OFFICES OF THE COUNTY EXECUTIVE

Isiah Leggett
County Executive

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November 10, 2008

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, 2008. 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. There were approximately 5,050 active members and 5,300 retirees participating in the ERS as of September 30, 2008.

Performance Results

The total return achieved by the ERS assets for the quarter was a loss of 9.46%, 20 basis points ahead of the 9.66% loss recorded by the policy benchmark. For the one year period ending September 30, 2008 the ERS' gross return (before fees) was a loss of 13.50%, 290 basis points ahead of the 16.40% loss recorded by the policy benchmark. The one-year return places the ERS' performance at the median of a universe of public pension funds constructed by the Board's consultant, Wilshire Associates. For the three-year period, our annualized performance was 3.33%, before fees, ranking in the top 34% of the universe. The asset allocation at September 30, 2008 was: Domestic Equities 33.4%, International Equities 18.2%, Fixed Income 25.8%, Inflation Linked Bonds 12.2%, Private Equity 6.4%, Real Estate 3.8% and Cash 0.2%. We estimate that the funded status of the ERS was 79.9% as of September 30, 2008, a decrease from 80.8% at June 30, 2008. 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.

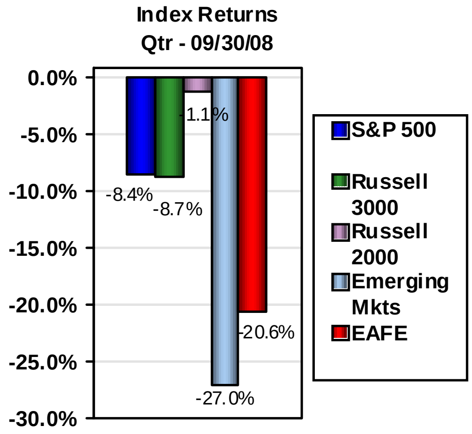
Major Initiatives

During the quarter, the Board approved the hiring of two commodity managers, Schroder Investment Mgt. and OFI Institutional Asset Mgt., to oversee the 5% allocation to the sector. Funding will take place gradually over the next twelve months. The Board also approved the hiring of a private equity consultant, Franklin Park, to assist staff with further implementation of the private equity program. In addition, the Board conducted their annual review of all vendors approving amendments to the investment consultant and custodian bank contracts. We continue to work to broaden the investment allocation with the aim to provide diversification as well as downside protection.

Capital Markets and Economic Conditions

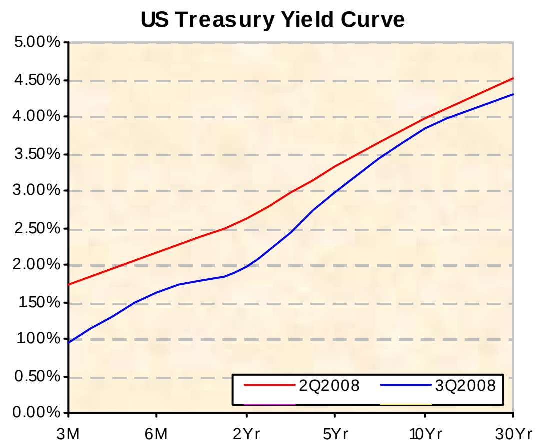
Over the past weeks we have experienced historic events in the world's financial markets which can be traced back to excess liquidity and the consequences of this liquidity freezing up. The last time such a panic occurred was the 1997 Asian currency crisis and the collapse of Long Term Capital Mgt. in 1998. The latest wave of the global credit crisis has been massive with many significant casualties, including one of the most revered names in U.S. investment banking, together with the world's largest insurer, the two largest government-sponsored enterprises, and a number of leading banks. The markets were dealt a lethal combination of a lenders' strike, characterized by banks' unwillingness to extend financing to one another, coinciding with a buyers' strike, where investors were reluctant to provide fresh equity capital. Even as the Federal Reserve and the Treasury, and their counterparts in Europe, aggressively inject more liquidity into the system in an attempt to loosen seized-up markets, and improve the functioning of credit markets, deleveraging will securitized asset prices stabilize.

Public Equity Markets: U.S. equity markets recorded major losses for the quarter due to a global economic slowdown and fears of a deep recession. The U.S. unemployment rate soared to 6.1% in September, the highest level since 2003, as employers trimmed jobs for the ninth straight month. As shown in the chart to the left, small capitalization companies (as represented by the Russell 2000 Index) outperformed their larger counterparts (S&P 500 Index) for the quarter. Value stocks outperformed growth stocks across the capitalization spectrum. The top performing sectors of the S&P 500 during the quarter were consumer staples, financials, and health care while energy and basic materials were the worst performing sectors. Our combined domestic equity performance was a loss of 10.79%, 206 basis points behind the Russell 3000 benchmark. For the one year period ending September 30, our combined domestic equity portfolio recorded a loss of 20.63%, 89 basis points better than the 21.52% loss recorded by the benchmark.



Within the international equity sector, developed markets, as measured by the MSCI EAFE Index, were down 20.56% for the quarter compared to emerging markets which fell 26.95%. Among the EAFE markets Ireland (-42.21%) and Austria (-41.22%) detracted the most from returns. With the exception of the Philippines, all emerging markets were in negative territory, with Russia (-45.27%), and Argentina (-43.96%) leading the underperformance. The asset class was hurt by a significant decline in commodity prices and forced selling by hedge funds to meet client redemptions. Our combined international equity performance was a loss of 18.39% (17.83% after including the performance of our currency managers) for the quarter, 352 basis points ahead of the benchmark's loss of 21.91%. For the one year period ending September 30, our combined international equity return was a loss of 26.46% (25.25% after including the currency managers), outperforming the benchmark by 386 basis points.

Fixed Income: A crisis of confidence led to a massive flight to quality and liquidity during the third quarter. The Lehman Treasury Index returned 2.30% while credit sectors underperformed as spreads widened to historic levels. Corporate bonds, led by financials, declined 7.80%, while CMBS and ABS posted their worst quarterly return on record, down 5.83% and 3.72%, respectively. The high yield market suffered its worst month on record, with the Merrill Lynch High Yield Master II Index declining 8.11% in September. The yield curve steepened as investors were not seeking a return on principal but an assurance principal would be returned and fled to the safety of short-term US Treasuries. During September the yield on four-week Treasury bills approached 0%. Combined fixed income performance for the quarter was a loss of 5.16%, underperforming the 3.43% loss recorded by the benchmark index. Our global inflation-linked bond portfolio, combined with the portable alpha overlay, declined 5.69% for the quarter, trailing the benchmark's negative 2.49% return.



Private Equity: Lack of debt availability continued to hinder buyout markets during the third quarter. Venture capital exits were slow, although investment activity continued to be robust in industries such as clean technology. During the quarter, our private equity managers called a combined $9.1 million and paid distributions of $1.4 million. Our current allocation to private equity is 6.4%, with a market value of $150.7 million.

Real Estate: The volume of real estate transactions continues to be relatively low due to the large spread between buyer and seller expectations regarding pricing. Market observers believe this spread will shrink in favor of buyers as owners of properties bought during the real estate boom with high levels of short-term debt may be forced to sell over the next several quarters due to the inability to obtain financing. During the quarter, there were capital calls from our real estate managers totaling $16.3 million and distributions of $1.2 million. Our current allocation to real estate is 3.8%, with a market value of $88.9 million.

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, 2008 and fiscal year-to-date.

Employees' Retirement System
Contributions and Investment Income (millions)

	Qtr 9/30/2008	Fiscal YTD
Employer Contributions	$ 27.8	$ 27.8
Member Contributions	4.5	4.5
Net Investment Income (Loss)	(248.2)	(248.2)
	$ (215.9)	$ (215.9)

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 9/30/2008	Fiscal YTD
Benefits	$ 44.5	$ 44.5
Refunds	0.1	0.1
Administrative Expenses	0.5	0.5
	$ 45.1	$ 45.1

Outlook

For policymakers the challenge over the next few months will be mitigating damage to the broad economy. It has become clear that the loss of economic value from the drop in housing prices, magnified by the securities backed by these assets, and the unwillingness of banks to lend capital, will result in a slowdown of global economies. The housing bubble was not only a U.S. problem but was occurring in the U.K., Spain, China and India due to the global nature of liquidity. The impact that this global crisis will have on the real economy will depend largely on how quickly credit markets become fully functional and how much further real estate prices fall. Banks will only start making loans when their capital bases have been restored and the prospect of getting repaid is very bright, and that is a function of inflation (in property values and selling prices) and optimism.

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF PLAN NET ASSETS
September 30, 2008

Assets		
Equity in pooled cash and investments	$	656,954
Investments:		
Northern Trust		2,343,620,317
Aetna		13,841,748
Fidelity - Elected Officals Plan		938,332
Fidelity - DRSP		6,627
Total investments		2,358,407,024
Contributions receivable		6,013,674
Total assets		2,365,077,652
Liabilities		
Benefits payable and other liabilities		7,237,659
Net assets held in trust for pension benefits	**$**	**2,357,839,993**

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF CHANGES IN PLAN NET ASSETS
September 30, 2008

	Quarter	Fiscal YTD
Additions		
Contributions:		
Employer	$ 27,771,911	$ 27,771,911
Member	4,536,316	4,536,316
Total contributions	32,308,227	32,308,227
Investment income (loss)	(243,373,275)	(243,373,275)
Less investment expenses	4,823,463	4,823,463
Net investment income (loss)	(248,196,738)	(248,196,738)
Total additions	(215,888,511)	(215,888,511)
Deductions		
Retiree benefits	32,891,106	32,891,106
Disability benefits	9,729,518	9,729,518
Survivor benefits	1,816,621	1,816,621
Refunds	141,430	141,430
Administrative expenses	494,260	494,260
Total deductions	45,072,935	45,072,935
Net increase (decrease)	**(260,961,446)**	**(260,961,446)**
Net asset held in trust for pension benefits		
Beginning of period	**2,618,801,439**	**2,618,801,439**
End of period	**$ 2,357,839,993**	**$ 2,357,839,993**