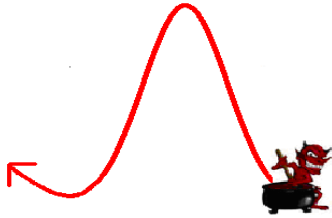




**2009 INVESTMENT REVIEW  
THE BOARD OF PENSIONS BALANCED INVESTMENT PORTFOLIO**

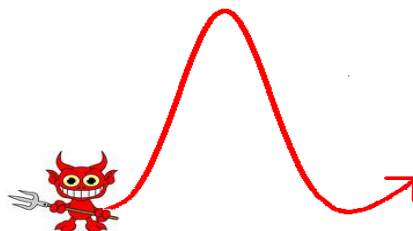


**A Whiff of Sulfur and a Devilish Tale (Risk)**

Did you smell sulfur throughout the last decade? Sometime in the earliest days of this new century, people began to think they could have everything they wanted. They sought out people at places that could help them get houses, cars, wide screen TVs, and electronic gadgets. There was no shortage of enablers. Some had recognizable names like Freddie Mac and Countrywide Credit; some had the history and stature of an AIG or the Federal Reserve; some were famous denizens of Wall Street and academia. All were ready, willing and able to enlist the unwitting in Faustian bargains. They made it far too easy to trade a lifetime of work and a soul for a few baubles and trinkets. It all came to a crashing halt in 2008, when the devils called in the chits and people realized the long-term implications of making poor short term decisions.

What does this have to do with investments? As we all remember, 2008 was a year when we experienced "Tail Risk", when the most impossible events became reality and virtually all asset classes provided negative returns at the same time. Statisticians have their own view of tail risk. Most of us should think of tail risk as the devil whacking us about the ears with his forked tail and laughing hysterically as everything planned and unplanned blows up in our faces.

In probability theory and statistics, the Gaussian or normal distribution is a continuous probability distribution that describes data that cluster around the mean or average. The graph of the associated probability density function is bell-shaped, with a peak at the mean, and is known as the bell curve. Our two little devils represent such bell-shaped curves. About 68% of values in a normal distribution are within one standard deviation of the mean; about 95% are within two standard deviations and about 99.7% are within three standard deviations. For those expecting investment returns to fall within the normal distribution of historical investment performance, it means the chance of performance being better or worse than a three standard deviation event is 0.3%, or virtually impossible. Yet impossible things happen every day. Bad tail risk gave us horrific 2008 investment performance; while in 2009, good tail risk provided investment returns that few would have anticipated in the first grim months of the year.



## Introduction

The Board of Pensions Balanced Investment Portfolio returns net of fees and the asset allocation on December 31, 2009, were as follows:

	2009 <u>Return</u>	<u>Asset Allocation</u>		Long-Term Strategic Asset Allocation <u>Ranges</u>
		<u>\$ Millions</u>	<u>Percent</u>	
U.S. Equity	34.6%	\$2,441	37.6	30-50%
International Equity	34.5	1,184	18.3	10-25
Fixed Income	20.0	2,242	34.5	25-45
Alternative Investments	7.0	<u>623</u>	<u>9.6</u>	1-15
<b>Total</b>	<b>26.2%</b>	<b>\$6,490</b>	<b>100.0%</b>	

### Did We Meet Our 2009 Objectives?

In recent years we have noted that we have several missions, and that risk management is as integral a part of our stewardship as good portfolio management. Let us compare what we said in our 2008 Investment Review with actual 2009 events and results.

#### In our 2008 Investment Review we wrote:

**“We believe 2009 will be a challenging year for investors. The U.S. economy is in a recession. It will take several years for the housing industry to rebound and the banking sector to regain its prior strength. Forecasting stock market returns in 2009 is foolhardy but a range of negative 15% to positive 5% is appropriate for global stock portfolios”.**

Thank goodness we were totally wrong about expected stock returns.

**“We expect the return on corporate bonds may be more attractive than the return on stocks in 2009, as fixed income markets stabilize and credit spreads narrow. We will delay rebalancing into stocks until credit spreads narrow and there is greater liquidity in our fixed income portfolios”.**

We were correct in our analysis of corporate bond markets. We stayed the course with our fixed income portfolios and our investment grade, high yield and emerging market debt portfolios provided superior returns in 2009.

**“While deflation appears to be more of an issue than inflation in 2009, the Investment Committee and staff will continue to evaluate inflation and real return strategies that could help to maintain the purchasing power of our retirees in periods of inflation and stagflation”.**

We initiated a portfolio of Treasury Inflation Protected Securities (TIPS) in 2009 and will implement a global absolute return strategy in early 2010.

**“We will use short-term market outperformance or volatility in individual asset classes to maintain cash to pay benefits. Benefit payments will require cash in excess of dues of more than \$250 million in 2009”.**

We had no liquidity problems in 2009. The funding of the short duration portfolio was completed in July 2009. In addition to dues received, we paid out \$263 million in benefits to our Plan Members and closed the year with 24 months of benefit payments in the cash management and short duration portfolios.

**“We will allocate significant time in Investment Committee meetings in 2009 to review lessons learned in 2008 and how we can better manage the Board of Pensions Balanced Investment Portfolio”.**

We reviewed strategies that could have improved performance for large institutional portfolios in 2008 and found that short of selling all assets and holding cash, very few strategies would have provided protection. The Committee revisited the use of hedge funds, since a small number of hedge fund strategies provided positive investment performance in 2008. An absolute return strategy will be our first investment in a hedge fund.

**“We are long-term investors. We have a long-term strategic asset allocation based on our liabilities or the promised benefits to our Plan members. We will not increase portfolio risk by using short-term trading strategies to improve investment performance”.**

We maintained our long-term strategic asset allocation throughout 2009, seeking and achieving superior investment performance.

### **Summary of Financial Markets: With the Flick of a Tail, from Risk Penalized to Risk Rewarded**

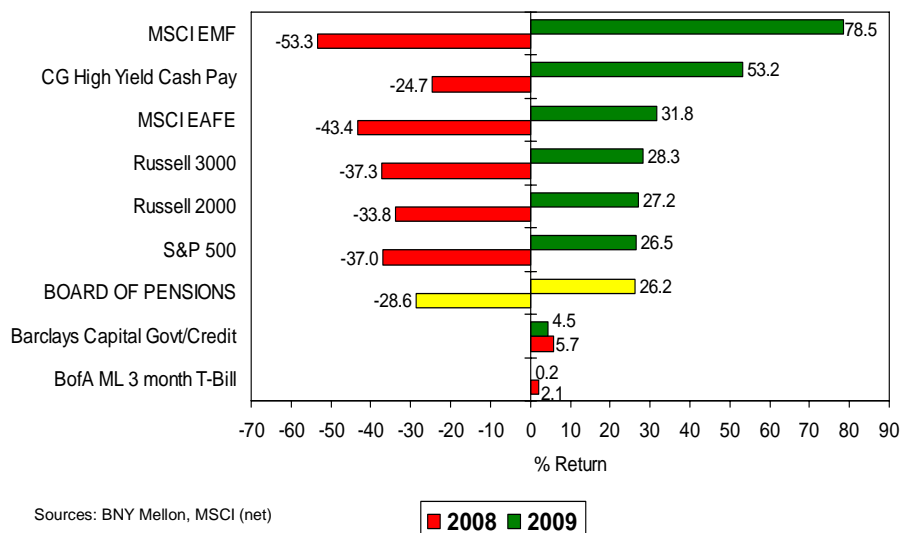
Let's see what markets did and how we positioned the portfolio. In 2009 virtually all asset classes had positive returns, as shown on the graph on page 4. We have included performance for various asset classes for 2008 as well as 2009, since many asset classes experienced their worst and best performance on record over the past two years.

The return patterns of 2008 and 2009 present striking differences, yet risk was the determining factor for success or failure in each year. In 2008, the mean-spirited little devil at the top of page 1 swung his tail and walloped holders of risky assets, including global stocks and every bond other than U.S. Treasuries. Just a few short months later, in 2009, the grinning little devil at the bottom of the page whispered in the ear of investors that risk was once again acceptable. Low and behold, in 2009 the riskiest assets had the best performance, from emerging market stocks in Macedonia, to the lowest quality junk bonds, to stocks of corporations with the lowest quality ratings.

Stocks in emerging markets, as represented in the MSCI EMF Index, were the worst asset class in 2008, with a -53.3% return, yet returned 78.5% in 2009, the best return on record for emerging markets. In 2008, high yield bonds also had one of the worst years on record, with a return of -24.7% for the Citigroup High Yield Index. For risk takers returning to the bond market in 2009, the Citigroup High Yield Index provided a 53.2% return.

The stocks of large companies, as represented by the S&P 500 Index, had a 2009 return of 26.5%, with small company stocks in the Russell 2000 Index returning 27.2%. Developed international markets, as represented in the MSCI EAFE Index, had a 31.8% return to U.S. investors. High quality bonds in the Barclays Capital Government/Credit Index had a 4.5% return and cash, or 3 month Treasury Bills, returned 0.2%.

## Returns of Market Indices and Board of Pensions Balanced Investment Portfolio 2008 vs. 2009



### What is the Structure of the Board of Pensions Balanced Investment Portfolio?

The Board of Pensions Balanced Investment Portfolio uses external investment management firms for the day-to-day investment of \$6.5 billion in assets. The Portfolio is unitized on a monthly basis and is the investment portfolio for the Pension Plan as well as other plans and programs administered by the Board of Pensions. The U.S. equity component of the Portfolio has ten investment managers, plus market-based index funds. The international equity component has eight managers, including two managers focusing only on emerging markets. The fixed income component has five managers, including one investing in high yield or below investment grade securities and one investing in emerging markets debt. The global balanced component uses one manager. Alternative investments include distressed debt, private equity, venture capital, natural resources, real return and real estate securities. There were commitments to 36 funds or limited partnerships on December 31, 2009. In an effort to address the reduced asset base and “right size” the Balanced Investment Portfolio, two investment managers were excused in 2009 and assets were reallocated among existing managers. Two liquid alternative portfolios were consolidated with existing portfolios due to overlapping strategies. Managers can be excused for changes in investment style and firm ownership as well as performance. Portfolio diversification is a function of the long-term expected return for each asset class, but also must include risk assessment based on investment styles, liquidity and the potential firm risk for each investment manager retained by the Investment Committee.

Each year separate account managers for the Balanced Investment Portfolio are provided a list of those companies on the current divestment lists. The lists include companies on the General Assembly Divestment List for military and tobacco, as well as those companies whose primary businesses are in the alcohol and gaming industries. The Board of Pensions divestment policy does not force sales of companies newly added to the lists, which could reduce the investment return on the Portfolio. Instead the policy prohibits the future purchase of the securities.

**PERFORMANCE HIGHLIGHTS**  
**BOARD OF PENSIONS BALANCED INVESTMENT PORTFOLIO**  
**PERIODS ENDED DECEMBER 31, 2009**

	<u>Annualized Rate of Return</u>				
	<u>1 Year</u>	<u>2 Years</u>	<u>3 Years</u>	<u>5 Years</u>	<u>10 Years</u>
BOP U.S. EQUITY	34.6	-9.1	-4.2	1.5	1.2
Russell 3000 Index	28.3	-10.3	-5.4	0.8	-0.2
BOP INTERNATIONAL EQUITY	34.5	-10.6	-2.4	6.8	3.3
MSCI All Country World Index ex US	42.1	-11.8	-3.0	6.3	3.1
BOP FIXED INCOME	20.0	5.2	5.2	4.9	6.3
Barclays Capital Gov/Credit Index	4.5	5.1	5.8	4.7	6.3
BOP GLOBAL BALANCED	24.1	-6.5	-1.6	2.9	2.8
World Balanced Benchmark*	25.2	-5.0	-0.4	3.5	2.5
BOP PRIVATE PARTNERSHIPS	2.4	-2.2	6.1	9.4	12.4
Russell 3000 + 500 basis points	34.2	-6.1	-1.0	5.5	4.5
BOP INFLATION / REAL RETURN	29.4	-8.1	-7.3	--	--
Consumer Price Index + 500 basis points	7.7	6.4	7.3	7.6	7.5
<b>BOP BALANCED PORTFOLIO</b>	<b>26.2</b>	<b>-5.1</b>	<b>-0.8</b>	<b>3.7</b>	<b>3.5</b>
BOP ABSOLUTE BENCHMARK					
Consumer Price Index + 500 basis points	7.7	6.4	7.3	7.6	7.5
BOP RELATIVE BENCHMARK					
Asset Mix Policy Benchmark**	22.3	-4.7	-0.6	3.5	3.0

Notes:

Returns are net of management fees.

The Russell 3000 +500 basis points is calculated monthly and linked to provide an annualized number that will be different than the sum of the annual return of the Russell 3000 +500 basis points.

\* World Balanced Benchmark is calculated using 65% MSCI All Country World Index and 35% Barclays Capital Global Aggregate Bond Index. Previously, the World Balanced Benchmark was calculated using 65% MSCI World Index 35% Barclays Capital Global Aggregate Index. Prior to July 2002, the World Balanced Benchmark was calculated using 65% MSCI World Index and 35% Salomon Brothers World Government Index.

\*\*Effective 1/1/2005, the Asset Mix Policy Benchmark is calculated using each asset class midpoint multiplied by its index. The policy benchmark is:

U.S. Equity = 47.5% \* Russell 3000 Index  
International Equity = 17.5% \* MSCI All Country World Index ex US (ACWI)  
Fixed Income = 35% \* Barclays Capital Gov/Credit Index  
Alternative Investments = 0

## Review of the Board of Pensions Balanced Investment Portfolio Performance

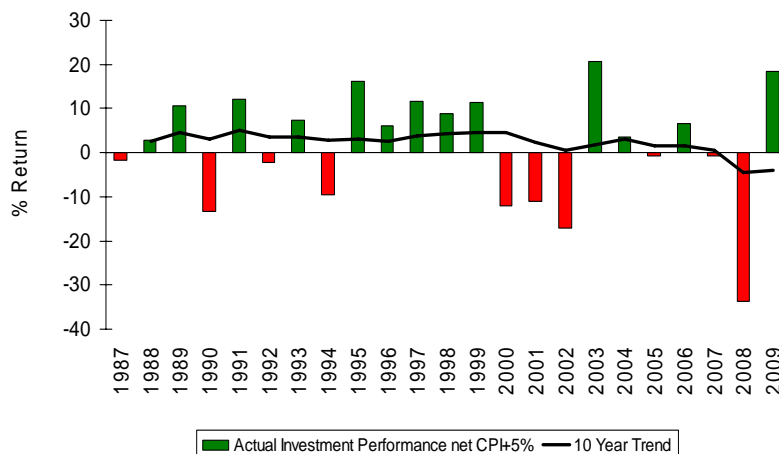
The Board of Pensions Balanced Investment Portfolio began 2009 with total assets of \$5.4 billion. The market value of the Portfolio increased to \$6.5 billion by December 31, 2009. Performance of the Board of Pensions Balanced Investment Portfolio is measured against both absolute and relative benchmarks.

### The Absolute Benchmark: CPI plus 5%

The absolute benchmark is unrelated to the performance of market indices. The long-term measure of success of the investment strategies of the Board of Pensions Balanced Investment Portfolio is a real return of 5%, or the Consumer Price Index (CPI) plus 5% annually. Market volatility over short-time periods, such as 2000 through 2002 and 2008, makes the CPI plus 5% a difficult absolute return benchmark on an annual or short-term basis, but one that should be achievable over longer investment time horizons. The design of the Pension Plan assumes that over the long-term, the return of the Portfolio will meet or exceed the absolute benchmark. This should enable the Board of Pensions to maintain a well-funded Plan, capable of maintaining and increasing the promised benefits to Plan members. CPI in 2009 was 2.7% and the absolute benchmark of CPI plus 5% was 7.7%.

The graph below illustrates the long-term success of the Balanced Investment Portfolio in meeting the absolute benchmark. Bars above the line are those years when the difference between the actual return and the CPI plus 5% is positive. Bars below the line, such as 2008, are years when the actual return was lower than the absolute benchmark of the CPI plus 5%. The bar for 2008 was the actual return of -28.6% minus 5.1%, or -33.7%. The bar for 2009 was the actual return of 26.2% minus the 7.7% of CPI plus 5%, or 18.5%.

### Investment Performance vs Long-Term Objective of CPI + 5% Annually

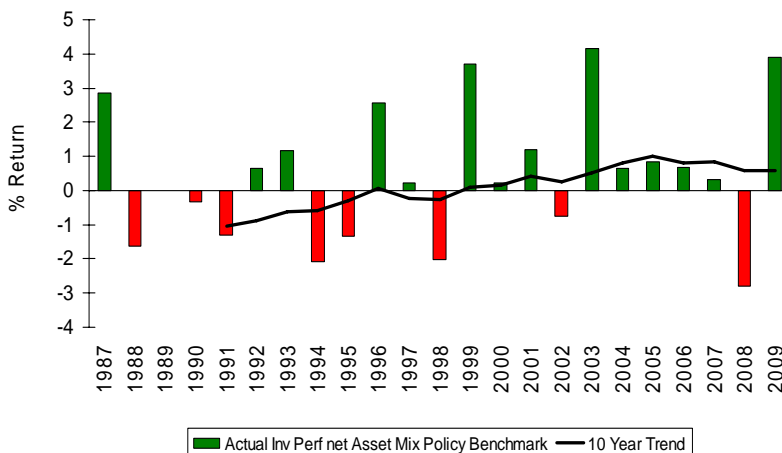


## The Relative Benchmark: Investable Market Indices

The relative benchmark is the asset mix policy benchmark that compares the performance of the Board of Pensions Balanced Investment Portfolio to that of investable market indices. The asset mix policy benchmark is the return the Portfolio would have achieved using the mid-point allocation to each basic asset class and the appropriate index return for that asset class. Above benchmark performance reflects the contribution of active investment management strategies and asset allocation decisions, including allocations to small capitalization stocks, high yield bonds, emerging markets stocks, distressed debt, private equity and other alternative investments. Alternatives are not included in the benchmark since there are no investable market indices for private partnership alternative investments.

The graph for the Balanced Investment Portfolio returns compared to the asset mix policy benchmark should be read in the same manner as the previous graph with the absolute benchmark of the CPI plus 5%. Bars above the line are those years when the difference between the actual return and the asset mix policy benchmark is positive. Bars below the line are years when the actual return was lower than the policy benchmark. The bar for 2008 is -28.6% actual return less -25.7% for the asset mix policy benchmark return or a shortfall of 2.9%. The bar for 2009 is the 26.2% actual return less the 22.3% return of the asset mix policy benchmark or outperformance of 3.9%.

### Investment Performance vs Asset Mix Policy Benchmark Actual Investment Performance net Asset Mix Policy Benchmark



## Performance Attribution

The outperformance of the Board of Pensions Balanced Investment Portfolio compared to the asset mix policy benchmark can be attributed primarily to fixed income performance and active asset allocation decisions. The U.S. equity component exceeded the benchmark of the Russell 3000 while international equity lagged the benchmark of the MSCI ACWI (All Country World Index) ex US. The significant outperformance of the fixed income component was the major contributor to the success of the Balanced Investment Portfolio in 2009, as shown in the attribution analysis on the next page. The alternative investment component, comprised of distressed debt, private equity and other limited partnerships, detracted from overall

performance, primarily due to a lag in reporting, such that the first quarter of 2009 returns for many limited partnerships were actually the returns generated in the fourth quarter of 2008. Asset allocation decisions made by staff and the Investment Committee to maintain an overweight in high yield and corporate bonds and introduce inflation protection strategies contributed to the 3.9% of total portfolio outperformance against the asset mix policy benchmark.

**2009 PERFORMANCE ATTRIBUTION  
BOARD OF PENSIONS BALANCED INVESTMENT PORTFOLIO  
vs ASSET MIX POLICY BENCHMARK**

U.S. Equity	+1.37 %
International Equity	-1.57
Fixed Income	+5.46
Global Balanced	+0.07
Alternative Investments	-1.43
Asset Allocation/Cash Flows/Timing	<u>-0.1</u>
<b>Net Impact on Portfolio Performance</b>	<b>+3.90%</b>

### Asset Allocation

While it may appear that there were minimal changes in asset allocation from 2008 to 2009, the Balanced Investment Portfolio was rebalanced throughout the year as we reduced our allocation to asset classes and managers with the greatest outperformance or with the lowest expected returns in 2009 and 2010. The outsized performance of high yield bonds in 2009 enabled us to raise cash and reduce our risk exposure to that asset class. We reduced our exposure to U.S. value managers, raising cash to pay benefits. While our managers outperformed their benchmarks, value stocks lagged growth stocks in 2009. We initiated a TIPS portfolio and funded the short duration portfolio. Cash was used for benefit payments and the funding of commitments to distressed debt and private equity.

**COMPARATIVE ASSET ALLOCATION  
BOARD OF PENSIONS BALANCED INVESTMENT PORTFOLIO**

	<u>December 31, 2009</u>		<u>December 31, 2008</u>	
	<u>\$Millions</u>	<u>Percent</u>	<u>\$Millions</u>	<u>Percent</u>
Equity	<u>3,625</u>	<u>55.9</u>	<u>2,903</u>	<u>53.9</u>
U.S. Equity	2,441	37.6	1,955	36.3
International Equity	1,184	18.3	948	17.6
Fixed Income	<u>2,242</u>	<u>34.5</u>	<u>1,935</u>	<u>35.9</u>
Alternative Investments	<u>623</u>	<u>9.6</u>	<u>549</u>	<u>10.2</u>
Private Partnerships	502	7.7	453	8.4
Inflation/Real Return	121	1.9	96	1.8
<b>Total</b>	<b>\$6,490</b>	<b>100.0%</b>	<b>\$5,387</b>	<b>100.0%</b>

## The Fixed Income Component of the Balanced Investment Portfolio

Historically the Investment Review has followed a pattern of reviewing each component of the Balanced Investment Portfolio, beginning with the U.S. equity component, then international equity, concluding with fixed income. In light of the significant contribution of fixed income to both the inferior returns of 2008 and superior returns of 2009, this year we will begin the review with the fixed income component of the Balanced Investment Portfolio.

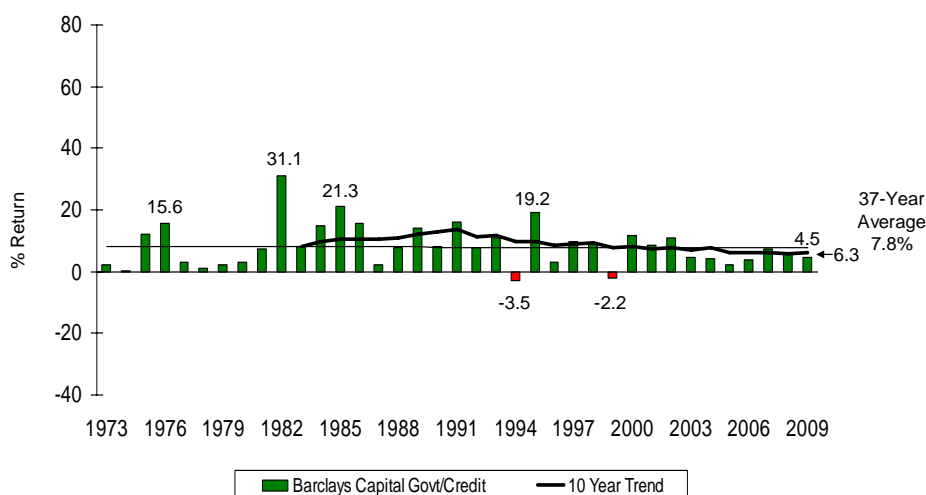
The fixed income component of the Portfolio increased by 20.0% compared to the benchmark return of 4.5% provided by the Barclays Capital Government/Credit Index. As portfolio holdings in corporate debt recovered from the depressed valuation levels of 2008, all three active core fixed income managers exceeded the 4.5% return of the Barclays Capital Government/Credit Index, providing returns of 11.3%, 15.6% and 28.3%.

The 20.0% return of the fixed income component included the returns from core fixed income managers as well as a 44.4% return from our high yield portfolio and 43.1% return from emerging market debt. Both strategies were hurt by the 2008 investor flight to the highest quality bonds and benefited in 2009 from an increased investor appetite for risk. As bond markets stabilized, investors were able to purchase high yield bonds and the debt of emerging market countries at attractive yields. Improved liquidity in 2009 and declining spreads provided exceptional returns.

### Fixed Income Market Historical Performance

The chart below provides the historical performance of the U.S. fixed income market, as represented by the returns of the Barclays Capital Government/Credit Index. Investors in fixed income can experience negative returns during periods of rising interest rates or when spreads widen on corporate bonds and other types of credit based instruments; however, as we will see on similar graphs of long-term performance for stocks, fixed income has had far fewer and less severe years of negative performance. Over the last 10 years, as shown on the 10-year trend line on the graph, the Barclays Capital Government/Credit Index had a return of 6.3%, below the 37-year average return of 7.8%. Fixed income markets had negative returns in 1994 and 1999, or 2 out of 37 years.

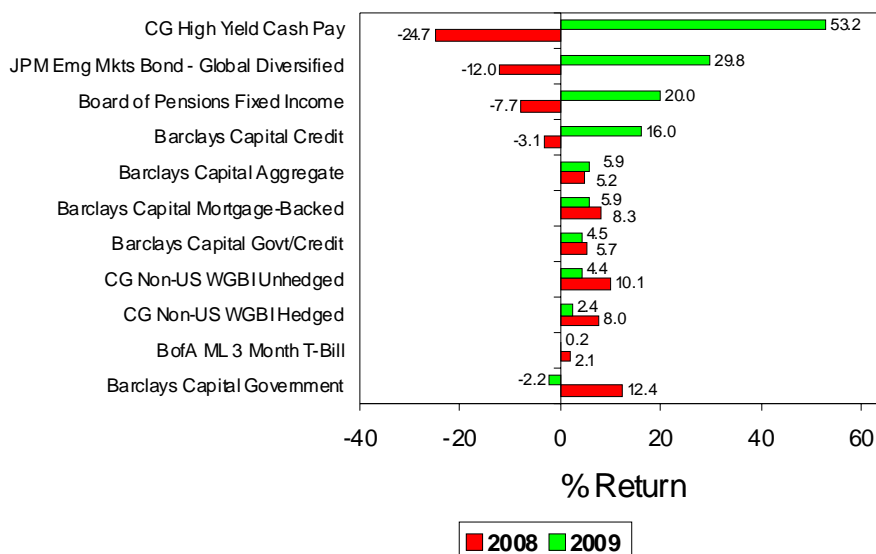
**Fixed Income Returns in Historical Perspective**  
January 1, 1973 – December 31, 2009



## Investment Performance

Bond performance depends on multiple factors but usually the most important ones are the level and direction of interest rates, portfolio duration, credit quality and investor appetite for risk, as reflected in the spread over U.S. Treasuries for corporate bonds. In 2008 safety and liquidity were most important. As shown in the graph below, in 2008 the best strategy would have been to invest in the Barclays Capital U.S. Government Index for a return of 12.4%. The worst performance, -24.7%, was from the Citigroup High Yield Index. This reversed in 2009. Risk averse investors in the Barclays Capital U.S. Government Index actually lost 2.2% as interest rates increased on U.S. Treasuries in 2009. High yield bonds and emerging market debt provided superior returns.

### Fixed Income Index Returns 2008 vs. 2009



Source: MSCI (net)

## Interest Rates

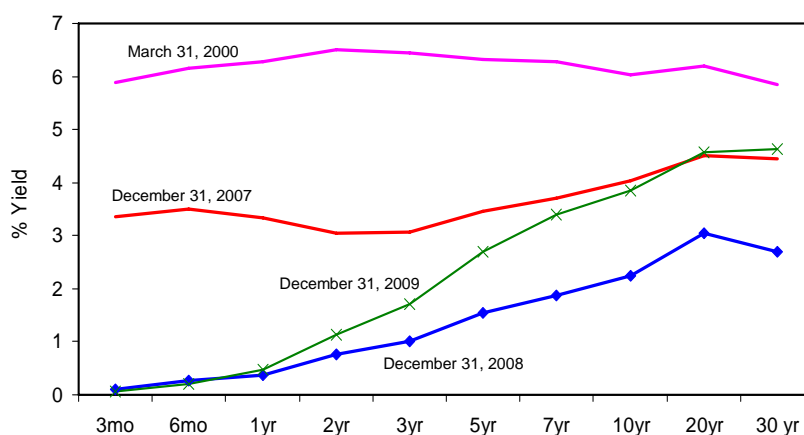
The Federal Reserve's target for the federal funds rate was 4.25% at the start of 2008. This is the interest rate at which private depository institutions, primarily banks, lend balances at the Federal Reserve on an overnight basis to other depository institutions. After six reductions in the first ten months of 2008, on December 16, 2008 the Federal Open Market Committee made the unprecedented move of setting the funds target rate in the range of zero to 0.25%. No change in the fed funds target rate was made in 2009.

While the federal funds rate is the rate used to regulate the supply of money and the level of lending activity in the U.S. economy, fixed income market-watchers also pay close attention to yield curves, the graph of actual interest rates and maturities of similar instruments, such as the U.S. Treasury yield curve shown on the next page. It is important to monitor the shape of the yield curve at different points in time. Under normal conditions, a yield curve slopes upward, with short-term securities having a lower yield than long-term securities. Curve-watchers scrutinize interest rates and the resulting shape of the yield curve to see whether a curve has even slightly inverted, as it did on March 31, 2000. The yield curve inverts when the yield on a short-term security is higher than the yield on a long-term bond. During periods of inverted yield curves, investors are not compensated for taking the additional risk of investing in longer term

bonds. The 2008 decreases in the federal funds rate impacted the yield curve in all maturities, but most dramatically for short rates. While the interest rate on maturities longer than one year increased in 2009, the yield on the 3-month Treasury bill decreased from 0.08% on December 31, 2008 to 0.05% on December 31, 2009. The yield on the 2-year note increased from 0.76% to 1.14% over the same period, while the 10-year Treasury yield increased by 163 basis points, from 2.21% on December 31, 2008 to 3.84% on December 31, 2009.

Curve-watchers in 2009 focused on the near-record steepness of the Treasury yield curve, as reflected in the 270 basis point difference in rates between the 2-year and 10-year Treasury. Historically, interest rates have subsequently increased when the spread between the 2-year and 10-year was greater than 300 basis points.

## U.S. Treasury Yield Curve

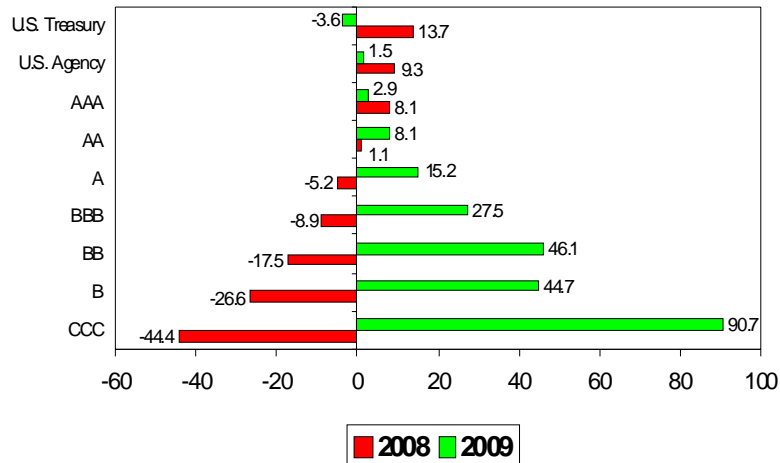


Source: Federal Reserve, statistical release

## Credit Quality and Spreads

Credit ratings are given to bonds based on Standard & Poor's and Moody's analyses of the ability of the corporation to pay interest and repay principal on schedule to bondholders. As reflected in the graph on the next page, credit markets changed dramatically in 2008 and in 2009. In the second half of 2008, many investors began to worry about portfolio risk and liquidity and sold any asset that was thought to be high risk. However, within six months some investors reevaluated their risk tolerance and purchased the riskiest of securities at bargain prices. U.S. Treasury bonds that had provided investors with safety and liquidity and a 13.7% return in 2008 returned -3.6% as interest rates increased in 2009. Despite the diminished appetite of potential buyers, investors sold CCC corporate bonds in the fourth quarter of 2008, compounding already severe liquidity and valuation problems. When depressed prices attracted buyers back to the market in 2009, these CCC securities of the least creditworthy companies provided investors with a 90.7% return in 2009 as spreads narrowed and liquidity improved.

## Returns by Corporate Credit Quality Rating 2008 vs. 2009



Source: Barclays Capital; Dodge & Cox

The U.S. Treasury bond is typically considered the highest quality long-term investment with the greatest liquidity and no default risk. As such, it is the benchmark security used by investors to price all other long term bonds. The spread for investment grade corporate bonds is a risk premium, or additional yield that investors require for any bond that is not a U.S. Treasury bond. The spread is calculated in basis points, with 1% equal to 100 basis points. As an example, if a corporate bond has a yield of 5.84% and the benchmark 10-year U.S. Treasury has a yield of 3.84%, the spread would be 200 basis points.

As shown on the graph on the next page, from 1990 through 2009 the average spread, or risk premium required by investors in an investment grade corporate bond, was 137 basis points. In 2008, rating downgrades, lack of confidence in the rating agencies, weak corporate earnings, accounting and pricing concerns all impacted corporate bond spreads. Market liquidity evaporated and investors demanded higher yields for anything with even the most remote potential for default risk. Before a slight decrease in December 2008 to 444 basis points, the yield spread for investment grade bonds compared to a 10-year U.S. Treasury was 502 basis points. Spreads narrowed throughout 2009, providing investors with price appreciation. While the 170 basis point spread between the yield of investment grade corporate bonds and 10-year Treasury bonds on December 31, 2009 exceeds the 19-year average of 137 basis points, the dramatic and unprecedented collapse in spreads was the good side of two unexpected tail risk events in 2008 and 2009.

## Investment Grade Corporate Bonds vs Ten-Year Treasury Bonds Yield Spread in Basis Points

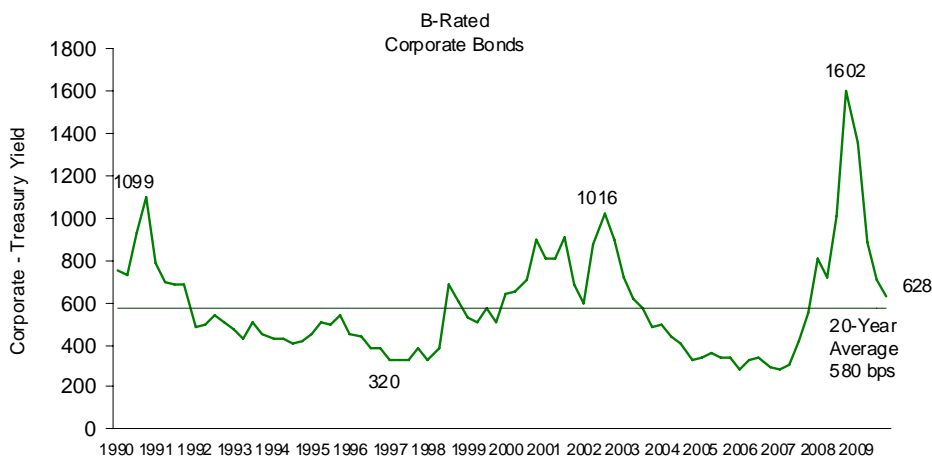


Source: Dodge & Cox; Citigroup

Based on investment grade bonds with maturities greater than ten years

As shown on the graph below, high yield bond spreads to U.S. Treasuries repeated the pattern of investment grade corporate bonds to Treasuries, with spreads tripling in the second half of 2008, to close the year at a historic high of 1602. Just as the spread between investment grade and 10-year Treasuries experienced an unprecedented collapse in 2009, the yield spread between B-rated high yield corporate bonds and 10-year Treasuries narrowed almost 1,000 basis points to 628 basis points on December 31, 2009, just slightly higher than the 580 basis point average.

## High Yield Corporate Bonds vs Ten-Year Treasury Bonds Yield Spread in Basis Points

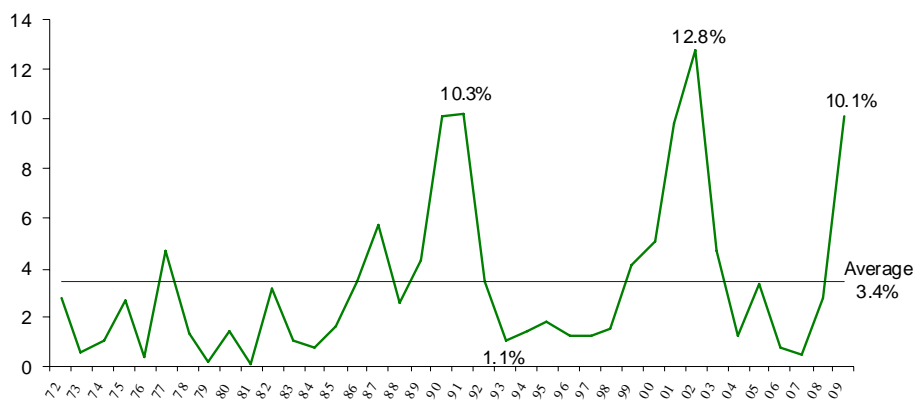


Source: Oaktree Capital; Citigroup

## Default Rates

As shown in the graph below, default rates for corporate bonds last peaked at 12.8% in 2002, when the investment grade corporate bonds of WorldCom and other highly leveraged companies fell to below investment grade and defaulted in a matter of days. The default rate for U.S. dollar-denominated bonds is the par value of defaulted securities as a percentage of the par value of outstanding issues. Default rates increased from 1.2% in 2004 to 3.4% for 2005, with many high yield and distressed debt investors expecting to see a further increase in defaults in 2006. This did not occur. A record number of mergers and acquisitions in 2006 and 2007 required high levels of debt financing. Some acquisition debt was provided at favorable rates and favorable terms to companies potentially at risk for future financial distress. Despite this confirmed decline in underwriting standards, defaults for 2007 remained low although they started to increase in 2008. Many distressed debt investors believed that based on the level of debt outstanding and expected levels of bankruptcies, the default rate in 2009 could exceed the 12.8% experienced in 2002. However, it is expected the rate will be about 10.1% for 2009 when final data is available.

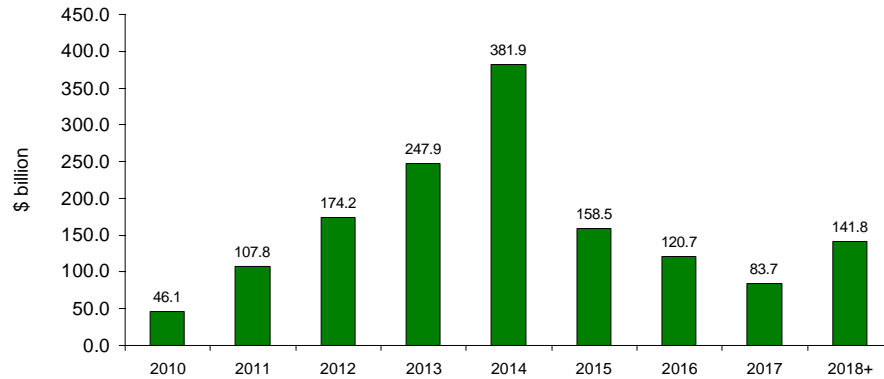
### Historical Default Rates 1972 through 2009\*



Source: Oaktree Capital, Ctigroup, and JP Morgan  
\* The 12/31/09 default rate provided is an Oaktree estimate.

One reason for the lower than anticipated default rate in 2009 has been the ability of corporations to restructure debt. Many banks were also willing to extend maturities as well as provide extra time for corporations to work through potential breaches in loan covenants. The majority of these efforts to restructure high yield bonds and bank loans did not result in a reduction of the amount of debt but rather the extension of maturities into 2013 and beyond. The graph on the next page shows the maturity schedule for \$1.46 trillion in high yield bonds and bank loans outstanding that will mature from 2010 through 2018 and beyond. Unless corporate balance sheets have improved significantly, default rates may increase in 2013 and 2014, when corporations will need to repay or refinance \$630 billion, 43% of the debt of \$1.46 trillion, or go into default.

## High Yield and Institutional Loan Maturities 2010 - 2018



Source: JP Morgan (as of November 2009)

## The U.S. Equity Component of the Balanced Investment Portfolio

The U.S. equity component of the Board of Pensions Balanced Investment Portfolio had a 34.6% return in 2009, exceeding the 28.3% return of the Russell 3000 Index. The large capitalization component of the Portfolio returned 32.1%, exceeding the 26.5% return of the S&P 500 and 28.4% return of the Russell 1000. With returns of 33.2%, 36.5% and 41.8%, all three active core managers outperformed the 26.5% return of the S&P 500. The three value managers returned 22.9%, 29.0% and 29.7% exceeding the 19.7% return of the Russell 1000 Value Index. The one active large capitalization growth stock manager had a return of 38.5%, exceeding the benchmark of the Russell 1000 Growth Index.

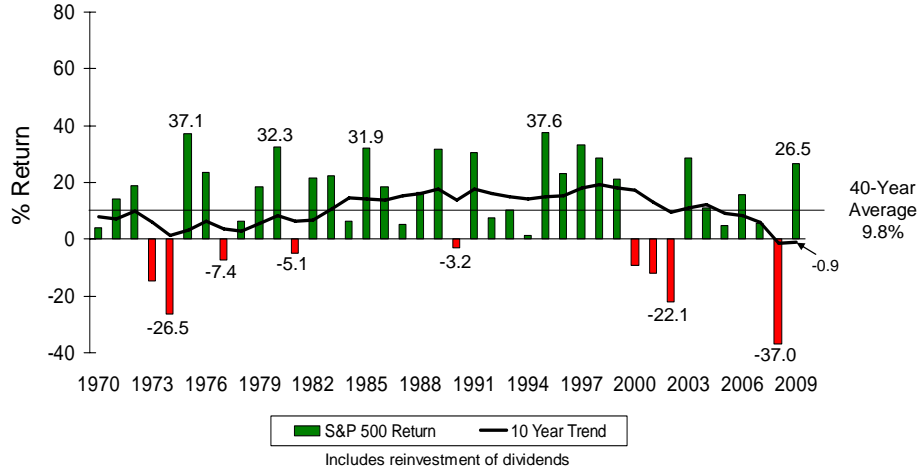
The small and mid capitalization component of the Portfolio returned 42.5%, exceeding the Russell 2000 return of 27.2% for small company stocks, primarily due to the 63.2% return of our small capitalization core manager. One small capitalization growth manager underperformed due to a high allocation to healthcare and biotech companies.

## U.S. Equity Market Historical Performance

The Russell 3000 Index includes stocks of large and small companies and is a broader measure of the U.S. equity market than the S&P 500. However, the Russell 3000 originated in 1984, so does not have the extensive historic database that is often valuable for long-term investment perspective. The S&P 500, though not as broad-based, offers this important longer-term data and is used in the following two graphs.

As shown on the graph on the next page, the U.S. equity market, as measured by the S&P 500 Index, had a 26.5% return in 2009. The 26.5% return is above both the -0.9% average return of the last ten years, as reflected in the 10-year trend line, and the long-term 40-year average return of 9.8% for the S&P 500 since 1970. The U.S. equity market had negative returns in 9 out of 40 years.

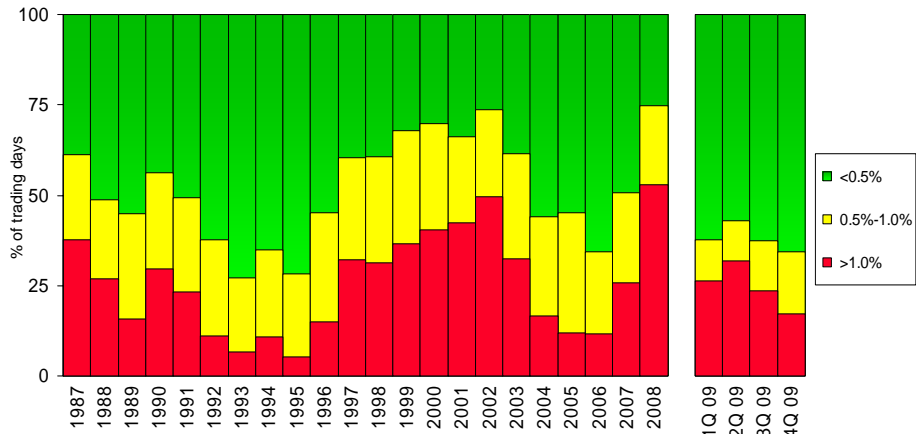
## U.S. Equity Returns in Historical Perspective January 1, 1970 – December 31, 2009



### Market Volatility

As global financial markets collapsed in the fourth quarter of 2008, the daily volatility of stocks in the S&P 500 Index significantly increased. The chart on the next page portrays the daily movement of the S&P 500, based upon the change in daily closing price from one trading day to the next. The graph divides market movements into three categories. The red or bottom bars are periods of high volatility, with daily movement of the index greater than one percent. The green or top bars are periods with lower volatility, when the index moved up or down less than one-half percent. As an example, in 1995, only 5.2% of all trading days had a daily price change of greater than one percent. This low volatility can be compared to the fourth quarter of 2008, as investors tried to sell stocks into a falling stock market and 78.1% of trading days had a daily price change of greater than one percent. Volatility dropped in 2009 to levels comparable to that experienced in 2007, when nearly 25% of trading days had a daily price change of greater than one percent.

## U.S. Equity Market Volatility Daily Movement of S&P 500 Index



\* Daily closing value of S&P 500 as compared to prior trading day's closing value. Does not differentiate between movements up or down. Does not reflect intraday movements.

### Market Capitalization and Style

Investors know that the size of the companies they invest in, or the market capitalization, can significantly impact portfolio success. Small company stocks in the Russell 2000 Index returned 3.5% annually for the ten years ended December 31, 2009, exceeding the -0.9% return of large company stocks in the S&P 500. However, the time periods mask years of significant over and underperformance. Large company stocks outperformed from 1994 through 1998, while small company stocks provided superior returns from 1999 through 2006. While growth stocks outperformed in 1998 and 1999, value stocks were the winners for seven years from 2000 through 2006. In 2007, large and growth turned the corner and provided the best returns but the trend reversed again in 2008, with value and small providing better performance. As shown in the table below, in 2009, growth stocks of all market capitalizations outperformed value stocks by a wide margin, with a 17.5% advantage to large company growth stocks over large company value stocks.

#### 2009 U.S. STOCK MARKET PERFORMANCE BY MARKET CAPITALIZATION AND STYLE

Russell 3000 – Total Market	28.3%	
S&P 500 Index (Large Capitalization)	26.5	
Russell 1000 Index (Large Capitalization)	28.4	
Russell Mid Cap Index (Mid Capitalization)	40.5	
Russell 2000 Index (Small Capitalization)	27.2	
Russell 1000 Growth Index	37.2	{ 17.5 advantage to growth
Russell 1000 Value Index	19.7	
Russell Midcap Growth Index	46.3	{ 12.1 advantage to growth
Russell Midcap Value Index	34.2	
Russell 2000 Growth Index	34.5	{ 13.9 advantage to growth
Russell 2000 Value Index	20.6	

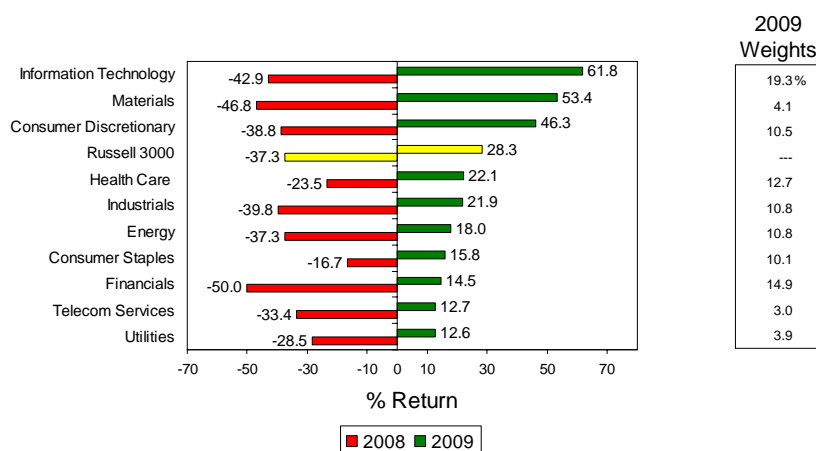
Data Source: Aronson + Johnson + Ortiz, LP, Vestek Systems

## Sector Performance

The U.S. stock market, as represented in the Russell 3000 Index, had a return of 28.3% in 2009. In 2008, all sectors had negative returns ranging from a low of -50.0% for financials to only -16.7% for consumer staples. Sector and stock selection were critical for success in 2009. Returns were positive for all sectors but ranged from 61.8% for information technology stocks to 12.6% for utilities. Financials had a sector return of 14.5% but individual stock performance varied from the 304% return of Genworth Financial to a -50.5% return for Citigroup.

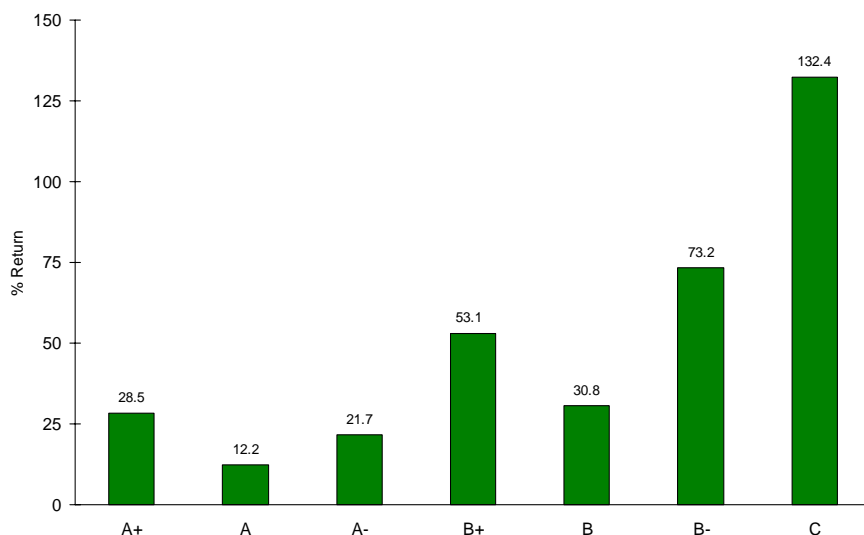
The Balanced Investment Portfolio had broad sector diversification in 2009. While not necessarily in the Balanced Investment Portfolio for the entire year, the top ten stocks held on December 31, 2009 with the stock's calendar 2009 return in brackets were Google [101.5%], Microsoft [59.5%], JPMorgan Chase [33.8%], Occidental Petroleum [37.8%], Hewlett Packard [42.8%], Goldman Sachs [101.9%], Novartis [12.4%], Amgen [-2.0%], Federal Express [30.8%], and Illinois Tool Works [40.5%]. These top ten holdings were a diverse representation from the information technology, financial, energy, health care and industrial sectors.

### Russell 3000 Index Sector Returns and Weights 2008 vs. 2009



If we return to our theme of risk, especially unanticipated tail risk, the performance of the U.S. stock market is even more interesting. As shown on the graph on the next page, the stocks of the poorest quality companies in the S&P 500 significantly outperformed the stocks of the highest quality companies. In some cases it may have been a dead cat bounce off the historically low prices of 2008. How else can you explain why C-rated companies returned 132.4% and A-rated companies returned only 12.2%? Actual company returns further illuminate the quality divide, with Tenet Healthcare and Ford providing returns in excess of 300%, while Wal-Mart returned -4.4% and Proctor and Gamble returned -1.6%.

## Returns of S&P 500 by Quality



Source: FactSet. Weighted average by category.

## Structure of the U.S. Equity Component of the Balanced Investment Portfolio

### Sector Selection in the U.S. Equity Component

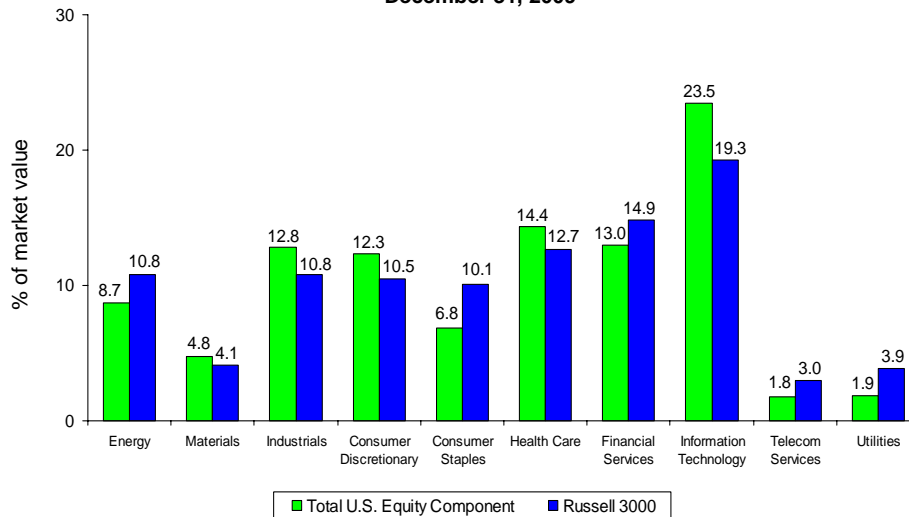
If we explore the structure and composition of the U.S. equity component of the Board of Pensions Balanced Investment Portfolio compared to the sectors of the Russell 3000 Index, as shown on the chart on the next page, we can see that the Portfolio's U.S. equity component, based upon sector allocations, does not look like the Russell 3000. Active portfolio managers make active stock selections and the sum of these company holdings should result in a portfolio that does not look like an index fund and reflects the selection of companies with the greatest potential for stock price appreciation. Since these are decisions made at the level of individual companies and not sectors, the resulting portfolio has over and under weights when compared to the sector weights of the Russell 3000 Index.

The U.S. equity component return of 34.6% exceeded the 28.3% return of the Russell 3000. The Portfolio was significantly overweight information technology, the best performing sector, with a 61.8% sector return in 2009. The U.S. equity component benefitted from managers selecting companies in the information technology sector of the Russell 3000, with a resulting Portfolio weight of 23.5% compared to a 19.3% weight in the Russell 3000 Index. The Portfolio also benefitted from overweighting materials and consumer discretionary companies, the second and third best performing sectors, with Russell 3000 sector returns of 53.4% and 46.3%, respectively.

Selecting the best companies is important but avoiding the worst companies is equally critical. Managers underweighted stocks of utility, telecommunication services and financial companies, the three worst performing sectors. An overweight in health care stocks detracted from performance as the health care sector return of 22.1% was lower than the 28.3% return of the Russell 3000 Index.

## U.S. Equity Component Characteristics Sector Weights vs. Russell 3000 Index

December 31, 2009



### Stock Selection in the U.S. Equity Component

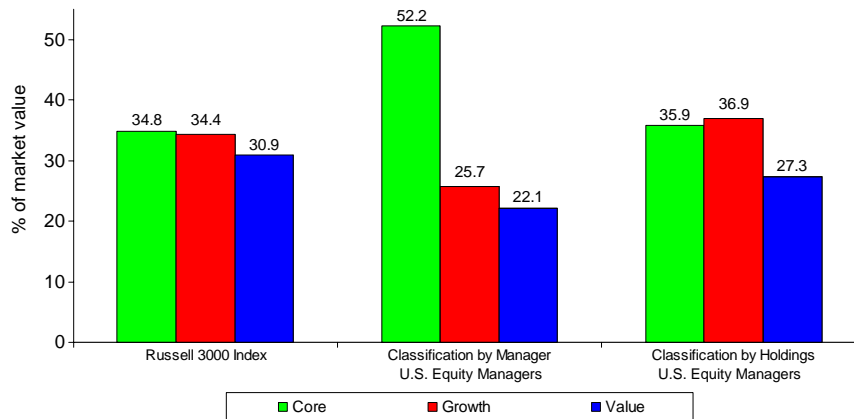
Active portfolio managers select individual stocks based upon valuations and expectations for future growth. Many of the best managers call themselves “benchmark agnostic”, meaning they are aware of a benchmark but don’t select stocks or sectors based upon the weighting in a benchmark. It is important to remember that the composition of most indices is backward looking, since it reflects the performance of prior periods. The weighting of an individual stock and its sector in most indices is based upon share prices, so strong past performance leads to a higher weighting. When you buy an index fund, you are buying more of the recent winners, and less of the recent losers. Since active managers try to anticipate the next winners, the stocks and sectors in their portfolios can differ significantly from an index.

As shown on the graph on the next page, on December 31, 2009, the Russell 3000 Index contained stocks that were classified as core (34.8% of stocks in the index), growth (34.4%) and value (30.9%). The index is rebalanced annually and stocks can move from value to growth and vice versa. The procedures for the reconstruction of the Russell indices can result in a railroad stock such as Burlington Northern, historically a value company, being assigned to the growth index for a time, then being reassigned to the value index.

A comparison of the structure of the U.S. equity component of the Balanced Investment Portfolio to the Russell 3000 Index by manager classification gives a very different picture of portfolio structure than a comparison by actual portfolio holdings. When the U.S. equity component of the Portfolio is classified by manager benchmarks, such as core, growth and value, the Portfolio has a 52.2% allocation to core managers, 25.7% allocation to growth managers and a 22.1% allocation to value managers. On the surface, this analysis could lead a portfolio strategist to reduce the allocation to core managers and increase the allocation to growth and value managers.

A review of the actual Portfolio holdings by stocks presents a different picture, with active managers invested 35.9% in core stocks, 36.9% in growth stocks and 27.3% in value stocks. With the collapse of financial stocks in 2008 and their underperformance in 2009, the manager allocation to traditional value stocks has declined. In 2009, managers were able to purchase stocks in beaten down technology companies that had long been too expensive for traditional core and value managers. Volatile markets and pricing pressure in 2008 created opportunities for active managers to add value in 2009.

### Growth/Value Characteristics U.S. Equity Component as of December 31, 2009



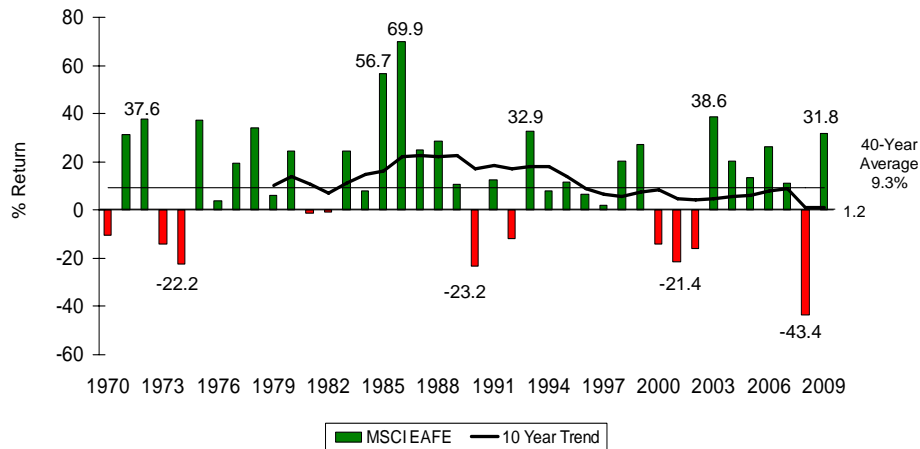
### The International Equity Component of the Balanced Investment Portfolio

The international equity component of the Board of Pensions Balanced Investment Portfolio returned 34.5% in 2009, compared to a 42.1% return for the MSCI All Country World Index ex US. While individual stock selection contributed to below benchmark performance, sector, country allocation and currency were also critical factors in performance. Four of the six active international equity managers had above benchmark allocations to Japan, one of the worst performing markets in 2009, with a return of 6.3%. A weak dollar generally improved performance for U.S. investors. Our international managers were uniformly underweight financials in 2009, a large sector with above benchmark performance in global markets outside the U.S. Our Portfolio underweight to emerging markets also hurt performance, when MSCI Emerging Markets Index returned 78.5% in 2009.

## International Equity Historical Performance

The developed international equity market, as measured by the MSCI EAFE Index, had a 31.8% return in 2009. As shown on the graph below, the return is significantly above the 10-year trend line return of 1.2% and the long-term 40-year average return of 9.3% for the MSCI EAFE since 1970. International equity had negative returns in 9 out of 40 years.

### International Equity Returns in Historical Perspective January 1, 1970 – December 31, 2009



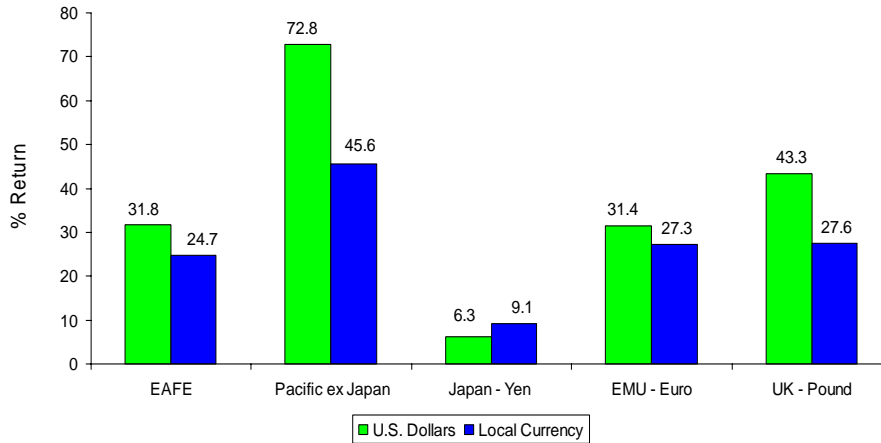
## Developed Market Performance

International stock returns in 2009 depended on both country and stock selection but, as shown in the table on the next page, currency contributed to superior returns to U.S. dollar investors. While a weaker U.S. dollar makes imported goods and vacations abroad more expensive for Americans, it helps our export industries and improves our returns since our international stocks are worth more in weak U.S. dollars than in strong local currencies.

The Japanese yen was the only major currency to weaken against the dollar, with a 2.6% decline in 2009. Many major currencies strengthened against the U.S. dollar, resulting in higher investment returns for U.S. dollar investors. The British pound appreciated by 10.8% against the U.S. dollar. This meant that an investor in a basket of stocks based in the United Kingdom and valued in British pounds had a return in 2009 of 27.6% while the U.S. dollar investor in the same stocks had a return of 43.3%.

The euro showed an increase of 2.5% for the full year but this masked the 10.5% range from an exchange rate of one euro for \$1.32 in March to one euro for \$1.46 in September. Currencies of commodity exporting countries strengthened sharply against the U.S. dollar, with the Brazilian real up 32.7% and the Australian, New Zealand, and Canadian dollars up 28.0%, 25.4% and 16.3%, respectively.

## MSCI EAFE Developed Markets U.S. Dollar Returns vs. Local Returns 2009



Source: MSCI (net)  
EMU: European Monetary Union

Country allocation was critical for success in 2009. Japan returned 6.3% while Pacific ex Japan, including Australia, New Zealand and Singapore, returned 72.8%. The table below shows the 20 year decline in the weighting of Japanese stocks in the EAFE Index compared to the increases for the rest of the developed world.

### MSCI EAFE INDEX Year-End Weight as a Percentage of Index

	<u>2009</u>	<u>1999</u>	<u>1989</u>
Europe ex U.K.	45.3%	47.4%	12.3%
United Kingdom	21.6	19.2	12.5
Pacific ex Japan	12.4	6.0	4.2
Japan	20.7	27.4	59.8

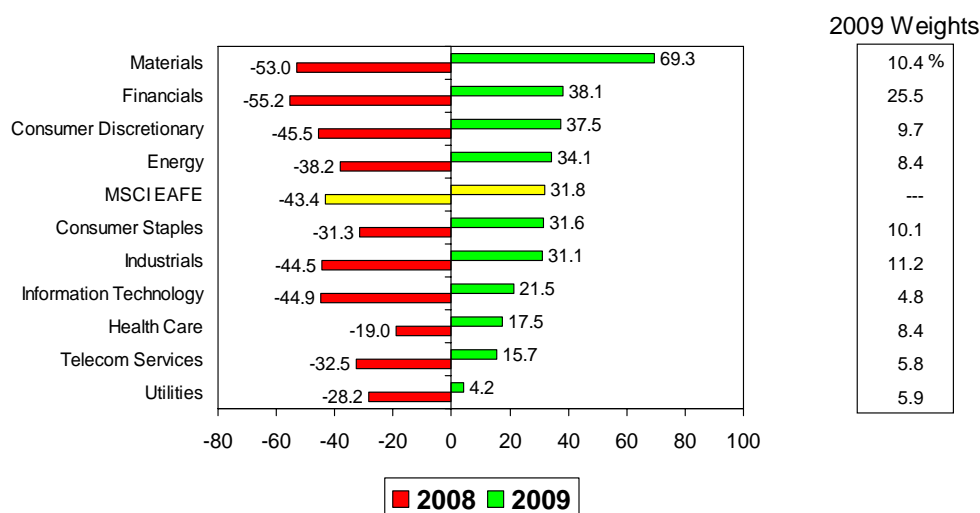
### Developed Market Sector Performance

As shown on the graph on the next page, the materials sector, with a 10.4% index weight and a 69.3% return, was the best performing sector in the MSCI EAFE Index. Financial stocks continued to be the largest sector in the EAFE Index, with a weight of 25.5% on December 31, 2009. Despite continued bank failures and scandals in the United Kingdom, Spain, and Switzerland, the 38.1% return of financial stocks provided the second highest sector return. All six active managers in the international equity component of the Balanced Investment Portfolio were underweight financials. Managers were overweight companies in the three worst performing sectors: utilities, telecommunication services and health care.

As investors review portfolio performance in 2009, it is important to appreciate the difference in composition between the Russell 3000 Index of U.S. companies and the EAFE Index of international companies. The types of companies and industries in the EAFE Index result in less sector diversification than the Russell 3000. Information technology has a 19.3% sector weight in the Russell 3000 Index. With fewer technology companies based in non-U.S. developed markets, information technology had only a 4.8% weighting in the EAFE Index.

The information technology and health care sectors combined make up 32.0% of the Russell 3000 Index. In contrast, financial companies alone comprised 25.5% of the EAFE Index, but only 14.9% of the Russell 3000 Index. While the sector return of U.S. financial companies underperformed the Russell 3000 Index return, EAFE financials outperformed the EAFE Index by 6.3 percentage points. The decision by our U.S. managers to underweight the stocks of financial companies in the Russell 3000 Index proved to be correct and helped performance, while international manager decisions to underweight financial companies detracted from their performance compared to the return of the EAFE Index.

## EAFE Index Sector Returns and Weights 2008 vs. 2009



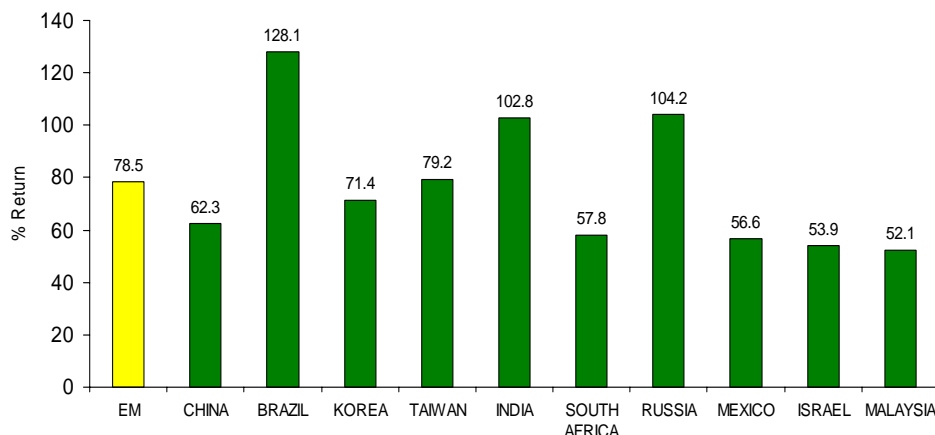
## Emerging Markets Performance

In 2008 the MSCI Emerging Markets Index returned -53.3%, the worst return in the history of the index. Emerging market countries were impacted by the collapse in global credit and the slowdown in the developed economies. The fall in oil prices from \$147 a barrel in June 2008 to below \$40 in December 2008, as well as the collapse in prices of other commodities, created currency problems for commodity exporting countries such as Brazil and Russia. However, as the price for oil and other commodities rebounded in 2009, the economies of many emerging markets proved to be more resilient than the economies of developed market countries.

Stocks in three of the four “BRIC” countries, Brazil, Russia and India, had country index returns in U.S. dollars that were significantly better than the 78.5% return of the MSCI Emerging Markets Index. Brazil returned 128.1%, assisted by a 32.7% increase in the value of the real

against the U.S. dollar. Russia returned 104.2%, India, 102.8% and China, 62.3%, all with minimal currency impact.

### Ten Largest Emerging Market Countries by Market Capitalization 2009 Returns in U.S. Dollars



Source: MSCI Emerging Markets Index (with dividends reinvested, net)

In 2003, the BRIC countries were identified by economists and investment bankers as those emerging countries with large populations and the ability to achieve rapid economic growth that could potentially eclipse many European and Asian developed market economies by 2050, if not sooner. In 2009, many developing countries, including China, continued to be net creditors to the rest of the world, as they used their trade surpluses and Sovereign Wealth Funds to increase overseas investments and fund internal projects for stability and long-term growth. Many emerging market countries experienced a lesser impact from the global recession than developed countries like the U.S., United Kingdom, Spain and Italy.

The growth in emerging markets has been significant over the past twenty years. The table below compares the growth in Gross Domestic Product (GDP) of emerging markets as a percentage of global GDP from 14% in 1989 to 25% in 2009. The market capitalization of companies in emerging markets as a percentage of the MSCI World Index increased from 2% in 1989 to 13% in 2009.

#### Emerging Markets Share of World GDP and Stock Market

Year-End Weight of MSCI Emerging Markets Index  
as Percentage of MSCI All Country World Index

	<u>2009</u>	<u>1999</u>	<u>1989</u>
Emerging Markets Share of World GDP	25%	17%	14%
Emerging Markets Share of Global Stock Market Capitalization	13	5	2

Source: FMRCo (MARE) 12/21/09

## The Alternative Investment Component of the Balanced Investment Portfolio

In 2007, following a year-long liquidity study, the Investment Committee approved an allocation of up to 10% in illiquid limited partnerships, including private equity, venture capital and distressed debt. The 10% includes market value plus any committed capital not yet invested. Liquid, marketable alternatives, including Real Estate Investment Trusts (REITs) and real return strategies, could be up to 5% of the Portfolio.

In 2008, valuations of public market securities collapsed just as new accounting standards required that limited partnerships reflect the valuation of public market securities as part of any process used to establish the fair market value of private market investments. As a result of market conditions and new valuation standards, the allocation to illiquid limited partnerships was reached in 2008 and no new commitments were made in 2009.

As shown on the table below, private equity and venture capital provided negative returns in 2009. This was primarily due to the timing of reporting. Virtually all limited partnerships report results on a three month lag. This meant that negative performance for the fourth quarter of 2008 was reported in 2009 and reflected in 2009 performance. The Board of Pensions began investing in alternatives in 1998.

The investments in real return strategies were initiated in 2005 to provide protection under conditions of increasing inflation. Inflation has not been a problem and those strategies reduced portfolio performance until 2009, when commodity price returns added value to real return strategies.

### ALTERNATIVE INVESTMENT PERFORMANCE HIGHLIGHTS PERIODS ENDED DECEMBER 31, 2009

	<u>Annualized Rate of Return</u>				
	<u>1 Year</u>	<u>2 Years</u>	<u>3 Years</u>	<u>5 Years</u>	<u>10 Years</u>
<u>Private Partnerships:</u>					
Private Equity	-4.9	-4.6	8.0	15.5	13.4
Distressed Debt	16.1	2.0	3.4	2.0	9.5
Venture Capital	-11.6	-7.4	-2.7	-1.8	n/a
Total Private Partnerships	2.4	-2.2	6.1	9.4	12.4
Russell 3000 + 5% Annually	34.2	-6.1	-1.0	5.5	4.5
<u>Inflation / Real Return:</u>					
Real Return	35.9	-0.8	2.3	n/a	n/a
REITs	22.2	-19.5	-18.6	n/a	n/a
Total Inflation / Real Return	29.4	-8.1	-7.3	n/a	n/a
CPI + 5% Annually	7.7	6.4	7.3	7.6	7.5
<b>Total Alternatives</b>	<b>7.0</b>	<b>-5.6</b>	<b>0.1</b>	<b>4.0</b>	<b>9.6</b>

## Portfolio Accounting

We measure the total return on the Balanced Investment Portfolio using the actual market value of assets held on January 1, 2009, and the actual market value of assets held on December 31, 2009. The beginning asset value is increased by interest income and dividends and decreased by fees and benefits paid during the year. During 2009 the Portfolio received \$166 million in interest income and dividends and paid \$263 million in benefits in excess of dues. The Portfolio had net unrealized gains of \$1,495 million due to increases in the market value of securities still held in the Portfolio on December 31, 2009.

### MARKET VALUE RECONCILIATION BOARD OF PENSIONS BALANCED INVESTMENT PORTFOLIO

	<u>\$Millions</u>
Market Value on January 1, 2009	\$5,387
Net Income	166
Net Realized Gain/(Loss)	(282)
Net Unrealized Gain/(Loss)	1,495
Cash Flows into Portfolio	3
Benefit Payments in Excess of Dues	(263)
Investment and Custody Fees	<u>(16)</u>
Market Value on December 31, 2009	\$6,490

## Plan and Program Participation

The assets of the Board of Pensions Balanced Investment Portfolio are unitized so that each participating plan and program owns units in the portfolio rather than individual securities. This reduces the investment and custodial fees for all plans and programs. The valuation of units is done monthly by BNY Mellon, custodian for all assets, using an accounting process similar to that used to develop the net asset value of a mutual fund. Plans, with the exception of the Assistance Fund, Medical Plan Long-Term Reserve and Medical Plan Contingency Reserve own only units of the Portfolio. All other plans and programs have the same asset allocation and investment performance as the Balanced Investment Portfolio, dependent upon the time the plan or program adopted a 100% allocation to the Portfolio.

The Assistance Fund and Medical Reserves own units of both the Board of Pensions Balanced Investment Portfolio and the Board of Pensions Fixed Income Portfolio. The Fixed Income Portfolio, valued at \$42 million on December 31, 2009, can be used by plans and programs with differing investment horizons, enabling us to customize their long-term asset allocation.

The table below shows the market values of plans and programs participating in the Board of Pensions Balanced Investment Portfolio and the Board of Pensions Fixed Income Portfolio at BNY Mellon.

### PLAN AND PROGRAM PARTICIPATION December 31, 2009

	<u>\$Millions</u>	<u>% of BOP Balanced Investment Portfolio</u>
<b>Plan and Program Participation</b>		
<b>Board of Pensions Balanced Investment Portfolio</b>		
Pension Plan	\$5,842	90.02%
Death and Disability Plan	521	8.03
Supplemental Death Benefit Plan	20	0.30
Medical Plan Long-Term Reserve	22	0.33
Medical Plan Contingency Reserve	6	0.09
Endowment Fund	16	0.24
Benefit Supplement Fund	24	0.38
Retirement Housing Fund	12	0.18
General Assistance Fund	19	0.30
Chaplains Deposit Fund	3	0.04
Restricted Gifts Fund	<u>5</u>	<u>0.08</u>
<b>Board of Pensions Balanced Investment Portfolio</b>	<b>\$6,490</b>	<b>100.00%</b>
<b>Board of Pensions Fixed Income Portfolio</b>	42	
<b>Total Investments at BNY Mellon</b>	<b>\$6,532</b>	

The Assistance Fund, Medical Plan Long-Term Reserve and Medical Contingency Reserve own units of the Board of Pensions Balanced Investment Portfolio and the Board of Pensions Fixed Income Portfolio. The GAC Special Cuban Fund and the SR Plan, which each have total assets of less than \$1 million, are not shown on the table.

Note: Due to rounding, percentages may not total 100%.

## Partnerships We Can Be Proud Of

The Board uses multiple investment managers for each asset class in the Board of Pensions Balanced Investment Portfolio. Staff and the Investment Committee evaluate, retain and monitor managers for specific assignments within the total portfolio. The managers are responsible for the selection of individual securities or companies for their portfolios.

**Custodian:** The Bank of New York Mellon Corporation, Pittsburgh, PA

### U.S. Equity

Adage Capital Management, Boston, MA  
AllianceBernstein LP, Chicago, IL  
Arbor Capital Management LLC, Minneapolis, MN  
BlackRock Institutional Trust Company, San Francisco, CA  
Barrow, Hanley, Mewhinney and Strauss, Inc., Dallas, TX  
John W. Bristol & Co., Inc., New York, NY  
Dodge & Cox, San Francisco, CA  
PRIMECAP Management Company, Pasadena, CA  
T. Rowe Price Associates, Inc., Baltimore, MD  
Royce & Associates LLC, New York, NY  
Wasatch Advisors, Salt Lake City, UT

### International Equity

Capital Guardian Trust Company, Los Angeles, CA  
Franklin Templeton Institutional, Fort Lauderdale, FL  
Genesis Investment Management, London, UK  
McKinley Capital Management, Inc., Anchorage, AK  
Marathon Asset Management LLP, London, UK  
Walter Scott & Partners Limited, Edinburgh, UK  
Silchester International Investors Limited, London, UK  
Tweedy, Browne Company LLC, New York, NY

### Fixed Income

BNY Mellon Cash Investment Strategies, Pittsburgh, PA  
Capital Advisors, Lancaster, PA  
Dodge & Cox, San Francisco, CA  
GMO, Boston, MA  
Oaktree Capital Management LP, Los Angeles, CA  
Pacific Investment Management Company, Newport Beach, CA  
Reams Asset Management Company, Inc., Columbus, IN

### Alternative Investments in Private Equity, Distressed Debt, Venture Capital, Natural Resources/Energy, Real Estate and Real Return Strategies

Bridgewater Associates, Inc., Westport, CT  
Capital International Investments, Los Angeles, CA  
The Carlyle Group, Washington, DC  
Cerberus Capital Management LP, New York, NY  
Commonfund Capital, Inc., Wilton, CT  
Kolberg Kravis Roberts & Company, New York, NY  
Madison Dearborn Partners LLC, Chicago, IL  
Oaktree Capital Management, Los Angeles, CA  
Riverstone Holdings LLC, New York, NY  
Silver Lake Partners, Menlo Park, CA  
Templeton Asset Management Ltd., Fort Lauderdale, FL  
Värde Partners, Inc., Minneapolis, MN  
Warburg Pincus LLC, New York, NY  
Wellington Management Company LLC, Boston, MA  
Whippoorwill Associates, Incorporated, White Plains, NY  
Wind Point Partners, Chicago, IL  
Yorktown Partners LLC, New York, NY

## Commentary and Outlook for 2010

The decade that ended December 31, 2009 has been named by some the decade of the naughts as well as aughts. For many investors, it was a lost decade. As shown in the table below, investors in growth stocks of large U.S. companies lost 4% a year compounded annually for the decade. However, there were a few bright spots, most notable emerging market stocks, up 10.1% annually, and emerging market bonds, up 10.9% annually.

### JANUARY 1, 2000 – DECEMBER 31, 2009 Ten Year Compound Annual Investment Returns

	<u>%</u>
Russell 1000 Growth	(4.0)
S&P 500	(0.9)
MSCI EAFE Index	1.2
Barclays Capital Long US Govt/Credit Index	7.7
Russell 2000 Value	8.3
MSCI Emerging Markets Index	10.1
S&P REIT Index	10.8
JPM Emerging Markets Bond Index	10.9

The Balanced Investment Portfolio had a return of 3.5% for the decade, above the asset mix policy benchmark of 3.0% but falling short of the 7.5% return of the CPI plus 5%. Obviously we would have had a higher return if we had ignored the possibility of tail risk and invested the entire portfolio in emerging markets.

We have several missions, and risk management is as integral a part of our stewardship as superior portfolio management. While difficult if not impossible to protect the Balanced Investment Portfolio from tail risks with a probability of 0.3% or less, tail risk is real. Investors should recognize that in an interconnected global economy, we will have more rather than fewer systemic global shocks on an increasingly regular basis. We need to be mindful of what could be tail risk events and the potentially devastating impact on investment portfolios. The possible, improbable and impossible are with us every day as part of a normal distribution of events. As always, the hard part is to know where we are on the curve today and where we could be tomorrow.

- We believe 2010 will be a challenging year for investors. The U.S. economy remains in a recession. It will take several years for job markets to stabilize; consumer, business and government credit balances to begin to rebuild; and the housing industry to rebound. Forecasting stock market returns is for the foolhardy but a range of negative 10% to positive 10% is appropriate for global stock portfolios in 2010.
- We expect longer duration fixed income assets will be less attractive in 2010 as interest rates begin to slowly increase. Spreads have narrowed on high yield and investment grade corporate bonds, reducing opportunities in credit in 2010. Selective investment in distressed debt will continue to provide attractive opportunities.
- The Investment Committee and staff will continue to evaluate inflation and real return strategies that could help to maintain the purchasing power of our retirees in periods of inflation and stagflation.

- We will use short-term market outperformance or volatility in individual asset classes to raise cash to pay benefits. Benefit payments will require cash in excess of dues of more than \$263 million in 2010.
- We are long-term investors. We have a long-term strategic asset allocation based on our liabilities or the promised benefits to our Plan members. We will not increase portfolio risk by using short-term trading strategies to improve investment performance.
- We are socially responsible investors and partner with the denomination's Committee on Mission Responsibility Through Investment (MRTI) to assist in the mission of the denomination on issues of corporate governance and social responsibility.
- We will faithfully pursue the goals of our assigned mission, recognizing the needs of those we serve in the Presbyterian Church (U.S.A.).

January 27, 2010

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The 2009 **Investment Review** was prepared by the Investment Team of the Board of Pensions of the Presbyterian Church (U.S.A.)

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