
Board of Investment Trustees



Montgomery County Employee Retirement Plans

Annual Report

Fiscal Year ending June 30, 2011

Overview

March 15, 2012

To: Employees, Retirees, and Beneficiaries

From: Board of Investment Trustees

The mission of the Board of Investment Trustees is to manage prudent investment programs for the members of the Employee Retirement Plans and their beneficiaries. The County's Chief Administrative Officer is responsible for overseeing the day-to-day administration of the retirement plans.

We are pleased to present this annual report for the fiscal year ending June 30, 2011 on the three investment programs established for the retirement plans.

- The Employees' Retirement System (ERS) is a defined benefit pension plan with net assets of \$ 2,897.2 million, established in 1965 and closed to employees hired on or after October 1, 1994, except public safety bargaining unit employees and employees electing to participate in the Guaranteed Retirement Income Plan (GRIP). As of June 30, 2011 the ERS had 5,515 active participants and 5,712 retirees and beneficiaries receiving benefits.
- The Retirement Savings Plan (RSP) was established in 1994 as a defined contribution plan providing benefits to all non-public safety and certain public safety employees hired on or after October 1, 1994. As of June 30, 2011 the RSP had \$185.0 million in net assets and 4,509 (3,747 active and 762 inactive) participants.
- The County Deferred Compensation Plan (DCP) is a voluntary plan established pursuant to Section 457 of the Internal Revenue Code. As of June 30, 2011 the DCP had \$273.9 million in net assets and 3,492 participants.

Shown below is a condensed presentation of the Net Assets and Change in Net Assets from the Comprehensive Annual Financial Report for the retirement plans for the period ending June 30, 2011:

Net Assets (Millions)						
	ERS		RSP		DCP	
	2011	2010	2011	2010	2011	2010
Assets:						
Cash and investments	\$ 3,153.5	\$ 2,656.1	\$ 183.4	\$ 131.9	\$ 272.3	\$ 228.6
Receivables	28.8	23.1	1.7	1.6	1.6	1.4
Total assets	3,182.3	2,679.2	185.1	133.5	273.9	230.0
Liabilities	285.1	236.5	0.1	-	-	-
Total net assets	\$ 2,897.2	\$ 2,442.7	\$ 185.0	\$ 133.5	\$ 273.9	\$ 230.0

Change in Net Assets (Millions)						
	ERS		RSP		DCP	
	2011	2010	2011	2010	2011	2010
Additions:						
Employer contributions	\$ 109.3	\$ 114.0	\$ 16.0	\$ 16.4	\$ -	\$ -
Member contributions	18.6	20.4	8.7	8.8	17.0	17.0
Transfer of member account asset balances	-	31.5	-	(31.5)	-	-
Net investment income	510.0	304.2	32.9	14.2	43.0	19.4
Total additions	637.9	470.1	57.6	7.9	60.0	36.4
Deductions:						
Benefits	178.8	169.1	-	-	-	-
Refunds and distributions	1.5	1.4	5.9	3.9	16.2	8.7
Administrative expenses	3.1	2.9	0.2	0.2	-	-
Total deductions	183.4	173.4	6.1	4.1	16.2	8.7
Total change in net assets	\$ 454.5	\$ 296.7	\$ 51.5	\$ 3.8	\$ 43.8	\$ 27.7

For detailed information on all three retirement plans, please visit the Board's web site at www.montgomerycountymd.gov/bit. For questions, please call the Board office at 240-777-8220.

Board of Investment Trustees

Kelda J.C. Simpson
Chair
Public Representative
Term Expires March 2011

Gino Renne
Vice Chair
OPT/SLT Bargaining Unit Designee

George Willie
Public Representative
Term Expires March 2011

Joseph F. Beach
Montgomery County Director of Finance
Ex-Officio Member

Jeffrey D. Buddle
Fire & Rescue Bargaining Unit Designee

J. Lodge Gillespie, Jr.
Montgomery County Council Representative
Term Expires March 2012

Sunil Pandya
Montgomery County
Department of Liquor Control
Non-Bargaining Unit Representative
Term Expires March 2011

Joseph Adler
Secretary
Montgomery County Director
Of Human Resources
Ex-Officio Member

Walter E. Bader
Police Bargaining Unit Designee

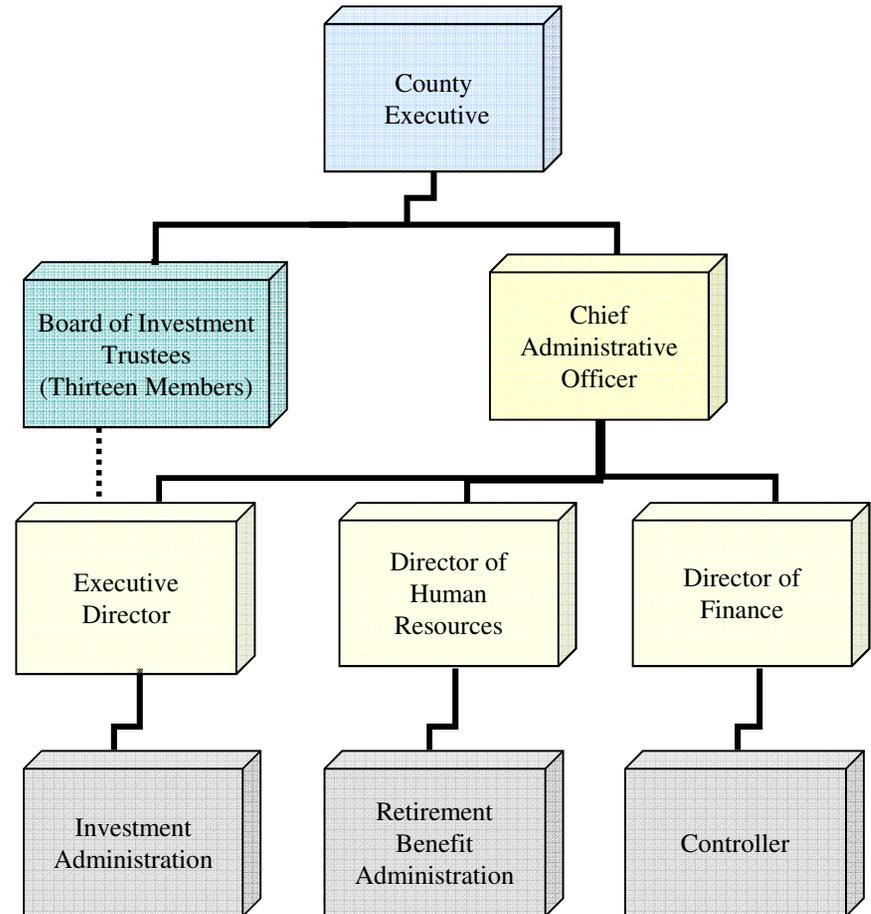
Jennifer A. Hughes
Montgomery County Director of
Management and Budget
Ex-Officio Member

Stephen B. Farber
Montgomery County Council Staff Director
Ex-Officio Member

Jeffrey Sharpe
Montgomery County Council Representative
Term Expires March 2011

Mary E. Menke
Retired Employees Representative
Term Expires March 2012

Retirement Plans Administrative Organization



Board Actions

- ***Employees' Retirement System (includes GRIP)***
 - *Continued to add new investments in private equity and real assets, including a natural resources fund.*
 - *Restructured the U.S. equity allocation and expanded the guidelines of fixed income managers to allow them to pursue additional market opportunities.*
 - *Enhanced the risk budgeting capabilities to provide support for recommendations on asset allocation, portfolio structure and manager weightings.*
 - *Revised the Board's Rebalancing Policy to include bands around both asset and sub-asset classes, as well as the rebalancing methodology.*
- ***Retirement Savings Plan***
 - *Instituted lower fees on 12 Fidelity Lifecycle funds.*
 - *Reduced expenses for Plan administration by implementing streamlined distribution options.*
 - *Expanded the Self Directed Brokerage Account to allow the purchase of ETFs, stocks, bonds, and CDs, in addition to mutual funds.*
- ***Deferred Compensation Plan***
 - *Held annual benefit fair to provide a forum for participants to ask questions about the Plan and gain additional information on investment options directly from investment firms.*
 - *Reduced expenses for Plan administration by implementing streamlined distribution options .*
 - *Instituted lower fees on 2 funds – the PIMCO High Yield Fund and Oppenheimer Global Fund.*
 - *Expanded the Self Directed Brokerage Account to allow the purchase of ETFs, stocks, bonds, and CDs, in addition to mutual funds*

Board Achievements

- ***Certificate of Achievement for Excellence in Financial Reporting***
 - *The Government Finance Officers Association (GFOA) awarded the Certificate of Achievement to the Board for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2010. The certificate of achievement is a prestigious national award that recognizes conformance with the highest standards in government accounting and financial reporting. The Board has received this award for each of the eleven years that it has published its own CAFR.*
- ***Employees' Retirement System***
 - *The ERS' investment return for the year ended June 30, 2011 was a gain of 21.77% . The ERS return ranked in the 41st percentile or better than 59% of returns achieved by similar public pension funds reporting results for the one year period. For the three and five year periods, the Board ranked in the 33rd percentile and 5th percentile of the universe, respectively.*
- ***Retirement Savings Plan***
 - *As of June 30, 2011 24% of the funds offered through Fidelity were rated as four or five star funds by Morningstar (five star is the highest rating). The one year return for the Plan was a gain of 22.60%.*
- ***Deferred Compensation Plan***
 - *As of June 30, 2011, 52% of the funds offered through ING were rated as four or five star funds by Morningstar (five star is the highest rating). The one year return for the Plan was a gain of 18.11%.*

Current Board Initiatives

■ ***Employees' Retirement System (includes GRIP)***

- *Determine the feasibility of introducing new strategies such as global equities and REITs to improve risk adjusted returns and operational efficiencies.*
- *Utilize various risk budgeting tools to analyze, evaluate, and monitor the risk of each investment manager/sector in the ERS portfolio to achieve the highest possible risk adjusted return within an acceptable level of risk.*
- *Continue to build out the private equity, private real assets, and opportunistic allocations.*
- *Provide the payment of annuities to retirees and beneficiaries via the County's PeopleSoft and Oracle Systems to streamline business processes, implement industry best standards, and provide the best controls over funds and expenses.*

■ ***Retirement Savings Plan and Deferred Compensation Plan***

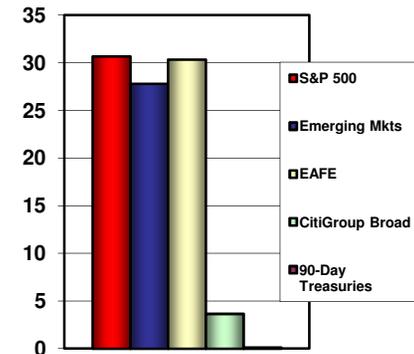
- *Conduct a search to select a consultant to provide assistance to Staff in consolidating record keepers with the goal of minimizing fees paid by participants while streamlining services to meet participant needs.*
- *Continue to expand investment counseling services to further assist participants in preparing for retirement by personalizing the materials to meet their individual needs.*
- *Evaluate investment fund line-up offered to participants to ensure that a diversified slate of top quality funds is available at the lowest possible fee.*
- *Review the lifecycle fund offerings to determine if structuring a custom fund offering is viable based on the demographics of each plan.*

Market Highlights – ERS Investment Performance

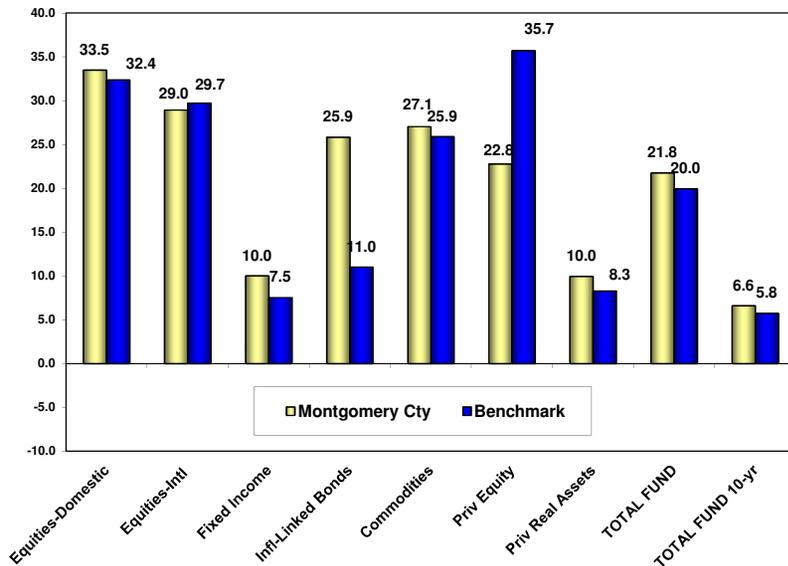
The economy continued to improve in FY11 but the pace of economic growth remains slow with GDP rising at just a 1.3% annual rate. The manufacturing sector, as measured by the ISM composite, expanded throughout the fiscal year. CPI rose 3.6%, increasing inflationary concerns. However, excluding volatile food and energy prices, core CPI rose a modest 1.6%. The unemployment rate remained above 9.0% and personal incomes had near-zero growth. The Federal Reserve maintained their target range of 0% to 0.25% throughout the year and announced that they would likely maintain “exceptionally low levels of the federal funds rate at least through mid-2013.” The Fed also took other measures to add liquidity to the markets through the purchase of Treasury and mortgage securities to help stimulate the economy.

The equity markets posted strong positive performance in FY11. The S&P 500 Index returned 30.7% and the MSCI Europe Asia Far East (EAFE) Index rose 30.4%. Emerging markets also performed strongly, rising 27.8% and commodities, as measured by the DJ UBS Commodities Index, rose 25.9%. The Treasury yield curve steepened with short rates falling while longer dated yields rose. Credit spreads continued to tighten which helped the fixed income markets post positive performance for the fiscal year. The CitiGroup Broad Investment Grade Index increased 3.7% and the Merrill Lynch High Yield Index increased 15.3%. Long duration bonds, as measured by the Barclay’s Capital U.S. Long Government/Credit Index, returned 3.2% during the fiscal year.

Index Returns
Year Ending 6/30/11



Employees' Retirement System
FY 2011 Returns by Asset Class-Gross of fees



The Board allocates ERS assets to a broad array of investment sectors resulting in the following allocation as of June 30, 2011: domestic equities 26.5%, private equity 7.3%, international equities 18.3%, fixed income 24.8%, opportunistic 2.8%, global inflation index bonds 10.8%, commodities 5.3% and private real assets 4.2%. The chart to the left reflects the returns for the fiscal year ending June 30, 2011 achieved by ERS assets in each investment sector compared to the corresponding benchmark. The Board establishes benchmarks for each market sector, usually an index of securities that represent most of the available investment opportunities within that sector, to evaluate the performance of the investment managers within each sector.

In overseeing the management of ERS assets, the Board has developed sound and prudent investment policies. The Board works to control the risk to which the ERS is exposed while maximizing the potential for long term increases in the value of the assets. The Board’s specific investment objectives are to:

- realize the actuarial assumed rate of return of 7.5 percent annually, over a long term time horizon (for the 2002-2011 fiscal year decade, the annual rate of return on the ERS’ investments was 6.6% before fees);
- manage portfolio risk to limit potential downside fluctuations in the value of the total ERS assets; and
- realize as high a rate of total return as possible consistent with the above.

Employees' Retirement System (ERS)

- **How do I know if I'm a participant in the ERS defined benefit plan?**

Employees who participate in the ERS have the following description on their pay stub next to the bi-weekly contribution amount: RETIRE

- **How do I know if I'm a participant in the GRIP?**

Employees who participate in the GRIP have the following description on their pay stub next to the bi-weekly contribution amount: RET GRI

- **How is my benefit calculated?**

If you are in the ERS (RETIRE on paystub), under County law your benefit is based on your salary, years of credited service, and age at retirement and is not based on the amount you contributed or the investment earnings of the ERS. If you are in the GRIP, your benefit is based on your account balance at time of retirement or separation of service from County.

- **How can I find more information on my benefit?**

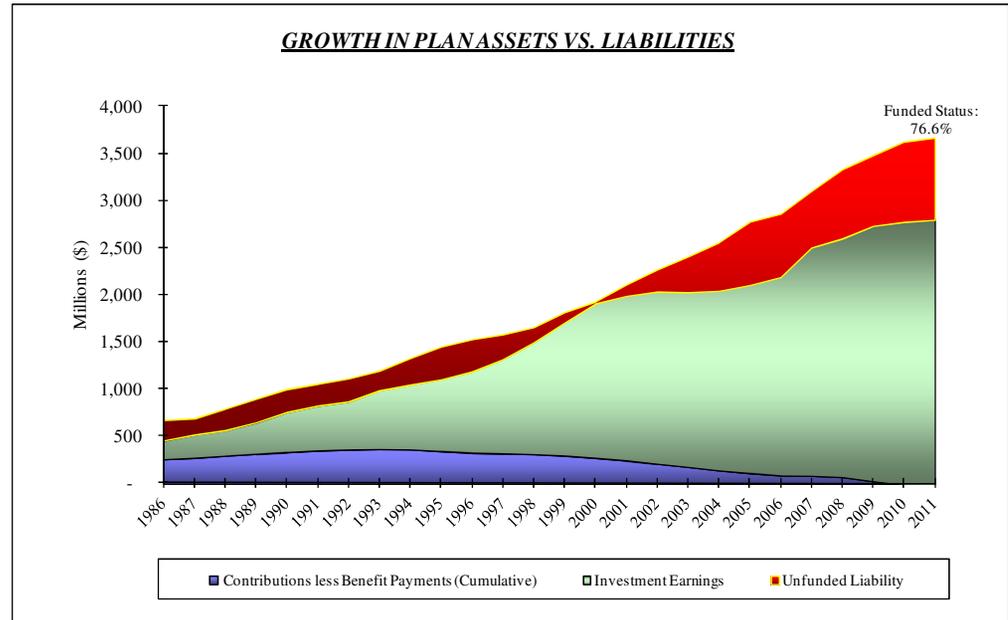
Contact the Office of Human Resources at 240-777-5120.

- **How does the amount earned on invested assets impact the ERS?**

While your ERS benefit is paid in accordance with County law, you may be interested in knowing about the status of the assets and liabilities of the ERS. Please refer to the chart below for a 25-year history. Your contributions, along with the County's, are used primarily to make benefit payments to retirees and beneficiaries and pay other costs associated with the administration of the ERS (shown as the bottom layer in the chart).

The earnings (shown as the green middle layer in the chart) represent the bulk of the growth in assets over the years. In funding the ERS, the County assumes the assets will earn 7.5% per year. During the strong equity markets of the late 1990s, the assets grew at nearly double that amount, and the funded status of the ERS was strengthened.

As of June 30, 2000 the ERS was nearly fully-funded, but because of the difficult financial markets in 2000-2002 and increased liabilities for higher future benefit payments, the funded status decreased. As of June 30, 2011, the ERS was 76.6% funded. The area shown as the top layer reflects the additional amount required (\$875 million) for the ERS to achieve fully-funded status. As noted earlier, the Board continues to implement sound and prudent investment policies that will maximize the potential for long-term increases in the value of the assets.



Retirement Savings Plan (RSP)

The County established the Retirement Savings Plan for all non-public safety and certain public safety employees not represented by a collective bargaining agreement hired after October 1, 1994. The Plan requires employees to contribute 4% of regular earnings up to the Social Security wage base and 8% above the wage base and public safety employees to contribute 3% up to the Social Security wage base and 6% above the wage base. During FY11, the County contributed 8% and 10% of regular earnings for non-public safety and some public safety employees, respectively.

How do I know if I'm a participant in this plan?

Employees who participate in the RSP have the following description on their pay stub next to the bi-weekly contribution amount: RET SAV.

How is my retirement benefit calculated?

Your benefit is based on your account balance at the time of retirement or separation of service. The balance includes your contributions, the County's contributions (if you're vested) and investment earnings.

How can I find out more information on my account balance and benefit eligibility?

Contact Fidelity Investments at 1-800-343-0860 or visit their web site at www.fidelity.com.

The Board oversees the investment program, providing a variety of investment options for participants to choose from. The Board formally evaluates these options quarterly.

The Board also provides two hours of investment counseling annually to all participants at no charge to encourage participants to expand their knowledge of investment products. Call 410-557-7300 to sign up or visit the Board's web site, www.montgomerycountymd.gov/bit.

Shown to the right is a list of the investment funds offered, along with their Morningstar rating and annualized performance as of June 30, 2011.

Fidelity's web site, www.fidelity.com, is an invaluable source of information. The web site contains:

- ✓ Your RSP account activity
- ✓ Analysis and performance information on all of the funds offered and information on investment markets
- ✓ Financial tools to assist you in determining the amount you'll need at retirement

Funds	Morningstar Rating	Rates of Return		
		1 Year	5 Year	10 Year
Stable Value Funds:				
Fidelity Managed Income	not rated	1.34	2.76	3.60
Income Funds:				
Fidelity Capital & Income	★★★★★	20.53	10.31	10.31
Fidelity Intermediate Bond	★★★	4.85	5.75	5.23
Spartan US Bond Index Investor	★★★	3.59	5.91	5.51
Fidelity Inflation-Protected Bond	★★	7.05	5.88	n/a
Balanced Funds:				
Fidelity Puritan	★★★★	22.28	4.84	5.22
Life-Cycle Funds:				
Fidelity Freedom 2000	★★★★	10.16	4.34	3.87
Fidelity Freedom 2005	★★★	16.31	4.22	n/a
Fidelity Freedom 2010	★★★	18.64	4.58	4.49
Fidelity Freedom 2015	★★★	19.13	4.40	n/a
Fidelity Freedom 2020	★★★	22.15	4.02	4.28
Fidelity Freedom 2025	★★★	24.37	3.97	n/a
Fidelity Freedom 2030	★★★	25.51	3.32	3.85
Fidelity Freedom 2035	★★★	27.37	3.22	n/a
Fidelity Freedom 2040	★★★	27.73	3.06	3.64
Fidelity Freedom 2045	★★★	28.28	3.10	n/a
Fidelity Freedom 2050	★★★	29.34	2.75	n/a
Fidelity Freedom Income	★★★	9.64	4.47	3.94
Growth & Income Funds:				
Fidelity Equity-Income	★★★	29.57	1.07	3.02
Davis New York Venture	★★★	24.51	1.55	3.96
Spartan Extended Market Index	★★★★	39.22	5.93	7.39
Spartan Total Market Index	★★★★	32.30	3.53	3.69
Spartan 500 Index	★★★	30.59	2.90	2.61
Growth Funds:				
Fidelity Contrafund	★★★★	28.21	4.96	7.14
Fidelity Growth Company	★★★★	41.56	7.65	4.69
Fidelity Low-Priced Stock	★★★★	34.29	6.10	10.35
Fidelity Small Cap	★★★	34.77	6.27	8.43
Artisan Small Cap	★★★	47.76	4.10	5.29
Northern Small Cap Value	★★★	33.97	3.37	8.15
Fidelity Value	★★	34.23	2.36	7.03
International Stock Funds:				
Fidelity Diversified International	★★★	30.50	1.43	7.30
Templeton World - A Class	★★★	30.77	2.72	6.02
Spartan International Index	★★★	32.14	1.67	5.59
Specialty Funds:				
Fidelity Strategic Real Return	★★	16.85	4.30	n/a
Fidelity Real Estate Investment	★★★	34.37	1.80	10.43

*Morningstar Ratings and 1 Year performance figures for the Life-Cycle Funds are for the Fidelity Freedom K shares. For longer time-periods, the regular Fidelity Freedom Funds performance was used.

Deferred Compensation Plan (DCP)

The County established the Deferred Compensation Plan for employees in 1980. In June 2004, the Board selected ING (formerly CitiStreet) to provide mutual and commingled fund investment vehicles for participants. The Board formally evaluates the investment performance of the funds offered quarterly. Shown below is a list of the funds available as of June 30, 2011, along with their Morningstar rating and annualized performance as of June 30, 2011. Additional information on the investment program is available on the Plan web site at <https://montgomerycountymd.ingplans.com/eportal/welcome.do> and the Board's web site at www.montgomerycountymd.gov/bit.

■ **How do I know if I'm eligible to participate in this plan?**

Non-represented employees are eligible to join the DCP at any time. Employees who are members of MCGEO, and were hired prior to March 1, 2005 and were not members of the DCP at that time, may also join the plan at any time. MCGEO members hired after March 1, 2005 are not eligible to participate. Employees represented by the FOP or the IAFF are not eligible to make contributions to the DCP.

■ **How is my retirement benefit calculated?**

Your benefit is based on your account balance at the time of retirement or separation of service. The balance includes your contributions and investment earnings.

■ **How can I find out more information on my account balance and benefit eligibility?**

Contact the ING onsite representative at 240-777-5054 or stop by the ING office located in the Executive Office Building, Office of Human Resources, 101 Monroe Street, 7th floor. Additional information is also available at the ING website at <https://montgomerycountymd.ingplans.com/eportal/welcome.do>.

Funds	Morningstar Rating	Rates of Return		
		1 Year	5 Year	10 Year
Stable Value Funds:				
SEI Stable Asset	not rated	0.44	2.39	3.24
Income Funds:				
Fidelity Inflation-Protected Bond	★★	7.05	5.88	n/a
Goldman Sachs Short Gov't Fund	★★★★	1.33	5.10	4.37
Hartford Bond	★★★	4.61	5.30	5.58
PIMCO High Yield	★★★★	13.85	7.90	7.87
SSgA U.S. Bond Index	not rated	3.84	6.56	5.65
Life-Cycle Funds:				
BlackRock Lifepath Retirement	★★★★	14.53	5.39	5.26
BlackRock Lifepath 2020	★★★★	20.44	4.03	4.34
BlackRock Lifepath 2030	★★★★	24.92	3.27	3.90
BlackRock Lifepath 2040	★★★	28.84	2.55	3.46
BlackRock Lifepath 2050	★★★	32.26	n/a	n/a
Growth & Income Funds:				
Hartford Dividend & Growth	★★★★	28.98	4.49	5.17
SSgA S&P 500 Index	not rated	30.53	2.87	2.61
SSgA Mid Small Index	not rated	38.92	5.34	6.46
Growth Funds:				
Legg Mason Appreciation	★★★★★	26.26	4.38	3.99
Hartford Capital Appreciation	★★★★	30.77	4.40	6.40
Amer. Funds: Growth Fund	★★★	28.01	3.19	4.15
Fidelity Low-Priced Stock	★★★★	34.29	6.10	10.35
Fidelity Small Cap	★★★	34.77	6.27	8.43
Legg Mason Sm Cap Grwth	★★★★	43.29	7.14	5.47
Northern Small Cap Value	★★★	33.97	3.37	8.15
International Stock Funds:				
Fidelity Diversified International	★★★	30.50	1.43	7.30
ING Oppenheimer Global I	★★★★	35.44	4.73	n/a
SSgA International Index	not rated	30.34	1.46	4.70
Specialty Funds:				
Fidelity Strategic Real Return	★★	16.85	4.30	n/a
SSgA Tuckerman Active REIT	★★	34.95	0.10	9.73

*Morningstar Ratings for LifePath funds are derived from the BlackRock LifePath mutual fund equivalent.