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**Defined Contribution Plan**  
**Quarter Ended September 30, 2014**  
**Quarterly Performance Meeting**  
October 30, 2014  
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  
David O'Brien, Trustee  
Anthony C. Blaz, Trustee

**Staff Present:**

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

**Other Present:**

Terry Dennison, Mercer Investment Consulting Inc.  
Doris Flores-Brooks, Office of Public Accountability

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**Joe T. San Agustin**  
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**DC Plan Economic & Capital Market Environment**  
**DC Plan Performance**

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## **Economic & Capital Market Environment**

Terry Dennison: Let's start with where we think we are with the markets and the economy in the world. And clearly I think the markets are now coming to the realization that the 5½ year recovery since the global financial crisis may already be over. The markets are suddenly really prayed to the disturbing thought that the expansion that we've seen since the Lehman crisis even before Europe has regained its pre prior level of output has come to an end. We've seen commodity prices decline dramatically the price of oil has declined 25% since June. Obviously part of that is supply, Libya has come back on extreme increased its output 40% even with the issues in the Middle East around all the trouble in Iraq and Syria. There's still a tremendous increase in the amount of oil the Saudi's for their own purposes are pumping as fast as they can despite the fact that prices are falling. Clearly the rising amount of oil coming from hydraulic fracturing in the US has increased in supply and other commodities had fallen dramatically in price because the demand from China has slowed dramatically. We're going to talk a lot about the deflationary pressures in Europe that the pricing of German bonds is now in a near plummet slump literally yields are now down to well below 1% at the last I looked at them the yield was 81 basis points. Leverage has increased dramatically literally since 2007 gross global leverage according to Morgan Stanley calculation has risen from 105 trillion to 150 trillion that's the amount of debt that has grown in the world. Debt has risen to 275% of GDP and the rich world to 175% in the emerging markets. In China it's up 250% of GDP both are up 20 basis points since 2007 and both are historic highs we're just drowning in debt. The Bank for International settlements in Switzerland which is effectively the central banks central bank says the world is at a hair trigger literally any disturbance in loss of liquidity is likely to have "violent" effects and their quote is that the world economy is so damaged that it may need permanent quantitative easing. Literally the economy may be completely dependent on permanent perpetual stimulus from the Central Banks but it literally can't, not just grow but even sustain itself without constant stimulus from Central Banks. If Central Banks have to continuously go through these programs such as we've seen in the US the Fed met yesterday and decided to end QE3 but realistically even some of the former inflation Hawks like the St. Louis Fed Share Board suggest we name it a QE4. Incidentally the Japanese are in QE8 but literally there is a question of whether or not the economy can function. If you look at the chart of the US stock market every time there is a quantitative easing program the market goes up, every time it stops the market either stops going up or starts to come down again. Literally, it's just like an attic that needs a fix that every time they inject more liquidity into the economy the market goes up, the liquidity stops the market goes down. We'll talk a little bit about whether or not we're in sort of a secular stagnation that's actually a word or phrase that was invented back in the 1930's but it's now resurfaced we're literally in a period where the economies simply can't grow anymore they just become stagnant. Do you have a sense of how much the central bank has slashed their stimulus? Since the beginning of the year they slashed stimulus 150 billion dollars a month principally in the US and in China. The Fed and the People's Bank of China which has stopped two variance of their stimulus have done 150 billion others have trapped their purchases of bonds by half partly because they've seen not just a reduction of capital inflows but actually out flows a lot of this have been from countries that have been getting capital inflow either from inward foreign investment or oil or other energy producing countries or commodities exporting countries that are no longer seeing exports of energy or commodities.

The Brazilians are net sellers in fact they're carrying out reverse QE's where previously exporting energy and other commodities now that flow has gone in reverse they're having to sell bonds the Russians have joined them again they're selling about 8 billion dollars a month worth of bonds because not just of sanctions but literally they're not selling as much oil as they used to. The markets basically are now running out of liquidity and this is where the Banks for International settlements comment that we're just on the knife edge if there is significant withdrawal of liquidity literally the global economic system is in danger. It's less understood what the effect of the global reserves that have been accumulated in these emerging markets, emerging Asia in the Petro states what that's going to mean because obviously the Petro states have accumulated enormous amounts of money since the global financial crisis with the exports of oil and now a lot of that has gone in reverse. The Peoples Bank of China returned to them they've actually completely withdrawn from the global asset markets they're now being in to sell bonds. Previously they were a big supporter of US Treasury bond issuance but now they're actually selling bonds. Now fortunately our deficit has actually diminished dramatically where previously we were running enormous fiscal deficit because of the improvement in the economy and tax collection unlike our deficit has diminished a lot. So actually it's been very fortunate because the Chinese which were financing our deficit when we were running huge deficits are no longer in a position to buy our bonds and now are actually liquidating bonds but we don't need to issue.

Doris Flores-Brooks: Is China liquidating their bonds? Terry Dennison: Yes. Doris Flores-Brooks: Because why would they sell bonds until they sold what they have? Terry Dennison: They're selling from their supply of bonds they're not selling their own debt, they're selling treasuries from their supply in bonds for cash but fortunately we don't have to issue as much in the way of debt because our deficit financing is nowhere as near as great because we're not running anywhere as near as much fiscal deficit as we were in the past. Doris Flores-Brooks: That's primarily because of the economy is doing better. Terry Dennison: The economy is doing much better. Doris Flores-Brooks: Because we're spending just as much. Terry Dennison: Right, but the tax collection are much higher we're spending less on social programs. So we dodged a bullet if you remember in the movie Matrix, we got very lucky here that our need for external financing diminished just as our ability to get external financing about seeing a sharp rise in interest rates has diminished.

Looking at how the worlds evolve if you think about how different countries have got their fixed they're in they made policy choices fiscal and monetary during the global financial crisis and in effect the choices they made it really positioned things the way they are, if you look at how the US did basically they open the money valves with various QE programs and they basically engage in a fair amount of fiscal and monetary stimulus and that has worked quite well. The Bank of England had fair amount of monetary stimulus not as much as the US and a fair amount of fiscal stimulus and they've also turned out fairly well. Europe has not had either much monetary stimulus or fiscal stimulus and they're in a very bad place and we'll talk about and if there is going to be a domino that tips over the world it's going to be Europe. And Japan which never seems to actually get it right continues to struggle and they now started to try to increase their fiscal stimulus but now with the new consumption tax that's now going in reverse and now they struggle to reflate their economy. Printing money which is what we did in the US that was about 4 trillion dollars was very helpful they've not done that in Europe because of real constraint imposed by the Germans who of course have a concern and that's part of the reason they got 40% youth unemployment in the Southern

European countries and now continuous low growth and no growth in most of Europe and now we have double dip procession in Germany.

At this stage they're running out of options in those countries. There is some interesting implication with the decline of oil prices obviously a lot of countries have got relatively high cost of production. Venezuela which is one of the advantage of this some of these countries are frailed to high cost of production are fairly nasty countries and having them be made uncomfortable probably isn't a bad thing. Venezuela is no friend of the United States they have a cost of production of a 140 dollars a barrel, so at this point they're going to run out money pretty fast and they already have shortages of food, toilet paper and other things that are kind of necessary to have so that economy is a complete wreck. Russia has a cost of production of about 130 dollars a barrel but they've got lots of reserves. So thinking is they could go 18 months to 2 years before they run out of money. Wilfred Leon Guerrero: Why is the price going down? Terry Dennison: They're going down because demand is diminished a lot and supplies increased enormously, Doris Flores-Brooks: The US doesn't have to buy as much. Terry Dennison: Demand has diminished a great deal. China is not consuming as much oil, things like conservation in the US has really impacted. Fuel economy of new cars is dramatic, cars are not burning much fuel, and airplanes are not burning much fuel.

Basically economy works and there's less demand for oil and energy based manufactured products plus you have the amount result of fracking. The other thing is there's some little geo political games being played normally Saudi Arabia is kind of the swing producer of old pack. And ordinarily the Saudi's who got a very low cost of production basically you don't have to dig off shore wells at 100 million dollars a pop to get oil in Saudi Arabia basically you go to your back yard with a shovel and you dig a hole about 10 feet deep and oil comes out at least in the Eastern provinces. You don't have enormous cost of production with off-shore wells and everything and ordinarily they stomped up and said if there is a surplus of oil to keep oil prices high we will reduce our production. Well they obviously have got problems with the Iranians and the Iranians have a fairly high cost of production and in order to make it uncomfortable for the Iranians they've decided to drive the price of oil down so basically they're just pumping like mad. The oil price break about \$85 dollars a barrel and I think at this point the Saudi's are going to pump like mad and drive it down even lower because that just makes life even more miserable for the Iranians. So there's a little bit of geo political game going on. Wilfred Leon Guerrero: Is that a factor, the Isis? Doris Flores-Brooks: That's why they're doing it.

Terry Dennison: Well obviously the Isis situation is immensely complicated because if you get in to Islamic politics it all gets weird because Isis is nominally and it gets very complicated but the areas where there aren't heavy oil producers the problem is Isis nominally of the Sunni group of areas. Doris Flores-Brooks: I thought the oil production was financing Isis. Terry Dennison: Well they sort of taking over most of the oil actually in Iraq it's in the part that's not the Arab part of Iraq, the Kurdistan actually most of the oil is in Kurdistan and that's why to the extent we can besides it's a minority that we like to help the Kurds have been getting a lot of help, so a lot of the oil is in Kurdistan. The other thing is oil is not something that you can easily just pop in the back of a truck and drive across the border I mean you need infrastructure for this so they can seize it but what are they going to do with it. So, it's pretty easy to keep them from doing much with it and conveniently countries like Libya and Tunesia which were big oil producers that were really off line because of political

issues before but now they're back on line so that was disruptive but from an oil perspective that's kind of a side show but clearly the Saudi's were disgusted with the whole business and at this point if they could put pressure on Iran which is obviously Chiai dominated, part of the problem is the Eastern province of Saudi Arabia is predominantly Chiai, so this all gets immensely complicated. There's an interesting chart in the economist trying to figure out who's allied with whom on all of this and it gets complicated because this is now the perfect example of strange bed fellows. Now we're kind of under the covers but sitting on the bed with the Iranians who sort have likes since 1981 fighting against the Sunni back insurgency sort of related to the Saudi's kind of our friends it's all complicated over there I could see why it's so hard to keep track on who's side we're on. But the reality is the reason all prices are going down is there's a huge over supply and demand has dropped a lot and this is not going to go away. Wilfred Leon Guerrero: Not a seasonal thing. Terry Dennison: It's not a seasonal thing and realistically I don't think you are going to see oil go to \$30 dollars a barrel again but you could easily go down to \$50. Doris Flores-Brooks: Really, then we don't need L&G. Terry Dennison: Well then be short sided remember most energy products usually are priced out of similar basis in terms of energy content, petroleum related products are generally priced in parallel based on their energy value, so within some perimeters liquefied natural gas which is actually cheaper than oil because it's easy to deal with will go down as oil goes down because they are interchangeable. Doris Flores-Brooks: Not in the plants. Terry Dennison: Realistically you can have dual plants and what they do is burn the cheapest one they can get that's what they've done with the plants in California they burn the cheapest one they can get and it's almost always natural gas, because that's almost always the cheapest but they're priced based on their energy value basically priced at BTU bases. So I think you're going to see that as the energy goes down you're going to see more deflationary pressure a little bit on deflation because that's a really interesting economic effect.

Let's talk about the US in a short term; the economy has been expanding at a 3% rate for the last couple of quarters. Doris Flores-Brooks: I thought it was below. Terry Dennison: Well it's now starting to slip and a couple of factors that are causing that slippage. One of the weaker spots is turning into housing and part of that is something we talked about previously, home buying is not as strong as people expect it we talked last time about it. Doris Flores-Brooks: People are still living with their parents. Terry Dennison: Well exactly things like student loans, falling marriage, and birth rates you are also getting a social logical effect. The prior generations saw homeownership is a right of passage and investment they learned that from their parents.

Millennials today don't see homes as an investment they see homes as a burden. So the urge to own a home and the willingness to invest and encumber themselves with this debt isn't as strong and this is something that's beginning to pull growth down because most of us I suppose have homes and I still remember when we bought our first home and celebrated the first day we didn't go to the hardware store twice, you buy a home you buy all sorts of stuffs, you buy appliances you are always buying stuff and if you don't buy a home all of that economic activity doesn't happen and that could take a ½% of GDP growth. And while the government sponsored housing organizations Fannie and Freddie are now looking and here we go again are looking at perhaps lowering the standards on mortgages moving back into high loan to value mortgages 10% down to 5% down not dead to long mortgages like we didn't learn our lesson the last time.

The reality is they're starting to see slowdowns in mortgage applications, you're starting to see slow downs in building permit, you're starting to see slowdowns in new housing starts and that's going to have a very significant impact on growth. And while we've seen the headlines on unemployment rate drop at a gratifying manner, I think most economist now believe the headline on unemployment rate is pretty much worthless is a measure of economic activity. Most of that drop down to 5.6% is due to retirements, people leaving the labor force permanently, people giving up looking for jobs or becoming disabled on some kind of program and the reality is that simply not a measure of labor force vitality. If you look at the percentage of people working age in the workforce its historically low. So yes unemployment if you look at the statistics you would think the economy is booming, walk around any shopping mall and see how booming the economy is. Joe San Agustin: It's a good political redirect. Terry Dennison: The reality is people aren't stupid they walk around the mall they see the empty stores they walk around the big box retailers there's an electronic store not just in Southern California they're all over the place called Frys and for techies like me, my car can go to Frys all by itself it's not self driving but it can go to Frys all by itself, if you went down on the weekend the line at the cashier was like blocks long now you go in there now there's nobody in the store. You go to Best Buy nobody's in the store, you go to the malls there's nobody in the mall half the stores are dead. So everybody knows the economy is in terrible shape you look at any of the surveys so the reality is the unemployment rate doesn't really mean anything and while economist says the inflation is low go to the grocery store and see if you think inflation is low. I live in a wealthy community and I do wealth financially and I look at a can of soup, \$2.00 for a can of chicken broth and I ask myself up in the single digit percent class I'm up there and I have a social conscience too and I ask myself how in the world do people live but the reality is how do people live? If they have to work 1/2 hour to buy a can of chicken broth, how do they work? So the reality is the economy is not doing very well and real inflation not inflation as the economist see it is much higher. And we talked a little bit about this secular stagnation and it's an interesting thing because even old folks like me got into this social net working stuff and you know how popular narratives and how things move and social networking and it's interesting how this concept which doesn't have a lot of academic interest in has simply become almost through the social part of the financial world become a popular narrative it characterizes a thought virus. It's not just the C and B types but literally this has taken over the narrative the sense that literally the economies of the world not just the US but of the world now have simply lost their ability to grow. We looked at a chart a couple quarters ago that has shown for the last calendar decades since the 1950's calendar decades that GDP growth has fallen inexuberately decade after decade in the US in the 50's GDP growth average 4%, in the 60's 3½, in the 70's 3, in the 80's 2½% literally decade by decade the ability the economy to grow has been falling. Look at where we are today literally the vitality the economy itself is falling.

Long term all the problems we keep talking about debt how are we ever going to pay this debt, we'll never pay the debt. This debt has interest attached to it the debt keeps growing how do we ever pay this obligations pension obligations, interest obligations on our national debt, our personal debt, corporate debt, state debt, city debt you name it debt. All of this is growing at a rate substantially faster than our incomes or whatever entity we're talking about is growing. We have poor labor force education we talked about we've never had in this country structural unemployment we always had the ability to learn new things and the reality is we now have a permanent unemployable class people who simply are unemployable they cannot produce enough economic value to be employable because their skills are so

lacking they're replaceable by robots or replaceable by a small number of people that they're never going to find employment. It's interesting if you read the financial press McDonald has a lot of issues now with poor earnings and they're under pressure to increase their wages there's been a lot of demonstrations about raising minimum wage and pay a living wage. And if you think about it fast food firms was never intended to provide a permanent job to support a family they were entry level job to teach people what's it like to work its a transition for teenagers.

The reality is they're working now on technology where you're going into McDonald's restaurant you're going to have a touch screen to place your order and the robots going to cook your order and come down a shoot, because that's what's going to be necessary they're going to replace the people that's just how things work today. I mentioned this before in California the land of silliness are spending 30 or 40, 50, 60 billion dollars to build a railroad through earthquake country because it's supposed to produce a lot of jobs. People said this is going to boost jobs never seen how to built railways today they think of something like of the age of the golden spike all these guys hammers they have a machine it's a block long and they put in ties and rails in the front and a railroad comes out the back and there's about 12 guys in the thing and that just runs along about 2 miles an hour and the railroad comes out the back end that's all there is. So people just don't understand what's going to happen and you're going to have a permanently unemployable class. Productivity gains and remember how GDP comes about and GDP is a product of work force growth assuming their employment and productivity gains. We've really exhausted productivity gains from automation really unless we start simply replacing people outright. We've gotten productivity gains from use of machines to eliminate low value added manual work we now begun to replace even fairly high value manual work. I read a lot of tech blogs and one of the tech blogs which I sent to a colleague of mine a firm that has hired about 400 people in India to do computer programming because its cheap to hire programmers in India is laying them off because it's cheaper to use robots now to do the programming. So now they got high value added low cost people in India being laid off because it's cheaper to deal with robots.

Doris Flores-Brooks: Could we just go back to Europe because you did touch on Germany is declining I saw something with France and Italy because I remember one time we were talking about the demise of Euro and there's been push back on France and Italy on deficit because politically they don't want to do it and of course we heard about what Great Britain was obsessed and they're fighting that and so what is going to happen with the European union and there's a push now with Britain to leave. Terry Dennison: There are basically empty European parties now in most of the countries, realistically where previously these people were basically considered nut cases. Actually if you google Euro skeptic parties and you'll find there's an entry in Wikipedia in every European country there are viable Euro skeptic. I am going to list 6 of them here. In the UK there's the UK independence party which is now not only has members in the European parliament which is a fascinating contradiction. Now elected one and almost elected one from a labor constituency in a viable only miss by 600 votes probably going to elect the second one from an electorant constituency in the next week. It is now pulling about 15-20% of the eletorants they're actually viable political force they're not pulling more than the liberal democrats.

In Germany you got Alternatives for Germany it's AFT in German which is now a viable anti-Euro party which is previously heretical, in Italy you got the Five Star movement which



wants to exit the Euro. In France you got the National Front, Marie La Pence party which in a heads up election would beat the incumbent. In Greece you got the Golden Dawn which is actually the Neo Nazi. You got in the Netherlands the party for freedom which is a little bit of a far right hinged to it. Literally you go through I just listed the six, there's one in every country and they're growing fast a lot of them are anti immigrant they all have different agenda some of them a little fringe, some of them probably aren't coherent although I think the National Front and UK are coherent enough to be viable political forces and I think AFT is getting there and clearly there is a anti Euro feeling that basically the Euro there was an interesting comment in the economist that AFT central principal is that Germany is locked in a currency union with deadbeats and scoundrels that's the word they used. Basically they're now being locked into a union if you correctly suggest what you got is 23 people with their hand out demanding money all of which are demanding money effectively from Germany and the question is are the Germans going to pay. I think the original argument was you started the war you pay forever and I think you're now getting to a point that was long time ago we're not going to pay we'll see what happens.

We will get a little bit with where we are with the German situation and this question which is going to come to a head about the power of the European Central Bank to buy sovereign debt and monetized the sovereign debts of countries which would actually be illegal and the question of whether this debt monetization could actually be done. Gerard Cruz: They're buying sovereign debt from the European countries. Terry Dennison: No. Basically that would be illegal they're dancing around it, the problem is that they would do anything necessary to protect the Euro the problem is that's not true because anything necessary would be illegal. There actually is a law basically they can't buy, they can't monetize the debt of member countries and the only way to solve this problem is mutualize the debt and that would be illegal. And the Germans this is where you get in to this problem the fact the way the European system works is it's a democratic deficit that these countries and this is the argument that the British have these countries are sovereign and the British don't have a constitution but other countries do, the Germans have a constitution called the basic law and they have a court.

The constitutional court in Carls Roe has been asked on former law suit what are the powers of the Boondespa which is the actual German member of the European Central bank to participate in a program where they are buying effectively the sovereign debt of other countries and if the constitutional court says that is a violation of the basic law, the Boondespa would be forbidden to participate in that program. Gerard Cruz: But, European central bank can is what you are saying? Terry Dennison: European Central bank does not have any money all it has the ability to get money from the member banks from the European central banks. Doris Flores-Brooks: What do you mean by monetize? Terry Dennison: Well what they would be doing is they would have to buy the bonds of Greece, and France and Italy and Spain. Doris Flores-Brooks: I thought they were doing that. Terry Dennison: No, not of the sovereign debt of these countries. Gerard Cruz: What debt were they buying? Terry Dennison: Buying debt from the banks and other shenanigans the bank corporates, they can't buy the debt of the countries that would be illegal.

Doris Flores-Brooks: I'm not buying the debt, I'm buying something else, but it's really their debt. Terry Dennison: Yes, they were playing a little game. But the problem is that they're getting closer to this red line and the Germans have been it's just a little game that's going on

this is the problem that Chancellor Merkel is definitely afraid she doesn't want to appear to blow up the Euro because you got issue with that but on the other hand she knows she's getting very close to a line she can't cross and previously she was able to finesse it, the problems now are beyond finessing they're too big and previously France would cite with her because France and Germany were always side by side they were the two original horseman and they would stand side by side. Now, France has moved from a giver to a taker, now it's only Germany and at this point you now have forces in Germany saying no more we're done with this and if basically the constitutional court says it is contrary the basic law to do this, games over.

Joe San Agustin: Bonds and sovereign debts are securitized by the member bank and that's why they're able to float back and forth. Terry Dennison: This would be the debt of the countries themselves not the banks. Joe San Agustin: But they're securitized by the member bank. Terry Dennison: The Central banks did not issue the debt the government themselves issued the debt. Doris Flores-Brooks: But who bought that debt? Someone had to buy the debt.

Terry Dennison: Yes. This is where you have the toxic interplay between the banks and the governments. The problem is the banks were insolvent because they bought the bonds, the governments that are insolvent because they just went through this process of assessing the quality of the banks previously the stress test were dismissed by everybody as being a joke because the stress consisted of a cloudy day. Well everybody said not much of a stress let's have a little bit more stressful stress. Well it turned out now the stress was what if inflation got down to 1%, well inflation is not even 2/10 of 1% so even this stress test are worthless and if that they had to finesse the test. They found some little bank around the corner to help, actually most of the banks are broke, but that would be a catastrophe because there's nobody to fix all these busted banks. So even these stress test which found most of the banks to be okay are worthless because even the worst stress they postulated is overly optimistic the worst stress they had was a level of inflation which they're already way below an inflation or low flation which is where they are now some cases in some of these countries they're in the deflationary environment it's very hurtful to banks. So basically they're running into a point now where this promise we will do anything is effectively going to get called he can say all he wants and everybody up until now said oh yeah Durage said will do anything promise can't do it because it's probably illegal to do what he's going to do what he needs to do and as soon as the Germans can't play anymore game over he's going to get called and it's game over.

And the reality is you've got this currency union that can't be made to work because the economies are so utterly disparate. We talked a couple quarters ago I can send you that article again which I thought was just splendid about how dissimilar these countries really are it was something that JP Morgan put together that basically looked at the likelihood of success of a currency union and literally this is less likely to be successful than a currency union of countries starting with the letter M, all the countries south of the 40<sup>th</sup> latitude, all the countries of the ottoman empire you couldn't come together with a more illogical set of countries and pretend to make this a workable currency. Gerard Cruz: Since everybody is already contemplating that, had they been contemplating in the future with no post Europe. Terry Dennison: I think we've talked about a lot of studies that had been done on how this would fall apart there was an actual interesting prize that an English economist who

sponsored for the best analysis of what would happen for the collapse of Euro. And there were five finalists they all read like Tom Clancy novels because they're not silly they're all how you would do it? Because they're not trivial problems, I mean first of all, what would you do with the currency? Because it takes about 8 months to reestablish national currencies. You run into things like a lot of people have mortgages in Euros if you're in Italy and have a mortgage in Euros how does that get converted? Doris Flores-Brooks: How does that get converted and who owns it? Terry Dennison: What are the rules and they went through a very thoughtful analysis of how you would actually do it and share the pain that if you have a mortgage and the bank is in one country and you're in a different country your debt is paid in your currency and the bank suffers.

So it'll effect the weaker party is protected in these transactions because there's now an incredible web of these contracts and how do you figure out these contracts what do you do with the currency? Because obviously like the Greek's exited, obviously the Greek currency would probably lose half its value so people would be running out of the countries with Euros. So how do you make sure that you manage that flow? You have to do it overnight you have to close the banks for a couple of days and you would have to have some mechanism for having some kind of money in the interim so you have to stamp the money so that the old euro notes would now be Greek notes that would only be usable in Greece and it's very involved on how you would do this process? How do you settle the contracts? It's not dissimilar from a lot of the thinking that what would have happened had Scotland separated from UK because you would have much the same situation if they had a different currency what would you do about long term contracts? Now the country had a different currency. You just have a difficult situation and the contradiction just aren't going to be settled because you have this North South divide between the reformers and the spenders and the problem right now that Germany is facing is the number of spenders and the way it's set up is just one vote per country there's now 23 spender versus 1 reformer.

Let's spend a little time in Japan because of the importance in the local economy Japan matters. Obviously the Abenomics seems now to be losing so much effectiveness one of the things that has happened is partly because of the improving balance for trade situation in the US plus the strength of the US stock market in weakness of other markets around the world capital has flowed into the US and that's had the usual effect in the value of dollar. The dollars added value against virtually every other currency in the world except the Yuan.

And the yen has dropped dramatically versus the dollar so the people coming from Japan are spending much more expensive dollars now and the Japanese economy which has strengthened dramatically with the fiscal stimulus now is slowing because they have now had a substantial increase with the consumption tax, the increase in the VAT. And we now see with the current fiscal policy and the VAT the fiscal drag is peaking and would remain significant in the fourth coming year so their economy is slowing dramatically. They're going to get some benefit from the rising dollar their currency has declined relative to a lot of their trading partners so they're going to get some export benefit particularly in their auto industry versus some of their trading partners but not against the US.

But a lot of their US auto production are not US based anyway so they're going to get some value if they repatriate their US earnings back to Japan but that's just going to be at the corporate level it's not going to have a lot of affect directly in the economy but I think the

Japanese economy is still going to continue to struggle and they still have their issue with aging. The demographics are awful it just gets older and older with no inward migration and their debt load although is owed to themselves they don't have a high degree of external debt. But I think as a trading partner for Guam it's not a healthy situation. Now I know you are really working to grow trading relations with other Asian countries and that is really going to be beneficial for the Guam economy because I think your traditional trading relation with Japan are going to continue to struggle.

It is interesting with China their growth continues to decline the government continues to tighten credit. It looks like the Government is willing to early in this cycle of people congresses willing to take some economic pain early in the cycle. It's interesting they profess to be willing to have some bankruptcies they realize they have a credit bubble they realize that they had over building you mentioned empty cities, they got empty factories, empty anything you can think of and factories producing stuff that nobody has any use for they did have a solar panel company go bankrupt which is a first never had a company go bankrupt. Unfortunately they then decided to bail out all the creditors they wimped out. They still don't get it yet how economic systems supposed to work which is very disheartening really because what that basically saying is that they really don't understand how the market system is supposed to work and what's bad about that is they don't have a bankruptcy law for cities and provinces so all of the debt that has been incurred in cities and provinces to build all these empty cities and all these empty infrastructure projects, unproductive debt is still sitting out there and at some point is going to have to be serviced or written off and while the government has huge reserve it's going to take huge reserve to pay it off. And it'll be interesting to see how they managed to slow down the economy was booming along at near double digit rates and that clearly filled the tremendous growth we saw in commodities it made the Australian economy and Canadian economy very strong and the economy was selling commodities and you now have seen what happened when the commodity boom stopped we will see how well it works at 6%. If you start to see unemployment in social unrest we'll see how well that's managed.

We talked about deflation clearly we got the continuing world bases all the political issues we talked about repeatedly I don't know what to make on Ebola I have done a little research. The concern that a lot of people have about it becoming more easily transmissible and obviously as it invades or hosts the potential of it developing more readily transmissible characteristic which will make it extremely dangerous, increases. That would be a significant game change and obviously because you have this extremely large reservoir of very dangerous material in an area that is already got various terrorist organizations that Voca Heirom group in one of those countries there the name in the local language means western education is evil which probably gives you some idea about their level of thinking about things has to give somebody pause I mean you can end up with jars of this getting tossed around in places is worrisome so it just gets more difficult.

Rosalia Bordallo: The lone wolf you know where just somebody that's been recruited from one of the terrorist group who goes on its own like what happened in Canada. Terry Dennison: The scary thing is the attractiveness of this to teenagers, particularly teenage girls you know they've got these 3 kids from Denver, what is the appeal of this? What's the romance involved here? Obviously I don't understand it's hardly surprising but there is a certain weirdness to some of this stuff but you do worry about this. I read the British papers and they're very

concerned about the returners because they've got a lot of people over there because of course they have a lot of east Asian or Islamic backgrounds and they're just worried about people coming back some of them they think about 10% of them are dangerous, 90% are probably just disillusioned idiots been over there for fun and romantic which is more fun than hanging out in the street corners but 10% of them are hardcore dangerous people some of whom were in Chechnya and some in Afghanistan and some of them in another nasty places and now they are going to come back and full of bad ideas. But there's a real risk here you got the Canadian situation a couple weeks ago and obviously this Ebola thing because it is "A" frightening and "B" so easy to get a jar of it and you know just start throwing it around.

Doris Flores-Brooks: Use it as a terrorist weapon. Terry Dennison: Absolutely. Doris Flores-Brooks: Well they've always been talking about German warfare. Terry Dennison: The bugs always win if you ever done any research there are some interesting books on this subject and the bugs always win. I mean it's very easy to weaponize just use aerosol.

There's an interesting question about the future trend of rates in the US. Until fairly recently the thinking was that we wouldn't see the first rate increase until maybe early 2015. Like everything else there's a distribution of expectation and they were some who thought might see it as early as the 4<sup>th</sup> quarter of 2014 which of course is now. But, the reality is I think it's probably receded to probably the middle of 2015. The view now is the reason to raise rates would be to forestall, arise and inflation. And getting back to the subject of deflation the idea of the Central Bank is to have the happy medium sort of goldilocks you want to have some inflation because a little bit of inflation is a good thing because it motivates people to make useful decisions. The general target for inflation is about 2% if you have inflation of about 2% people and companies and other economic entities will make good decisions. 2% is enough to make you buy something today because it will be just expensive enough in the future to make it worth buying today.

What makes deflation bad is you don't buy something today because it be cheaper tomorrow and if you don't buy it today because it would be cheaper tomorrow people stop buying things and economic activities stops and indeed it does become cheaper tomorrow and that's what's ailing Euro is people slam their wallet shut so nobody buys anything so it does become cheaper tomorrow but nobody has a job. But you don't want to have large amounts of inflation because that then becomes distorted in and out itself and so this 2% is supposedly a target of ECB and the Feds and the Bank of England just about everybody. But the reality is now inflation everywhere is running well below 2% and a sense is there won't be a rate increase until we start to see inflation begin to get to 2%. Now they have a lot of measures of inflation the one that you read about which is the consumer price index isn't the one they care about they typically care about something called PCE which is a deflator, it's used when they calculate GDP. It's a broader measure it's not a consumer price index it's not a producer price index it's a more technical measure on inflation and realistically it's also well below 2%. So their view is there's no reason to raise rates which would slow the economy we're already being low until we start to get some inflation. And their sense is that inflation would first show up as wage inflation and in fact they would like to see wage inflation they like to see people getting paid more and the reality is that there hasn't been much wage inflation if you look at real wages and the way the economist talk about it after inflation wage increases had been basically less than zero.

Most people adjusted for inflation are making less money than they did 10 years ago less money than they made 20 years ago because prices has risen faster than salary has risen. And their view is until we see real wage increases there is no need to worry about inflation. So until labor cost starts to increase we're not going to see a rise in interest rates. Now they control short term rates but there are long term rates and there are other forces that control interest rates also such as supply and demand of money if we start to see people having to sell bonds or wishing to buy US treasuries that has an effect on interest rates too. But the reality is I don't think people expect to see rates now rise until at least mid 2015 and estimates now you would not see interest rate reach normal levels until far out as 2018. Doris Flores-Brooks: What's normal? Terry Dennison: I would say 3 year 3%, 5 year 6% maybe typical normal interest rates. Doris Flores-Brooks: But isn't this more the new normal. Terry Dennison: This is the new normal now the scary thing is that if you start to look at how securities are priced forget about the fact that stocks were 30% more last year but the way securities should be priced. There are models for figuring how for example equity should be priced. If you got low interest rates expected returns for equities are low there are four factors that drive equity returns. Obviously growth and earnings, inflation because you want to get paid for inflationary losses, dividend yields and adjustment of price earnings ratios. Inflation zero you are not going to get any money for that, earnings increases are not going to be high because profits are not going to grow rapidly if there is very little economic activity. Dividends aren't going to be high because you're not competing against high bond yields so you are not getting any for that. Well why are you going to pay more for earnings if earnings aren't growing very fast so why are you expecting to get anything for stocks. Gordon growth model four factors that go into the return for equities. Doris Flores-Brooks: The stock market defied all that. Terry Dennison: The stock market doesn't follow the equation every minute, look at what's going on this year stocks are up less than 8% this year don't keep counting on getting 30%, you won't even get 10% this year and in fact you won't even get 5% this year if trends continue. So, now looking at people with pension plans and actuarial assumptions look at your Gordon growth model expected return for equity. What are those four factors? Where are you going to get those?

### **DC Plan Performance**

Terry Dennison: Let's talk about the performance of the plan if we just turn to page 1 and go quickly through what's going on in the markets. This is relevant because the questions about how the economy affected the securities market the left hand column looking at the performance of the 3<sup>rd</sup> quarter. You can see that for the 3<sup>rd</sup> quarter other than just a few assets classes most of the performance was negative and even in those categories where the performance is positive the numbers were very small. The S&P 500 was up 1.1%, the Russell 1000 growth was up 1½%. You can see Small Cap was particularly negatively impacted and especially small cap value really got nailed. The Russell 2000 growth was down 8.6%. If we go to the right hand column looking at year to date numbers other than in the US other than the Small Cap the numbers are positive but we're not looking at anything like what we've seen for the last 2 years year to date we're looking at high single digits. And we're looking at numbers that are more or less if we continued on those for the rest off the year pretty much what we would expect for annual performance for equities high single digit numbers. International again this would be negatively impacted by the increase of the value of the dollar and some cases actually the local currency terms the performance was actually positive but with the increasing value of the dollar that converted the returns into negative

numbers. The all country world index the ACWI was actually positive that includes the emerging markets some of which were positive but overall basically the results were pretty much zero. The alternative space the one really strong number was the REITs real estate investment trusts they were up 13.4% for the year to date although they were negative for the quarter. You could see as we've been talking about the commodities if you go over quarter to date the commodities were absolutely clobbered. Rosalia Bordallo: Can I just have one clarification on the REITs you have an equity and a global, so the equity. Terry Dennison: That's just US REITs, that index is just US. Doris Flores-Brooks: Equity is US REITs. Terry Dennison: Yes. Wilfred Leon Guerrero: Terry just so that we're cleared on this thing 3<sup>rd</sup> quarter 2014 is September 30? Terry Dennison: Yes. David O'Brien: The 3<sup>rd</sup> quarter returns are annualized, right. Terry Dennison: The 3<sup>rd</sup> quarter returns those are quarterly numbers. The year to date are not annualized those are per period numbers. Doris Flores-Brooks: This is for the nine months ending September. So, which is different for your year end because you have to add the quarter before.

Terry Dennison: Turn to page 2 looking at GDP Growth. It's kind of interesting we talked a little bit about declining rate of GDP growth. If you look at this chart which goes back to 1992 the red line there is showing average for decades and even for this relatively short period you can see that the average for the decade has fallen. Now, obviously the decades have different economic periods in them but even for this short period you can see that the decadal growth in GDP has been falling. If we looked at the world economic growth in the bottom chart we're showing 2 periods here the blue bar is the forecast for 2014 and of course 3 quarters of that is already in the book the 2015 at the black bar is the forecast in some cases I think these forecast are extremely rosy particularly if you look at Italy and France those are very rosy numbers for economic growth but you can see that those numbers are not particularly strong. US are forecasting 3% for next year the reality is I think those numbers are probably optimistic there is a narrative on the right hand side that I think is significant.

If we turn to page 3, looking at currencies you can see the effect of the strengthening of the dollar only the Chinese Yuan strengthen versus the dollar you can see on the Japanese yen which two-thirds of 3 quarters way down the chart how much that's fallen relative to the US dollar which again is a significant impact here of course on trade on Yuan. The yen declined 7.6% for the 3<sup>rd</sup> quarter versus the US dollar. If we turn to page 4 you can see the statistics through the Broad market and again very negative performance of small cap sector on the US market and also in the sector performance you can see a tremendous diversity of performance there. Health care continues to be a very strong growth segment in the market. I think a lot people expect with the affordable health care act that health care would see its growth stunted particularly the devices segment of the market which is a significant part of the health care market that segment is just continued to boom in a year to date the health care segment is up to 60½% and as you expect the oil prices going down dramatically the energy sector is decline significantly. In terms of valuations, stocks are still probably relatively fairly valued profit margin still stay high again at the expense of the employees the high profit margins have really been at the expense of wage growth. The sense is with true unemployment still relatively high employees are not in a position to demand significant wage increases. If we ever start to see significant shortages of labor particularly in skilled areas are very narrow segments of the market where skills do matter and wages increase

profit margins may begin to fall and that could have affect on reducing profitability and may reduce stock prices to some degree.

If we turn to page 6 looking at International performance obviously with mix there is a good discussion here about the performance in local currency terms versus translated in the dollars interestingly the losses for the EAFE Index were entirely due to currency decline the index itself and local terms actually rose. So, the currency translation effect here was very powerful it really shows the effect of currency when you invest outside of the US when the dollar rises investing outside of the US is hurt. We'll see that also with the international bonds because again international bonds are traded in foreign currencies.

In fact let's turn to page 9 were looking at the Non-US Bonds this is relevant because you do have a global bond portfolio in the defined contribution plan and actually it's one of the best performing options you have in your portfolio and it actually is something that's relatively rare in the defined contribution plan it's not a common option to offer to participants. Doris Flores-Brooks: Which one is it? Terry Dennison: It's the global bond portfolio it's only gained about less than 1% of the assets only 6 tenths of 1% of the assets and frankly it's been one of the best performing options in your entire plan. David O'Brien: One of my favorites, Dreyfus Standish. Terry Dennison: Yeah. It's done very well.

David O'Brien: What's your take on utilities, growth market? Terry Dennison: Utilities are driven more by interest rates because they don't have growth they trade really as a bond replacement. When rates are rising they tend to do better because people would flock to them because they're an attractive source of yield. But, because they don't have any growth potential to them as being a regulated business but when the other areas of the market are doing well people just leave them behind. So I think despite the fact that the markets been relatively flat they don't really do particularly well in markets where there's something else exciting to look at, their defensive and right now until recently the markets been doing well and the defensive stocks have not been doing well. Defensive stocks are kinds of industries that do well in declining markets consumer staples people buy food, toilet paper, and those sorts of things with their last dollar. Consumer discretionary are things you buy when you have a lot of money, gaming stocks are the classic consumer discretionary when you're feeling rich you go to Vegas.

David O'Brien: So all the durable good orders don't even matter. Terry Dennison: Well those are more corporate decisions so those are more very long term corporate planning decision and decision cycle on those isn't the same as consumers making decisions. Those are results of strategic planning decisions that got cycles looking out 12, 18, 24, 36 months. If you're looking at durable goods you got to look at things like ex air craft where you're looking at decisions where somebody's buying something that has a 10 year, 20 year life to it.

Let's go to page 11 this is routine more for the minutes. Again, I think you got a well diversified set of options we have nothing to recommend here to add to the list you have. Again, you got the International Bond fund you can see that really fills the hole in the array here that many other plans have, I think it's a good option for your participants. Turning to page 12 again we're not seeing a tremendous growth we had the last 2 years where the market was up 30% if you were invested in equities there was a modest amount of growth. Plan 401A is getting closer to 100 million. The top five funds interestingly the Great West



Secure Foundation lifetime fund is the first time among the top five there's been a substantial increase a real migrations from the BlackRock Life Path into the Secure Foundation Fund. Paula Blas: That was the mapping that took place. Terry Dennison: And the 457 the assets are up to almost 40 million so about a tenth the size.

There is some key observation here if we look at the Dreyfus Standish we did look at the results of the proxy vote that we've been talking about for the last couple of quarters. The vote that we express a concern about 6 months ago did pass. I think that the vote was regrettable I think the action was regrettable but nobody reads proxy. The reality is I don't think they're going to use the discretion but what we suggest is particularly because the fund is not only an excellent diversifier it is an excellent performing fund if all the funds are doing as well as this you would have a hell of a plan that's a technical term we use when we discuss things with sophisticated investors. The language we use here is intentionally stated we would monitor the portfolio because of the earliness of this report we can't monitor it as of the day of the report, the diagnostics of the fund are embargo for 30 days so we can't give you an analysis based on the date of the report. So when we give you a statement that we don't see something that is worrisome it would be 1 quarter behind because we're giving you this report within 30 days of the closure of the prior month and the mutual funds are entitled to embargo detailed assets level analysis of the Fund and I think righteously so to protect the fund from people front running the Fund by doing an analysis of what they're doing. So we don't have any visibility of what their investing in at the time we're running this report so we're going to be looking at this 3 months in arrears.

We don't actually expect they're going to use this authority they've been given to go crazy but we'll be looking at it to monitor for unusual changes in the portfolio structure. But at this point we certainly recommend retaining it but we will keep an eye on it. The rest of these we are comfortable with retaining there is a narrative here explaining the rationale for that. There are some manager updates these are all basically completely innocuous. Doris Flores-Brooks: But one is replaced, Baron. Terry Dennison: That decision has already been made and that process has been implemented.

There's one on page 18 a kind of an interesting discussion a little technical nature. DFA which is significant because they're an incumbent and just coincidentally are going to be the replacement on the additional fund for Baron. DFA is an interesting manager they are different from most of your other managers in that they buy a great number of securities in the fund they don't have real views about individual securities rather they buy everything in a particular range of assets that meets certain screens. So rather than holding 40 stocks that they know a great deal about and think you're going to do well they own hundreds or in some cases thousands of stocks that pass certain filters and the original filters were based on Value and Small Cap premiums. There's a well understood and well documented I guess true theory that Small Caps stocks and Value stocks outperform in the long term and they have built a system for identifying in over weighting Small and Value stocks in a portfolio. And part of what they do is they add value by trading in effect they hold a very large number of stocks it's not an index fund but its kind of awaited fund but they make the stocks available to anybody who wants to buy them at their price or they will buy stocks at their price.

So for example if you are an active manager who absolutely positively got to own a stock and willing to pay whatever it is you got to pay, got to own it now and willing to pay a high price

for it they're a seller. If you absolutely hate a stock and want to sell it right now and don't care what price you get they're a buyer because they don't have a view about any of the stocks they own. As long as they meet the tests they own it and this is proven to be a very effective strategy because most active managers fall in love with stocks when they want to buy it they pay too much and when they want to sell it they accept too little and there's a premium that you could earn if you are a patient owner.

What they found was that they could improve their performance if they added a third factor which is profitability that in addition to over weighting smallness and valueless if they over weighted profitability they would improve the performance of the portfolio. So over the last year they've been adding an overweight to profitability as a factor in the portfolio and there is a discussion here on page 18 about how they're adding this profitability factor to the structure of the portfolio and this would be across all of the DFA portfolios and we think that this would be a significant addition to the value adding potential of the portfolios. Wilfred Leon Guerrero: We just hired these guys under the DB plan and the word that they're using they want to be Nimbo they don't want to get married to anybody. David O'Brien: Go with the winners. Terry Dennison: They don't have a strong belief about anything it's actually a very clever way of thinking about stocks because their thinking is most active manager's fall in love with their stocks and they're willing to pay too much and when they fall out of love their willing to accept too little when they sell and they're unemotional they don't care and they take advantage of people's emotionality and they make a lot of money for their clients doing it. Gerard Cruz: They invest across in several different mandates. Terry Dennison: They have a huge number of different mandates that are run using that exact same strategy.

The next several pages are pie charts and associated tables that show allocations and flow of funds and you can see the significant allocations from the BlackRock to the Secure Foundation Funds which are now significant allocations in the portfolio from pretty insignificant allocations. If we turn to page 25 again one of the things for the benefit of the minutes if one of the responsibilities the committee is to ensure that we're getting a fair deal for fees. We don't see any significant excessively high fees being paid in fact the fees are pretty competitive for the various asset classes.

If we turn to page 26 looking at performance now we're going to look not just at this compliance table but then move on to pages 28, 29, 30 and 31 looking at the detail. The compliance table is based on the investment policy it's prude in a sense that you get an X if you just miss it and you get a check if you just make it. So in some cases it's a little bit deceiving if we look at the BlackRock we see a lot of X's and if you look at the number of consecutive quarters it looks like not only underperforming but they've been underperforming for a long time.

If we turn to page 29 and we made this comparison for a number of quarters and look at the BlackRock funds particularly the 2020, 2030, 2040 and 2050 which are the top 4 rows on page 29 and you see the Red X's that we've saw in the prior page but if you actually look at the numbers and look at the X's you can see that basically they've been steadily improving if you look for example the 2020 in most cases they're just barely missing getting a check. So they've gone from under performing by a significant amount to really just barely under performing and that's pretty much the same pattern and in fact if you look at the BlackRock 2040 fund for 3 years they got a Red X for 3 years. The fund was up 14.6, the Index was up

14.8 they got a Red X for that they missed 20 basis points out of 1480 basis points. So, I think the improvements have been pretty substantial and conversely they got a green check for 1 year for the 2050 fund where they beat it by 20 basis points out of 1080. So basically they're pretty much matching the target and have been pretty modest but continuous improvements if you look at the relative performance so they're coming back. If we look at the Secure Foundation basically they're pretty consistently 3<sup>rd</sup> quartile performers out of relative basis and pretty much matching the benchmark on an absolute basis again it's a little hard to see how well they do relative to a comparative benchmark because they're different from a typical fund because they got this additional lifetime floor component to it so making a relative comparison against other target date fund isn't really fair.

If we turn to page 28 the one above, I would just point out the performance of the Dreyfus Standish fixed income fund. If you look at the absolute performance in the middle of page 28 the absolute performance against the benchmark is just outstanding. I mean generally it's above in every case and in some cases 200 basis points ahead of the benchmark. And very solid always positive performance getting pretty close to not equity level performance but very solid performance relative to what you would expect and relative on a comparative basis I mean pretty much first quartile for every period first deciles for recent periods. So that fund has just been outstanding and as a diversifier from an editorial comment it's really a shame that only 6/10 of 1% of the money is in that. This has been a funny quarter you can see that the Hartford which is the total return bond fund which has been an excellent performer had a bad quarter, the TIPS fund which has been an excellent performer had a bad quarter.

If we turn to page 30 and again I would caution you as I have always had don't pay attention to one quarter either good or bad incidentals one quarter improvement doesn't mean much, one bad quarter doesn't mean much. T-Rowe basically had a poor couple of quarters so did ClearBridge. Baron somewhat annoyingly this is that one we did terminate to replace with DFA had a good quarter but I don't regret the change out of that don't worry about it, Champlain actually had an improving quarter. Transamerica slipped a bit for the quarter, DFA just continues to roll along. You can see that DFA has added value for every single period and has been a consistent 2<sup>nd</sup> quartile performance so DFA really just keeps hitting singles and doubles period after period. I think the placement of Baron which is all over the map with DFA has been a great choice for us and is going to continue to pay dividends for us.

David O'Brien: DFA Small Cap. Terry Dennison: DFA Small Cap, yes. David O'Brien: Couple of questions I like to discuss. One is this whole issue of asset allocation by individual investors which is our DC case versus professional management and the substantial difference in returns to professional managers versus our individuals just like you to address that. Terry Dennison: There's been some studies of this and of course it's all over the map. Generally most of them had showed that the average individual underperforms professional investors by 200 basis points per year. 200 basis points per year compounded over a lifetime is enormous amount of money, I mean over a lifetime staggering amount of money. The other thing about it is because it's your money or my money you view it differently than a professional does, you internalize a decision, I am an investment professional I am trained and have been doing this for 40 years.

David O'Brien: The things you're hitting are just my point, you take the difference in return that's the proof in the pudding, second thing you take this issue of chasing the decency, third thing you take the issue of risk pulling and I know you're heading towards there and the other issue is statistics I just found out is rebalancing so you put all of those together and you ask, what's going to happen in our DC plan? Because the proof is also in our pudding because we know just because we tried this latest round of things we know what's happening and so yet we persist with the strategy that doesn't have risk pulling that has sub standard returns that we see are people chasing recency effects that we know that they're not rebalancing because you can see the fund flow as you said, except when we force them to do something differently. I mean we could almost calculate based on the asset allocations that we see in the DC pulls what our return is going to be for the next 30 years for our members and as you well pointed out its enormous given professional returns yet we persist with this strategy. I want to add one more thing to that speech, I am also saying that I love the thing you put together on page 11 that shows the choices we have across the risk return continue, I love that but what we're also doing is forcing these individual investors to make choices on asset allocations within a fairly sophisticated and complex thing and what we just saw I take your point that some of these are just a tick away from being rather green but if you look at that tick it's about the median it's not about the high performance if you look at the expense ratios yes while they're pretty good deals you know the predominant affect if you put the cost together with the tips is on the negative side for both so very often we have Red benchmark performance together with higher than average expenses. You put all that together I wonder what the hell we're doing to our DC plan and it's a fundamental question but I have been kind of heading this way since I started to pay attention to some of this stuff and I just want your thoughts on what's a fairly negative view on my side.

Doris Flores-Brooks: Could I also add just food for thought, why not risk pulling a portion of the money to say and it'll be professionally managed of the DC contribution rather than us picking this one and this one and this one. Let's say we put our money in DC whatever we're contributing and for those who elect to be professionally managed but you would need at least 10-20 million or so if there is enough people who said yes could you professionally manage my inter global pull, just to offer that.

Paula Blas: In the DC. David O'Brien: Yes we do it but you know to find that professional management in the screens that GW has to get to that professional management it's there you have to go through 10 screens to get there. Doris Flores-Brooks: Where? Alice Tajeron: What's offered? Gerard Cruz: The other thing that the professional management doesn't take into account is the investment in the DB without the limited investment horizon doesn't matter how you slice it a DC member only has a 20 year time horizon, where as a DB member has investment for an annuity. Doris Flores-Brooks: What I am trying to say is to help the DC member be professionally managed knowing that it is like a 20 year horizon that's all I am trying to say is to offer that skill to the average person who knows nothing even as sophisticated as I am my return of investment for the last pardon my expression crappy and because you are right like I buy and I don't look especially during the hay day I didn't look at my thing for the last 3 years I did not want to touch it it's like buying in a hole and the hole is I don't know when to sell. David O'Brien: My fundamental question Terry is where are we going with the way we're running our DC plan given all these things.

Terry Dennison: Let me try to answer all these questions. The part of the reason why individuals struggle with this fundamentally is they don't understand what their fundamental risk is. Their fundamental risk is not losing money in the short term their fundamental risk is not having enough money in the long term so they're looking at oh my god I lost money this quarter I am going to reduce my risk and that's what target date funds are intended to do. The problem is that the target date funds are still presented to them as an investment that they can change all the time. So what happens is they look at it and say I don't like the return this quarter so they sell out of that. But what they need is something in fact locks them in so that it's like a safe deposit box, but you are suggesting is something that they buy into and they can't get out off because their not psychologically wired to stick with something long enough to let the long term work for them.

The other reason that it's so much more expensive for DC plans which you're relating to is the architecture required to support daily pricing, daily transferability all of this record keeping cost money. The reason DB plans are cheaper because they have none of this infrastructure its pure investment they do record keeping on a quarterly basis they're not doing participant accounting it's just a pot of money. So part of the reason that DC plan are so much more expensive is you got to keep daily record keeping of all of these funds rather than just one big pot of money that's why the DB plan is so much cheaper you're not doing participant level record keeping on a daily basis your not allowing people to go on the website to move money from here to there both of these decisions are just idiotic I just don't feel good about this fund I'm going to change it they have no idea what they're doing they have no reasonable bases for making this changes they don't like it because somebody at the next desk said this is a much better fund you should change.

Doris Flores-Brooks: But there are some funds that restrict the number of transfer you can make. Terry Dennison: They're doing that not because it's for the benefit of the participant they're doing because the damages the behavior of the investments of the fund to do it, has nothing to do with benefiting the participant it has an operational impact on the fund. Doris Flores-Brooks: Just propose as an idea is there such a way is to have it professionally managed as a pull knowing as an alternative. David O'Brien: There's still individual funds you can still select stuff.

Terry Dennison: When I started at a bank in 1972 it was then called a profit sharing fund but it wasn't participant directed it was sponsored directed and you make contributions into it and the sponsored directed it you got a share balance there was no daily transferability there was no reporting it was all managed by a committee like this and the money grew and you got a quarterly report and said it was worth this and it was invested pretty much like the defined benefit plan was invested. And if they wanted to put hedge funds in it and if they want to put private equity in it, it had no liquidity issues and basically it had all the investment flexibility of a defined benefit plan because you couldn't take any money out of it the only way to get money out of it was to leave the company get paid out we had enough liquidity to deal with pay outs and I got away from all of this participant directive nonsense because from an investment perspective that's what's wrong with all of this it all goes back to the tax reform act of 1986. Tax reform act 1986 is what actually section 401K of the Internal Revenue Code you look up tax reform act that's where it came from it said you could give people the right to manage their investment if we went back to that you could have what amounts to a profit sharing plan with all the investment benefits of a DB Plan.

Now you would still have the fact that you are not sharing risk to do that you can't pull the actuarial risk factor without DB plan structure you're either alive or dead so you can't have income for life without the DB structure that's the bridge you can't cross. But there are structures you could have where you could get rid of the participant direction and have a single pull of assets which could have much more investment flexibility you wouldn't have share classes, you wouldn't have any of this daily transferability architecture it would just be a pull of assets you would own units in it and there would be a single pull of assets you would buy into it and sell out of it every pay period there is only one pull of assets your contribution would buy into the pull every pay period and if you left the organization your units would be paid out to you but you could invest in anything. I mean the committee could invest in anything and as long as you have enough liquidity to handle people leaving you could use hedge funds, you could probably use private equity you would not be bound to all of this architecture that cost money.

David O'Brien: I mean it's such a fundamental question for us because we are dealing with multiple pressures here. The biggest pressure is frankly is our members are where they are so we have transition issues but we also have to think about assuming the policy makers and their wisdom throw us into the social security, what do we have as an option? I think given the performance we've seen today and we have how many years performance since '95 to 2014 I think with some work obviously we could map out how deficient we are compared to almost any kind of benchmark you want to throw up. Wilfred Leon Guerrero: Doris getting back to you asking whether you could get a part to be professionally managed. Doris Flores-Brooks: The pulling to be professionally managed. Wilfred Leon Guerrero: I think the minute you do that you start an unfunded liability. Terry Dennison: No there is no liability. Doris Flores-Brooks: It's just for those rather than me make a decision my 250 dollars that I contribute every week goes into a pull and somebody else manages it. David O'Brien: And it's more than just risk pulling that Terry is talking about.

Terry Dennison: There's no risk here, there's no risk pulling, there's no liability. Doris Flores-Brooks: It's the economy of scale of the contribution being professionally managed. Terry Dennison: Now the negative is its one size fits all. Doris Flores-Brooks: Yes that is the negative. Terry Dennison: The negative is the risk somebody's going to have to decide what the riskiness of the portfolio is. The advantage of the target date fund is in theory the near date target date fund the 2020 has got less volatility than the far target date fund and less return potential this single pull somebody would have to decide what risk it takes. David O'Brien: Again that would be a professional versus 2000, 4000, 6000 individuals investing. Doris Flores-Brooks: 7000 trying to decide. David O'Brien: I really think that we know, we've seen that our DC model is not doing what we would like it to do and I think it's the Board we need to consider things because if the policy makers don't let us head towards what our recommendations are or if they start talking more seriously about the fantasy of social security. Doris Flores-Brooks: Why are you saying it's the fantasy? David O'Brien: For obvious reasons and the fact that its not only a fantasy, Doris it's not only a fantasy it's a false vale hell, social security is not going to let these people retire anymore than the DC plan that we have is allowing them to retire. Doris Flores-Brooks: At least they start. David O'Brien: I am just saying we know this actuarially. Rosalia Bordallo: It's not addressing your current problem with the people now, yes it's for the people of the future. Doris Flores-Brooks: Even your own investment report said that on your hybrid plan that you needed

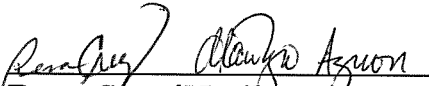
social security. David O'Brien: No it didn't say that. Doris Flores-Brooks: Yes it did at the end there is a paragraph in there. Paula Blas: There is a paragraph in there because that's to pacify somebody down there that it would be considered if... Doris Flores-Brooks: It said you had to consider it with other plans and I quoted from that. David O'Brien: So as Board I think and we're not in a Board meeting or anything like that we're just in a due diligence session. I think our diligence has to be fundamental our diligence has to be that these members aren't going where they're going and they have extreme risk they suffer from all this individual investing problems and I think personally we need to consider a different model for our DC Plan if that's where we're going. Joe San Agustin: Well that's where we started off with the hybrid that was the whole basis of that otherwise. David O'Brien: I'm just saying Mr. Chairman if they don't let us go to a hybrid there's a possibility and we have dichotomy in our population we have people who's going to need to transition into something else just so that they can retire and we have people in the front end of their careers the younger people who would benefit from rethinking on our part of the DC that's my view. Joe San Agustin: Secured foundation is an alternate.

Terry Dennison: You do have a problem because you now got a couple of decades of people and you can look at Alice's data of the near retirement cohorts of people and what the average balances are. Doris Flores-Brooks: Even our average balance is lower than the average balance with the US. Terry Dennison: And they're nowhere near adequate. David O'Brien: The issue is the DC problem it extends to the people with 401K, extends to all this whole dog the new world of retirement.

Terry Dennison: It's not just here I mean the difference is in the private sector in the US people have Social Security. Social Security isn't adequate but you don't have the extreme situation that you got here. Doris Flores-Brooks: Yes, at least they're going to get a check. Wilfred Leon Guerrero: Okay, we're done right. Terry Dennison: We're done.

**Respectfully Submitted:**

**Affirmed:**

  
**Rena Cruz/Marilyn Aguon**  
**Recording Secretary**

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

