OFFICES OF THE COUNTY EXECUTIVE

Isiah Leggett
County Executive

Timothy L. Firestine
Chief Administrative Officer

November 24, 2009

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 September 30, 2009. 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 (effective July 1, 2009). There were approximately 5,000 active members and 5,400 retirees participating in the ERS as of September 30, 2009.

Performance Results

The total return achieved by the ERS assets for the quarter was a gain of 10.70%, equal to the 10.70% gain recorded by the policy benchmark. For the one year period ending September 30, 2009 the ERS' gross return (before fees) was a gain of 2.94%, 9 basis points ahead of the 2.85% gain recorded by the policy benchmark. The one-year return, after fees, places the ERS' performance in the top 15% of a universe of comparable pension funds constructed by the Board's consultant, Wilshire Associates. For the three-year period, our annualized performance was a gain of 1.00%, after fees, ranking in the top 6% of the universe. The asset allocation at September 30, 2009 was: Domestic Equities 28.8%, International Equities 20.4%, Fixed Income 27.8%, Inflation Linked Bonds 9.5%, Commodities 3.7%, Private Equity 6.0%, Real Estate 3.1% and Cash 0.7%. We estimate that the funded status of the ERS was 80.2% as of September 30, 2009, an increase from 78.4% at June 30, 2009. 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.

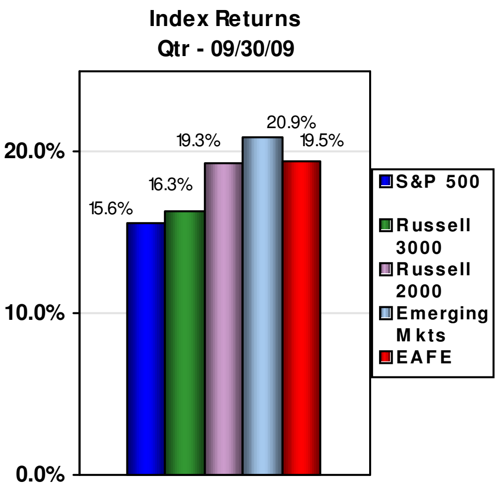
Major Initiatives

During the quarter, the Board approved investments in two private equity partnerships totaling $12,000,000 each; KPS Special Situations Fund III (Supplemental) and Riverside Fund IV. The Board also approved a reduction in the long duration fixed income allocation to 12.5%, the hiring of Jennison Associates for the long duration mandate, and the addition of an opportunistic allocation of 5%. The Board transmitted the first annual Sudan Divestment Report, dated June 30, 2009, to the County Council reflecting compliance with the County Code.

Capital Markets and Economic Conditions

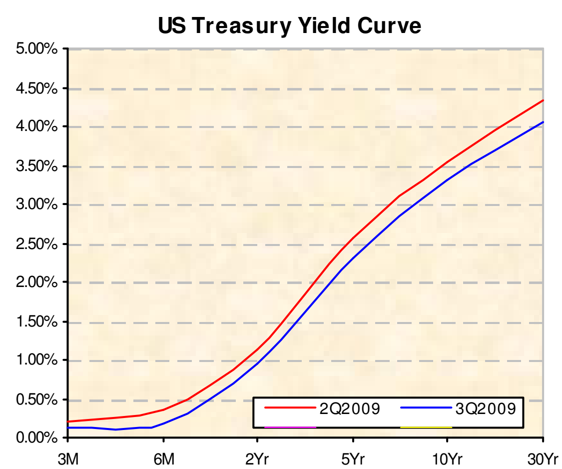
Real GDP rose 3.5% in the third quarter with positive contributions coming from inventory investment, personal consumption, exports, and government spending. Real personal consumption expenditures increased 3.4% in the third quarter, in contrast to a decrease of 0.9% in the second quarter due to government initiatives including the "Cash for Clunkers" program. Unemployment remains weak, hitting 10.2% in October, its highest level since 1983, with many economists expecting it to reach 11% by year end. The U.S. manufacturing sector, as measured by the Institute of Supply Management's (ISM) composite, expanded for the third consecutive month in October after 19 months of contraction. In addition, the residential real estate sector is moderately improving with home prices and sales volumes rising.

Public Equity Markets: All U.S. equity markets rallied strongly during the third quarter as corporate earnings continued to exceed expectations. The S&P 500 posted its steepest two-quarter advance since the first half of 1975. As shown in the chart to the left, smaller capitalization companies (Russell 2000 Index) outperformed their larger counterparts (S&P 500 Index). The U.S. equity rally was broad based with all sectors of the S&P 500 posting positive returns during the quarter. However, cyclical sectors including Basic Materials, Industrials, and Technology strongly outperformed more defensive sectors such as Utilities and Telecommunications. Our combined domestic equity performance was a gain of 16.35%, in line with the 16.31% return recorded by the Russell 3000 benchmark. For the one year period ending September 30, our combined domestic equity portfolio recorded a loss of 5.12%, outperforming the benchmark's 6.42% loss by 130 basis points.



Within the international equity sector, developed markets, as measured by the MSCI EAFE Index, were up 19.47% for the quarter, compared to emerging markets which advanced 20.91%. All EAFE markets were up with Australia (+32.12%), Korea (+31.92%), and the Netherlands (+30.61%) recording the strongest performance. The markets of Hungary (+41.58%) and Peru (+37.09%) took the lead within the emerging markets sector. Our combined international equity performance was a gain of 18.89% for the quarter, 80 basis points behind of the benchmark's gain of 19.69%. For the one year period ending September 30, our combined international equity return was a gain of 11.64%, outperforming the benchmark by 575 basis points.

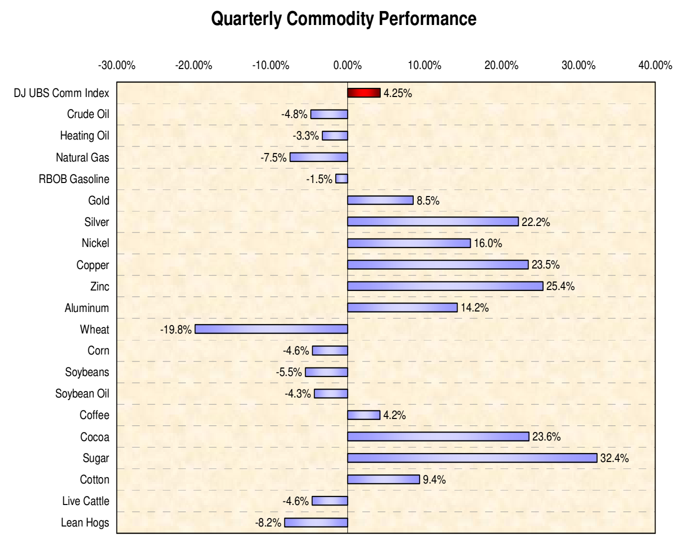
Fixed Income: Treasury yields declined throughout the quarter, led by the long-end of the curve, despite record Treasury issuance. The FOMC left interest rate policy unchanged through its two regularly scheduled meetings in August and September. The yield curve flattened slightly (shown in the chart to the right) as the 2 year Treasury bond fell 17 bps from 1.12% to 0.95% and the 30 year Treasury bond fell 28 bps from 4.33% to 4.05%. A broad based rally occurred during the third quarter as near-zero interest rates on risk free assets fueled the search for yield. The high yield bond market, represented by the Merrill Lynch High Yield Master II Index, recorded its third highest historical return on record, up 14.80%. Long investment grade credit issues also posted strong returns with the Barclays Long Govt/Credit Index up 8.53%. Our combined fixed income performance for the quarter was a gain of 8.71%, outperforming the 6.70% gain recorded by the benchmark index. Our global inflation-linked bond portfolio, combined with the portable alpha overlay, returned 4.70% for the quarter, compared to the 3.41% return of the benchmark.



Private Equity: Third quarter investment activity remained muted and consisted largely of smaller deals, though a recent uptick in deal size may be indicative of the opening of some credit markets. Venture capital activity has also stabilized at the levels observed earlier in 2009. Much of the recent activity went to fund existing portfolio companies rather than initial funding of new enterprises. In both the buyout and venture spaces, fundraising volume continues to be quite low both in terms of number of funds and amount raised. During the quarter, our private equity managers called a combined $3.4 million and paid distributions of $0.2 million. Our current allocation to private equity is 6.0%, with a market value of $141.8 million.

Private Real Assets: Global real estate investment activity has increased from recent lows, though it varies significantly by geography. Asian real estate markets have rebounded sharply, led by China, while U.S. activity has shown only a small uptick from the early 2009 lows. In energy, oil drilling activity has picked up as pricing recovers, while gas drilling remains suppressed due to low prices resulting from supply concerns. During the quarter, our managers called a total of $1.9 million and paid distributions of $0.2 million. Our current allocation to private real assets is 3.1%, with a market value of $74.0 million.

Commodities: The commodity markets continued to advance during the quarter, led by the metals markets. The base metals sector (+20.1%) continued to benefit from optimism of China's demand for raw materials. Demand for precious metals (+12.5%) was strong on the basis of longer-term expectations of higher inflation and a decrease in the value of the dollar. Among the other advancing markets, sugar rose to a 28 year high (+32.4%) during the quarter on expectation of a large global deficit and upward revisions of Indian imports needs for the coming season. Cocoa markets rebounded strongly on supply concerns in West Africa and Indonesia. Within the energy sector, natural gas was the largest detractor from performance, on weak demand, excessive production, and high levels of inventory. During the quarter, our commodities portfolio advanced 3.47%, trailing the DJ UBS Commodities Index by 77 basis points.



Additions

The primary sources of additions for the ERS include member and employer contributions and investment income. The following tables show the source and amount of additions for the quarter ending September 30, 2009 and fiscal year-to-date.

Employees' Retirement System
Contributions and Investment Income (millions)

	Qtr 9/30/2009	Fiscal YTD
Employer Contributions	$ 28.9	$ 28.9
Member Contributions	5.1	5.1
Net Investment Income	264.3	264.3
	$ 298.3	$ 298.3

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 9/30/2009	Fiscal YTD
Benefits	$ 41.5	$ 41.5
Refunds	0.3	0.3
Administrative Expenses	0.7	0.7
	$ 42.5	$ 42.5

Outlook

Equity market performance will depend heavily on corporate earnings which appear somewhat uncertain. The strong rally in stocks since their March 2009 low has some market experts wondering if the rapid rise in stock valuations is premature and earnings expectations too high. Companies have shown improved earnings over the past year due mostly to cost savings measures rather than top line growth.

The economic recovery is likely to look quite different from traditional recoveries. Consumer spending, which is normally the largest driver of growth and accounts for 70% of GDP, remains sluggish. Taking the lead in this recovery will be government spending, business investment and foreign consumers. Federal government spending is up nearly 30% from a year ago. The steadily declining dollar has made U.S. based manufacturing more globally competitive which should produce improvement in the U.S. trade deficit and cause businesses to begin increasing inventories from their current low levels.

The Fed continues to reaffirm that they would likely maintain "exceptionally low levels of the federal funds rate for an extended period," and that "the Committee will continue to evaluate the timing and overall amounts of its purchases of securities (quantitative easing) in light of the evolving economic outlook and conditions in financial markets." On the inflation front, despite the level of excess capacity and weak consumer spending, rising commodity prices and massive government spending have sparked some future inflation fears.

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF PLAN NET ASSETS
September 30, 2009

Assets		
Equity in pooled cash and investments	$	475,570
Investments:		
Northern Trust		2,381,609,264
Aetna		13,768,735
Fidelity - Elected Officals Plan		785,171
Fidelity - DRSP		1,982,017
Total investments		2,398,145,187
Contributions receivable		6,886,114
Total assets		2,405,506,871
Liabilities		
Benefits payable and other liabilities		3,708,476
Net assets held in trust for pension benefits	**$**	**2,401,798,395**

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF CHANGES IN PLAN NET ASSETS
September 30, 2009

	Quarter	Fiscal YTD
Additions		
Contributions:		
Employer	$ 28,944,424	$ 28,944,424
Member	5,074,849	5,074,849
Total contributions	34,019,273	34,019,273
Investment income	266,990,133	266,990,133
Less investment expenses	2,706,885	2,706,885
Net investment income	264,283,248	264,283,248
Total additions	298,302,521	298,302,521
Deductions		
Retiree benefits	30,152,795	30,152,795
Disability benefits	9,430,684	9,430,684
Survivor benefits	1,881,999	1,881,999
Refunds	302,596	302,596
Administrative expenses	735,247	735,247
Total deductions	42,503,321	42,503,321
Net increase (decrease)	**255,799,200**	**255,799,200**
Net asset held in trust for pension benefits		
Beginning of period	**2,145,999,195**	**2,145,999,195**
End of period	**$ 2,401,798,395**	**$ 2,401,798,395**