structures are in terrific shape, you own the equity not indicating any concern and we can concur with that. Balance sheets are in terrific shape and their access to debt is terrific.

The other reason was cash flow going down. And that's why it's so important to look at cash flow right now. The cash flow of REITs, if you go forward to page 34, this is just showing you on all these squiggly lines all that's happening right now is when these lines are above zero, in our forecast that means the rate of change of revenue is positive. And every property type is positive right now a vary degrees some more positive than others. But right now we are in that sweet spot where things are growing on the revenue lines nicely if the economy gets stronger they'll grow even faster but what's happening is in general all your cash flows are going up in all the property types and one of the reasons worldwide is a strong right now is if you'll turn to page 38. The price of real estate to build new real estate continues to grow this is the U.S. construction cost index for everything you need to make commercial real estate in the United States. And you can see it even though it dipped a little in the great recession we had in '08, '09, it continues to escalade and this doesn't include the price of land in the United States and the price of labor. The price of labor in construction is skyrocketing. What happened was that sharp recession we had in United States, a lot of union construction went bankrupt left the business and right now the price of labor the price to actually build on top of these cost is very, very high. One of the reasons we're getting such good cash flow more than we expected is there's so little building going on in the United States. There's very, very little building so our cash flow estimates for you are and usually you ask for a guarantee, usually high conviction right now because in commercial real estate the toughest thing is when you get a lot of competition like you know that's going to cause a problem on the bay that new hotel going to cause a problem. But I bet not a huge problem because their costs are so high that they are going to have to charge a lot for those rooms. That in a nutshell is why commercial real estate is doing so well in the United States. Yes there's a little supply here and there but the cost of it is so high right now they can't under cut your real estate. Your own existing real estate and so that's the secret sauce right now. The fact that these construction cost are forcing up some new supply but the new rates they have to charge us so high to your existing real estate really won't get affected by that.

So you took the full benefit of a rising economy, usually when the economy gets better there's a lot more building. The reason there's not a lot more building is because construction cost, land and the labor is so high right now. That's what's happened that's why you should have commercial real estate in your portfolio because your stuff and the price that it was built at is very competitive to anything new coming up the ground. And so your cash flow is just better than we thought right now. We thought there'd be more building started but it still not happening, it's very little building. I told you on page 39, my bottom line. This is what we've looked at all the cash flow that we expect to happen in your portfolio and this is for the whole market. We look at the price of your stocks, the prices of real estate and then we figure out with all that cash flow what's the discount rate to bring it back to current market pricing. That's the top line 8.7% that's for the whole REIT market. We believe that the cash flow and the price you're paying even if you just bought all of it you'd make an 8.7% rate of return. Your portfolio is about 9.2% on a 5 year rate of return.

Kenneth Statz: Again the cash usually at this point of time I'd have to say but watch out for this, this and this. The most important thing is your cash flow growth. With no more building in the United States that's happening your cash flow growth is in very good shape, that's the bottom line. And if we keep your leases short, even with interest rates rising as they are starting to do we think you're going to make net 90% range in this environment. It'll be volatile but 90% and so when we look at the entire market you're 1% cash right that means we like the market a lot but we like the parts of the market that we've chosen for you. So I think it's a very strong story right now not in which is surprising I think with the interest rates going up but again our system we anticipate that so we're trying to figure that out all the time. So I'll stop and let you ask more questions.

Wilfred Leon Guerrero: When you talk about I need to ask you this, changes in personnel and any regulatory agencies have issues? Kenneth Statz: No we continue to of course be part of JP Morgan so we're carefully watched. JP Morgan clients is terrific. All of our audits are fine. Wilfred Leon Guerrero: JP Morgan is categorized as something? Kenneth Statz: They've been in the news a lot. Wilfred Leon Guerrero: What did they do? Kenneth Statz: Oh good lord, they'll say anything and everything. You know its 260 thousand people, it is a monster place. You know number 1 they got involved trying to hedge the big book of JP Morgan where they were trying if bad things happen they wanted to hedge it and they got aggressive I don't even know exactly how it all happened. Wilfred Leon Guerrero: London again right? Kenneth Statz: The London Rail they lost 6 billion dollars on their hedges and now the FBI is involved so it's too bad. Wilfred Leon Guerrero: Why they don't go to jail when those things happen? Kenneth Statz: Well I think there might be people going to jail now. Gerard Cruz: Really? Kenneth Statz: Because the FBI is doing it. Wilfred Leon Guerrero: I like to send them cigarette or something. Kenneth Statz: Yeah I think the investment management group which will work harder our investment management group manages 2 trillion dollars, 2.4 trillion, they came out of the recession and all that stuff very, very well, I mean no problem no regulatory issues things like that so it's a big place our part is doing very, very well and the firm is still very rock solid. Wilfred Leon Guerrero: Stay away from London. Kenneth Statz: Yeah I guess I don't know about that. And they've had problems with the energy market it's a big place. They treat us well and their great people so. Those are fair questions. Gerard Cruz: You guys are pretty independent right? Kenneth Statz: We're totally independent. The only thing that JP Morgan does for us is they compliance in legal and what's happening in our platform right now because of the fact that we do full capital structure investment, we're getting a lot of business REITs from them right now because the real asset group is using us as a commercial real estate core account. You know there are lines of people in the

United States Cues are called trying to get into direct real estate funds it's very popular right now. They're using us for the cue. Gerard Cruz: To do direct real estate? Kenneth Statz: No while they are waiting. Gerard Cruz: Oh while they are waiting. Kenneth Statz: While they're waiting, yeah the cue. It's kind of interesting I mean we've never used that. But you're right we are very stand alone we are in Chicago, everybody else like our boss they are all in New York. We are the only part that does what we do and we do it in Chicago.

Maggie Ralbovsky: JP Morgan has another REIT platform. Kenneth Statz: Yes they do. Maggie Ralbovsky: So what's their thinking on that? Kenneth Statz: Well remember JP Morgan bought us accidentally, they bought another bank called Bank1 and we had just sold our business to Bank 1 in 2003 and so my partner and I sold the business to Bank1 and then 51 days later JP Morgan bought Bank 1. So they already had a REIT platform right and so the thinking at that time was oh well will that work but the other platform was in the equity group and we're in the real estate group. And so we're now what 10 years later, we're still there and they're still there and I think it's because they run an equity product. It's really more in terms of I think more momentum sort kind of things I think. We run a real estate product but we're saying well what real estate are you buying, what real estate do you own and how is it financed? And so we have our clients say their clients and they do global we do not do global. Wilfred Leon Guerrero: Okay. Kenneth Statz: Well thank you very much. Gerard Cruz: Thanks, Ken. Kenneth Statz: I really appreciate coming in. Now I'm just going to be down by the bay.

Cornerstone

Gerard Cruz: You're tired. Dave Wharmby: No revitalized. Had my nap early late morning and ready to go. Wilfred Leon Guerrero: We thank you very much for coming and same routine, 45 minutes to lead us in discussion and we reserve the right to interrupt you at any time. Dave Wharmby: Please do. Scott Westphal: We enjoy interruptions because they are usually good questions. But anyway everybody has the books that were provided here. Dave is going start out and talk about a little bit about some big picture organizational things and then I'm going to get into the U.S. picture here in a little more detail and you know as you imagine please free to look at this at any time. And you know we enjoy your questions.

Dave Wharmby: So just on page 4 really quickly, I know every year you like to hear if there's any changes with the firm organization and structure. No big changes, we're continuing our growth, Cornerstone overall has $40 billion dollars of assets under management both public and private debt and equity. The largest part of our business is private debt underwriting. We also have the big private equity business. The securities business is a growing piece we're subsidiary of mass mutual financial group as you know. Changes were always on the private equity side, we're always launching new funds and their usually themed around what's going on in the recovering macroeconomic environment. So there have been new debt equity funds of the private side of the firm the firm has launched. Our goal is to launch two new funds every year. So that's outside of what you invest in but that's part of the growth of the business.

Dave Wharmby: On the security side, one new product has been launched. We launched a global real estate fund it's a mutual fund with Oppenheimer our sister company. So it's a global real estate it's called the Oppenheimer global real estate fund it includes developed an emerging markets. Gerard Cruz: Those are recent launched. Dave Wharmby: Yes, April. We've been managing the strategy for about 6 years. We have a gets compliant track record that's almost 6 years old and we just launched the fund with Oppenheimer, mostly retail in fosters but there's some other shares not corporate shares for institutional investors as well. That fund has grown in short amount of time to $100 million dollars so it's growing quite rapidly, seems to be a good focus there.

Dave Wharmby: Terms of the organizational structure of the firm, no changes. Page 6, I'll highlight a couple of things for you. We did open an office in Tokyo probably since Scott was here last year with two individuals there that are client service and also looking for new business for Cornerstone on the investment side. And that joins our Hong Kong office for our two offices in Asia. Two smaller offices we opened in Europe as well in Stockholm and Helsinki so of course it's continuing to grow globally. And then on the team there's been new edition to the team, I'll let Scott describe.

Scott Westphal: One thing I want to remind everybody is that you know Dave has been the corporate portfolio manager around our U.S. strategy overall so he's you know he oversees the global effort he's also our major contributor to our U.S. management effort and something that I want to remind people about because some people forget it sometimes, anyway just to mention that. He runs the Global portfolios but the thing I want to special note on this is that we added a very similar member to the U.S. analytic team, Mike Marron. Mike came to us from European investors which is a you know pretty well established in the U.S. the real estate security. Wilfred Leon Guerrero: Finally hired an analysis? Scott Westphal: Yeah. Wilfred Leon Guerrero: You had two vacant right? Scott Westphal: We did and we basically put some very senior level person.

Dave Wharmby: What we had we had two kind of mid level guys and as we looked at how the firm was growing and our business was developing, rather than replace two mid level guys we went out and got a very senior guy so Mike has almost 30 years of real estate experience. Wilfred Leon Guerrero: So you don't have things covered? Dave Wharmby: Yeah we are very covered, we have one we're essentially fully staffed at the moment. We are going to hire somebody in Hong Kong and that search is going now as part of our growth. Scott Westphal: Mike is one of the executives we really were attracted. We've had a long term policy here that we talked to you before about. We want people that are real estate securities handlers that also have direct real estate experience because we think that underline the really understanding the underline real estate for these companies are really key to our process and key to our fundamental analysis. And the thing that we liked about Mike is that he not only had over a decade's worth of securities analysis experience but he also had over a decade's worth of direct real estate experience as well. So he was somebody that was you know fairly well known, very highly sought after in the market place and the land and we're very happy about that. He's worked out great for us.

Scott Westphal: If you go to the page 9, want to go over the our view of the sort of the U.S. economic backdrop because they're such a key driver in everything we do. One of the things that we've been talking about for a number of years is that on page 9 the chart shows that we actually recovered more than the GDP that we've lost, the economic activity that we've lost due to the down turn in the economy. The thing that is been a little frustrating and I think it's probably something you're all too aware of is that we've done it with less people so we've recovered our GDP doing with less people that means we're more productive, that's a good thing in that a proactive economy is a good economy. The fact that we still have 7.4% unemployment in the country is not a good thing. We need to drive more job growth and we'll talk a little bit about that during the duration of this presentation. But essentially our expectations for GDP growth are running between 2 and 2 ½% as you can see as our forecast in the bottom here. And our expectations for growth in unemployment are trailed a little bit by 1.6 and 1.9%.

Scott Westphal: If you go to page 10, you'll see that one of the real positive things supporting U.S. economy is that the network of households in the U.S. has actually recovered completely from its downfall. It happened during the credit crisis and that's really a function of the fact that the housing market has recovered and the stock market has recovered. Why that's important is because consumers are impacted by what we call a wealth effect and if people feel wealthy either because the value of their home is increased or the value of their stock portfolio is increased, that generally adds to additional consumption. Consumption adds to economic growth it adds to high demand for additional real estate.

Scott Westphal: The other thing that I want to point out here though is that we do have a little bit of a concern, we have rising debt levels in the U.S. still a lot of that I mean the real out wired here it's going straight to the sky here, our student loans, and as you are probably are well aware escalating student loans are real problem for not just the U.S. but around the world as you know kids struggle to find a way to finance their education and it's a real challenge for the U.S. economy and around the world. We need to figure out a way to better finance education so the kids don't come out of school burdened by hundreds of thousands of dollars worth of debt, it's a real challenge. I mean if you look at this line it just sort of hits you right in the face. In terms of other forms of debt. Antolina Leon Guerrero: Is this in dollars or numbers or bonds? What is this? Scott Westphal: This is actually index. Dave Wharmby: It's growth from a base line.

Scott Westphal: The other forms of debt, consumer debt basically are also credit card debt are growing a little bit. There are concerns that we do have with debt levels is that although debt service is lower part of the reason debt service is lower is because rates are so much lower. Rates continue to increase that debt service could go up. That is a yellow flag that we need to be conscious of. Another interesting thing about our economic recovery here on page 11 is that typically a major driver of the U.S. economic growth picture is the housing construction business and as you can see here by the dark line, there really hasn't been as much housing construction as there've been in past recoveries. And this is something that we think is a future leg of growth for the U.S. economy. But obviously it hasn't occurred yet so there is some concern about how much it's going to kick in, in a major way and how much it's going to contribute to the overall growth of the U.S. economy. Right now we're developing less than a million units of housing typically in a pretty robust recovery we're developing more than that. And part of that is because we are coming out of such a deep hole and part of that is that there is an affordability issue with housing in some markets in the United States.

If you go to the next page, one of the things that track pretty closely is consumer confidence because consumer confidence over time not necessarily coincidence indicator but over time it's a pretty good indicator of what's going to happen with retail sales. The U.S. economy is 70% consumption so obviously retail sales are very, very critical. As you can see here, the blue line is really at a meteor rise recently but the growth in retail sales hasn't really accompanied that. We think that will kick in either later this year or next year but it is a source of respiration for us. One of the reasons that there's a little bit of a lag is that people are spending money on autos and housing and not necessarily in the malls because there's been a bit of a lag effect on autos the average age in the auto fleet in the U.S. is old it tends to cause for more buying that's what's going on right now. We also had a lag in housing purchases, that's what's going on as well.

Scott Westphal: In the bottom here obviously employment is very important for us because employment drives household formations, household formations drives the demand for real estate and employment as you can see here on the right hand access the growth and employment is extremely strong in some of the southern and western states of the country. A lot of this has to do with what we're cost to doing business it also has to do with the fact that two of the big drivers of growth in the U.S. Economy are energy and technology. A lot of that has taken place in some of these western and southern markets. So we look for more growth and employment in energy and technology. We also look for more growth in the construction trade associated with the housing boom that we were talking about earlier. If you go to the next page, we have a couple of pages in here that talk about the international economic back drop, but let me give you a couple of explanations for why we inserted it in here. We are a very obviously a very connected role economy. How Europe does and how Asian does impacts the U.S. in a very profound ways. And you need to understand what's happening in those markets both from an economic point of view and from a real estate point of view. And so what we thought what we would do is let Dave talk for you for a little while about what he sees going on in the international markets part of his global analysis and just give you a little bit of a backdrop of how it impacts the U.S. economy and the U.S. real estate markets.

Dave Wharmby: Yeah it's important obviously because our trade partners in Europe and Asia have a lot to do with the U.S. economy and Europe is taking a different approach. Europe took an austerity approach which caused a short term pain and the theory was longer term benefit and we may in fact be beginning to see some of that. The chart on the top left shows you annual budget deficit situations are improving across the Euro zone and with that you see PMI's are expanding and they are above 50 in some of the northern European economy. So with PMI which is basically a measure of overall growth sort of expanding budget deficits coming in line. European government have taking a softer stance on austerity lately meaning although they haven't actually dominant the meaningful way yet, they are talking less about taking money out of the budget more about spending a little bit. And you can see the bond rates they had the spikes throughout different parts of the euro crisis are generally in line with the U.S. now France, Austria, Switzerland, Germany their borrowing rates are all around 2% for the long tenure sovereign.

So this is telling us is that Europe prepares to be lifting out of a recession finally. We need to see some more confirmation before we get really excited about that but it is important if the U.S. is starting a little bit of austerity and there are some things that we might be doing in Washington that might take a little bit of money out of our economy. It's important to know that Europe might be able to balance that at least in a global sense. So Europe looks slow but steadily recovering and perhaps finally out of a recession. And with that there's been a lot of attraction to European real estate markets. Mostly in prime markets London, Paris prime locations but there's very, very high demand, very competitive for real estate in those markets. Real estate yields have been driven very, very low but it's really the top 10% cream of the crop and there's a lot of investment opportunity in Europe should Europe continue to improve, pull itself out of a recessionary environment. So that's positive for the U.S. to the extent that it helps balance what might be continuing slow growth here.

Dave Wharmby: Couple of quick points on Japan, on 16 and 17 also fairly interesting I'm sure you're quite dialed in to abenomics and what's going on in Japan. It's had quite an impact on the capital markets and the equity markets. The stock market is spiked quite a bit in Japan including the property market. Abenomics is as you know has got 3 different approaches, 3 different pieces of it, the 3 arrows they call it and one is the 2% inflation target sort of driven by quantitative easing sort of U.S. dollar quantitative easing. The reason that's important the way the equity markets are reacted and why real estate becomes more attractive in that environment is we've had a such a prolonged period of deflation in Japan, we've basically have had negative growth rates in the real estate cash flow so you're projecting lower rents, higher expenses and you've reached a reflection point where you're seeing office markets in particular bottom and at the same point the idea of an inflation target suggest that grants may finally begin to grow. So you take negative growth out of your models, put positive growth in it's quite a dramatic impact on the value of that hard asset. So you've seen as a result Japanese real estate companies listed real estate companies up 60 or 70% with actually looking quite cheap still if you are able to achieve some growth in Japan. So that's what's important for Japan it's pretty aggressive experiment and bares careful watching.

Scott Westphal: And we know that obviously the Japanese economy has a pretty big impact on Guam through your tourism. Gerard Cruz: The yen rate is not helping, being as dollar as strong against the yen doesn't help us. Dave Wharmby: That's the other yeah you see that here in the yen shot up to above 90 and above 100 briefly. Wilfred Leon Guerrero: What's the exchange rate now? Gerard Cruz: When I was there it was a 100 actually. Scott Westphal: Well that's part of their strategies they want to devalue their currency so they can be more competitive in the global trade market. Gerard Cruz: It works for us when we go there. It's just when they come here. Wilfred Leon Guerrero: We want them to come here. Scott Westphal: You want them to come here. It makes figuring out the exchange. Joe T. San Agustin: There has been a decrease in Japanese tourist in the last 6 months. Dave Wharmby: I asked my cab driver about the economy and he said there's been an increase in the Korean is that true? Well the Chinese too, that's good. Gerard Cruz: Chartered. Joe T. San Agustin: They come in for 30 days for one month. Scott Westphal: Russian too. We're at the Sheraton and the guy at the desk told me it's over 90% the occupancy. Gerard Cruz: Yeah that's at Sheraton that's kind of outside the strip. Wilfred Leon Guerrero: I think the numbers are. Gerard Cruz: Oh they are occupied, yes. Not by Japanese though. Scott Westphal: Sheraton mention they were targeting Korean group business. Joe T. San Agustin: They are making up the difference. Dave Wharmby: Has it been enough to make up the drop in Japanese? Gerard Cruz: Not really. Dave Wharmby: Not quite. Gerard Cruz: Koreans don't spend much. Independent. Dave Wharmby: That's what the cab driver said. Scott Westphal: We need to bring the big spenders here that's why. Joe T. San Agustin: The big spenders are Japanese.

Gerard Cruz: We have a Russian Visa waiver so they don't need Visa. Dave Wharmby: Okay that works, that's smart. The countering what's going on in Japan, potentially countering what's going on in Japan as the continued we view it as a soft landing in China continuing to manage their economic growth. It's focused on property so it's something we watch pretty closely Anna Zhong in our Hong Kong office is Chinese national and she is very plugged into what's going on locally. The GDP for so long have been driven by infrastructure spending and real estate spending they did that from the all the way through the global financial crisis sort of managed the economic growth and managed the social situation in China. So the result is now with the global economy sort of getting better the central planners in China view that they have a little bit of leeway they begin to manage that growth right down. And really what they are trying to prevent is property hard rise in pricing bubbles. Some other bubbles but what we deal with is the pricing bubble. Property is still very expensive in the tier 1 cities in China, not accessible for a lot of the population and the government is trying to manage that. So China.

Gerard Cruz: How would they do that though? Dave Wharmby: They are doing a lot of things there. They are requiring higher down payments, putting limits on the ability to purchase a second home by requiring no lending in some cases and they can also do it directly and indirectly by managing what local governments are doing, what the local banks, how the local banks were able to loan. So the first thing they do is the first thing they did and they've been managing this for 4 or 5 years, they start raising the down payment requirements, so that you have to come up with more money to be able to buy a unit. Then on second home purchases they make that down payment even higher. They are experimenting with real estate taxes in some parts of their country which is the first time they haven't had real estate taxes. So if you were newly wealthy Chinese you could buy these condominium units and there was very little cost of carry because condominium fees as we think about them were very low because of the cost of labor and there were no real estate taxes. So you could carry and many of these investors that bought these units didn't even bother to lease them. In fact if the unit had been occupied it's considered less valuable than if it had never been occupied.

Scott Westphal: Some of our union bought out. They just buy like the Shell unit and hold it as a good long term investment. Dave Wharmby: So the developers are assured so they when the government started limiting the rates price increases through these direct and in direct methodologies that they have, so the developers were smart they say let's just deliver the unit unfinished, prices won't go up but the effective price went up because you're getting an unfinished unit. But the investors didn't mind because they are buying as a second gold brick buried in the back yard is the way that real estate is viewed in China. China is also exploring mobilizing investment programs for individual investors so they're likely to have mutual fund type regime through Hong Kong where Chinese investors can invest in this Hong Kong mutual fund regime. Our sister company Barring Asset Management is very involved in working in trying to provide advice and figure out how that would work but there's a sense be very limited very restricted and slowly allow Chinese investors. They don't want to flood of money in or a flood of money out, so they're carefully managing that. But it's another way to soften the property bubble is to allow investors other vehicles you know if you are Chinese national you have very few places to invest your money in. Real estate being the most sought after so it's going in China we don't expect GDP we expect GDP to sort of bottom out between 5 and 6% that's low historically for China but we still view it as a soft landing because it's managed. A number is just a number they could have 8 or 9% GDP growth if they took the curbs off the property market but we sort of see it. And then with what's going on if Japan's successful in inflating their economy a little bit, Europe is coming out of a recession. We are continuing to grow in the U.S. we think overall slow steady global environment.

Scott Westphal: Right, which we you know in the real estate world we love steady, moderate growth because what it does it allows landlords to increase occupancies, increase rents for dozens spur a lot of development generally there are two ways to kill a real estate cycle, you either kill off the demand or you flood the supply. As long as we have financing relatively difficult to get for construction, and we don't have out of control development that's good for the long term picture. Dave Wharmby: Another issue is worth talking about Scott is another sort of fear that's come up is our rapidly increasing interest rates that would affect real estate and rapidly increasing interest rates would affect real estate but we don't see rapidly increasing interest rates. In order to have that we have to have really robust type economic growth and inflation across the globe. And there are some challenges in some emerging market but generally you worry more about deflationary environment is some places not inflationary. So in the U.S. and it affected Japan a little bit when the Feds started the tapering talk at the end of May, the U.S. treasury shot up a little bit, it's been volatile since then but our forecast basically or based on a did we go up to 3 and a quarter in that last revision 3 and 3 and a quarter 10 year treasury. Gerard Cruz: By when?

Dave Wharmby: We call it end of the first quarter of 2014 and then what we did was we went back and all our valuation models and recalibrated all our multiples and required yield rates based upon that and growing another 100 basis points over another 6 quarters to see what would happen. And there's more than enough growth in real estate in the U.S. to offset that the outside is concerned would be if something occurred where rates would spike up faster. In fact we're seeing a little bit of the opposite. Scott Westphal: I think rates are going to be volatile you know based on the Fed chatter. I think in general people spend way too many hours trying to dissect what the Fed says but I think essentially we're looking at rates between 275 and 3 and a quarter for a while and we basically got to everything under that basis. Dave Wharmby: Which is you know I think on a low is 1, 6 not too long ago right? Scott Westphal: Back in the spring. Dave Wharmby: So seems like a long way from there. But that was an admiration to but before that we've been running around 2,2 so we're not really seems like a dramatic increase because the rate has been so historically low but capital is still cheap. Then turn over to Scott some of the specific fundamental of the U.S. property market on 18.

Scott Westphal: We're going to go through and give you a pretty good view of what's going on with the major sectors of the U.S. real estate market. Safety part of the market first. You current market is in phenomenal shape in the U.S. There is as I will show you on a chart a little bit, the growth in supply but this growth is really in response to pretty strong demand. A lot of that demand is being created by the growth in household creations essentially being created by what we call the eco boom generation, the children of the baby boomers. Which I have two that are out of the house and off the payroll. Antolina Leon Guerrero: Are they moving out? Scott Westphal: They are out more importantly they are out of the house and off the payroll. Dave Wharmby: It was a little longer. Antolina Leon Guerrero: Light at the end of the tunnel. Scott Westphal: Yeah and the second one is way more important than the first. Dave Wharmby: Do they have rights to come back on the payroll. Antolina Leon Guerrero: Did you change the locks?

Scott Westphal: No but you got these household formations that are the result of the baby boomers children and that's creating a lot of demand for housing. These people are not at an age where they can afford to buy houses or condominiums, they don't have the down payments, they don't have the credit history so they're going to create a lot of demand for apartments. You're going to hear stories continuously about increase on development activity in the apartment markets in the U.S. It's a concern on certain markets but in general not a major concern. Just want to make sure you guys understand that.

Scott Westphal: As far as the office market is concerned, the vacancy rates you're going to see is published 15%, really are a bit of a misrepresentation, that's a national rate, it doesn't include the CBD the major CBD markets or includes the CBD markets but the CBD markets are much lower. The vacancy rates in the major CBD markets are single digits. Antolina Leon Guerrero: I'm sorry CBD? Dave Wharmby: Central Business Districts like midtown Manhattan. Scott Westphal: Downtown markets. Generally when you have single digit vacancy rates, you're able to raise rents because their just the type of vacancy rates that allows landlords to do that. And so we think in the major CBD or downtown markets we see the markets actually pretty healthy. The industrial market which is basically the warehouse market is actually recovering quite nicely with the recovery in the U.S. economy. We think this is the one market that's probably going to have the greatest sort of surge in the turnaround in the next couple of years because there's very little supply and the demand is increasing in a nice level of ratings of nice moderate rate of growth and demand.

Retail there's you know a little bit of something that you have to understand is that retails is a pretty complex probably type there's so many different types of retail and when we say 12% vacancy rate in retail it really varies a great deal. The vacancy rate in a quality regional mall is actually around 6 or 7%. The vacancy rate in any field community centers is actually in the high single digits and the vacancy rate in power centers is actually like in the low double digits. All of those are pretty healthy markets right now and all those are going to benefit from the RevPAR growth and grow occupancies in the future. So we actually have a big range.

The hotel market I think is one of the most probably one the strongest recovering markets we have in the country right now and I have charts that later on we're going to show that. But essentially we've got about 75% occupancy. You have to understand that in the hotel markets particularly business hotels, they're not occupied on the weekend. So when you say 75% occupied for business class hotel, that's essentially almost full because you have to take. Antolina Leon Guerrero: Does that include the non vacant I mean the empty weekend? Scott Westphal: Right. The empty weekend. You take that into account you have very, very healthy hotel market particularly for business class hotels. And if you travel to the U.S. recently and experience the rates that you are paying now, it's unbelievable, it's a little embarrassing how much rates have gone up. The reality is that the markets are in very good balance and demand is great. When you look at the vacancy rates by market you'll see that the apartment markets have virtually every major market are below their historical averages or close to their historical averages. And that's really a function of the fact that we've had such great household formations. We've had a lot of not only did we have a of a lack of eco boom kids we also had a lot of demand from the kids that wanted to get jobs, couldn't get them now their giving them so you have this sort of hemmed up household creation that's happening that is occupying a lot of the apartments that are out there. So it's a very favorable environment.

In the other 3 property types you'll see that vacancy rates are still in many cases above what historical average is. And I think that you know the positive news there is that you know we grow our earnings with a combination of internal growth and external growth. Internal growth is growth with rents and occupancy and external growth is growth through acquisition in the homeland. What we are seeing here in many of the property types is that they are able to grow their occupancy now in a pretty meaningful way which ultimately means they are going to be able to grow rate and very soon because as soon as they get their occupancy levels to a level where their below double digits in most cases, they are going to be able to start to grow rate. So you going to get a combination of growth and occupancy, growth and rate. That's a very favorable situation for real estate in the U.S. If you go to page 20, this is a little bit of as I said earlier little bit of a deep dive in the hotel market. You can see here that there is a really, really healthy trend here in terms of RevPAR. RevPAR is basically an acronym says it's basically revenue per available room and what it means is this is how much revenue you are getting per room on a year over year basis. So if you have RevPAR growth of around 6.9% which is what we're currently experiencing, that means that on a same store basis you're increasing your revenues by almost 7% a year. Which means your occupancies are going up but your rates are going up probably more than occupancies because of that earlier statistic I showed you which was basically showing that the hotels were essentially full at this point in time at least from a you know a business perspective. A very healthy situation, we do have some increase in supply in the market place which I'll show you in a bit, but it's actually very much under control.

Scott Westphal: There is a bit of a this is a little bit of a deep dive into the Washington DC market here as you can see you've had a very good growth in rates both nationally and the DC market and we think that that's going to continue for the most part. Again a little bit of a blip in DC because of sequestration but overall we're still a healthy market. You go to page 22, we're going to take a real quick look at what the supply situation for real estate is in U.S. markets, as you can see in the chart on 22. We're pretty much broke in supply and virtually every property type there, generally 1% or less when you can stop to consider that the population in this country is growing by about 1% and you also have properties that obsolesce themselves every year just by virtue of their age. That's actually a very modest level of growth in development for all property types and I think that's something the markets can digest very easily.

When you look on page 23, you'll see a little bit of deep dive into what we expect over come down in 2015 in terms of growth out of percentage base. As you can see, as I said earlier there is a bit of a growth in development in apartments more so than any other property type. We do think though large eco the demographic supporter it is you know basically concentrated in 12 markets. We focus very closely on the supply dynamics as high and demand dynamics by every market in the country and we're able to basically focus our portfolios in the markets that have the best supply and demand dynamics. Hotels 1.1% increase mostly select service product. Really doesn't have a major impact on what we call the upper scale product which is essentially business class hotels. The other property types as you can see office industrial retail less than 1% supply. This is practically no supply when you look at it over the long run, so we think that you know these markets are very, very good you know very, very balanced and not only that when you look at where the supply is concentrated it's generally concentrated in a handful of markets so nationally you'll have a better situation.

If you go to page 24, this is a brief review of where we are in terms of price recovery. As we talked about last year this continues to be the case we have a pretty healthy recovery in the gateway markets which are essentially the markets that are listed here in the 2nd bullet, it's basically the major CBD type markets. The other property types in their the other markets have not recovered as much we think they'll recover in the years to come but they still have a ways to go. The next. Wilfred Leon Guerrero: You're mentioning in Austin. Scott Westphal: In Austin? Austin is one of those places. You know when you look at it, one of the things that I studied very carefully is the growth in GDP by state and nationally GDP in the U.S. is growing around 2% but when you look at growth by state it's very interesting because states like Texas, in 2012 they actually grew their economy by 4.8% which is about 2½ times the national growth rate.

Scott Westphal: And when you look at the variation in the growth in GDP by state, it's very interesting information because last year the variation went from basically flat growth to as much as 10% growth depending on what state you're in. So by understanding where the growth is and how that impacts demand for real estate it really allows us to you know guide our portfolios in a way that is in a very informed way. So. Dave Wharmby: And you will see new supply in those areas where the economy is growing 4 or 5%. Wilfred Leon Guerrero: Yeah but what's happening there? Dave Wharmby: If it was an imbalance should be more concern but as long as the economy is growing 5%. Scott Westphal: What's happening in Texas is really a couple of things, one is it's a very pro business environment, it's a low cost environment to do business in, it's a low tax environment, it's also a market that has traditionally been an energy market so that right now there's a boom going on in energy in the U.S. as you probably know and Texas is sort at the center of that.

The other thing that's going on in Texas which is probably not as well known is that it's become a magnet for technology companies. In fact there's actually been a number of technology companies that were previously in California then moved to Texas. My youngest son Evan actually works for a company called Texas Instruments that is a chip producer in Dallas area. And they are very successful company and obviously a major technology company so you got not only a growing economy but you have a diversifying economy and that's usually generally positive formula for most markets. So you know that. Dave Wharmby: Cheaper cost of business than the Sulikin Valley. Scott Westphal: Right. The chart on page 25 basically just shows where we're at in the recovery in terms of how far property prices go. Where we're at in the recovery as you can see apartments in CBD office are really the only property types that have fully recovered or close to fully recovered the downfall they felt during the downturn of property markets. The rest of the markets still have quite a ways to go in terms of recovery.

The next page is the transaction buy in as you can see our transaction buy ins are picking up across the U.S. Transaction buy ins drive pricing, pricing drives the value of the property and drives the value of stocks that we invest in. In terms of our overall summary of the U.S. markets, we basically see our GDP growth at around 2 to 2½% now on page 27, and employment growth of around 1½ to 2% and you know we basically as I said earlier we like moderate growth. Generally is a very positive environment or positive backdrop where the real estate markets don't get a lot of spec development and that generally allows landlords to gradually increase occupancies and gradually increase rates without sparing a lot of new supply. And we think that you know the demand for real estate continues to be pretty strong institutionally and for individuals who are buying residential real estate and we think that, that you know continues to paint a pretty backdrop. We have a positive environment for investment, a positive environment for financing and a positive fundamentals for real estate market.

I want to spend a minute here on page 28, to give you a view of what's happening with evaluation on the REIT market. The REIT market did fall back recently partly because of the chatter Federal Reserve. We think that the market is attractively valued or at a minimum fairly valued right now. If you look at page 28, you'll see comparison of the dividend yield to be a corporate that's essentially an investment grade corporate bond that is typically compared to real estate. And as you can see basically the long term averages that REITs dividends are about 120 basis points below the yield average yield on BAA corporates actually were right in line right now. The AFFO yield the bottom chart is a measure of cash flow basically shows the cash flow of the REIT compared to BAA corporate yields. As you can see there we are right in line with historical average as well. So both these things are in pretty healthy shape despite the fact that we've had interest rates that have moved up quite a bit lately we think the real estate markets are attractively valued despite that. Dave Wharmby: And the difference between the yields and the corporates of course you get growth in the stocks and the earnings of the REITs and another point in the dividend yield status is that U.S. REITs are at very low payout ratios at the moment. They took advantage of the global financial crisis to stop increasing the dividends and in some cases cut them to the statutory minimum that they have to pay out and their still at those levels and being forced to increase. So actually Scott we see U.S. dividend growth at 9.

Scott Westphal: Time doesn't really permit to get into to explain to you why that's the case but that's historically been the case. So the reality is that you know REITs typically traded about 3 to 5% premiums to their net asset value. Right now they are trading at a discount with the exception of that one property type. Another measure of their relative track list in the market place. And on the bottom here is just a brief comparison of dividend yield spread to these health care sectors which historically had higher yields just give you additional information. Wilfred Leon Guerrero: Ken is there. Paula Blas: No. Scott. Wilfred Leon Guerrero: Scott, I'm trying to find out how much money you got? Paula Blas: About 51 at cost, 55 at market. Wilfred Leon Guerrero: You never talked about how much is in the portfolio. Only percentage. Scott Westphal: We generally we talk about the allocations within the portfolio. Paula Blas: 55 market. Dave Wharmby: The percent of the fund that we manage. Wilfred Leon Guerrero: Scott, I'm trying to figure what you got but I can't find it. Gerard Cruz: They manage. Maggie Ralbovsky: $55 million. Gerard Cruz: 55. Paula Blas: At market. Scott Westphal: It's something that we typically speak to but don't include in the report but if you'd like in the future we could include it in our report. Dave Wharmby: Yeah we should put it in there. Wilfred Leon Guerrero: How much is in the portfolio? Gerard Cruz: 55. Wilfred Leon Guerrero: 65? Maggie Ralbovsky: 55. Wilfred Leon Guerrero: Where are you getting that Gerry? Gerard Cruz: Wilshire's report. Maggie Ralbovsky: On this sheet. Wilfred Leon Guerrero: Okay, 65. Paula Blas: No 55. Gerard Cruz: 55 Sir. 5, 5.

Dave Wharmby: And the characteristics are in tab 3. The last 2 pages were just a summary of everything Scott and I just ran through so we can go ahead to tab 3. But you're right the top of page 34 we should put the account size there. Wilfred Leon Guerrero: And the return was how much? Dave Wharmby: That's page 36, so if you look at page 36 since inception when you start investing with us in December of 2008, your compound annual return has been 21.1% net, that's the furthest to the right, the year to date is the furthest to the left is your net is 5.3%. That's actually improved here through the end of August. Wilfred Leon Guerrero: This year to date. Dave Wharmby: And the 1 year. So these are the different periods of time that were requested so you got year to date, quarter 2, quarter 1, quarter 4 of last year the 1 year and then since inception. The timing of your investment was quite good in 2008 you caught it at the bottom of the global financial crisis and it benefited quite a bit from that but still strong as you see from the. Wilfred Leon Guerrero: From the quarter, yearly perform right that's what Wilshire is saying.

Dave Wharmby: Yeah based on this number here it is about 90 basis points of underperformance. But Scott you checked the year to date. Scott Westphal: For the up to date. From a performance point of view, I'm on page 36. The performance point of view we actually closed the gap we're basically even with the index right now. We've done that essentially in the month of August. Let me explain to you a little of what happened. You know last couple of months on May 22nd this year, Ben Bernanke spoke about his tapering effort and what happened was that shook the markets quite a bit and what happened was a lot of stocks that were well regard stocks got hit indiscriminately and so we had a bit of a tough quarter entering that environment. No one expected Ben Bernanke would come out and say that he was taking away the quantity reason and what he did sort of sent shock waves through the market. The market is recovering from it right now, and we're actually able to you know actually been able to put up some pretty good relative performance during that time period. So that's essentially what happened during that time period.

If you want to briefly speak about talk about the composition portfolio I'd be more than happy to do that on page 34 and 35. Wilfred Leon Guerrero: Yeah I'm actually more interested in knowing because we're looking at this is a yearly review and I was trying to find out how much we had last year and how much we made this year. Scott Westphal: Right. Well one of the things to keep in mind is that you do, do a dividend withdrawal. Wilfred Leon Guerrero: Right I understand. Yeah I understand. Dave Wharmby: Does come out of the fund. So when you look at that you have to take into account the dividend withdrawals that are used to pay. Wilfred Leon Guerrero: To me we just got caught up on all kinds of details and the major thing is how much did you have last year, how much did you have this year? Dave Wharmby: Well the most of it has been distributed as of the account size being pretty static I believe. Scott Westphal: A lot of it has and there's this in addition to the dividends there's been some withdrawals of capital. Gerard Cruz: We had to rebalance because there was a huge run off right in market value for like '08, so. Dave Wharmby: Well there's the distribution and a $9 million draw down. Gerard Cruz: 55 as of. Paula Blas: 8/23. Gerard Cruz: As of 8/23. But starting. Wilfred Leon Guerrero: 8/23, this report is up to date. Paula Blas: This is as of June 30. July 31st. Dave Wharmby: July 31st.. Scott Westphal: The dates we have in this report were the dates that we requested the most to include in the report. Gerard Cruz: Cornerstone started at 22. We're at around 55. That's net of the distributions. Antolina Leon Guerrero: And exceeded target. Dave Wharmby: So after the capital withdrawal and periodic dividend withdrawals. Wilfred Leon Guerrero: That is what I was looking for. Dave Wharmby: I apologize for that and we'll have them in the next report. Scott Westphal: We'll map that in for you and we should have that in the quarter reports as well.

Gerard Cruz: Did we give you some more money? We may have given you more money as well. Scott Westphal: I think you gave us like $12 million. Paula Blas: Started at 22. Dave Wharmby: Some point 2012 there's a $9 million draw down. Scott Westphal: Yeah but there was a draw down that off set that. Dave Wharmby: Yeah. I don't have the entire history, you know. Gerard Cruz: Okay. We can get. Diana Bernardo: I think it was in three separate instances, right. I think they were funded three times and at one time we had drawn down. Gerard Cruz: Oh that's right we got our feet wet and then we said okay. Paula Blas: Partially funded and then fully funded. Dave Wharmby: But your performance on 36 is the performance of the dollars at work and you have the trailing year has been about 32% you know we don't see that going forward. I mean that was a remarkable period of time but you do have you know 4% yield, you've got high single digit growth, you're still in a market environment where you've got kind of 8 to 12% returns for real estate. Scott Westphal: And the fact that you got the you know dividends to presumably use those to pay beneficiaries. Very important part of the program.

Dave Wharmby: One quick highlight on page 34 is you know the real estate securities market place has a handful of stocks that are very large capitalization companies so when you look at your managers you'll see Simon properties, Boston properties and a lot of the ownership we are really quite active despite the fact that we own number of those large companies. We like to show our largest active over and under weights. And these are in some smaller companies. Companies like Cube Smart and Extra Space, Acadia even Camden Property Trust. Camden is an apartment company that's in those high growth markets like Boston as compared to Avalon Bay the QR which are in those coastal barrier markets where Scott showed you the pricing chart. Those markets already at 130% peak value so we're out of those large cap companies. We're in the sort of smaller company that's got high growth exposure. So the portfolio really does reflect what we see going forward but you know from quarter to quarter there will be some volatility in the excess returns.

Scott Westphal: I mean we try to take advantage of you know smaller companies that have unique strategies that we think might add value for the portfolio. Dave Wharmby: And our single largest tilt on 35 is lodging in hotels as you can see that's something that over the last 2 quarters were note at pretty aggressive and that's consistent with our macro. Scott Westphal: And we basically we took a procyclical tilt with the portfolio that's hotels, that's storage. We think that's going to really pay off between now and the end of the year. There may be as Dave mentioned seeing volatility in the performance but we think you know overall that's our overview. Is there any other questions we can answer? Gerard Cruz: Is this relative weights? Dave Wharmby: Yes. Gerard Cruz: Is this by chance or is this by design? Dave Wharmby: By design. Gerard Cruz: I know that you're really you're under weight heavy on the apartment complexes or apartments in general, and earlier you talked how people are moving out, kids are starting to seem to be that you would be positive in the apartment.

Scott Westphal: We are with couple caviage. First of all we still have a pretty significant weight in the apartments despite the fact we are under weight, it's a fairly large sector within the REIT market. But there's a couple of things that you need to be respectful of, one is that although the apartment market or the apartment companies have had very healthy what we call same store and I grow up same store, than operating growth and that level of growth is to decelerating some and generally speaking the equity markets are not very favorable towards the decelerating growth. So generally speaking we tried it avoid companies that have decelerating same store in a wide trend. The other thing to keep in mind is that you know we do have to take into account the evaluation of the companies, the apartment companies in general are somewhat more aggressive value companies in the market place. So we may not own a particular sector we think the evaluation is too rich given the growth dynamics that we think exist in the market place. Dave Wharmby: The two largest apartment companies are Avalon Bay and Equity Residential and they're in these gateway markets that are 134% of peak value so by not owning those two companies we're structurally underweight the sector but very exposed to those high growth markets. Scott Westphal: The other thing to keep in mind too is that there was a major acquisition done by these 2 large companies, Avalon Bay and Equity Residential, they bought what used to be a company called Hearthstone, was taken private during the credit phrase and they bought that entire portfolio. One of the reasons that we're not overweight on those companies is that these companies had to do a very large equity issuance in order to fund that acquisition, and generally speaking the equity issuances are not something you want to be in front of because it's usually generally it's a little bit of a downward bias towards the value of stock. So you have to be careful that you don't own a stock, at least have an overweight position rather than issue a large amount of equity. And they are going to be issuing billions of dollars directly not like a small fund. So these are all factors that we have to take into account when we decide on what our portfolio allocation is. And we may very well have a larger weight in the apartment sector once the equity issue is first released to companies.

Scott Westphal: Generally speaking when companies do an equity issuance they generally do it in a discount to the previous market price and that's one of the ways they sell and buy for each investor to buy into the deal. That's something you need to be careful with. Dave Wharmby: So still quite an attractive environment for real estate. Scott Westphal: Any other questions we can answer? Gerard Cruz: No, I'm okay. Paula Blas: Mr. Chair? Gerard Cruz: Mr. Chair? Wilfred Leon Guerrero: You didn't answer me, I kept asking you guys, what's the initial investment, 51? Gerard Cruz: The initial is 22. Paula Blas: Housekeeping. Do you have any questions for them? Wilfred Leon Guerrero: No. Antolina Leon Guerrero: You getting the answers? Wilfred Leon Guerrero: Oh yeah. Any of the regulatory agencies have issues with you? Scott Westphal: With Cornerstone? No. Wilfred Leon Guerrero: We're doing this for the record, we're just you know. Dave Wharmby: No. Overly compliance shop can't do anything without checking with the compliance office. Scott Westphal: I'm on the very first name basis with our compliance office. Wilfred Leon Guerrero: Okay, thank you very much. Antolina Leon Guerrero: When do you head back? In the morning?

Respectfully submitted,

Angelina Castro / Marilyn Aguon
Recording Secretary

Affirmed:

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