

SAN JOSE FEDERATED CITY EMPLS RET SYSTEM
PERFORMANCE MONITORING REPORT
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ECONOMIC REVIEW

- The trade deficit grew sharply in July to \$62.2 billion as oil prices spiked, but fell back to \$59.1 billion in August as exports surged while oil imports and prices fell. In the third quarter, the U.S. Dollar gained significantly against the euro (+10.6%) and the pound (+10.6%) but remained relatively stable versus the yen (-0.2%)
- After reaching an all-time high of \$147/barrel in July, oil prices plummeted in response to declining global demand brought on by the economic slow-down. The Consumer Price Index jumped by 0.8% in July to an annual rate of 5.6% -- the highest point since 1991 as the cost of energy surged. Prices fell slightly in August (down 0.1%) to an annual rate of 5.4%, and remained flat in September. The PMI dropped sharply in September to 43.5, a seven-year low, from a level of 49.9 in August.
- Housing starts declined each month in the 3rd quarter to a 17-year low in September of 817,000 units – 31.1% lower than a year ago. Although sales of new and existing homes were up in July, prices continued to sink and housing inventories rose. Sales of existing homes rose in July to 5.02 million, but fell back to 4.91 million in August, down 10.7% from a year earlier. In August, new home sales fell to the lowest level in 17 years, coming in at an annual rate of 460,000, after rising to 520,000 in July. The rate of sales was down 34.5% from a year ago.
- The unemployment rate jumped to 6.1% in August as employers trimmed jobs, but remained at that level in September. It was 5.5% at the end of June and 4.7% a year ago. Unemployment is now at the highest rate since September 2003.

EQUITY MARKETS REVIEW

- Stock prices were significantly lower during the third quarter. Only the Russell 2000 Value Index was able to post a gain, returning 5.0% for the quarter. The Russell 1000 Growth was the laggard over the quarter, losing 12.3%. Over the year-to-date and one-year period, every major equity index was negative. The Russell 2000 Value Index posted the smallest loss year-to-date, with a return of -5.4%. Of the ten sectors that comprise the S&P 500 Index, Consumer Staples led with a return of 4.6% while Financials lagged, returning -25.7%, due primarily to falling commodity prices.
- Value outperformed growth at both ends of the market cap spectrum. The Russell 1000 Value and Russell 2000 Value returned -6.1% and 5.0% respectively, while the Russell 1000 Growth and Russell 2000 Growth lost 12.3% and 7.0%, respectively. Over the longer one year period, growth outperformed value by 2.7% among large cap stocks but trailed by 4.8% among small cap stocks.
- The MSCI EAFE had a calamitous Q3 2008, losing 20.5%. The U.S. Dollar actually increased in value over the quarter as the index returned -13.3% in local currency. Over the longer one year period, the increase in the value of the US Dollar amplified the losses as the index lost 28.8% in local currency, and 30.1% in US Dollar terms.

FIXED INCOME MARKETS REVIEW

- The Federal Reserve left the Fed Funds rate unchanged at 2%. However, in wake of the failure of Lehman Brothers and the precarious situation of other banks, it expanded its short-term lending to banks by starting to accept investment-grade debt as collateral instead of just Treasuries and other high-grade securities. In the last 3 months, the yield curve has shifted downwards slightly.
- During the third quarter, major bond index returns were mixed, primarily according to quality. High quality indices such as the LB Government (1.9%) and LB Mortgage (1.9%) led the way. Investors shied away from riskier securities as represented by the LB Credit Index (-6.4%) and the Citigroup High Yield Index (-9.2%). For the trailing 12 months, the LAB was up 3.7%, the CWGB gained 5.9%, LBMB rose 7.0% and the CHY fell 11.7%.

REAL ESTATE MARKETS REVIEW

- For the period ending 9/30/08, the one quarter returns for, respectively, the NAREIT index and the NCREIF Property index (one quarter lag), were 5.6% and 0.6%; one year, -11.1% and 9.3%; three years, 5.6% and 14.9%; five years, 13.4% and 14.7%; and ten years, 12.5% and 12.2%.
- According to The Wall Street Journal, September sales for new homes slipped to a seasonally adjusted annual rate of 464,000.

