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**Quarter Ended December 31, 2013 DC Plan  
Quarterly Performance Meeting**  
January 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  
James R.F. Duenas, Trustee  
Antolina S. Leon Guerrero, Trustee  
David M. O'Brien, Trustee

**Staff Present:**

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

**Other Present:**

Terry Dennison, Mercer Investment Consulting Inc.  
Doris Flores-Brooks, Office of the Public Accountability  
John Borne, Great-West  
Alice Taijeron, Great-West

**Defined Contribution Plan**

**Economic & Capital Market Environment**  
**DC Plan Performance**

Pages 2-20  
Pages 20-35



## **Economic & Capital Market Environment**

Terry Dennison: Being in this case one of the two multi asset classes or the two target date funds. I think you would look at it and say what is the most appropriate for the notionally average participant and it becomes a judgment call. Clearly moving away from the stable value is the smart choice the stable value guarantees the average participant would not have enough money to live on because the stable value fund produces no real return it only produces a return that is approximately real return zero it matches inflation. So they will end up with this much money in terms of purchasing power that they have put in. So you already made the right choice then becomes a question of do you want to give them income for life, some income for life or just give them a pot of money at the end of their working life time and say here's a pot of money and then they have to make some kind of intelligent decision.

I think in the beginning this was a fairly new concept I would say it might be at this point time to say this now a mature concept it might be time to say this is now proven itself and maybe we should take a serious look at making a switch.

I don't think there's a burning bush that says we should switch. But I think it's perfectly sensible at this point to say we had it for sometime its gain some currency with participants the organization provides it as clearly stable and sound it's been through the worst financial crisis we had in post World War II period, let's at least look making a change. Doris Flores-Brooks: It is not so much making a change but offering that option. Antolina Leon Guerrero: No it is an option but making it the default.

Terry Dennison: The default is what happens in the absence of direction to the contrary. They always have an option to move. What we have is participants who do not provide directions so this is the absence direction in the contrary what you do with the money. Doris Flores-Brooks: But at least that offers them an option, in other words no option becomes an option. David O'Brien: As the silver tsunami hits it also changes a bit of the thinking of the DC group to post retirement because this a very much post retirement focus kind of thing post retirement everybody talks about pre-retirement and retirement, hardly anybody talks about what am I going to do now that I'm retired no income or whatever they worry about it but don't plan for it. Joe T. San Agustin: That's what happened to our DC people up to Medicaid.

Terry Dennison: This addresses the one big issue with DC Plan which is the lack of income for life. Now the problem is it doesn't give you a living income unless you saved enough money to provide a living income it doesn't make money out of nothing but it at least gives you a management tool.

Doris Flores-Brooks: Particularly since right now the DC members are not members of Social Security, because Social Security becomes the default annuity. Terry Dennison: Yeah. James Duenas: Not all, some do have quarters in Social Security. Doris Flores-Brooks: But the vast majority don't, it's not normally available, it's available if they came to GovGuam later in life to work. Joe San Agustin: They can't continue to contribute for Social Security while they work for the Government. James Duenas: Actually, if they have part-time in the private sector I think they do. Antolina Leon Guerrero: That's the only

way is if you work for the private sector. Doris Flores-Brooks: Because I've been talking to different plans and there are some states that were in the DC Plan that they are members of Social Security others are not members so it's kind of a mix bag. David O'Brien: Some have it, some don't. Joe San Agustin: Social Security has to be there in place then you could always add anything.

Antolina Leon Guerrero: So I think you should add that to your investment committee agenda is us to look at our default. Wilfred Leon Guerrero: No, that's Benefits and. Antolina Leon Guerrero: We'll do it. Sure, we'll bring it up tomorrow we'll be at the Board Meeting, that's fine. No problem. Terry Dennison: I can do the search while you eat.

Terry Dennison: The objective here is to consider options to replace Thornburg is our international fund. If we look at page 3, we have four candidates this is our practice we have listed Thornburg in here so we can compare Thornburg with the other four. The four candidates are AQR Capital Management, Dodge & Cox, Thompson, Siegel & Walmsley and Tweedy, Browne Company that's not a cartoon character despite every time I look at them I start to think of them as a cartoon character they're really not actually. The Thompson, Siegel & Walmsley is the manager for the Transamerica International equity fund so sometimes you'll see Transamerica but were always going to think of them as Thompson Siegel & Walmsley.

Turn to page 4 we got the characteristics of the fund the total assets, the total fund assets, strategy inception year, manager tenure, all of these are fairly large fund except the Transamerica fund they all go back at least 10 years. The manager has been with them a fairly lengthy period of time. Going fairly fast here but I am going to stop on page 5.

Looking at characteristics couple of things to look at here the P/E which is price to earnings and P/B which is price to book are indications of style. P/E & Price to earnings you can think of is how much you're paying in terms of price for a dollar worth of earnings, price of book how much you're paying in terms of price for a dollar worth of book value. The larger the number the more it's a growth type of strategy value, the smaller the number more value. In international most managers are of a more value nature there's not a lot of international growth managers historically most international managers tend to be value oriented they're not too many particular successful.

Growth managers all of these managers would tend to be in the value category. Couple of things stand out the average market cap you have a sense of whether tend to be more large cap to mid cap. Basically anything north of average cap of more than 50 million is going to be in the large cap base the only one more toward leaning a little bit toward mid cap is going to be Transamerica fund, the Thompson, Siegel and Walmsley.

The AQR has very large number of holdings 380 because this is an international fund there's a potential for emerging market exposure. There's none in the AQR fund there's some in the Dodge & Cox and Thornburg but in the double digits only and single digit in the Transamerica & Tweedy Browne.

The expense ratio shown in the second column from the right you can see the Thornburg is much higher than the ones we're considering but part of the reason for that is the revenue share and I'm glad that Alice and John are here could either of you comment on

what it does for the economics of the plan if we went to a fund with no revenue share. Because you can see here right now Thornburg is contributing 35 basis points towards the cost of the administration of the plan and the share classes we're looking at here all have no contribution to revenue sharing.

Terry Dennison: With the growth and asset I would assume we're probably in fairly good shape on revenue sharing just a few blows here if we have zero revenue sharing. John Borne: We have to look at where the assets are. Terry Dennison: Thornburg has 16 million out of total plan of 394. John Borne: So just an FYI our record keeping system is able to put an administrative fee on specific fund. Terry Dennison: Okay, so we could basically produce a synthetic expense ratio on it.

So we'll move on turn to page 6, I'm not going to spend a lot of time on strategy but I'm just going to mention a couple key things those of you who did your homework and read these and I'm sure they're great bedtime stories. AQR is a quantitative strategy it's extremely sophisticated if you read this its model based it's a very quantitative strategy they build models that they use for selecting and weighting the securities. They've done a lot of work trying to identify models that identify the most efficient portfolio. It works on 3 different models that produce a stock portfolio and 2 overlay portfolios, a country portfolio and a currency overlay portfolio.

If we turn to page 7 using the four factors. The idea generation gets the double plus we think very highly of the idea generation we think a very extensive research and this firm goes back a very long way we think their analysis of factors in how they select their portfolio is amongst the most sophisticated in wide reach in the industry.

Their portfolio construction gets a single plus we think is amongst the best out there, the implementation which is looking at capacity and how well they construct the portfolios we think is excellent. We give them overall rating of A which is our highest rating. We think very highly of the firm if you like quantitative strategies. It's a course strategy but it does tilt toward value it does use derivatives there are futures contracts that are involved in some of the hedging strategies that are used in it.

Turn to page 8 go to Dodge & Cox this is the entthesis of a quantitative strategy it is an extremely fundamental strategy. It's predicated on long term value they do in depth analysis of companies and their view is they consider themselves owners their horizon is beyond that of an investor, they consider themselves owners of the company. If you think about a continuum of lifespan of an ownership they're the speculator, the people hold them for days in some cases hours through investor to owner they hold things for years. What that means is they could be early and could hold them for a long time they also stick to their style.

Dodge & Cox was one of the very few value managers that stuck with value during the late 1990's. When value was terribly out of favor when growth manager or growth was in favor and just about every value manager on earth was losing assets and everybody gave up value for debt and even the most diligent growth value manager said well maybe growth at a reasonable price we can live with these guys were hardcore value they're religious fanatics to value.

What that means is that if value is out of favor they don't care and they're going to stick with it and that means if value is out of favor they're going to have some tracking error they're going to underperform the market they have a very discipline strategy, they got great continuity in their team.

Terry Dennison: Turn to page 9 we think their idea generation is buying under value stocks. They're looking for value they do their own research. It's not model base they really drill down into the companies, they've managed assets for a long time they started in 1930 if you think about it that was a heck of year to start in the investment management business and they been at it for a long time.

Portfolio construction is kind of loose they don't really stick to a lot of guidelines. They don't have a lot of risk guidelines in terms of sector weights or industry weights if they like a bunch of stocks they own a bunch of stocks and if it has a lot of weight in a particular sector and if they like the stocks that's okay with them that generates that (T). What that means is the strategy we like it's got an A rating but it can produce a lot of tracking error. Tracking error means it can produce a lot of volatility verses the bench mark. In general I am uncomfortable with managers with tracking error in defined contribution plans they produce excellent performance. In a DB Plan we love these guys the problem in the DC Plan is participants don't really understand tracking error they don't have the same horizon they don't have the same judgment.

If the managers have a couple bad quarters they bail out and what that does is they tend to bail out at the bottom and they're not there when the manager's turns around. So if the participant was professionally guided you might say this would be an ideal manager but they got great performance they're an excellent international manager.

The next fund is Thornburg to be there you can see this one is B rated we do talk about them we just basically state we think they're better people out there. Next manager Thompson, Siegel & Walmsley this was interesting because the other fundamental managers or what's called bottom up they start looking at stocks. This one got a top down component they look at stocks but they also have a micro view. They look not just at individual stocks they say this sector attracts us so this industry attracts us. So they have a macro view that is also an overlay so they might find a lot of health care stocks that they like but if there's some issue with the health care sector like uncertainty about the affordable care act. They might limit their exposure to health care stocks even though the fundamentals of these health care stocks are appealing. So this has some interesting aspects to it because of this duality to it they're bottom up stock pickers but they got this micro overlay on top of it. This is really not a team approach this is really a star Brandon Harrell is the Portfolio manager he's supported by team of analyst but he's really the key guy the final decision maker.

There four factors ago into his style. It really is a traditional value manager he's looking at market value he looks at a lot of cash flow data, free cash flow yield, price to cash relative to sector, earnings estimate revision, earnings surprise, relative price strike so he's looking a traditional valuation factors in trying to find companies that the market is mispricing. If we look at the four factors again because it's A rated he's going to have the double plus

idea generation. You can't get an A rated from us if you don't have our best thinking on idea generation.

The dedicated team isn't large but we really like how that team works together and obviously Brandon Harrell's leadership. It's well diversified across sectors part of the outcome of having that micro overlay. He doesn't fall in love with a bunch of stocks in one sectors on over weight that and gives you some good diversification. It's a sensible process a skilled team we like the intellect, we like the leadership.

The emerging market are constraint in no more than 10% and because we have an emerging market fund in the plan we don't want to have a heavy weight necessarily in emerging markets we have a place for people to go if they want to have emerging markets. And then we get Tweedy, Browne, Tweedy Browne is an interesting company goes back to the 20's this is another company that started a long time ago. It started as a brokerage firm started by Forest Tweedy. It's started out closely held firm and evolve it's now own partly by one of these aggregators affiliated managers grew. There's a company that owns money management firms and actually Thompson Siegel & Walmsley is owned by a different one of these aggregators that owns a whole set of money management firms.

They are a Benjamin Graham deep intrinsic value manager. Benjamin Graham is one of the inventors of the value style it's very classic their metric for risk is avoidance of permanent loss. They do start with the smaller floor they look not at company of a billion dollars or more but companies with 250 million or more. So they are looking a little bit toward the mid cap range that gives them a chance to take a bit of advantage of mid cap bias.

If there are companies that are not fully recognized by the market in terms of cap size they do some screening looking at enterprise value and the like, they don't spend a lot of time doing models but they do look at a lot of fundamental research. It is a little bit of committee driven process. They start with relatively small position sizes but they do too will take significant position 2 or 3 percent. If they got very high confidence positions they try to be fully invested but if they don't have good ideas they'll let some fairly significant cash develop. It also has the T tracking error if you go to page 16 again it's got the double plus. The business management it is characterized as an iconic firm.

Again sharing roots with the lives of Benjamin Graham and Lauren Buffet they only do this one thing it's not a product type firm. We like the risk management again its sound and we think that they do this style very well. If we look at the performance going to page 19 all of these funds if you look at it for the one year, three years, five years and forget Thornburg the left pointing triangle you could see for a longer period all of these are great it's what you'd expect. The interesting thing is if you go to page 20 none of them are great all the time. These are rolling one year periods because we are doing 12/31 ending periods here these are all one year periods these are calendar years 2006 to 2013.

So, if you look at AQR, Dodge & Cox, Thompson Siegel & Walmsley and Tweedy Browne and just look at the number in parenthesis that's the percentile ranking. It's easier to interpret than the absolute performance. The interesting thing is while on the accumulative basis they all do great. None of them do great every year and you wouldn't

expect them too. Some of them do great in up market some of them do great in down market even Thornburg does great sometimes but the reality is nobody is going to do great all the time but if you look at longer periods they all do very well.

Page 21, looking at 3 year periods and one of the things that strikes you is Tweedy Browne which does have the tracking error code for rolling three year periods looks pretty darn good.

Terry Dennison: Page 22, going to focus on a little bit because we don't just want to look at return we also want to look at risk. What we're looking at here the little gray dots are a cloud in risk return space return is the vertical access, risk is the horizontal access every dot represent in risk return space a fund in the EAFE Universe of International funds. You can see that they tend to have a slightly upward sloping left to right lower left hand corner upper right hand corner although not terribly clear. We would like to be in the upper left hand corner that's the free lunch high return, low risk. And Tweedy Browne is up in the upper left hand quadrant if you think about this as a map of the United States you like to be up towards Seattle that's not a reference to the Super Bowl incidentally actually looks like it's more towards Denver than anything else, risk return space but also Thompson Siegel and Walmsley is in a pretty decent space, also.

The next charts are a little bit for the map fans go to page 23 I'm only going to talk about the right hand bar that's called information ratio this is something the beloved of finance majors. This basically is the ratio of return to tracking error and what you like is a big number you certainly don't want a negative number and basically the finance people would say you would like the highest number you can get in terms of that ratio of return tracking error because that is a measure of the return per unit of risk and in this case there's an obvious massive winner which is Thomas, Siegel and Walmsley.

Literally they have a striking level of return per unit of risk tracking information ratio of 1.3 that puts it in the 6 percentile so if we use that statistics they're the obvious winner. If you look at their return again they are in the upward pointing triangle you can see in the return bar they're quite high but if you look at the tracking error bar which is the second from the right they're out the bottom of the bar so they're getting a pretty attractive return at very low risk.

And if you think about what we want for a defined contribution fund we're not looking for somebody who shoots out the light and then goes in the dumper and shoots out the light we're looking for somebody who produces a good return consistently not somebody who's really violent because this is the kind of fund that somebody will stick with that's the way to get rich. The way to get rich is to get rich slowly consistency is the winner.

Next set of chart Thompson, Siegel and Walmsley on page 27 as an example and then we look at page 28. The scribbly lines the green and red bars these are excess returns on a quarterly basis. The zero is the index return so if it's above zero it's a positive return relative to the index below zero is a negative return, green bars quarters where the return is positive relative index return is positive, the red bars the index return is negative so if the green bar is up that means they out perform in the up market, if the green bar is down that means they out perform in the down market vice versa.



The three dotted lines are the 25<sup>th</sup> percentile, 50<sup>th</sup> percentile and 75<sup>th</sup> percentile. The colored solid line is the rolling 3 year return for the manager. So for example Thomas, Siegel and Walmsley has got a lot of green bars that are positive that means in up markets they tend to do very well but also a lot of red bars that are positive which mean in non markets they do pretty well. Basically they do pretty well in both up and down markets also don't have any big negative excursion they don't do badly in any particular market and basically they're always above the median and if now in accumulative basis above the first quarter.

Terry Dennison: Turn to the next page look at Tweedy Browne here looks better than down markets you see lots of red bars that are positive little worse performance in up markets some green bars that are negative but basically the rolling 3 years return is pretty much consistently in the first quartile.

Let's look at page 32, looking at up and down market performance this is the numerical form of looking at the red and green bars. At this point let's focus on Transamerica which is the Thompson, Siegel & Walmsley and Tweedy Browne. So up market Transamerica outperform 10 times 67% of the time average excess return 60 basis points. Down markets outperform 80% of the time excess return 70 basis points. All markets outperform 70% of the time 60 basis points excess performance.

Tweedy Browne outperform 100% of the time in down markets 55% of the time in all market so that how you read this gives you a sense of performance of up and down markets. You can see for AQR are great up markets performer and poor down market performer. Dodge & Cox is really not terribly good in either market that's why we're not paying much attention.

Gerard Cruz: But this out performance for Tweedy Browne in down markets like 500 basis points is that correct? Terry Dennison: Yes and then we get to page 35 Terry's favorite page you've been with me a long time because I firmly believe that consistency is the way to win. This however presents an interesting conundrum because if consistency is the way to win. I would argue that Thompson, Siegel and Walmsley being always above the median mostly second quartile 55% of the time the second quartile 35% of the time first quartile is probably a safer bet than Tweedy Browne which is 95% of the time in the first quartile. It is tough to stay in the first quartile but clearly one of those two looks like our winner.

The average percentile rank for Tweedy Browne is a 15th percentile literally the average percentile rank is first quartile. You know my head says Transamerica or Thompson, Siegel & Walmsley because I like the consistent middle of the road but the Tweedy Browne always being in the first quartile sure looks appealing.

Wilfred Leon Guerrero: Tweedy Browne is that of bigger than. David O'Brien: The tempting analysis is the one on 27, the Transamerica I mean not just alpha but kind of alpha. Terry Dennison: I like the consistency, just being right even if you're not right by much but being right most of the time that's the way to win. David O'Brien: That's this one, to

me that's Transamerica. Terry Dennison: Yeah. David O'Brien: Because Tweedy Browne a little more. Wilfred Leon Guerrero: Tweedy Browne is the one that hits the homerun.

Terry Dennison: Remember on page 35 we're looking at rolling 3 year performance and rolling 3 year basis they're in the first quartile 95% of the time but that means in that 3 year period you might be looking at some stinky times. That means you have a 3 year holding period because if you look at page 28, there's a couple quarters in a row there where they loss nearly 2 quarters in a row were they were down nearly 400 basis points, 1 quarter they were down 800 basis points, another quarter they were down 700 basis points.

David O'Brien: Those two graphs on 27 & 28 tell me that Transamerica is far more at debt when the market switching because look at what they've done Tweedy Browne likes their bets and holds on to them, right.

Terry Dennison: I like Thompson, Siegel & Walmsley, I like people who hit singles all the time. Gerard Cruz: I agree. David O'Brien: I mean that's pretty at debt they've gotten better overtime. Gerard Cruz: Agreed Mr. Chairman. Wilfred Leon Guerrero: To what? David O'Brien: Gerry wanted to be first. Wilfred Leon Guerrero: Gerry. Gerard Cruz: Yes sir. Wilfred Leon Guerrero: Tweedy Browne cost more. Gerard Cruz: Yup, that's true too.

Terry Dennison: Just to be clear, Mercer's recommendation is Thompson, Siegel & Walmsley, the Transamerica fund. Wilfred Leon Guerrero: Say that again. Terry Dennison: The Transamerica fund. Gerard Cruz: Set that recommendation, Mr. Chairman. Terry Dennison: I think you probably need to make this part of that asking Great West to apply some kind of load factor on it so that the economics work and they owe you 35 basis points just so that you end up with the same number that you have or whatever it takes to come up with the same revenue that you have I guess it'll be the 35 basis points.

Joe San Agustin: When will there be a candidate for that proxy that passed away. Terry Dennison: Oh no, this is a completely different kind of fund. Gerard Cruz: So you're going to apply an expense factor for this and then so that way only those individuals in this plan are the ones to buy. Terry Dennison: Yes they're going to pay its totally fair. Paula Blas: You're already searching. Joe San Agustin: You got to start searching. Wilfred Leon Guerrero: So, you want to hold back on the decision until we hear from those guys. Gerard Cruz: No, no, no, they could do it, right. David O'Brien: Hello, let's spread it out. Gerard Cruz: Yeah, let's go ahead, let's do it. But, you'll come up with the exact dollar, I mean the exact percentage amount. Wilfred Leon Guerrero: Okay. David O'Brien: This is a replacement. Gerard Cruz: Yes this is a replacement. David O'Brien: How soon does the replacement happen? Paula Blas: Within... Alice, 60 days when you do the transition of a new fund. Alice Tajjeron: As soon you give us the letter we have about 60 to 90 days. Paula Blas: We have to notify all the participants and let them now that the fund is, but even the ones that aren't in it get notified.

Terry Dennison: One quick thing turn to page 5 before we just say let's just throw on the 35 basis points if I could suggest that the committee ask Great West to just take a sharp pencil and see if there's 15 basis points extra left because right now Thornburg is at 125 and giving us 35. Transamerica is at 105 and giving us nothing if we put 35 on the 105

the participants are seeing an extra 15 cause that gives us 140, if we could squeeze the stone and get 15 out of that we can make the participants level. John Borne: That will be the idea.

David O'Brien: What happens do you guys go back and negotiate? John Borne: No, we look at the revenue report so there's 16 million at fund and we look at the RFP requirement on the plan. Terry Dennison: They get a spread sheet, they'll work on it.

Gerard Cruz: Okay, good, so moved Mr. Chairman this is a motion to accept Mercers recommendation to hire Transamerica for the purposes of replacing Thornburg and the International Equity Space and in addition to that to work with Great West to come up with an implicit replacement for the revenue sharing portion that Transamerica that doesn't offer in the share cost. James Duenas: Second. Wilfred Leon Guerrero: James any objection. James Duenas: I second. Wilfred Leon Guerrero: Alright, are we done, Terry.

Wilfred Leon Guerrero: Terry, tell us we're going to make tons of money. Doris Flores-Brooks: He said it's a momentum driven. Terry Dennison: Yes. David O'Brien: Works so far this year.

Terry Dennison: Well I don't know if I can tell you we're going to make tons of money. But I started my discussion yesterday with Doris's group with the observation that there's a Chinese curse may you live an interest in times and we seem to be living increasingly interest in times. In fact those of us who are relatively old can remember the joy of living in less interest in time perhaps reminiscing of that. I did point out that it's been 7 years since we've entered the global financial crisis and 5 years when it's supposedly ended.

But, recent polling in the US indicated that more than half the US believes we're still in a recession. So we still have high levels of unemployment and clearly a lot economic issues around the world and realistically I think we're still coming out of that global crisis. What we saw going into and through the global crisis all the economy around the world stimulated aggressively with coordinated physical monetary policies trying to produce expansionary growth to counter the recession and it had different effects around the world. I mean clearly it's been the most successful in the US I think the Federal Reserve did a good job dealing with the effects clearly it started to some degree with the US the failure of Lehman before that Bear Sterns the whole subprime mortgage issues but there were issues around the world that those problems surfaced.

The Fed has increased its balance sheet by more than 3½ trillion dollars. We had tremendous fiscal stimulus period of low interest rates. But the reality is it's had the effect of really bringing the US more or less out of recession we haven't had the kind of robust growth that typically we would get coming out of the recession. Typically in the Post World War II period coming out of the recession we would expect to have a period of 4 to 5% real growth. Typically in a steep recession we have a period of very robust growth the depth of the recession would correspond to the height of the recovery. So if you have a steep V shape recession you would have a very strong recovery we haven't had that. Doris Flores-Brooks: And will we. Terry Dennison: No. It's realistically we're now well into the average

length of the Post World War II recovery most Post World War II recovery last in the range of 50-60 months. In fact by average length we're heading into the next recession we're really to the end of this part of the economic cycle.

Now the cycle is obviously operating in a very typical environment. Most economic cycle are caused by inventory buildup and interest rates in the like. Right now the economy is very managed so we're no longer in the typical cycle that we saw years ago where inventory would build up and production slows and the like it's now being completely managed.

But the reality is we would now in ordinary times be heading back into a recession. If we look at other places obviously the Euro Zone has been struggling dramatically, Southern Europe has been in recession a very steep recession with unemployment particularly youth unemployment continuing to be very high. And even Northern Europe the countries are struggling even Germany which is the best Northern European country is seeing their growth very limited because their export markets are suffering. Their major trading partner France is very much struggling.

Terry Dennison: The emerging market which before the strongest part of the economy are having now their own difficulties because they really have done well because they have fed on the enormous dollar liquidity that the Fed has fed into the world. They've lived on for incoming investment because the Fed has flooded the world with dollars and have seen tremendous inward investment.

Their economy has grown very rapidly and they have not grown necessarily productively they haven't grown by adding wise plant in equipment they just built things. We've seen in China cities built where nobody lives and very unproductive use of that money and now we are seeing the effect was the Fed the open market committee met today and they've reduced the QE3 another 10 billion dollars a month, it's now down to 65 billion dollars a month. And the reality is that's going to have further slow down in economic activities and emerging markets.

It was interesting because Christine Lagarde head of the International monetary fund more or less begged the Fed not to do it she said that this is going to have a very damaging effect on these emerging market countries which are very vulnerable to slow down in flows of dollars and they basically said that's not our problem. This is not the global Fed the name on the door is the US Federal Reserve it's appropriate for the US to slow down the amount of bond buying and will just let the emerging market fend for themselves. So we are seeing countries like Turkey in particular and Argentina, Brazil, South Africa and others now have to jack up interest rates to keep their currency from collapsing and because they're jacking up interest rates they're destroying their economy. So we are now seeing this emerging market crisis now spread to a growing number of countries because in effect the Fed's have turned off the valve of cheap easy money.

The real focus identified by a lot of commentaries will come back to this of concern is China. They had a failure we talked last time about these trust companies they had a failure of one of these trust organizations. The government had to bail out one of these entities to the tune of 500 million dollars. They basically invested in what amounts to a worthless coal mine and in order to keep this from turning into a Lehman like contagion

the government just said okay we will bail the investors and obviously the Chinese government has a lot of money but 500 billion dollars is a lot of money. And they have something out in the order of 8 or 9 trillion dollars more of these sorts of things and at some point they might run out of money but we'll come back to that, also.

Economic activity China is high but slowing previously they were running close to double digit growth they're now slowing to 5% growth and that's partly being managed they're clearly concerned. The government is concerned about the growth credit bubble and they're trying very hard to slow the economy down without causing it to crash. I mean this is a very delicate thing we're trying to do because if they step on the brake too hard the economy is going to slow dramatically and the ability of these over extended debtors to service this enormous amount of debt is not going to be sufficient and you're going to have a way of failures of these heavily leverage trust banks, wealth management products which we'll talk some more about later. But on the other hand everybody in the world is frightened about this credit growth. I mentioned last time I was here since 2008 the growth of credit in China is greater than the total value of the US commercial banking system literally the growth of it is larger than the US commercial banking system.

Terry Dennison: So we are now seeing the driver of growth in the world, China trying very delicately to slow down and this had a dramatic effect on the economies of countries like Australia and Canada who had tremendous prosperity due to their exports of commodities to China. Commodities like iron ore in the case of Australia, timber and other commodities in the case of Canada and this is causing a decline in commodity prices and the effect of the decline of commodities prices is producing a concern about deflation and deflation is something that worries economists and we'll get to the discussion about deflation in a bit.

When we talk about where the economy is going we have to get into this area of austerity. Pretty much there's been austerity throughout the developed world. In the U.S we had austerity too, we called it sequestration. Doris Flores-Brooks: We have short lived. Terry Dennison: Yeah, we've short lived, but we're now back to concerns about the debt limit and the question of whether or not we'll be able to fund the federal budget as much as we would like concerns about the fact the deficit has caused the monetary base the size of the balance sheet of the federal reserve to grow now to 4.1 trillion dollars whether that can be allowed to grow forever. Clearly austerity a fact of life in Europe and the reality is we've seen fiscal drag from things like austerity and reduce state and local spending be a drag on growth.

There's a belief that austerity both federal level but also particular state and local level probably took a percent of GDP growth in 2013. We may be seeing the end of that we might see GDP growth lose that 1% drag going to 2014. Right now we're running about 3½% GDP growth in the US which is the fastest it's been since the global financial crises. Certainly fastest growth in the developed world nowhere else can touch us, UK is probably running about 2 and that's about the fastest outside of the US.

Let's get back to this issue of inflation and deflation we're always had this concern about inflation and of course it's a source of great eggs in countries like Germany that had bouts of inflation. But what really concerns economists is deflation our friends just up to the North West of us, in Japan of course have been struggling with this for the last 20 years.

And the reason the economists are concerned about deflation is once you get into a deflationary cycle it's very hard to break out of it because if prices are always going down it's very difficult to get people spending money. Because if it's always cheaper next year why spend money this year and it's very hard to break out of that cycle, Japan's been in the deflationary cycle since the late 1980's. In fact that's the whole focus about abenomics to try to break this deflationary cycle.

Well if you look at what's been going on in Europe inflation in Europe is now less than 1%. It's now to about 7 tenths of 1% and the concern there is in fact if you look at typical market basket of goods and services a quarter of that market basket prices are actually going down in Europe. So the concern there is if they can't get people to start spending because they think prices are going down that they're going to get locked into this deflationary spiral and the growth that everybody says we need is never going to happen. We're overlaid on top of that is what we see with commodities that you're seeing corn half the price it was 3 or 4 years ago.

All these industrial commodities that go into manufactured goods because of lower demand from China, lower demand from the developed world in general because of simply lower production fall in value and of course the one thing that seems to always be expensive oil we're likely to see dramatic fall in oil prices largely due to political things. We tend to think about fracking oil in North America we're now producing about a million barrels of oil in the US.

But you're going to start to see Libya which is been not producing any oil produced between six hundred thousand barrels a day and million barrels a day. You're going to see Iran because they're now worked out pretty much a deal to get out of sanctions start to produce several million barrels a day. You are going to see Iraq which has had basically been out of the oil market produce a couple million barrels a day.

In fact there is a discussion that you might see Iran and Iraq together yet up as high as 9 million barrels a day by the end of decade and even what's always the kind of buffer the thing keeps oil prices relatively stable which is Saudi Arabia not being able to do that because the Saudi's were previously they could say okay we can turn the valve off to keep prices high they've now have issues of their own.

The oil unfortunately for them is in their Eastern province which is dominated by Shea's and the Shea majority sunic country the Shea minority is not happy and basically they're kept quiet by big payments they're just bought off and of course Iran will just assume they have a revolution there. So basically they have to keep paying them off so they have to produce. So there's been seriously speculation see oil go to 60 dollars a barrel you could see oil prices fall almost in half because of the tremendous amount of potential production both from countries for geo political reasons not being able to produce or the necessity to produce all of a sudden have to put this oil on the market coupled with reduced demand. You're seeing cars now with substantially less consumption, airplanes less production obviously living in West Los Angeles perhaps a little artificial but I would say one car in 50 is now a tesla.

They're working out a sort of popular price model 70 thousand dollars, maybe not too popular price but literally oil is no longer something you're going to see a lot of spending on so the reality is you're now seeing commodity prices start to fall. Doris Flores-Brooks: Hasn't happened on Guam, though. Terry Dennison: No. Joe San Agustin: Commodity keeps going up.

Terry Dennison: But, the reality is what you are going to see is commodity prices including oil start to drive deflationary forces and the usual way that you start to fight deflation is try to stimulate growth by reducing interest rates because that makes money cheaper, rates already low, rates already zero, what are you going to do? You can't reduce rates they're already zero so we're in a very difficult spot. How do you stimulate growth? We have these forces driving down inflation producing deflation you can't stimulate it by all the usual methods debt is already high you just can't print money, interest rates are already low you can't cut them to try to stimulate growth we're kind of in a tough spot.

Gerard Cruz: You're talking in terms of the Global economy in X, US. Terry Dennison: Yeah, but US is in much the same situation. Gerard Cruz: If that was the case why would they be turning off the dial on QE and forecasting in 3 ½ % growth in GDP. Terry Dennison: Well they're doing it because they feel that at some point they simply can't let the monetary base continue to grow to this level. Gerard Cruz: But all the other indicators are showing positive signs alright, employment is down to 6 or 7.

David O'Brien: Some point you have to test as Terry says is this bigget driving the economy monetary policy where there's a real economy there, right. Terry Dennison: Yeah.

Gerard Cruz: For all these years when they were talking about protecting from any deflationary risk by keeping rates low and continuing to buy debt if that's still the case given the same players in the Fed why they would begin to turn it off now, I mean it just seems contrary to their statements all the prior and then the fact that they're going to continue to keep short term rates low, would seem.

Terry Dennison: Well part of the reason they're trying to manage rates is who's the biggest debtor in the world. They're also trying to keep the federal reserve and the treasury, treasuries interest rate burden low, if rates start to rise you're going to start to see crowding out of the discretionary federal budget. Gerard Cruz: But if rates start to rise if that happens wouldn't you see greater risk of deflation. Terry Dennison: No, you'll start to see inflation because you'll see the interest component. Gerard Cruz: If there's less money on the street if they tightened by turning off the spicket, wouldn't you see less economic activity.

Terry Dennison: Depends if they do it in this stage fashion what you have if you had unexpected inflation, unexpected tightening that would do it. This is why they focus on forward guidance. What they're afraid of is a situation across is unexpected something this is why despite Christine Legard please don't do it. They started on a program watch what they're going to do every meeting it's going to go like this, because once they start on something they send a giant signal if they start to deviate from the program. So they're very concerned once they said we're going to start to do this if they deviate from it the tea leaf readers are going to start to wonder what that means.

Doris Flores-Brooks: So is growth flowing then they have to go back to stimulate more.  
Terry Dennison: Yeah, I think they want to stay the course and if they don't want to send a we're now concerned about something now clearly if all of a sudden you saw a spike in unemployment then they would change course because do not react to that because as long as the numbers stay within some corridor that they have in their mind they're not sharing with anybody they're going to stay the course because if they change the signal having made such a thing about forward guidance I think the market would react in a very strange fashion.

Gerard Cruz: So the market's reaction over the last week is part of what was announced today. Terry Dennison: Yeah, I think the market been more reacting to what's come out from Dagos it's been more of the Geo political concerns and all the talk about possible war in the South China Sea. The concerns about slow down and credit risk in China. I don't think is as much more about what's going on in the US, I think the US is now seeing a fairly benign situation.

David O'Brien: Gives new meaning Gerry, two fundamentals - free market forces what does that mean and the second thing is it gives new meaning is everything correlated or not correlated. Powerful things if everything is managed and if everything because of these relationships is correlated where do you go if you're us.

Terry Dennison: Interesting thing is everything is managed ignores chaos theory the idea that there is all of these things can be perfectly managed because you do have the chaos theory effect the either misguided state actor or the crazy none state actor, crazy non state actor think North Korea well that is a state actor but crazy certainly qualifies or some misguided action. Some group ever decides to invade these little islands but if you read some of the narrative that's going on in Diablo's particularly some of the narrative at private dinner in Diablo's there's some scary talk going on there. You see characterization like Prime Minister Abe characterizing where China and Japan is being pretty much like UK and Germany was in 1914. Gerard Cruz: Really, that close.

Terry Dennison: That close and the level of rederick and Abe visiting the Akashone Shrine it's escalating dangerous point there and on top of this you've got, can China manage this credit bubble and defuse the potential social concerns. You have about 400 million population of newly middle class people who invested in the wealth management products like these people who invested in the 500 million dollars the name of this thing the China Credit Trust it was invested in a coal mine and literally 500 million US dollars was invested by the newly wealthy middle class a wealth management product.

Terry Dennison: The people bank of China pays 1% for savings account for Chinese citizens well if you have a lot of money you don't want 1% so they invest in wealth management products that pay the number I was getting is 10-12% annual interest. The only way to make 10-12% is you loan money to people who built buildings or factories or something and these are usually financed by short term debt that has to be rolled over every 6 months if the word Ponze comes to mind that probably not far off and this is how the 6 trillion dollars of shadow lending and local government financing vehicle and all of these other acronyms start to get us into trouble. They have their own set of acronyms



just like we have our own set of acronyms. Let's keep going here go back to spend a little time with our friends in Europe.

The euro zone we talked about the deflation going on there near deflation. A couple of things we talked before about the big domino being France obviously we've been having a certain amount of yuk of Meshere Mulan personal life which is about a big shamble this countries economics situations. He's now retained as advisor one of the advisors that Germany used to set up the hearts for program to liberalize the labor laws in Germany that led to a kind of simplification of the governance in Germany that led to economic rebound.

Now obviously it's a little harder to do in France because they have a history of resisting any kind of change to the government they go out and riot at a moment's notice out there so any kind of reform is actively resistant. So it's unclear whether or not they're actually going to be able to enact any reforms and of course this is a socialist government so he's probably not going to be able to keep his own side of assembly in line.

Terry Dennison: He's now got the lowest level of support before this of any modern French government. I am reminded of the late lady Thatcher made a wonderful state comment about why socialism does not work. She said that socialism fails when you run out of other people's money. And I think they're pretty much out of it. I've seen some estimates the only way you can get France and Germany to be roughly equally competitive if you cut the standard of living in France 40%. So I suspect that's probably going to be resisted.

Terry Dennison: So the other thing rate of the game there's been an effort in the German constitutional court to question whether or not the (OMT) open market transactions basically the European central bank buying unlimited amount of government bonds would be legal under the German basic law. And if it's not that would not allow the Germans to participate which would mean basically the market will no longer accept the premise that the European central bank would be able to support the southern European countries. They're suppose to announce their decision as to whether or not the Buda span would be able to support OMP program in April there's a fair amount of thinking that they would say they can't which would throw the Euro zone back into crisis.

The last thing that's going to be fun to watch in May there will be elections for the European parliament and at this point a variety of nationalist parties the UK independence party, the National Front in France has now been winning seats not just from right but from the left we'll be the strongest party in the European parliament which is kind of a laugh if you think about it since they're largely anti Europe. They also have anti European parties some of which are rather nasty some bordering Neo Nazi in Greece, and the Netherlands and some other countries so it's going to be a big mess over there so we live in interesting times.

We're fortunate most of our investments are in the US. Gerard Cruz: That's the outlook going forward. Terry Dennison: Yeah, we're fortunate we're in the US. Any questions on the market or the economy. Okay. Wilfred Leon Guerrero: I don't understand what you just said. David O'Brien: Fixed income where do you see fixed income. Terry Dennison: Well realistically the Feds are going to try to keep rates low for the foreseeable future short

rates obviously that's the only rate they control probably to 2015 that's as far out that they're willing to say now, long rates have drifted up if we start to see either a flight to quality the US dollars is still despite the fact it's gotten weak to relative to other currency particularly the pound in Euro amazingly.

The pounds up to \$1.66, the Euro \$1.39 but the reality is if there is a crisis there will be a flight to quality the interesting thing is that if the problems develop in China the peoples bank in China have a lot of Yuan if they have to start bailing people out they don't have to sell foreign currency to do that they have a printing press. The 500 million dollars they didn't pay people off in dollars they paid them off in Yuan.

But if for some reason they had to start to liquidate some of their foreign currency holding for some reason like some of the holder of this debt needed to be paid off in foreign currency and they had to start to liquidate some of their holdings that could put some pressure on treasury prices and therefore cause rise in treasury yields. But I can't see a circumstance where treasury yields would go up unless there was some kind of panic selling of treasuries.

David O'Brien: You mean in a short term. Terry Dennison: In a short term. So I think you are going to see rates low or falling if you had a flight to quality and I think they'll keep short rates low for awhile. Long term they're going to go back up the Fed has a real interest in keeping rates low because if they started to go back up to historical levels literally the interest cost in the treasury of paying historic market rates on this enormous federal debt talking 16 trillion dollars worth of mostly relatively short maturity meaning the bond they allow average maturity of the stock of federal debt to come down which means there're going to have to refinance it they don't have a lot of low coupon long dated debt out there.

Terry Dennison: They're going to have to refinance it relatively quickly you're going to see the interest expense in the federal government go up a lot and it's going to crowd out part of the discretionary part of the federal budget.

Federal government has had a very free ride in terms of interest expense for the last 10 years and the office of the public debt which is part of the treasury that manages the debt portfolio has been shortening the maturity of the federal debt portfolio. They been paying off the long term debt and refinancing it with the short term debt because of yield curve that they'll replace a 30 year bond with a 3 year bond because of the shape of the yield curve well that's a terrific idea unless rates start to rise and you have to now refinance that all of a sudden the effect of the rising rates hits you much faster. So they been having easy time the cost of debt service has been artificially depressed but it's a gamble.

David O'Brien: Because one of the issues that keeps coming up is, let me see if I could put it in context that I want my question to come out. We have a lot of under funded liabilities, we have an asset allocation an actuarial study that says where going to be about 7% or where ever we are, a big part of our portfolio is still fixed income from whence do you go. I mean if the fixed income market particularly bonds a) are more volatile than they've ever been, (b) you can swing either way, you can swing with the yield curve, you

could swing down get this manage situation what do you do with fixed income part of your asset allocations.

Terry Dennison: Well remember you're not a corporate pension plan you wouldn't necessarily want to try to match the duration of the assets and liabilities because well I mean you could that's what the corporate plan is doing is match the liabilities and the assets.

Gerard Cruz: But we're so underfunded I don't think our liability driven strategy is going to work but fixed income on the US treasury side is one component of the total fixed income universe so I think corporates at some point would start to play a bigger part in our fixed income allocation, but then beyond that if this new law is passed I think we're going to have less focus or less concentration of our portfolio in fixed income. I think we've been in fixed income at our given level because of the limitation of being able to go elsewhere so now we're about 60-40, 35-65, something in that neighborhood we count REITs as part of fixed because of its real estate, but anyway once this law passes I think we'll have less.

David O'Brien: I am just worried because with increasing volatility all these markets, increasing correlation which is the point I was trying to bring up later and cash needs that we have, right. Gerard Cruz: I agree. David O'Brien: Where do you go and in actuarial study that says you are going to be at 7% I just don't see it that the future looks difficult. Doris Flores-Brooks: Don't forget Terry now does not do DB. David O'Brien: It doesn't matter. Terry Dennison: I am talking theory not talking about your plan.

Gerard Cruz: The good news is from what I understand from what I heard today the last presentation. I think there was a bigger concern on the fixed income side because it seems that the economy was really starting to move and there was still that pressure out there the uncertainty for sure but seems that we were moving in a direction that a larger and more severe hike was eminent. What I'm hearing now maybe not, maybe there's some deflationary pressure out there that can offset the inflationary pressure that were more eminent last time and so therefore we have a little more room and a little more time to figure out what we're going to do with our fixed income portfolio.

Terry Dennison: I just don't see a break out of very strong growth because the reality is. Doris Flores-Brooks: The new normal. Terry Dennison: You got the new normal you got persistent high unemployment. Gerard Cruz: But you still had the one month in May where you saw rates go up 100 basis points. Terry Dennison: Right but that was due to somebody talking, somebody said the word taper and what you had was the market reacting to one of the instantaneous changes. The market had settle into a QE was going to go on forever we were going to have this constant buying of 85 million dollars a month of bonds and its going to go on in perpetuity and all of a sudden somebody said maybe it won't and the market reacted to a change in the environment.

Now the interesting thing is when they actually said its going to happen the reaction the reality was it wasn't the action, it was the mention of the action I thought that was kind of an instructive thing you actually saw you have to be careful with what you talk about. Bernanke has always been good about messaging and for once in his career something

crept out of his mouth, his mouth got ahead of his brain. I think it was a very interesting object lesson that when you are in that position you better be very careful about what you say.

David O'Brien: But didn't he learn fast because the next pronouncement in December where they announce the further tapering was couched incredibly well. Terry Dennison: Clearly and the funny thing is nothing happen for six months, I mean literally he didn't even say we are going to start to taper he said we may start thinking about possibly maybe considering it and the market went berserk rates went up 100 basis points, we saw all of the countries that we're seeing tremendous inward flows of dollar liquidity start to get shaky. The reality is somebody moved my cheese and all of a sudden the world trembled. Joe San Agustin: They didn't expect that. Terry Dennison: Yeah, they didn't expect it.

David O'Brien: Yeah and they didn't know what tapering was either because there's a difference between 80 million dollar taper and 10 million dollar taper done several times. Terry Dennison: It was a word never been used before it was unquantified, it was a word with no meaning no quantification its subject to interpretation and all of a sudden fear ran wild. The reality is I see some bounds to how much growth there's going to be because you have reduction in the work force, you got people now starting get into the big thick wedge of the baby boomer's retiring.

Obviously people by necessity going to have to keep working or desire to keep working but you got people for whatever reason want to work part-time, you got people who are struggling with still with loans and the like. But the reality is I don't think you are going to see all of a sudden break out 6% growth producing great upward pressure in interest rates people are going to discover 3½ maybe a quarter to 4 is the tops were going to see.

Gerard Cruz: I'm sorry, so we've been talking about monetary policy but on fiscal policy the budget that was passed by the federal government pass isn't that close or near to sequestration level or has?

Terry Dennison: Well what happened is tax receipts have picked up a lot. They haven't really cut spending or change spending much but actually if you look at the deficit it's been falling pretty dramatically because tax receipts been picking up.

First of fall you got the 3.2% the high income sur tax on super high. They change the tax rule because of the Affordable Care Act. So you got the 39% maximum rate you got the 3.2% sur tax on Capital gains you've got the unlimited 0.8% Medicare tax, you got the 20% Capital gains rate for people 39% tax bracket plus you got stock market returns you got all the stock option goodies. So what happens is I think you see tax receipts. That's why California got a 4 billion dollar budget surplus. I mean the usual basket case of the western world is all of a sudden rolling in dough. Gerard Cruz: The fifth largest economy, right. Terry Dennison: Absolutely. We've gone from Greece to Switzerland. Gerard Cruz: I remember that one year when California avoided that deficit by moving the payroll over to the next fiscal year by one day. Terry Dennison: If there are games to be played we will play them.

Doris Flores-Brooks: That's when they're going to spend on that monorail. Terry Dennison: No we're not going to build that stupid train. Doris Flores-Brooks: Jerry Brown signed did I thought. Terry Dennison: Yeah, but the courts basically said they violated the thing that allowed them to build it and the courts are going to block it. Gerard Cruz: The monorail? Terry Dennison: They're building they just spend 80 billion dollars to build this ridiculous railroad. Doris Flores-Brooks: It connects San Francisco and LA. Gerard Cruz: Are they culturing? Terry Dennison: Yeah, they're going to build this 200 mile an hour train. Doris Flores-Brooks: It's going to cost more than the big ding. Terry Dennison: You'll be able to go from Bakersfield to Stockton at 200 miles an hour now why you want to go fast to any of those places.

Antolina Leon Guerrero: You want to go there as slowly as possible. Terry Dennison: You can go on Southwest for \$89.00 none of this makes any sense. Doris Flores-Brooks: That's fiscal stimulus. Terry Dennison: Realistically if you look at the bad deficit we are not running the trillion dollars deficit we were running and it's not because we are spenders the reality is the tax receipts picked up. They've been goosing the 1 percenters. Gerard Cruz: Mind us we'll join us the 5 percenters, then. Terry Dennison: So we'll see. Gerard Cruz: What about the President's initiative to further increase spending through increasing payroll and things like minimum wage. Terry Dennison: I think that's a side show the effects on the margins going be minimal.

### **DC Plan Performance**

Terry Dennison: Okay, let's talk about the Fund go to page 11 some of this of course is just for the record to show we are doing our good governance page 11 of course is looking at Fisher Frontier as always we want to make sure were providing a range of options to allow the participants to find a set of funds to allow them to built a portfolio to satisfy their own unique risk and return requirements. We indeed do have set of funds that provide them options along the risk and return continue on. There's no obvious holes in this and no fund recommend to adding to the portfolio in fact you actually have quite a wide range here to allow people to take advantage of what the market provides.

Terry Dennison: Going to page 12 the markets continues to be fruitful the 401A plan grew by 24 million dollars 7.2% increase. We didn't get the data in time to incorporate in the book there are some pages that were supplied extra. We did provide Great West kind enough to give us the data to give you a break down terms of gains and losses both of the fund level and total of the plan level that's in your packages. So you can see what we had in terms of gains and losses and decompose the gains and losses.

There are plan summary starts in page 13, there's one note here if we get down to the Standish Melon Global Fixed Income Fund. Wilfred Leon Guerrero: Just a second, there's an increase, how much is return and how much is contribution?

Terry Dennison: Dr. LG, you should have in your package some forms. If you look at the total plan there are 2 columns here if you look at net contributions disbursements in gains and losses what we've done, actually we didn't Great West did and we just took their data we are not taking credit for their work. What this does it decomposes the net change into

the 2 components which is market effect and the result of participant actions. Antolina Leon Guerrero: So, the difference between those two columns is market. Doris Flores-Brooks: Market was more. Terry Dennison: The market dominates the participants move money in and out of funds and into and out of the plan contributions in, withdrawals, distributions and so forth out. Because of the size of the market movement the market dominated contributions and distributions were relatively a small component of it but the market effect was the dominant component.

Turn to page 13 we've got the usual summaries one here if we go down to the second paragraph in the bottom the Dreyfus/Standish Global Fixed Income fund. The executive director sent me a copy of a proxy and asked for my opinion. A proxy is a request from the sponsor of the fund for vote of the shareholders and you as the plan are the representative of the shareholders which are the participants. And they're asking for approval of a number of changes to the guidelines for the fund and most of these are fairly routine as I read through the proxy these are rather none routine, they were very non routine, basically almost like we want to be able to invest in pretty much anything we want to be able to buy almost anything we want to buy regardless of what it is the fund is called some of these they want to remove a lot of the investment restrictions.

And my first reaction is and unfortunately this is where this gets to be very difficult let me take you to page 28, let's look at the performance of this fund under global fixed. This is the Dreyfus/Standish Global Fixed Income fund. This is a fund that invest in fixed income investments globally so it's a bond fund that invest in fixed income securities around the world. Its performance has been outstanding both absolute basis and regular basis and my first reaction after reading the proxy statement is if they actually got disapproved I would want to exit the fund. I would want out of this fund because I no longer have any idea what they're going to be doing. David O'Brien: What did the proxy say?

Terry Dennison: Well the proxy said if the shareholders approve this at least the theory the ability to invest in all sorts of stuff whatever they want to do. David O'Brien: They need that now because. Terry Dennison: They feel that the guidelines that are currently in place are too restrictive. Antolina Leon Guerrero: And yet they've managed through the guidelines to perform. Terry Dennison: They want to invest in lots of other interesting things and herein lies the dilemma that we have.

Terry Dennison: The fund has done an excellent job for our participants now there's not a vast amount of money it's got 6 tenth of 1 percent. But on the other hand we have a fiduciary responsibility there's a truth in advertising issue here this is labeled a Global Fixed Income fund and if they're buying common stock and all sorts of other stuff. Gerard Cruz: Is that what the proxy. Terry Dennison: Well basically effectively they're removing all the restrictions. They're basically in effect is not exactly turning into anything goes hedge fund but you read this and my first reaction was if they actually had this approved I almost recommend just getting out of the fund replacing with something else. Antolina Leon Guerrero: Because we don't know what they're buying. Terry Dennison: We can't let the participants preferably minimum have to change characterization of this. We can't let it have this name and those guidelines. I hate to Pearl Harbor our colleagues here from Great West. Do you have this in any of on your other clients have other people have expressed their concerns about this or is this a kind of unique situation to us. John

Borne: We have not that brought up to us. Terry Dennison: Now, I don't know think wanted the requested proxy back to them by early February they want a total votes if it fails we don't have an issue.

The trouble is most of these proxies people don't think about it they just sign and vote yes it's just like a no brainer. The Board recommends approval, of course the Board recommends approval if somebody on the Board didn't recommend approval they wouldn't be on the Board so it's going to be approved. I cannot in good conscience as your coach fiduciary which is what I am respectively investment decisions recommend you retain this fund if they get approval to do this. Look at how well this thing is done this is a tragedy. Antolina Leon Guerrero: I would like to say past performance does not predict the future and if they're going to go off on some new tangents who knows what their performance is going to look like. Joe San Agustin: What's the timing for that? Paula Blas: Oh you mean to exit I think it's really contingent on the outcome but we believe it's actually going to pass.

Terry Dennison: I would be astonished if people give it as much thought as we have given it. David O'Brien: I agree with Terry most plans just sign off. Joe San Agustin: Participants probably rely on it. Doris Flores-Brooks: Thank you for noticing it. Gerard Cruz: Yeah, thanks Terry. Paula Blas: Well we sent it to him to look at because we've never got a proxy before on the DC side of the house but the stuff they were asking was kind of a strange request so Diane sent it to Terry and let's see what his take is on it. Terry Dennison: It was out there? Joe San Agustin: You have to put this on your agenda. Gerard Cruz: Maybe begin a search. Paula Blas: To begin a search on this one. Joe San Agustin: Yeah, start talking about a replacement.

Terry Dennison: One thought is this fund. Gerard Cruz: Maybe just keep it and reclassifying it to what it's going to be, but finding a replacement for Global Fixed. Terry Dennison: I don't know what I'd call it because we don't know what they're going to do. You know the go anywhere, do anything. David O'Brien: You have to ask why such a well successful fund would do this mindless thing, they wouldn't. Terry Dennison: I would suspect they have something in mind they've asked for a very, very liberal set of guidelines. Joe San Agustin: Trust me che'lu.

Terry Dennison: This is an uncommon asset class in the 401K fund. Gerard Cruz: It is or is not? Terry Dennison: It is uncommon. I mean one thought I would have given this fund is only attracted six tenth of 1 percent of the assets is drop the options. David O'Brien: Hello, I'm in it. Antolina Leon Guerrero: Those who chose it since it's such a small portion they're the ones that are looking for what they wanted. Terry Dennison: That is an option, it's not fair for me to say you should just replace it I've got to give you options that's my job. If this was 10% of the fund that will be one thing it's very important diversifier if you do so wisely. Joe San Agustin: Are you saying Terry you don't have to exit you just give the options if you want to stay in or not. Terry Dennison: The only way you could keep it in there and I'm not recommending this is if you had a brokerage window and basically said move it out of the primary array but allow them to retain in the brokerage window that is sort of an unsupervised playpen. Gerard Cruz: Could we do that? Paula Blas: He's not recommending it. Terry Dennison: I'm not recommending, I'm just saying you could do it. If I characterized it as an unsupervised playpen you probably

could draw some conclusion. Gerard Cruz: I'm all over it, you got me at unsupervised. Terry Dennison: That is with respect to its performance not with respect to this issue. Wilfred Leon Guerrero: We know that either we retain them or? Terry Dennison: It is with respect to the performance not with respect to this issue regarding the proxy.

Joe San Agustin: They may have a good performance now but when they said proxy it may not be there. We're talking about anticipatory, right now it's okay. Gerard Cruz: Right now if they stay with their existing. Joe San Agustin: But if they insist on having a proxy. Terry Dennison: The fund as it is now is marvelous but if they are successful in getting this proxy change and I suspect it will because of people's behavior its not critically looking at what they're asking for. Joe San Agustin: It could be better. Terry Dennison: It probably will be better its just not appropriate.

Antolina Leon Guerrero: And it may not be global fixed income they want to get out of that. Terry Dennison: I'm not saying it's going to be worse it could be better. Wilfred Leon Guerrero: What's the policy on this proxy thing? Paula Blas: That's just it for the DC we weren't sure that's why we sent it to Terry because we didn't have anything, we have it for the DB. Wilfred Leon Guerrero: We don't have a policy on the DC? Paula Blas: No, this is the very first time we actually got a proxy on DC.

Terry Dennison: Let me explain the reason why you typically don't see proxy. In the DB plan you are the shareholder of the companies in the strategies that you invest in. So if you are in the Portfolio you own the stocks in the portfolio. Here what you own are shares in the mutual fund you don't own the shares that the mutual fund owns, the mutual funds owns the shares that the mutual fund owns. So the proxy you got is not with respect to what the mutual fund owns the proxy you got is with respect to the mutual fund itself and very rarely does the mutual fund itself want to change its guidelines. Companies have to go every year to get auditors approved to change guidelines for compensation for the Boards of Director get Boards of Director change in like, you don't see very many proxy to change guidelines for the mutual fund itself but that's why you saw this proxy they're much rarer.

Wilfred Leon Guerrero: Okay, so there was a request for that proxy and Paula asked your advice. What's your advice? Paula Blas: No, that's basically what he's saying. Terry Dennison: My advice is that these are unacceptable changes. Wilfred Leon Guerrero: Okay, but you're saying that if the changes do take place that we should get out of this plan. Terry Dennison: Yes. Wilfred Leon Guerrero: Okay. Doris Flores-Brooks: Depends on the nature of what it is if it goes into a different direction then you have to valid that direction, the name and the possible future direction may not call it.

Terry Dennison: The reason here is if I owned it personally I'd probably get more money. Gerard Cruz: You like that unsupervised. Terry Dennison: The problem is this is a DC plan. Joe San Agustin: This is owned by individual participant. Terry Dennison: This is an unusual kind of option in a 401K Plan or in a DC Plan this is not a common fund in a DC Plan. If you're an individual participant you'd probably say terrific let's give all the flexibility they want they've shown they can do great things let them do greater things. The problem here is we are giving this to very unsophisticated participants who are going to



look at the name and it says global fixed income and if the thing turns into a kind of a hedge fund we can't let participants think its global fixed income. David O'Brien: They have no plans to change the funds name.

Terry Dennison: They didn't say that they are silent on that. There's a truth in advertisement aspect of your fiduciary responsibility. Joe San Agustin: All we're doing is confusing them, just don't make this available to the participants. David O'Brien: So then you're reinvesting my money for me. Joe San Agustin: That's right. David O'Brien: I understand the idea if it doesn't belong in this space anymore. These are also individual investments as you say. Terry Dennison: Yeah. Doris Flores-Brooks: But this is not the first time you've done that. David O'Brien: But, it's always been for performance. Terry Dennison: It's always been for performance reasons. David O'Brien: This is not a performance issue. Terry Dennison: This is an unusual circumstance, it's a suitability issue that's the technical term for this. It's a suitability issue rather than a performance issue. Joe San Agustin: But the participant is going to say they just give me more money why are you guys telling me I can't do it anymore. Terry Dennison: Well obviously it's going to fall on Great West to explain to the people they're going have to deal with this. It's going to be Alice and her staff's job to explain why because the reason here is less obvious than it is in some of the other cases.

Terry Dennison: We are going to have to decide whether we look for a replacement or drop the option? There's an action item that has to be decided here. Wilfred Leon Guerrero: You're saying that there's an election that is suppose to take place and it all depends on the results. Terry Dennison: Right, we can condition the action based on the result of the election we can conditioned it. Wilfred Leon Guerrero: We need to change the recommendation instead of retaining it or watch or something. Terry Dennison: Now the recommendation to retain has to do with the performance, the recommendation that goes to the Board if the result of the proxy election is approval of the proposed guideline changes replace the option or terminate the availability of replace the fund in this option with the new fund or terminate availability of this option either case there gone.

If the amendments are defeated no change because we're. David O'Brien: But that's not our only alternative as you said in or out, right? Terry Dennison: If the amendment is defeated it's retained, the recommendation is retained. David O'Brien: The recommendations don't just have to be those two. Doris Flores-Brooks: What he's saying is to retain it and call it something else? David O'Brien: Get a replacement for the space.

Antolina Leon Guerrero: What we suggest as alternatives he's just telling us what his recommendation is and if you want to come up with alternatives. Doris Flores-Brooks: Added to the space to whatever it may come but find a global fixed. Paula Blas: If the results are positive and the proxy vote goes through then you are saying whatever that change in the name of the fund, if there's a change but I have a feeling it should be based on the types of changes so if they change the name we would change the name and still find a replacement. Doris Flores-Brooks: But, Terry's predicament is we don't know what it'll be. Antolina Leon Guerrero: But it's all conditional on what the election is what the results are.

David O'Brien: The due diligence you do on the fund before you invest in it is still there, so obviously the purpose and intent of the fund will change based on this proxy statement. To me it's about transparency to investors like me because we are all individual as to this significant change and this is what they want and Mercer recommends that you take a hard look that this is no longer a global fixed income fund but you know still a high performance fund.

John Borne: All of our investment fund performance reporting is done in conjunction with Ibbotson so we're not allowed ourselves to say this type of fund we have to put this through Ibbotson's filter and see if it's classified based on. Doris Flores-Brooks: Who is that again? John Borne: Ibbotson who is owned by Morning Star. Doris Flores-Brooks: Okay. Wilfred Leon Guerrero: What is the action item?

Terry Dennison: There are two forks first if the proxy action is defeated then the Mercer recommendation retained stays in effect. Wilfred Leon Guerrero: Okay, that goes back to your recommendation of retain, so we really have to retain. Joe San Agustin: If the proxy goes through get out.

Terry Dennison: First test if the proxy vote fails this controls we retain it, if the proxy vote passes then we have another fork on the road then we are not going to retain it we either terminate the option, we no longer have a global fixed income option or we seek another global fixed income fund to replace this.

Doris Flores-Brooks: I think what he said was to reclassify. Terry Dennison: The problem is we have no idea what the classified. These guidelines are so wide if you ask me I'd call the hedge fund because I don't know what it is. Paula Blas: That's not good. Doris Flores-Brooks: If you say hedge fund people are going to run. Paula Blas: Not for DC. Joe San Agustin: I don't know why they stick around, just get out. Why do we have to go through classified and all that stuff? Antolina Leon Guerrero: Because you have a Board member and he wants us to consider it.

Terry Dennison: Well the problem is they might classify it something. The question is you have a fiduciary responsibility to explain to everyone in a understandable manner is and you own that responsibility you cannot say well Ibbotson called it this you own that and the participant says that isn't what I thought it was you own that you can't say well Ibbotson called it this. David O'Brien: But, let's stay there for a second Terry that is our due diligence that Ibbotson in fact did this and they knew about this change and they still put it in that space. Why would we even with the advice of you say no, Ibbotson is wrong. Terry Dennison: You better talk to your lawyer about that I'm not going to give you legal advice. I would be very surprised if you can defeat a claim that you misled a participant because you could probably find somebody that would call it a grapefruit. Joe San Agustin: I think our main job is to set up our menus for the participant to choose and if you include that you are actually acknowledging that it's okay, that's all it's to it, you put a stamp of approval. Knowing this thing and you keep on putting it on the table and the menu, then you're equally suit you have to share that responsibility.

Gerard Cruz: Yeah, but if we are going to believe that then we need to go back to every manager and reread the prospectus. Joe San Agustin: If you set up the menu you have

that responsibility, the job of the Board on the DC is to set-up a menu for participants to select to invest. Gerard Cruz: I agree but we also rely on experts who are in the business to set up the category by which we create our own universe. Joe San Agustin: Of course that's the law I am not arguing that. I'm just saying that you give the participant a choice to select. David O'Brien: So if they rely on Ibbotson on 100% of what they have in our funds and we pick one fund that's changed and say no we can't rely on Ibbotson anymore, what do we say? Joe San Agustin: We just take them out we can't select anymore. Antolina Leon Guerrero: All of these are determined by Ibbotson. Paula Blas: Yeah. Antolina Leon Guerrero: All these categories, okay.

Gerard Cruz: They're based on their holdings so what's happening is perspective we don't know because if it passes and their holdings change Ibbotson in all likelihood is going to change their category, we just don't know. Doris Flores-Brooks: Have these funds change, like I heard you say from Mid-Cap. David O'Brien: Franklin changed at one point. Joe San Agustin: If this proxy change knowing the risk and we don't tell the participants and say go ahead continue knowing the risk, are you saying the Board is going to share that risk? Gerard Cruz: No, if we continue to keep them on then I think we're responsible to inform those that are invested that there have been significant changes in the plans. Joe San Agustin: Are you going to leave it in the menu of Investments, are you going to leave it there or take it out?

Wilfred Leon Guerrero: Terry, I think the investment committee should recommend that this fund be put on watch. Joe San Agustin: If it goes through. Gerard Cruz: I just think there are people who made the choice to invest and I agree. Joe San Agustin: They made the choice based on what we recommend. Gerard Cruz: I understand and it's changed so we need to go back to them since it's only a handful and let them know it's changed. Joe San Agustin: I'm not arguing the notification but you're going to have to say this is no longer a viable option for you. The Board can no longer sanction it.

John Borne: One thing to keep in mind back to Terry's earlier point everything classified not a sub category whether it's a global fixed income for a DC Plan or just a regular global fixed income so it could stay in that global fixed income category based on the holdings or based on the new proxy it may have investment may not be appropriate for a DC Plan specific.

Paula Blas: There's about 300 people. Antolina Leon Guerrero: I just think the uncertainty of it is we are no longer able to assure our DC participants that this is what they originally signed up for. Gerard Cruz: I know but what's the flip side of the risk what hypothetically happens if we take it off the menu and it goes through the roof or do we have a liability for just taking it off the menu. Joe San Agustin: We tell the people there's no longer an option. Doris Flores-Brooks: You take it out right, you have to move the money to someplace else. Joe San Agustin: You have to give them the option to move it. Doris Flores-Brooks: Most of the time the people don't respond it just goes. David O'Brien: Well typically you just do a replace, right.

Wilfred Leon Guerrero: Gerry, I think you've been ahead of us, let's just recommend that this fund be placed on watch based on the condition of what Terry has mentioned and if it happens the way things. Joe San Agustin: The watch should be conditioned if it does

happen automatically get out you don't have to wait for another Board action. Wilfred Leon Guerrero: The problem that we have hopefully the law gets signed so that we can hire somebody. Gerard Cruz: No, this is different the law won't affect DC. Paula Blas: We have one here, right now.

David O'Brien: Look at its performance compared to our other fixed option, it's the only one, it's true I'm sorry. Terry Dennison: That's the dilemma. David O'Brien: Thank you exactly my point. Antolina Leon Guerrero: And you volunteered for this job. David O'Brien: I don't agree with this decision but it's not a decision, I don't agree with these options. But what I am trying to say is there's precious few good options at the moment in fixed that we have and maybe Terry spins his magic and comes up with Dreyfus II you know or something like that. We have a lot of investors who are in fixed but we obviously have some amounts in our portfolio that in our fixed income total there must be a lot of money in fixed income total. We are relegating them at the moment to some part of performance because until now Dreyfus by the evidence are pretty darn good, good relatively, good absolutely and that's a tough choice I think this Board.

Joe San Agustin: But actually what they're doing is changing the methodology of managing the Fund and which means give them as you said unsupervised. Gerard Cruz: I think we just need to give them notice. Joe San Agustin: We have guidelines. Gerard Cruz: I agree, but those participants made a conscious effort. Antolina Leon Guerrero: We just need to figure out if the Board decides that they want to give them that option then we just need to find a space on this continuing. David O'Brien: We cannot even do that because we are bound by Great West and Ibbotson we can't make up our own space. Terry Dennison: You just added your liability. David O'Brien: Exactly, my point is just that simple in a very tough fixed income universe here this is a good fund they're changing. Gerard Cruz: I mean if it was March and they were on our line-up and we ran a search they would come up on our list I suppose and we would probably pick them based on their past performance. Antolina Leon Guerrero: If they came up in that category.

Wilfred Leon Guerrero: Terry, let's move on and place on watch and it's based on the stuff. Terry Dennison: How often does Ibbotson look at their holdings? John Borne: It gets its updates every fund fact sheet every quarter. Terry Dennison: I mean obviously until they do something wild and crazy, we don't have an issue just because they have the flexibility my concern is they have the flexibility in unbeknown to us they go do something wild and crazy until they do something wild and crazy the concerns is not as high. Gerard Cruz: Do you notify us if a fund has move from one classification to another? John Borne: Absolutely, we will notify the participants via the quarterly statement.

David O'Brien: You know Terry it's almost like those funds if you read the prospectus they have in the little synopsis that they've got there may invest in currency hedges you know and they don't but they have the option to. Terry Dennison: And again, if this wasn't a participant directed fund I wouldn't worry about it if this was my money I would send them another check. The problem is, is there some surveillance process that's keeping an eye on this are they supervised is there adult supervision of what they're doing. If there is adult supervision like Ibbotson raises a flag saying, not that they've gone rogue, but they're using some of this power and its no longer straight global fixed income fund but its

now getting into a little wooly until there's some way of detecting that then the concern is a little. Wilfred Leon Guerrero: And it becomes the responsibility of the Board.

David O'Brien: Well that's the question, does it become the responsibility of the Board. Terry Dennison: Well your surveillance mechanism are those guys. Joe San Agustin: Not really. David O'Brien: I agree with that statement they are. Joe San Agustin: Surveillance of the performance is not really them. Paula Blas: Not the performance. Joe San Agustin: Any changes they're not, they should tell us. Paula Blas: If the Dreyfus fund changes. Antolina Leon Guerrero: They will be the first to notify. John Borne: We can have AIG run a report on your whole line up as frequently as you like we can do it every quarter or semi-annually, we can have that report run through AG then filter them and then we can actually send it to Terry for review. Doris Flores-Brooks: Quarterly. Terry Dennison: Yeah, quarterly.

David O'Brien: I find this discussion interesting for the following reason which is that much of what's out there in the world is about unsophisticated investors in DC Plans. So we accept the fact that will allow the unsophisticated investors in all these plans but when one changes we decide that they're so unsophisticated that we can't let that one change go through. But yet we have whole portfolios in DC where the style of the people James and I are supposed to be talking about. Joe San Agustin: If Terry didn't open his mouth then maybe we go with what we have but based on this role in the law that's his role in spite of this warning and do it then we take the risk, that's the law. James Duenas: Based on Terry's suggestion maybe we should instead of mixing it right away keep it on watch and if there are any changes. Paula Blas: That's what we were saying we would go ahead and vote no on the proxy place them on a watch because it's still within the next quarter anyway you're looking at the next quarter and then make a decision at that time, by that time Ibbotson would run them through their data base and give us an idea, they might not even do anything. Doris Flores-Brooks: They may not do anything or do it gradually such that you step into the temperature and you don't know it's hot until it's boiling right. Joe San Agustin: And it's too late.

James Duenas: Even if they do that the quarterly report would show that there's a change in it. Doris Flores-Brooks: It'll be several quarters down the road because a little change is not going to change it. John Borne: I'm going to get you one more piece of data that might help your decision we're going to research how many people in this fund are actually managed accounts and Ibbotson picking form. Joe San Agustin: Even if it's one person. John Borne: Ibbotson picking a form they'll know when to move and they're actively moving them. Paula Blas: Dave are you in a managed account? David O'Brien: No. Paula Blas: No, and I think very few are probably in the managed account most of them are direct picking. Joe San Agustin: That's an interesting system but it does not matter to me all you need is one person involved that's not our responsibility.

Doris Flores-Brooks: Just to show you like with my staff because each year I kind of do an annual about telling them to invest and then I made a comment if you haven't invested in your Roth IRA you should and the question from one of my staff, what's a Roth IRA? David O'Brien: DC, DB. Doris Flores-Brooks: And these are out of college and they don't know.

Wilfred Leon Guerrero: Okay, Terry so that's what we're going to recommend, is to place on watch and the rationale for that is you're going to give it. Joe San Agustin: You better document that. Paula Blas: Okay, so the motion is to vote no on the proxy. Doris Flores-Brooks: Make sure you turn it in. Joe San Agustin: Are we on the Investment committee now. Paula Blas: No, that's how this is all coming about the proxy hasn't been voted on yet. Wilfred Leon Guerrero: I know but on the fund itself we're going to recommend to the Board and the Board should say put this fund on watch, okay. Doris Flores-Brooks: And the next quarter Terry would update us. James Duenas: The first portion on that we wanted to vote no on the proxy because the proxy affects the watch. Paula Blas: That's the reason we're putting them on watch. Wilfred Leon Guerrero: I think we best have a policy on the proxy because we don't have a policy. Joe San Agustin: For DC. Antolina Leon Guerrero: You could come up with a policy I mean the only reason it's very unusual you got a request. Paula Blas: This is the first time and like Terry said it's really not a normal thing that we're going to be getting. Doris Flores-Brooks: What's the total amount in this fund? Antolina Leon Guerrero: 2.4 million. Doris Flores-Brooks: Okay. Wilfred Leon Guerrero: I think you're coming up with a real easy answer about the proxy, I don't know what the implications are. Paula Blas: That's what Terry was discussing earlier he was explaining. Gerard Cruz: We could vote on the proxy provided that we get input from Mercer.

Doris Flores-Brooks: Terry more than likely though unless these are a lot of individual more than likely they've already signed in or not even to bother to turn in the probability of passage is very high. Terry Dennison: Very high, because the default is approved. Wilfred Leon Guerrero: Why are they asking the Board for this proxy when we don't. Terry Dennison: Because the Board is the nominal owner of the shares, the trust is the beneficial shareholder but you are the nominal shareholder you're voting on behalf of the trust. Doris Flores-Brooks: Of the DC members. You have 2 million votes. Terry Dennison: In fact you do, 2 million divided by the share price. So, you are voting on behalf of the participants you have to vote in the best interest of the participants. Wilfred Leon Guerrero: Okay, we're fortunate that you spotted this, okay but in the future. Joe San Agustin: Spotted, Paula gave it to him. Wilfred Leon Guerrero: If another Fund comes back and ask for a proxy vote that's why I am saying I think we should have a policy. Doris Flores-Brooks: And maybe you should ask Terry to help develop a policy because he's your advisor. Terry Dennison: Well basically the simple policy is voted in the best interest of the participants. The procedure should be unless it is a strictly a routine matter such as approval of auditors or approval of Directors refer to appropriate advisor that's all you have to have. Policy vote in the best interest of the participants procedure unless it's strictly routine refer to appropriate advisors.

Terry Dennison: Okay, I'm going to abbreviate here if we go to page 14, I'm only going to hit the things that really matter. The BlackRock LifePath Funds the results are less negative they're actually improving and basically they're now getting close to their target still a little negative but less negative and improving. Great-West Secure Foundation still doing great. There some replacements we have noted in here some note on page 17 nothing there that's critical. We do want to make a quick stop on page 25 looking at expense ratios we always want to show that we spend a little time here. You can see all those green numbers we've done a great job of getting low fees for the participants, the red numbers are pretty small. The fairly large ones at the bottom aren't terribly large relative

to the other ones of the real bargains of course is DFA their expense ratio is very low relative to other emerging market funds so we've done a good job on participants. David O'Brien: Terry what is the green or red on the last column. Terry Dennison: Green is cheaper than average, red is more expensive than average so we want to be green. The compliance table on page 26 again. If you miss by a tiny fraction you get an X if you make it by a tiny fraction you get a check the red X on the BlackRock Funds they still get the X but basically were going to start to see some of those turn into green checks we're actually making some improvement. You can see the Franklin and Nuveen they've got some red X's are in the process of being replaced we have a search to get rid of Thornburg that's the next up there and those are the two red X's.

We've looked at the performance in fact if you look at BlackRock you can see that there's actually a fair amount of green numbers for three months and even some for one year on the BlackRock we're starting to make some progress on those. Just real quick to keep us roughly on schedule.

Antolina Leon Guerrero: Is the one when we talked about the options is this related to the Target Date Funds I just remember the last time Terry was here. Terry Dennison: Yeah, we were looking at is BlackRock something we want to replace and we've been looking at to see we did two things is BlackRock something we wanted take a look at and we're seeing the improvement and is there something we need to look at is just to see is there a competitor for Great West there's nothing really the like out there, we found a couple but there's nothing really we want to look at and their performance continues to be great.

Paula Blas: They went ahead and prepared something on Secure Foundation just so that you have the additional information that you needed. Gerard Cruz: Great West? Paula Blas: Yes. David O'Brien: That came up last time I think that's good information this is the issue turning it into annuity. Terry Dennison: Yeah. Antolina Leon Guerrero: And target date is our default. Paula Blas: Yes, BlackRock is.

Terry Dennison: The other thing about the BlackRock is with the market up so much because they're passive they have a built-in sort of disadvantage if we get a more choppy market they're going to look a lot better. Active strategies have an advantage if the market just goes straight up verses passive. Antolina Leon Guerrero: Is Secure Foundation being considered active. Terry Dennison: No, I am talking about BlackRock, why is BlackRock lagging they're going to lag active funds. So, that's why BlackRock is not looking as good when compared to other Target Date funds which are more active. Joe San Agustin: So if they continue to underperform why are we still keeping them. Terry Dennison: They're starting to improve and they're cheaper. I think it's over to you guys.

John Borne: Thank you everyone it's great to be here my name is John Borne well we want to cover Secure Foundation today and the echo what Terry said earlier these are interesting times. But unfortunately for recent retirees and soon to be retirees these are not interest bearing times there's no way to get yield anywhere. We really identify four risks that recent or newly retirees face: (1) it's always the market risk what's the market going to do, (2) Inflation risk which changes based on cycles and (3) the longevity risk people are living longer than they've ever had, and (4) is a fairly new one that's being discussed its called sequence risk.

These are the order in which you get your return based on your career. So if you're getting 10% a year throughout your early years but in the last four or five years before you retire or in the first five years after you retire the market goes down 20% or 40% like we saw in 2008 that can really devastate your retirement income and really that puts your whole plan out of whack. What's a retiree to do? There's no interest rates to be earned anywhere, the market just crashed 4 or 5 years ago down 40% so while everybody is done issuing equities to have a long term inflation hedge and make your money last throughout retirement well you just lost 40% a couple years ago you are not that thrilled about the prospect about putting money back into equities.

The other option is would be to buy some type of annuity that guarantees you income for a life-time basis. Again, the problem with those goes back to interest rates. So if you buy annuity the insurance company takes your money and has to invest it somewhere well they're not getting interest rate either. So the pay out on annuities are at all time lows right now. What we've done with this product design is try to take the best of everything. So the product you have in places on Target Date fund has a traditional life path so as you get close to retirement it reduces the equity exposure.

But unlike a traditional Target Date fund which keeps reducing the equity exposure at 10 years out from retirement is going to lock in at 60-40. So you are going to stay at 60% equities, 40% stocks. At that point in the target date fund 10 years out the guarantee kicks in as well so there's a guarantee of benefit base and depending on your age. Let's look on page 4, so depending on your age and anniversary date of your contribution that 10 years out from that target date fund the actual date the guarantee kicks in so based on all your contributions that's going to be your guaranteed minimal withdrawal rate and depending on your age if you started at 55 it's going to be a guarantee 4% of that balance for life. And if you do a joint life it goes down by ½% so this is a way for you to stay in the market beat the zero to 2% interest rate and also have a down side protection.

And unlike an annuity you also maintain control of the account so some type of emergency happens you can pull out money out of it just reduces your benefit base. If there's money left and you pass away before you get the exhaust the whole covered base you can leave that to your heirs as well. And in a plan like Guam where for new enrollees there's no guarantee income and this is a way for you to replace that. We're seeing a lot of success in the DC side and making it a QDI qualified default investment. A lot of people in these plans don't change you'll see people get enroll whatever the default is and hopefully nowadays it's either a target date fund or managed account back in the days used to be stable value which the GUL said that's not a appropriate default anymore.

So we are seeing a lot of movement towards target date funds or managed accounts which gives people long term high growth account for retirement. So we are seeing in the DC space corporate K 400 plan this year has made this a default option. It's not as frequent on the government side because a lot of them still have DB but we are talking to Alaska about this as well because they eliminated their DB options as well it's a way for participants that have the basic necessity for food, water, shelter and rent guaranteed a retirement when there's no other DB option.



John Borne: And so the cost of this once the guarantee kicks in is 90 basis points. We take that through Great West we actually have a hedging system so we put our risk as well has to do with something a little bit of my level to comprehend when it has to do with buying equity futures and eliminating our exposure as well.

So once the money gets exhausted in the fund you can see on page 4 there's a guarantee that kicks in there is also upside potential so in every anniversary date we look at your account balance and if the benefit base is higher than the covered fund value you can actually rash it up. So let me explain that in simpler terms if your account is 100 thousand your taken out 4% a year 4,000 well the market growth may be amazing you get 4 or 5 percent makes it go back up to 102 thousand that's going to be your new benefit base.

And you can wait until you hit another age at 65 the former set guarantee goes up to 5% you can rash it at that point as well. So it's really a way to hedge against inflation and out live your money as well to eliminate the sequence of risk exposure as well like I said a lot of plans consider as a new default option. In the past 3 years of period of performance compared to what BlackRock has been doing and is actually a little cheaper than the Black Rock Funds as well. I said a lot in five minutes so I'll just pause for questions because it's a product that has to be talked about pretty thoroughly to fully comprehend.

David O'Brien: Can you just go over the basics again the terms you used there's a benefit base that's established over a period of time? John Borne: That locks in at 10 years can't go down, but once you start taking. David O'Brien: So what if that locks in, let's say you have someone who has 100 thousand. John Borne: 100 thousand so 10 years out if the market crashes when I start taking, so I'm 55 I'm going to retire at 65 I got 100 thousand at 55 if the market drops, so the market goes down I retiree at 65 with 70,000 my benefit stays at 100 I can take 4% of 100 out. David O'Brien: Because you had that at 55. John Borne: Right, once the guarantee start locking in.

Doris Flores-Brooks: But does the person have to do that automatically because most people won't. David O'Brien: If this is a default option that's kind of one of my question to are you automatically in this? Alice Taijeron: 10 years prior to the target date. David O'Brien: So if you're in this fund and you're 55 and going to retire at 65 at 10 years out you lock in to this scheme. John Borne: You lock in your down side risk so in the 10 years it can still go up, the lowest you'll get is 100 thousand and 10 years continue to go up, up until the day you take your first withdrawal that's when it's going to lock in. And based on that you'll either have that guarantee for life, your single life or a spouse or continue to ratchet up but you'll never get lower than the day you take your first withdrawal.

Paula Blas: So, John you are at a base of 100, first year it was a good year so you made 5,000 say now you are at 105 so you are locked in at 105? John Borne: As long as it's that on the anniversary date of first contribution. Paula Blas: So you're locked in at that and now your base becomes 105 thousand. John Borne: As long as you didn't take a withdrawal and the market went up higher. Paula Blas: Market is good so you made 5,000 on your anniversary date.

David O'Brien: So there's no downside I understand that but during this period 55-65 you are also contributing so is your base building could your base build up to 110 if you put in 10,000 next year that would be your new base. And if you withdraw during the 55-65 year period your base goes down based on your voluntary withdrawal.

John Borne: So when you take withdrawal whether before or after accumulation base say your account is 100,000 it's actually going to look at your covered fund value which includes with the previous withdrawal. So you had 100,000 in benefit base your covered fund value say the first year you took the 4% out it's at 96,000 go back to round numbers. So you take 50,000 out of the 100,000 you took 50% out so your new withdrawal rate would be 50% of the 96. David O'Brien: You lost me there. Gerard Cruz: So your new benefit bases now 56,000 rather than the 100 because you took the major withdrawal, so you're down percent risk is only protected from the market risk it's not protected from withdrawals. David O'Brien: Okay, that makes sense. John Borne: It's protected from withdrawal risk if you stick with the 4%, if you have to take an emergency withdrawal it's going to affect it.

Antolina Leon Guerrero: When is the retirement target date determined so when they sign up for the fund. John Borne: It could be determined by the Plan actually, like you said target age is 65 or 60 based on your plans target date we would enroll people. Antolina Leon Guerrero: And currently what is it? Gerard Cruz: So you look back though at the time they retire you look back 10 years. John Borne: Benefit will kick in, in 10 years. Gerard Cruz: So they will come in and tell you. John Borne: They can enroll in the Fund themselves or computer by QDIA which we are going to default people based on the plans.

David O'Brien: Let's say we're contemplating QDIA and we have people who are all along the age spectrum 62-63 even older right, who now we move this in the QDIA and they want to be in this, what happens then, how do they take another 10 years from that point. John Borne: There's a couple of ways you can do the strategy first of all QDIA is the plans default option that's one decision, the second decision is do you want to reenroll the plan and that's moving people from one option exist option into the new QDIA that's two separate decisions. And you can also choose to eliminate some people and link the ones that's over 60 and let them keep whatever funds they have.

Paula Blas: Individuals, new participants now are even young ones say somebody 40 right now that isn't going to retire until 65 any gains they make between now and 10 years out is subject to the market you are not protected your not protected until the 10 years out you are not paying for it there's no fees to protect you during this time.

David O'Brien: The lock-in isn't necessarily 65 the lock in is 10 years before your intended retirement and that's a notification thing or what is it?

Gerard Cruz: Somebody needs to know when they retire years 10 years from now. Doris Flores-Brooks: Most people don't make that decision either. David O'Brien: That's what I am kind of asking so back to the 62 year old that now becomes aware of the secure foundation fund says okay I like this idea of the guaranteed annuity on this type of thing but I'm 62 so I'm not going to have 55-65 build up, what are my options?

John Borne: We actually also have a balance fund here they can move money into the balance fund which the benefit kicks in right away. It's not a target date fund it's a 60-40 balance fund which operates it'll be like if you want to retire today and you can move percentage of your money in there or if you want to keep some you just want the basic food and shelter needs. David O'Brien: Your balance fund has the same. John Borne: It works the same way except there's no 10 year lead up to it. Joe San Agustin: You have no protection after age 55. Antolina Leon Guerrero: That's your benefit base. John Borne: Correct: David O'Brien: And obviously since it acts like annuity down the way once any person is retired they no longer have access to their 100 thousand. John Borne: They do until they've actually exhausted see this blue part the covered fund value this is their account and if they live longer than that account last that's when Great West kicks in with insurance, so you can take money out up until this point when there's none left we would have to guarantee whatever the pay-out was at that point. David O'Brien: The amount of the blue say they die with a balance here that goes to their. John Borne: Goes to beneficiaries.

Joe San Agustin: You don't establish guaranteed base until 55. John Borne: Not necessarily. David O'Brien: That's what we were talking about Chairman. Joe San Agustin: So what do I have at up to 55? Nothing. John Borne: The Plan is set the default option to kick in at age 55 the participant can decide I want to work longer and change the funds if they want to, they could move into the balance fund and guarantee it right away. Joe San Agustin: Before 55 you build up your base or not you don't have any base. John Borne: There's no base. Joe San Agustin: Until after 55. Alice Tajjeron: There's no protection unless you're on the balance fund. Joe San Agustin: So all might investment up to 55 can be gone. Only protection here is after 55 which is 10 years before you retire. Alice Tajjeron: Not after 55, 10 years prior to that target date. James Duenas: But if you get in at 50 you have to go 60 before. John Borne: You can join the balance fund at age 30 if you want and everything. David O'Brien: Alice how successful have you been in getting this concept across. Alice Tajjeron: It's been slow. Gerard Cruz: How old has this been? Antolina Leon Guerrero: It's only been a couple of years. Alice Tajjeron: We just introduced it in 2011. Paula Blas: We just added it. Joe San Agustin: How many people you have so far? Alice Tajjeron: Maybe a little over two hundred. Gerard Cruz: 2011 but we just started the following year. David O'Brien: Because this issue to me if you don't go to a hybrid, if the hybrid fails what do you have in terms of some bottom side security safety net this is it for us. Gerard Cruz: Absolutely.

Joe San Agustin: So you're sitting back saying which is better hybrid or this one? Doris Flores-Brooks: Unless somehow we can convince you to go to Social Security. Antolina Leon Guerrero: It's just going to cost more, it's going to cost the government more it's going to cost everybody more to go to Social Security because we're not going to get rid of the unfunded liability I don't know why they keep talking about social security. Doris Flores-Brooks: No, well this won't guarantee like social security.


David O'Brien: Yeah, this is Great West tell me more about Great West is an insurance company mainly, right. John Borne: We're an insurance company but we're also a record keeper so actually we're a subsidiary power financial which is a fortune 20 company. And they own Great West Life Co they own about 12 different insurance companies around the world. Great West Life Co is Great West Financial our parent. We are either rated highest

or second highest rating out of every rating agency in financials. David O'Brien: In terms of annuity those same ratings are equitable. John Borne: We included here on page 7 in the book very conservatively run and actually the recession in 2008 were the only North American Insurance Company that did not get downgraded by any rating agencies. David O'Brien: I mean that's always the issue is the security of the capital.

Wilfred Leon Guerrero: Terry, anything else. Terry Dennison: Done. Gerard Cruz: Move to adjourn, Mr. Chair. Terry Dennison: We got the search for the International. Gerard Cruz: Oh yeah, International. You've done this, that's the booklet. Terry Dennison: That's the book. Wilfred Leon Guerrero: I don't know if we can do anything with this because the new law. Paula Blas: No, this has nothing to do with this with DC, the new law is DB. Gerard Cruz: No, it's different, this doesn't apply. Wilfred Leon Guerrero: Okay. Antolina Leon Guerrero: It doesn't apply to this. Paula Blas: You're replacing a fund, a mutual fund. Gerard Cruz: This is governed by a plan document, a separate part of the law, we're okay. Wilfred Leon Guerrero: Okay. Paula Blas: You just replaced two funds. David O'Brien: May I ask Alice another question just to follow up to the one on the roll out if you will, so we've been two years in to it. Alice Tajeron: About 2 years, yes. David O'Brien: Number of participants? Alice Tajeron: About 300, almost a million. David O'Brien: Same people in the Dreyfus Standish and you have more of a roll out plan in mind. Alice Tajeron: Yes marketing campaign.

**Respectfully Submitted:**

**Affirmed:**

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

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