

FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM

Summary of Quarterly Investments Committee of the Whole

THURSDAY

SAN JOSÉ, CALIFORNIA

December 11, 2008

Present:

DAVID BUSSE, CHAIR	- Civil Service Representative
Matt Loesch	- Employee Representative
Patrick Skillsky	- Employee Representative
Jeffrey Perkins	- Public Member
Pete Constant	- Council Representative
Forrest Williams	- Council Representative

Also Present:

Russell Crosby	-Secretary/Director	Patrick Thomas	-SIS
Carmen Racy-Choy	-Staff	Dan McLaughlin	-BlackRock
Ali Amiry	-Staff	Brian Weinstein	-BlackRock (via phone)
Ceara O'Fallon	-Staff	Robert Thompson	-Dodge & Cox
Cristin James	-Staff	Raffaello Distefano	-Loomis Sayles
Bob Leininger			

MEETING SUMMARY

PRESENTATIONS

The following presentations were given to the Board:

- ☐ **Strategic Investment Solutions (SIS)** – Patrick Thomas
Performance Monitoring Report for quarter ending September 30, 2008.

Mr. Thomas stated that the Federated portfolio is built for the long term with no overexposure in any area. Active management hurt performance in the third quarter of 2008. If all investments had been indexed, the System would have performed 200bps better for the quarter. Manager fees are inexpensive at only 30bps. The Northern Trust securities lending crisis cost the System 11bps.

The System returned -9.1% in the third quarter of 2008 and ranked in the 61st percentile among all public plans greater than \$100 million, with a median return of -8.9%. The System trailed its policy index, which returned -7.0% during this time period. The System's one year return of -14.0% ranked above the median return of -14.9%.

The Federal Reserve held the key Fed Funds interest rate at 2.0% during the entire quarter as concerns over inflation began to mount. In the last 3 months, the yield curve has shifted slightly downwards. There have been tremendous opportunities to buy assets in the last year due to forced sales, especially with alternative investments.

Atlanta Capital and Boston Company both performed well during the third quarter. Fisher, McKinley and Wellington had poor performance. Bond managers underperformed due to poor security selection in the financial sector.

Ms. Racy-Choy explained that the System's 10 year rate of return is 6.4%. The actuarial rate for the System is 8.25% net; adding manager fees of 60 bps and SRBR of 10 bps, brings the actuarial assumption to

approximately 9.0%. Since the System's rate of return is lower than the actuarial assumption, its unfunded liabilities have increased. The portfolio's financial condition as measured by the funding ratio has deteriorated over the last few years.

Member Perkins stated that the performance over the last nine months has dragged down the 10 year rate of return.

Ms. Racy-Choy explained that, if the System's fund earns 8.5%, it appears that there are excess earnings over the actuarial assumption of 8.25% and, thus, SRBR is paid. However, "excess earnings" in an actuarial sense only exist if the plan is fully funded. Smoothing could be used to help insure that payouts are only made in years when there is truly an excess.

☐ **BlackRock Financial** – Dan McLaughlin
Quarterly Report for quarter ending September 30, 2008.

Mr. McLaughlin stated that Bank of America has assumed Merrill Lynch's 49.0% stake in BlackRock. The transaction has no impact on the existing structure of the company.

Mr. Weinstein explained that 2008 has been a year with unprecedented underperformance of spread sectors. The credit crunch, which began in the summer of 2007, has evolved from a seemingly contained issue in U.S. sub-prime mortgages into the most significant liquidity and solvency crisis that has faced markets in modern times. As the crisis has spread across markets and assets, it has prompted over \$500 billion of asset write-downs, the seizing-up of the corporate bond and money markets, and the failure of some of the world's largest and most respected financial institutions.

The portfolio does not hold low rated securities. As holdings are downgraded, BlackRock is actively swapping into older, higher quality securities.

Mr. Amiry asked why BlackRock was continuing to buy mortgage-backed securities while the market was deteriorating.

Mr. Weinstein stated that BlackRock wanted to be overweight in mortgage-backed securities as there is no credit risk since they are backed by Fannie Mae and Freddie Mac.

Mr. Amiry asked what risk structure was in place if the market does not improve in the next six months to insure that our portfolio does not continue to lose money.

Mr. Weinstein explained that the chances of recovery are good with all the programs created by the Federal government to pump money back into the system and reducing interest rates. Mortgages rates are at a record low. Money Market funds seem to be functioning. Over the next year or two mortgages will outperform treasuries.

☐ **Dodge & Cox** – Robert Thompson
Quarterly Report for quarter ending September 30, 2008.

Mr. Thompson stated that Dodge & Cox is generally invested in investment grade, marketable, fixed-income securities (AA average). The portfolio has been underweight against the benchmark in treasuries

and slightly overweight in mortgage-backed securities and corporate credit notes. The performance at the end of September did not include the loss of Kaupthing Bank, the Icelandic bank that failed in the last month.

Mr. Thomas asked why Dodge & Cox held on to the Icelandic bank with the crisis in that market.

Mr. Thompson explained the Kaupthing Bank was a large Pan-European bank that was funded internationally and operated in thirteen countries. Unfortunately, unlike a U.S. bank that would have FDIC backing, Kaupthing Bank was not supported by any entity, so it was allowed to fail.

Member Perkins asked about the System's exposure to Ford Motor Credit and what Dodge & Cox is doing with this security.

Mr. Thompson stated that the portfolio will continue to hold Ford Motor Credit and GMAC. Even if there is a crisis within the auto industry, these credit companies should be able to maintain their value and survive off their assets and income.

■ **Loomis Sayles – Raffaello Distefano**
Quarterly Report for quarter ending September 30, 2008.

Mr. Distefano stated that September was one of the worst months on record for investment grade and high yield debt. The driver of underperformance for the quarter was the sector/security allocation as credit spreads widened further. The overweight position to corporate issues suffered as credit spreads widened to record levels. On a positive note, the overweight US dollar and underweight Euro and Japanese yen aided performance as the dollar strengthened during the quarter. There were some downgrades in the portfolio. Overall the performance was below the benchmark as was any other portfolio not invested all in treasuries.

Member Perkins asked why the portfolio is so overweight in Germany and if there would be undue risk going forward with 32.0% of the portfolio in corporate securities.

Mr. Distefano explained that the portfolio currently holds German Bunds, which are equivalent to U.S. Treasury bonds. The 32.0% that is being held in corporate securities includes 9.0% in high yield securities and 23.0% in investment grade securities. The portfolio has a large amount of high quality treasuries that should give positive performance numbers well into 2009.

PERFORMANCE SUMMARY WITH BENCHMARKS – PERIOD ENDING SEPTEMBER 30, 2008

Total Returns Net of Fees – (*Annualized)	Quarter	YTD	1 YR	3 YRS*	5 YRS*
TOTAL FUND	-9.2	-13.8	-14.3	2.4	6.5
Custom blended benchmark	-7.0	-11.9	-12.1	3.3	6.9
DOMESTIC EQUITY PORTFOLIOS					
Large Cap Manager					
<i>Atlanta Capital</i>	-9.7	-16.2	-15.9	1.9	5.1
Russell 1000 Growth	-12.3	-20.3	-20.9	0.1	3.7
<i>Dodge & Cox Large Cap</i>	-11.7	-24.9	-28.4	-2.8	N/A
Russell 1000 Value	-6.1	-18.9	-23.6	0.1	N/A
Index Manager					
<i>Northern Trust</i>	-8.9	-18.9	-21.5	0.3	5.7
Russell 3000	-8.7	-18.8	-21.5	0.3	5.7
Small Cap Equity Manager					

Eagle Asset MGT	-7.7	-13.3	-14.7	5.7	10.1
Russell 2000 Growth	-7.0	-15.3	-17.1	1.5	6.6
Brandywine	2.3	-6.6	-15.6	-1.5	7.2
Russell 2000 Value	5.0	-5.4	-12.3	2.0	9.4
All Cap Equity Manager					
Wellington	-16.0	-22.0	-21.5	-0.2	N/A
Russell 3000 Growth	-11.9	-19.9	-20.6	0.1	N/A
INTERNATIONAL EQUITY PORTFOLIOS					
Boston Company	-17.4	-27.3	-28.6	-0.2	8.8
Fisher Investments	-25.5	-29.1	-31.2	0.4	N/A
McKinley Capital	-29.4	-35.7	-36.3	0.5	N/A
MSCI ACWI (EX-US)	-21.8	-29.5	-30.0	3.1	11.8
FIXED INCOME PORTFOLIOS					
Domestic					
Dodge & Cox	-3.6	-3.1	-1.8	2.6	3.0
BlackRock	-3.0	-2.9	-0.1	2.8	3.2
Lehman Aggregate	-0.5	0.6	3.7	4.2	3.8
Global					
Loomis, Sayles	-7.3	-4.2	-1.5	3.8	N/A
Citigroup World Govt Non US	-3.0	1.9	5.9	5.6	N/A
REAL ESTATE PORTFOLIO					
MIG	0.0	0.0	1.4	16.9	8.3
Fidelity LP	-13.2	-13.4	-11.0	23.1	26.4
Fidelity Growth Fund III	-1.3	-16.3	-19.5	N/A	N/A
PRISA	0.2	1.1	7.2	12.8	N/A
NCRIF Property Index	-0.2	2.0	5.3	13.2	14.2
GEAM Asset LP	-0.2	-0.3	0.2	N/A	N/A
American Realty	1.3	4.2	7.9	N/A	N/A
DRA Growth & Income II	0.0	10.8	45.1	87.6	50.6
DRA Growth & Income V	1.3	5.1	11.4	N/A	N/A
DRA Growth & Income VI	0.8	6.8	N/A	N/A	N/A
NCRIF Property Index (Quarter lag)	0.6	5.5	9.3	15.0	14.7
PRIVATE EQUITY					
Private Equity	-0.7	1.6	4.2	N/A	N/A
S&P 500 + 3% (Quarter lag)	-7.3	-16.7	-19.0	N/A	N/A

INFORMATION AND COMMUNICATION

- ▣ Quarterly Proxy Voting Report.
- ▣ Report on Rebalancing Transfers.
- ▣ Commission Recapture Report.
- ▣ Investment Managers' Performance Reports for the quarter.

Approved:



RUSSELL U. CROSBY, SECRETARY / DIRECTOR
BOARD OF ADMINISTRATION