OFFICES OF THE COUNTY EXECUTIVE

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County Executive

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February 20, 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 December 31, 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 4,900 active members and 5,500 retirees participating in the ERS as of December 31, 2008.

Performance Results

The total return achieved by the ERS assets for the quarter was a loss of 11.99%, 188 basis points ahead of the 13.87% loss recorded by the policy benchmark. For the one year period ending December 31, 2008 the ERS' gross return (before fees) was a loss of 23.48%, 387 basis points ahead of the 27.35% 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 -1.57%, before fees, ranking in the top 39% of the universe. The asset allocation at December 31, 2008 was: Domestic Equities 28.6%, International Equities 17.2%, Fixed Income 28.6%, Inflation Linked Bonds 12.9%, Private Equity 7.4%, Real Estate 4.3% and Cash 1.0%. We estimate that the funded status of the ERS was 78.7% as of December 31, 2008, a decrease from 79.9% at September 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

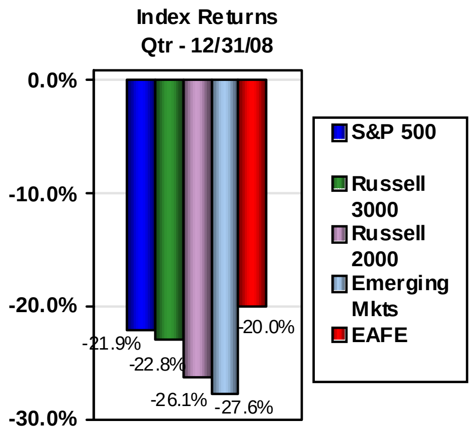
During the quarter, the Board approved a private equity investment plan for 2009 targeting a total commitment of $50-$70million. Due to current market conditions, the Board voted to postpone implementation of the long duration/portable alpha mandate and will reevaluate the mandate at their next meeting. Finally, the Board identified one company held by an ERS separate account manager that is doing business in Sudan and does not meet any of the exemptions stated in the County's Sudan Divestment Legislation. The manager was advised that it must divest the company's securities within the next twelve months. In addition, the company will be placed on the restricted list for future investment by all ERS separate account managers.

Capital Markets and Economic Conditions

The credit crisis continued to spread to the broad economy during the quarter. Manufacturing slowdowns, job losses, consumer spending coming to an abrupt halt, and a collapse in commodity prices all confirmed what the National Bureau of Economic Research reported in December – that the economy is in a recession. In an effort to diminish the length and severity of the downturn, policymakers worldwide cut interest rates substantially with the U.S. cutting the Fed Funds rate to a 0.00%-0.25% floor range. The benchmark rate has been cut by more than 5% since the summer of 2007 when the Fed's battle against the credit crisis began.

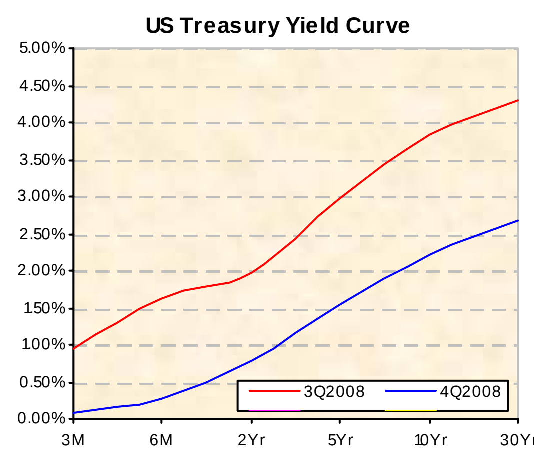
The decline in home prices intensified in the final months of 2008 reflecting an 18% drop from a year earlier – the largest decline in the 20-year history of tracking prices. The Labor Department reported nonfarm payrolls declined by 524,000 in December, and the unemployment rate increased to 7.2%. The total number of jobs lost last year exceeded 2.5 million – the most since 1945. No single economic indicator influences financial markets as much as the jobs reports. The current deterioration suggests weak consumer spending ahead.

Public Equity Markets: U.S. markets fell sharply during the fourth quarter resulting in the worst quarterly loss since 1987. Despite the efforts of policymakers and legislators, tight credit conditions continued to be a drag on the economy. During the quarter, poor economic reports of high unemployment (worst since 1974) and further weakening of the housing market continued to heighten investors' concerns of a deepening recession. As shown in the chart to the left, large capitalization companies (as represented by the S&P 500 Index) outperformed their smaller counterparts (Russell 2000 Index) for the quarter. Value stocks continued to outperform growth stocks across the capitalization spectrum. The top performing sectors of the S&P 500 during the quarter were telecommunication services, utilities, consumer staples, and health care while financials and materials were the worst performing sectors. Our combined domestic equity performance was a loss of 23.35%, 57 basis points behind the Russell 3000 benchmark. For the one year period ending December 31, our combined domestic equity portfolio recorded a loss of 37.11%, 20 basis points better than the 37.31% loss recorded by the benchmark.



Within the international equity sector, developed markets, as measured by the MSCI EAFE Index, were down 19.95% for the quarter, compared to emerging markets which fell 27.60%. All EAFE markets were down with Austria (-43.23%), and Norway, Greece, Ireland (each fell approximately 40%) detracting the most from returns. Emerging markets followed the downtrend, with Russia (-51.30%), Hungary (-46.67%), and Argentina (-43.83%) leading the underperformance. The asset class continued to be hurt by global economic weakness and the general downturn in commodity prices. Our combined international equity performance was a loss of 19.04% (18.27% after including the performance of our currency managers) for the quarter, 330 basis points ahead of the benchmark's loss of 22.34%. For the one year period ending December 31, our combined international equity return was a loss of 40.56% (38.94% after including the currency managers), outperforming the benchmark by 497 basis points.

Fixed Income: The massive flight to quality and liquidity continued, amid the negative economic reports indicating a deep recession, leading to the lowest Treasury yields in more than 50 years. The yield curve also flattened based on expectations for quantitative easing measures utilized by the Fed. The 30 year Treasury bond dropped 163 bps from 4.31% to 2.68%. Corporate credits posted positive returns for the quarter but underperformed Treasuries. The Barclays Corporate Index returned 3.98% while the Barclays Treasury Index was up 8.75%. Weakness in CMBS and ABS accelerated on deteriorating economic fundamentals, down 13.52% and 6.82%, respectively. Although the high yield market rose 7.11% in December, the Merrill Lynch High Yield Master II Index suffered its worst quarter on record, declining 17.69%. Our combined fixed income performance for the quarter was a loss of 3.08%, underperforming the 0.21% gain recorded by the benchmark index. Our global inflation-linked bond portfolio, combined with the portable alpha overlay, increased 2.31% for the quarter, outperforming the benchmark's negative 0.07% return.



Private Equity: Fourth quarter buyout activity remained sluggish amidst low availability of financing and sellers' expectations regarding price levels. The venture capital industry closed the year having only taken six companies public, five of which occurred during the first quarter. During the fourth quarter, our private equity managers called a combined $12.1 million and paid distributions of $5.0 million. Our current allocation to private equity is 7.4%, with a market value of $150.6 million.

Real Estate: The economic slowdown is increasingly being reflected in commercial real estate fundamentals. Office rents were down and vacancies rose nationwide, though the magnitude varies significantly by geographic region. Retail property owners are being hurt by consumers' reluctance to spend and, in some cases, aggressive financing. During the quarter, our real estate managers called a total of $0.5 million and paid distributions of $0.6 million. Our current allocation to real estate is 4.3%, with a market value of $88.4 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 December 31, 2008 and fiscal year-to-date.

Employees' Retirement System
Contributions and Investment Income (millions)

	Qtr 12/31/2008	Fiscal YTD
Employer Contributions	$ 27.7	$ 55.5
Member Contributions	4.8	9.3
Net Investment Income (Loss)	(282.6)	(530.8)
	$ (250.1)	$ (466.0)

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 12/31/2008	Fiscal YTD
Benefits	$ 42.0	$ 86.5
Refunds	0.2	0.3
Administrative Expenses	0.6	1.1
	$ 42.8	$ 87.9

Outlook

The crisis that began in a small corner of the mortgage market has infected the broad economy globally, as is evidenced by the weakness in manufacturing, retail, consumer confidence, and housing statistics along with the rising rate of unemployment. Prompt and thoughtful monetary and fiscal policy actions will be required to promote a recovery. Improving the financial status of banks is another challenge that must be met, since they play a critical role in economic expansion through their lending activities. As traditional measures to fix the economy, like interest rate cuts, become less effective, creative and more drastic solutions may be sought.

The unprecedented global magnitude of the crisis and the responses from various government entities has introduced significant uncertainty in the investment landscape. The interaction of these two forces will determine whether the next several years will be inflationary or deflationary, the direction of currency exchange rates, whether certain industries will benefit from a government subsidy at the expense of others, and the timing and magnitude of debt availability.

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF PLAN NET ASSETS
December 31, 2008

Assets		
Equity in pooled cash and investments	$	87,254
Investments:		
Northern Trust		2,171,418,579
Aetna		13,847,141
Fidelity - Elected Officals Plan		595,929
Fidelity - DRSP		334,356
Total investments		2,186,196,005
Contributions receivable		8,809,698
Total assets		2,195,092,957
Liabilities		
Benefits payable and other liabilities		130,244,657
Net assets held in trust for pension benefits	**$**	**2,064,848,300**

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF CHANGES IN PLAN NET ASSETS
December 31, 2008

	Quarter	Fiscal YTD
Additions		
Contributions:		
Employer	$ 27,693,928	$ 55,465,839
Member	4,778,279	9,314,595
Total contributions	32,472,207	64,780,434
Investment income (loss)	(280,909,561)	(524,282,836)
Less investment expenses	1,721,588	6,545,051
Net investment income (loss)	(282,631,149)	(530,827,887)
Total additions (deletions)	(250,158,942)	(466,047,453)
Deductions		
Retiree benefits	30,881,779	63,772,885
Disability benefits	9,313,871	19,043,389
Survivor benefits	1,825,523	3,642,144
Refunds	215,081	356,511
Administrative expenses	596,497	1,090,757
Total deductions	42,832,751	87,905,686
Net increase (decrease)	**(292,991,693)**	**(553,953,139)**
Net asset held in trust for pension benefits		
Beginning of period	**2,357,839,993**	**2,618,801,439**
End of period	**$ 2,064,848,300**	**$ 2,064,848,300**