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○ OCTOBER 2008

○ FIRE AND POLICE RETIREMENT SYSTEM

# Retirement *quarterly*

## CFRS RESPONDS TO FINANCIAL CRISIS

### RETIREMENT BENEFITS SECURE AMID MARKET DOWNTURN

Please be assured that **NO** City of Fresno Retirement Systems (“CFRS”) members’ or retirees’ benefits are in jeopardy even though we are currently experiencing unprecedented volatility in the global financial markets. CFRS has sufficient assets and reserves to more than adequately weather this financial storm and pay accrued benefits for members and retirees for many decades. According to our most recent actuarial valuation, the Employees Retirement System was

approximately 148% funded and the Fire and Police Retirement System was approximately 130% funded making them the two highest funded public pension systems in California. Given the current negative market conditions, it is expected that our funding status will be somewhat reduced in the near future, but given our current funding status, it should be without impact to our members base benefits. The markets will likely have a negative impact on the Post Retirement Supplemental Benefit (“PRSB”) paid to retirees which are not currently known. The Retirement Boards will likely have their actuary study the projected impacts on contribution rates and the PRSB benefit amount once the investment markets stabilize.

**CFRS consists of two separate defined benefit plans that, by law, guarantee lifetime retirement benefits for its members.**

All institutional investors have suffered significant paper losses as a result of the recent stock market fluctuations. However, a snapshot taken on any one day or week is likely to be misleading due to the unprecedented market volatility. As an example, on October 13, 2008, the DOW index closed up over 936 points returning over 11% for the day.

### HOW THE FINANCIAL CRISIS DEVELOPED

Today’s credit crisis stems from a variety of causes that trace back in our markets over the last 5-10 years.

They include:

- Excessive optimism on the part of mortgage borrowers.
- Independent mortgage brokers made many bad loans focusing on quantity rather than quality of loans issued.
- Housing boom was driven by faith in an endless rise in home prices which in truth is not sustainable.

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## Retirement Staff is Growing

In October 2008, Mr. Alberto Magallanes Jr. (*pronounced ma-ga-ya-ness*) joined the Retirement Staff. Albert was hired as Senior Accountant-Auditor to oversee and monitor the Retirement Office's accounting and internal controls.

"Albert" graduated from California State University Fresno in June 2004 with a degree in Business Administration, Accounting option. He has served as the lead auditor for four school districts, participated in multiple single audits of State Grants and Funds, including the reporting of investment income.

Albert was born in Fresno, raised in Firebaugh, and now resides in Fresno. His hobby is jogging and he is looking forward to a winning year for the San Francisco Forty Niners ... in **2009!**

### New Board Member Sworn-In

In September, **Mr. Oscar G. Williams** was sworn-in to serve as the Outside Board member on the Fire and Police Retirement Board. A recruitment was conducted due to the resignation of Dr. K.C. Chen.

As a retired Finance Officer, Mr. Williams has many years of experience to support the Retirement Board. His service to the community has been without limits. To name a few, he volunteers for CASA, Big Brothers/Big Sisters, San Joaquin Rehab Center, United Way and the Housing Authority. In his spare time, he has written two books, working on two more, he is a private pilot and the proud owner of a Gold Wing motorcycle; and of course, there is always time for tennis and golf.

The Outside Board member is appointed by a majority vote from the four existing members and term is continuous.

### Status of Investment Committee Projects

In July, the Boards approved Phase I of the new Asset Allocation Plan which increases the target allocation from 20% to 30% for international equity (developed and emerging market) portfolios and reduces domestic equity (large and small cap) from 40% to 30%. The Boards also approved the Investment Committee's recommendation to rebalance domestic equity with the termination of the Goldman Sachs Enhanced Large Cap Equity portfolio and further reductions of all domestic large cap equity portfolios as necessary to fund the maximum amount to international equity.

The Boards' approved the Committees' recommendation to retain four new international equity managers and to terminate the interim BGI International Alpha Tilts and Genesis Emerging Markets international equity portfolio managers based upon the outcome of the international equity (developed and emerging markets) manager search. Effective September 1, 2008, the Boards' hired Baillie Gifford and Principal Global to manage international equity (ACWlxUS and EAFE) mandates respectively; and hired Batterymarch and Wellington to manage international emerging markets equity portfolios.

The Investment Committee conducted a core and value added real estate manager search as part of its preliminary evaluation for Phase II implementation of the new Asset Allocation Plan which increases the real estate allocation from 10% to 15% and lowers the System's total allocation to fixed income from 30% to 25%. Given the current state of the economy, the Investment Committee will continue to evaluate the real estate market conditions before moving forward with a recommendation and proposal concerning real estate opportunities.

### The Economy

The fallout from the credit crisis which began in August 2007 with sub-prime mortgage defaults has continued with rising home foreclosures and the ensuing tightening of credit which severely impacted less credit worthy individuals, companies, banks and investment banks. The Bear Stearns collapse and sale in March was followed in September with the Lehman Brothers bankruptcy and the unraveling of the financial system stemming from the brokerage and investment bank debacle. The forced sale of Merrill Lynch, takeovers of Wachovia and Washington Mutual and the historic closing of the nation's oldest money market fund (Reserve Primary Fund) have all led to a lack of confidence in the global financial markets.

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Just a reminder of the option that allows you to leave a continuance to your new spouse or domestic partner, after you have retired. Within six months from the date of your new marriage or domestic partnership registration, you can request a calculation from the Retirement Office.

**There is a one-year waiting period before your election becomes effective;** however Board Policy now governs your ability to change your mind during that waiting period. Once you have chosen your new option, if circumstances are such that you

# REMINDER

## Marriage after Retirement Option

change your mind, you may rescind your election.

If you change your mind *during the first six months of the one year waiting period*, then decide you want to make the election after all, you may begin the waiting period where you left off, complete the year waiting period, and have your election become effective. If you change your mind *during the*

*second half of the one year waiting period* and rescind your election, then decide to reinstate it, you will begin the one-year waiting period at the beginning and have to wait a full year for the election to become effective.

If you have questions regarding the Post Retirement Marriage option, please call a Retirement Counselor at (559) 621-7080.

### FINANCIAL CRISIS

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- Excessive leverage among lenders. Some experts allege that the investment banks and other financial institutions holding the packages of mortgage securities didn't know how much their portfolios had been leveraged.
- Insufficient understanding of financial innovations that developed during this time.
- Little regulatory oversight and supervision.

Investment banks pulled the stock market down with them. Lenders tightened credit, reducing the flow of money needed to keep the economy moving. Many investors cashed out their stocks, reducing share values.

### NEXT STEPS TO FIX THE MARKET

- Continuing federal action is needed to restore stability -- step by step, market by market -- to remove leveraging and take losses.
- The federal rescue plan is a positive first effort of what should be a comprehensive, thoughtful review of the federal role in overseeing the financial markets. The focus should be on solving the problem and implementing the lessons learned.
- There's talk in Washington, D.C., of changing the regulatory environment to eliminate gaps in oversight and make it more comprehensive. These changes might entail stronger capitalization rules, realistic

leveraging limits, and better reporting rules.

CFRS is a long-term investor with a well diversified conservative portfolio. Our Asset Allocation Plan targets 60% of our holdings in equities, 25% in fixed income and 15% in real estate. CFRS's portfolio is global and holds securities in well-established and fundamentally sound companies. Since we don't have all our eggs in one basket, we can soften stock market losses by investments in other asset classes. CFRS is diligently monitoring all investments and taking advantage of opportunities on a risk controlled basis.

We expect the investment markets to eventually recover from this volatility, although it is not clear when a full recovery will take place.

## Investment News

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Despite the challenges that the economy faces which appear to be even more profound than a recession and financial crisis, the Retirement Systems remain very well funded and have provided a solid rate of return from a long-term perspective.

### Investment Performance of the Systems

For the current twelve months ending September 30, 2008 our System's cumulative investment returns were -17.17 percent. However, our long-term investment results remain fairly solid with annualized returns of 8.37 percent over the past fifteen years. For the past five years the System's annualized return was 6.93% which compares favorably with the five year return of the SP 500 return of 5.17%, the Russell 2000 Growth return of 6.63%, MSCI EAFE International Index return of 10.16 and the Lehman Aggregate bond index of 3.78%.

As of September 30, 2008, the Retirement System's portfolio had 55.5 percent in equities, 32.6 percent in fixed income, 12.0 percent in public and private open ended real estate investment funds. The investments were further diversified into the following asset classes and target percentages:

	<u>Actual</u>	<u>Target</u>
Large-Cap equities	21.9%	22.5%
Small-Cap equities	8.7%	7.5%
International equities	21.2%	25.0%
Emerging Market equities	3.6%	5.0%
Domestic fixed income	27.8%	25.0%
High Yield fixed income	4.8%	5.0%
Real estate	<u>12.0%</u>	<u>10.0%</u>
Total	<u>100%</u>	<u>100.0%</u>

This asset class diversification along with portfolio investment style diversification is all part of the Retirement Board's Investment Risk Management Program.