OFFICES OF THE COUNTY EXECUTIVE

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County Executive

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June 29, 2012

Members of the Montgomery County Council

I am pleased to present to you the Quarterly Report of the Montgomery County Employees' Retirement System ("ERS") for the quarter ended March 31, 2012. This quarterly report is designed to assist you in understanding the current status of the ERS. This report was prepared pursuant to the provisions of the Montgomery County Code.

History

The Employees' Retirement System was established in 1965 as a cost-sharing multiple-employer defined benefit pension plan providing benefits to the employees of Montgomery County and other agencies or political subdivisions who elect to participate. The System is closed to employees hired on or after October 1, 1994, except public safety bargaining unit employees and employees who elect to participate in the Guaranteed Retirement Income Plan. There were approximately 5,350 active members and 5,850 retirees participating in the ERS as of March 31, 2012.

Performance Results

The total return achieved by the ERS assets for the quarter was a gain of 7.58%, 206 basis points ahead of the 5.52% gain recorded by the policy benchmark. For the one year period ending March 31, 2012 the ERS' gross return (before fees) was a gain of 8.21%, 90 basis points ahead of the 7.31% return recorded by the policy benchmark. The one-year gross return places the ERS' performance in the top 10% of the universe of comparable pension funds constructed by the Board's consultant, Wilshire Associates. Our annualized performance of 18.11% for the three-year period ranked in the top 40% of the universe, and 5.02% annualized performance for the five-year period ranked in the top 15% of the universe. The asset allocation at March 31, 2012 was: Domestic Equities 26.2%, International Equities 16.4%, Fixed Income 25.1%, Inflation Linked Bonds 10.3%, Commodities 4.7%, Private Equity 7.3%, Private Real Assets 4.9%, Opportunistic 3.6%, and Cash 1.5%. We estimate that the funded status of the ERS was 77.3% as of March 31, 2012, an increase from the June 30, 2011 level. The actual funded status will be affected by the ERS' membership experience, as well as demographic and economic changes and may be higher or lower when calculated by the actuary during the next valuation.

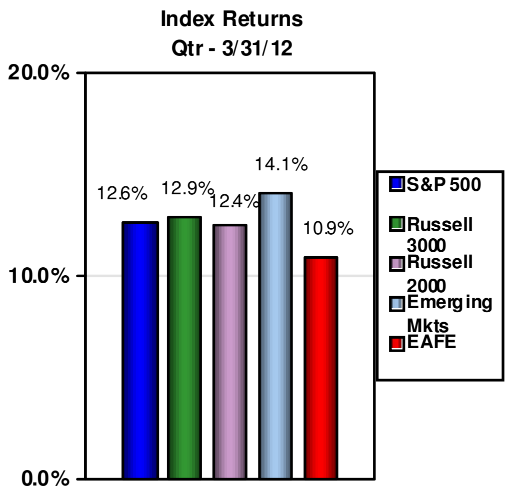
Major Initiatives

During the quarter, the Board approved the recommended 2012 commitment pace for private equity resulting in similar levels to 2011. Within the private equity sector, the Board approved an investment of $13,000,000 in Riverside Fund V, L.P. The Board also approved an $80,000,000 investment in Eagle Asset Management Small Cap Growth. Staff continues to review opportunities within the private real assets, private equity and opportunistic allocations.

Capital Markets and Economic Conditions

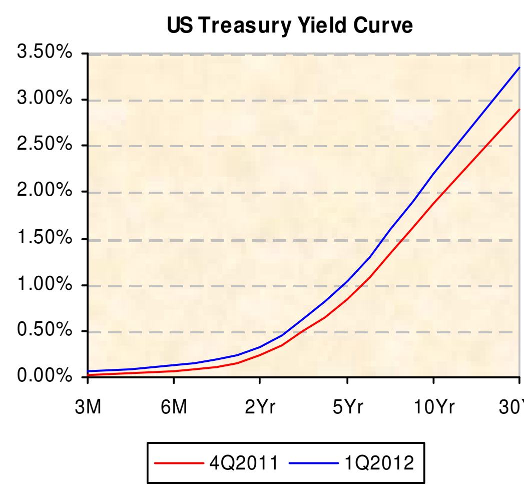
Signs that the U.S. job market continue to improve were evident in the first quarter. The unemployment rate fell to 8.3% and initial jobless claims touched their lowest level in nearly four years. The unseasonably mild winter resulted in lower heating bills, increasing disposable income which may have boosted consumer confidence and spending. Manufacturing activity, as measured by the Institute for Supply Manager's index, came in at a solid 53.4 in March, continuing to reinforce the view that manufacturing remains a key driver of the economy. Other critical areas of the economy such as capital goods orders have also experienced a meaningful recovery. While still at low levels, housing statistics are starting to show signs of improvement. Central banks around the world continue to provide a tremendous degree of monetary accommodation. The Federal Reserve maintained its target for the Fed Funds rate and pledged to keep short-term interest rates near zero at least through late 2014, extending its previous mid-2013 commitment. The European Central Bank (ECB) provided European banks with a second round of low interest, three-year loans though the Long-Term Refinancing Operation (LTRO) program.

Public Equity Markets: U.S. equities rallied sharply during the first quarter, as the S&P 500 index turned in its best quarterly performance since the third quarter of 2009. Investor relief that the eurozone appeared to back away from the point of collapse, signs that the U.S. economy continues to recover and strong corporate earnings reports helped bolster returns. Larger capitalization (as represented by the S&P 500 Index) stocks slightly outperformed their smaller counterparts. All sectors of the S&P 500, except utilities, advanced led by financials and information technology with returns higher than 20%. Our combined domestic equity performance was a gain of 15.34%, outperforming the 12.87% gain recorded by the Russell 3000 benchmark.



International markets also advanced in the first quarter. European equities were driven higher by investor optimism about progress in resolving the debt crisis and the European Central Bank's infusion of liquidity into its banking system reassured investors about the stability of the eurozone. Japanese equities also performed well amid improving prospects for exporters. During the quarter, developed markets, as measured by the MSCI EAFE Index, rose 10.86%. Emerging markets gained 14.08% during the quarter, outperforming their developed counterparts. Among the BRICs, Indian stocks surged roughly 20%, lifted by signs of slowing inflation and Russian stocks returned more than 18%, helped by elevated oil prices. Our combined international equity performance was a gain of 12.98% for the quarter, outperforming the 11.23% gain recorded by the MSCI ACWI ex-US Index.

Fixed Income: U.S. Treasury yields traded in a narrow range through most of the quarter before moving higher in mid-March as investors shifted toward a "risk-on" paradigm. The liquidity injections provided by the European Central Bank and the Federal Reserve led to a rally in global equities and a move out of the safety of the bond market. Although current Treasury yields are at the highest levels since last August, yields are still near historic lows, and investors sought out higher risk-adjusted returns in riskier assets. Last year's best performing sector, long-term Treasuries, was the worst performer in the first quarter, closing down 5.80%. The yield curve steepened (shown in the chart to the right) as the spread between 2-year and 10-year Treasuries, the main gauge of the yield curve, widened to 188bps. For the quarter, the 2-year Treasury yield rose 9bps at 0.33%, while the 10-year Treasury yield rose to 2.21%, up 33bps. Credit spreads tightened resulting in both investment-grade and high yield credits outperforming relative to Treasuries. Investment grade credit spreads narrowed by 62bps while high yield spreads narrowed by 133bps. For the quarter, the Merrill Lynch High Yield Index returned 5.16% and the Barclays Aggregate returned 30bps as tighter credit spreads compensated for higher Treasury yields. The 30-year Treasury yields rose 44bps resulting in the Barclays Long Govt/Credit Index declining 2.12%, despite tighter credit spreads. Our combined fixed income performance for the quarter was a gain of 3.20%, outperforming the custom benchmark which returned 0.88%. Our global inflation-linked bond portfolio, combined with the portable alpha overlay, returned 1.32% for the quarter, compared to the 1.48% gain recorded by the benchmark.

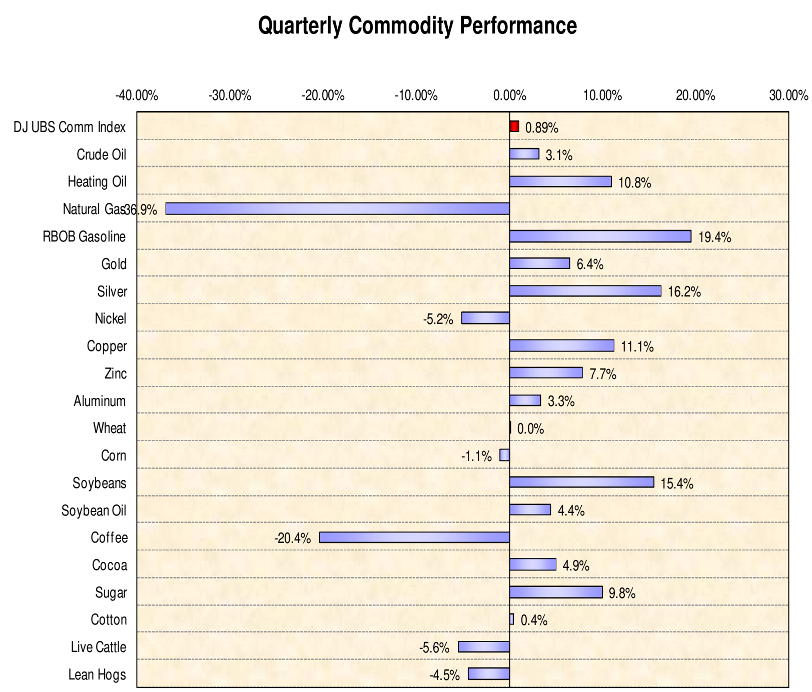


Opportunistic: Hedge fund gains were broad-based across strategies in the first quarter with the HFRI Composite Index returning 4.9%, the best first quarter since 2006. Equity strategies posted strong gains with the HFRI Equity Hedge Index returning 7.3%, the best first quarter performance since 2000. Directional long equity strategies were the best performers due to the equity market rally. Global Macro funds returned 1.2% for quarter, the weakest performer among the strategies. Performance was mixed across commodities, currencies and developed government bond exposures which detracted from relative performance. The HFRI Emerging Markets Index returned 7.4% for the quarter, despite a decline of 1.5% in March. Relative value arbitrage rose 4.3%; fixed income-based relative value posted gains as strong corporate credit markets offset the impact of rising U.S. Treasury yields. Event driven funds were positive all three months of the quarter, benefitting from strong equity and credit markets, with the HFRI Event Driven Index rising 4.5%. Fund-of-hedge funds in aggregate posted a gain of 3.4% for the quarter. The return of the opportunistic allocation was a gain of 3.80%.

Private Equity: The number of private equity deals completed during the first quarter was on par with recent levels of deal activity, albeit at a lower average transaction size. Exits to public markets (initial public offerings or IPOs) were at their highest levels of the past 2 years. As use of leverage diminished during the quarter, average purchase valuations also fell. Private equity fundraising saw a slight dip, mainly attributable to Europe and Asia. During the quarter, our private equity managers called a combined $5.8 million and paid distributions of $2.7 million. Our current allocation to private equity is 7.3%, with a market value of $217.4 million. From its 2003 inception through September 30, 2011, the private equity program has generated a net internal rate of return of 5.6% versus a 3.3% return for the dollar-weighted public market equivalent (the Russell 3000 Index plus 300 basis points).

Private Real Assets: First quarter global real estate investment activity was down significantly due to diminishing activity in Europe and Asia, more than offsetting an increase in activity in the U.S. In spite of the reduction in investment activity, pricing has remained stable or even risen in most markets. Investors in general are focused on the highest quality assets in prime markets, a reversal from trends in recent quarters which have seen investors willing to take on additional risk. In the energy sector, weak natural gas pricing (a function of the warm winter and massive new reserve discoveries) has shifted investor preferences toward oil-oriented opportunities. During the quarter, our managers called a total of $6.3 million and paid distributions of $0.9 million. Our current allocation to private real assets is 4.9%, with a market value of $144.5 million. From its 2006 inception through September 30, 2011, the private real assets program has generated a net loss of 6.6% versus a 9.0% loss for a broad real estate price index (the Moody's/REAL U.S. Commercial Property Price Index).

Commodities: The Dow Jones-UBS Commodity Index gained 0.89% for the quarter with a wide set of returns across sectors. The energy sector was the worst performer, as heavy natural gas losses (-36.9%) weighed on the sector due to decreased demand from a mild winter in the U.S. Industrial metals posted moderate gains primarily from copper, which benefited from strong U.S. economic data and prospects for increased Chinese demand. Precious metals were the strongest performer due to strong Chinese physical demand for gold. Additionally, the Federal Reserve's commitment to keep interest rates exceptionally low through 2014 prompted "store of value" buying by investors looking to hedge inflation. During the quarter, our commodities portfolio advanced 1.93%, outperforming the 0.89% gain recorded by the benchmark.



Additions

The primary sources of additions for the ERS include contributions from members and employers and investment income. The following table displays the source and amount of additions for the quarter ending March 31, 2012 and fiscal year-to-date.

Employees' Retirement System
Contributions and Investment Income (millions)

	Qtr 3/31/2012	Fiscal YTD
Employer Contributions	$ 26.6	$ 81.2
Member Contributions	5.8	17.2
Net Investment Income	207.1	144.7
	$ 239.5	$ 243.1

Deductions

The deductions from the Employees' Retirement System include the payment of retiree and survivor benefits, participant refunds, and administrative expenses.

Employees' Retirement System
Deductions by Type (millions)

	Qtr 3/31/2012	Fiscal YTD
Benefits	$ 51.7	$ 150.4
Refunds	1.7	4.7
Administrative Expenses	1.0	2.6
	$ 54.4	$ 157.7

Outlook

The outlook for the global economy continues to be a slow recovery in 2012. Risks to the global economy are tilted to the downside, as the European crisis continues to be the single most worrying concern for the global recovery followed by rising oil prices and a slowdown in China.

In the U.S., the recovery continues at a subdued pace. There have been improvements in corporate profits, retail sales and employment but the housing market remains sluggish and the levels of monetary and fiscal stimulus supporting the U.S. economy cannot be sustained indefinitely. In addition, instability in the Middle East has caused oil prices to rise, increasing gasoline prices and reducing consumer's disposable income.

Although enhanced liquidity measures and a successful Greek bailout package appear to have tempered fears, there are still a number of issues facing European economies. Important political elections including a presidential election in France and national elections in Greece could alter the political landscape and the impact of austerity policies should begin to show through in economic statistics during the second quarter.

The economy in China has avoided a hard landing, but growth momentum has continued to soften and the cyclical slowdown will be felt in the rest of the world. The Chinese government remains more concerned with inflation pressures then slower growth. Retail sales and private-sector construction activity have softened and exports have slowed amid sluggish demand from Japan and Europe.

Sources: Bloomberg, Northern Trust, MSCI, S&P, Pyramis Global Advisors, FRM, Wilshire Associates, Bridgewater, JP Morgan, BlackRock, PE Hub, Private Equity Analyst, Pitchbook, Real Capital Analytics, RE Alert, Schroder, Oil & Gas Investor.

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF PLAN NET ASSETS
March 31, 2012

Assets		
Equity in pooled cash and investments	$	537,329
Investments:		
Northern Trust		2,969,215,674
Aetna		1,208,330
Fidelity - Elected Officals Plan		403,566
Fidelity - DRSP		8,869,842
Total investments		2,979,697,412
Contributions receivable		7,464,498
Total assets		2,987,699,239
Liabilities		
Benefits payable and other liabilities		5,059,843
Net assets held in trust for pension benefits	**$**	**2,982,639,396**

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF CHANGES IN PLAN NET ASSETS
March 31, 2012

	Quarter	Fiscal YTD
Additions		
Contributions:		
Employer	$ 26,601,284	$ 81,225,770
Member	5,819,035	17,168,935
Total contributions	32,420,319	98,394,705
Investment income	210,714,366	159,026,181
Less investment expenses	3,677,574	14,299,665
Net investment income	207,036,792	144,726,516
Total additions	239,457,111	243,121,221
Deductions		
Retiree benefits	38,688,207	111,352,267
Disability benefits	10,950,303	32,766,463
Survivor benefits	2,008,217	6,228,899
Refunds	1,736,931	4,718,079
Administrative expenses	1,010,518	2,623,830
Total deductions	54,394,176	157,689,538
Net increase (decrease)	**185,062,935**	**85,431,683**
Net asset held in trust for pension benefits		
Beginning of period	**2,797,576,461**	**2,897,207,713**
End of period	**$ 2,982,639,396**	**$ 2,982,639,396**