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# Board of Investment Trustees



## Montgomery County Employee Retirement Plans

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Annual Report

Fiscal Year ending June 30, 2014

# Overview

December 17, 2014

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, 2014 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 \$3,652.8 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, 2014 the ERS had 5,535 active participants and 6,242 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, 2014 the RSP had \$292.5 million in net assets and 4,462 (3,585 active and 877 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, 2014 the DCP had \$344.3 million in net assets and 3,418 participants.

Shown below is a condensed presentation of the Plan Net Position and Changes in Plan Net Position from the Comprehensive Annual Financial Report for the retirement plans for the period ending June 30, 2014:

| Net Position<br>(Millions) |                   |                   |                 |                 |                 |                 |
|----------------------------|-------------------|-------------------|-----------------|-----------------|-----------------|-----------------|
|                            | ERS               |                   | RSP             |                 | DCP             |                 |
|                            | 2014              | 2013              | 2014            | 2013            | 2014            | 2013            |
| <b>Assets:</b>             |                   |                   |                 |                 |                 |                 |
| Cash and investments       | \$ 3,882.8        | \$ 3,461.1        | \$ 291.3        | \$ 235.2        | \$ 343.7        | \$ 303.3        |
| Receivables                | 11.5              | 21.1              | 1.2             | 0.9             | 0.6             | 0.6             |
| Capital assets             | 0.9               | -                 | -               | -               | -               | -               |
| <b>Total assets</b>        | <b>3,895.2</b>    | <b>3,482.2</b>    | <b>292.5</b>    | <b>236.1</b>    | <b>344.3</b>    | <b>303.9</b>    |
| <b>Liabilities</b>         | <b>242.4</b>      | <b>298.0</b>      | <b>-</b>        | <b>-</b>        | <b>-</b>        | <b>-</b>        |
| <b>Total net position</b>  | <b>\$ 3,652.8</b> | <b>\$ 3,184.2</b> | <b>\$ 292.5</b> | <b>\$ 236.1</b> | <b>\$ 344.3</b> | <b>\$ 303.9</b> |

| Change in Net Position<br>(Millions) |                 |                 |                |                |                |                |
|--------------------------------------|-----------------|-----------------|----------------|----------------|----------------|----------------|
|                                      | ERS             |                 | RSP            |                | DCP            |                |
|                                      | 2014            | 2013            | 2014           | 2013           | 2014           | 2013           |
| <b>Additions:</b>                    |                 |                 |                |                |                |                |
| Employer contributions               | \$ 144.7        | \$ 127.9        | \$ 17.1        | \$ 15.6        | \$ -           | \$ -           |
| Member contributions                 | 26.5            | 24.8            | 8.7            | 8.3            | 17.0           | 18.2           |
| Net investment income                | 534.4           | 307.9           | 42.4           | 23.7           | 48.9           | 34.1           |
| <b>Total additions</b>               | <b>705.6</b>    | <b>460.6</b>    | <b>68.2</b>    | <b>47.6</b>    | <b>65.9</b>    | <b>52.3</b>    |
| <b>Deductions:</b>                   |                 |                 |                |                |                |                |
| Benefits                             | 229.7           | 208.9           | -              | -              | -              | -              |
| Refunds and distributions            | 4.3             | 1.9             | 11.6           | 9.4            | 25.5           | 19.8           |
| Administrative expenses              | 3.0             | 2.4             | 0.2            | 0.2            | -              | -              |
| <b>Total deductions</b>              | <b>237.0</b>    | <b>213.2</b>    | <b>11.8</b>    | <b>9.6</b>     | <b>25.5</b>    | <b>19.8</b>    |
| <b>Total change in net position</b>  | <b>\$ 468.6</b> | <b>\$ 247.4</b> | <b>\$ 56.4</b> | <b>\$ 38.0</b> | <b>\$ 40.4</b> | <b>\$ 32.5</b> |

For detailed information on the investment programs for all three retirement plans, please visit the Board's web site at [www.montgomerycountymd.gov/retirement](http://www.montgomerycountymd.gov/retirement). For questions, please call the Board office at 240-777-8220.

## Board of Investment Trustees

**Jennifer E. Barrett**  
Chair  
Retired Employees Representative  
Term Expires March 2015

**Gino Renne**  
Vice Chair  
OPT/SLT Bargaining Unit Designee

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

**Jeffrey D. Buddle**  
Fire & Rescue Bargaining Unit Designee

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

**David J. Locke**  
Montgomery County Council Representative  
Term Expires March 2017

**George Willie**  
Public Representative  
Term Expires March 2017

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

**Arjan Berkelaar**  
Montgomery County Council Representative  
Term Expires March 2015

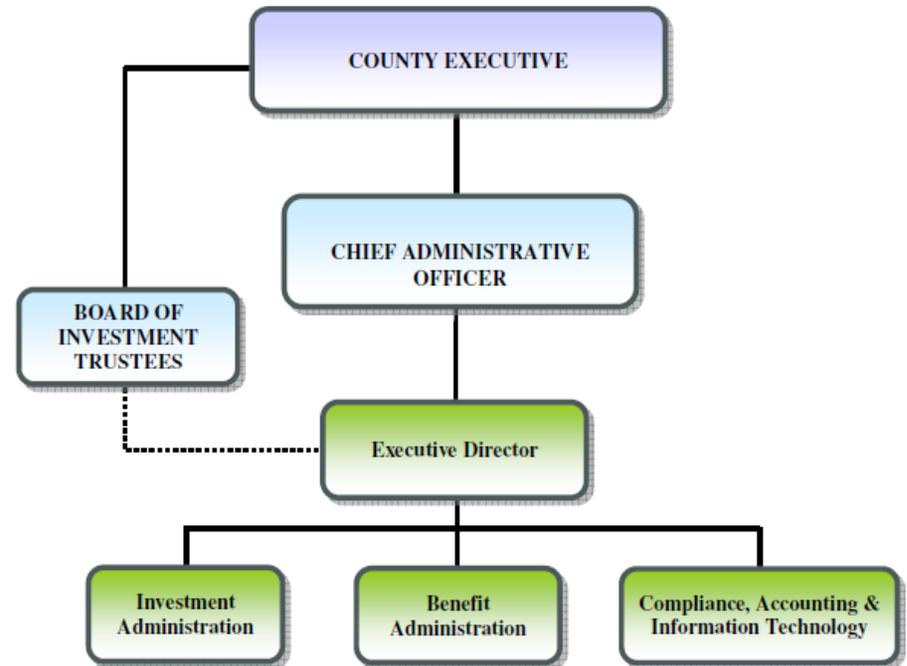
**Stephen B. Farber**  
Montgomery County Council Administrator  
Ex-Officio Member

**Jefferi K. Lee**  
Public Representative  
Term Expires March 2017

**Kelda J.C. Simpson**  
Police Bargaining Unit Designee

**Diane Wurdeman**  
Non-Bargaining Unit Representative  
Term Expires March 2017

## Retirement Plans Administrative Organization



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## **Board Actions**

- ***Employees' Retirement System (includes GRIP)***
  - *Continued to add new investments in the following sectors to further diversify the portfolio and manage risk: public equities, private equity, private real assets, private debt, and opportunistic.*
  - *Approved a structural change to the asset allocation that will result in the addition of master limited partnerships and non-U.S. small capitalization equity investments.*
- ***Retirement Savings Plan & Deferred Compensation Plan***
  - *Approved transitioning target date fund offerings across all retirement plans to the SSgA Target Retirement Funds.*
  - *Converted the Managed Income Portfolio to a lower fee share class which resulted in an average cost savings of 22% for participants.*
  - *Added the JP Morgan U.S. Government Money Market Fund to the standard lineup as the Brokeragelink default option.*
  - *Held annual benefit fair to provide a forum for participants to ask questions about the Plans and gain additional information on investment options directly from investment firms.*

## **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, 2013. 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 fourteen years that it has published its own CAFR.*
- ***Employees' Retirement System***
  - *The investment return for the year ended June 30, 2014 was a gain of 17.66%. The return ranked above median compared to returns achieved by similar public pension funds reporting results for the one year period. For the three and five year periods, the ERS' investment returns ranked in the top quartile of the peer group universe of public pension plans.*
- ***Retirement Savings Plan***
  - *As of June 30, 2014, 76% of the funds offered through Fidelity were rated three stars or above by Morningstar (five star is the highest rating). The one year return for the Plan was a gain of 17.60%.*
- ***Deferred Compensation Plan***
  - *As of June 30, 2014, 94% of the funds offered through Fidelity were rated three stars or above by Morningstar (five star is the highest rating). The one year return for the Plan was a gain of 16.20%.*

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## **Current Board Initiatives**

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

- *Continue to 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 return within an acceptable level of risk.*
- *Build direct exposure to opportunistic investment managers, and continue to add private equity, private real assets, and private debt funds, in order to improve the portfolio's risk adjusted return.*
- *Monitor and evaluate fees paid to financial managers to ensure the ERS is paying the lowest possible fee for the service provided.*

- ***Retirement Savings Plan and Deferred Compensation Plan***

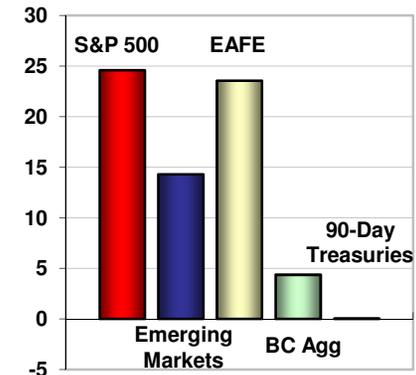
- *Continue to evaluate the investment fund line-up offered to participants to ensure that a diversified slate of top quality funds is available at the lowest possible fee.*
- *Evaluate the possibility of offering the investment managers used in the ERS to Retirement Savings Plan and Deferred Compensation Plan participants which should result in lower fees and a more diversified investment offering.*
- *Expand the investment educational opportunities available to participants through third-party vendors to provide them the tools necessary to plan for retirement.*

## Market Highlights – ERS Investment Performance

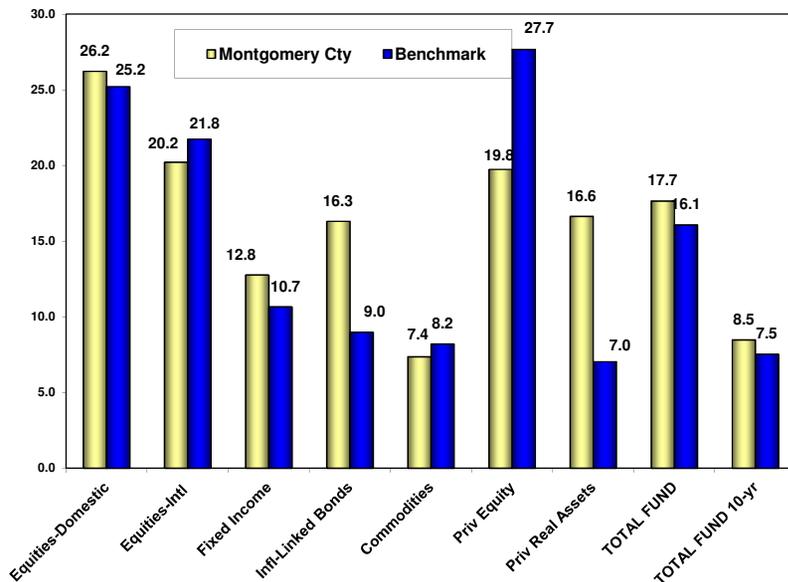
The past twelve months can be characterized by uneven but increasing economic growth as the US enters the sixth year of economic expansion that began in June 2009. GDP fell in the March quarter due to weather related issues but rebounded 4.6% in the June quarter, which was broad-based, with consumer and business spending, exports, homebuilding and government contributing. The manufacturing sector, as measured by the ISM composite, expanded throughout the fiscal year. The housing recovery has slowed. All of the jobs lost during the 2008 recession have been recovered with the unemployment rate declining to 6.3%. CPI rose a modest 1.7%, below the Federal Reserve's 2.0% target rate, giving them the ability to keep interest rates lower for an extended period of time. However, the Federal Reserve is expected to end its bond-buying program over the next six to twelve months as the economy continues to grow and the fiscal drag from spending cuts and tax hikes is fading and business spending is accelerating.

Both the U.S. and developed equity markets posted strong performance in FY14 (see chart to the right). Despite a 14.31% return, emerging markets underperformed their developed counterparts due to geopolitical concerns and slowing growth in China. Commodities, as measured by the DJ UBS Commodities Index, advanced 8.21%. The Treasury yield curve flattened with long rates declining and shorter rates remaining steady at close to zero percent; however, the yield curve remains historically steep. The Barclay's Aggregate Bond Index rose 4.37% and long duration bonds, as measured by the Barclay's Capital U.S. Long Government/Credit Index, advanced 10.77%. High yield was the best performing fixed income asset class, returning 11.79% during the fiscal year.

Index Returns  
Year Ending 6/30/14



**Employees' Retirement System**  
**FY 2014 Returns by Asset Class-Gross of fees**



The Board allocates ERS assets to a broad array of asset classes resulting in the following allocation as of June 30, 2014: domestic equities 18.1%, private equity 7.1%, international equities 16.4%, global equities 4.0%, fixed income 24.7%, opportunistic 3.5%, global inflation indexed bonds 10.0%, commodities 5.5%, private real assets 5.1%, and global REITs 5.6%. The chart to the left reflects the returns for the fiscal year ending June 30, 2014 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:

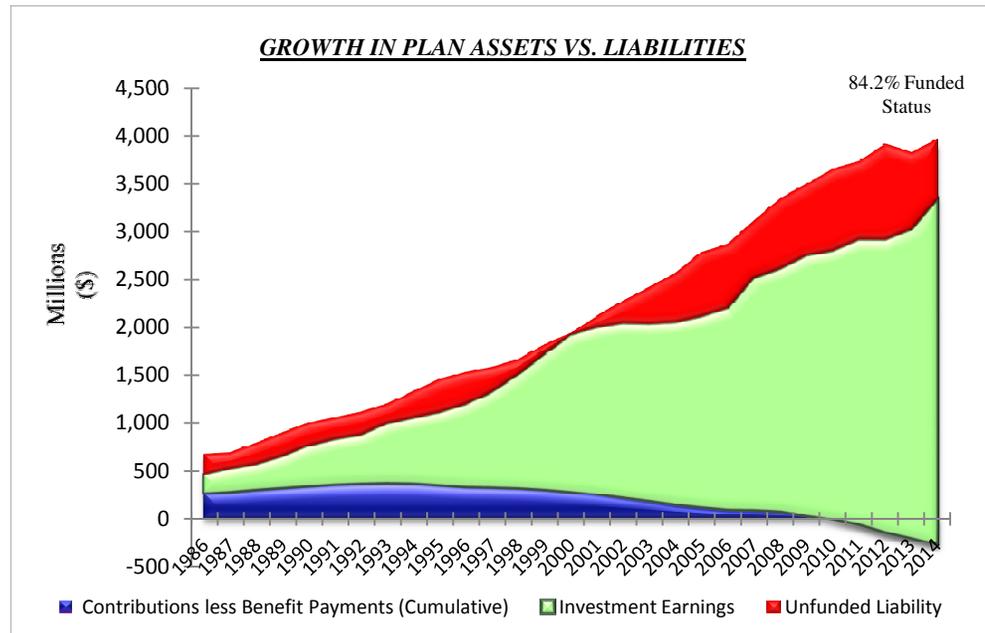
- realize the actuarial assumed rate of return of 7.5% annually, over a long term time horizon (for the 2005-2014 fiscal year decade, the annual rate of return on the ERS' investments was 8.5% before fees);
- manage portfolio risk to limit potential downside fluctuations in the value of the total ERS 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 Montgomery County Employee Retirement Plans at 240-777-8230.
- **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 27-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 2008-2009, plus increased liabilities for higher future benefit payments, the funded status decreased. As of June 30, 2014, the ERS was 84.2% funded. The area shown as the top layer reflects the additional amount required (\$625 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 FY14, 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's onsite representative at 240-777-8228 or stop by the Fidelity office located in the Executive Office Building, 101 Monroe St, 15<sup>th</sup> floor. Additional information is also available at the Fidelity website at <http://plan.fidelity.com/MCG> or by calling 1-800-343-0860.

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 RSP 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, <http://www.montgomerycountymd.gov/mcERP>.

Shown to the right is a list of the investment funds offered, along with their Morningstar rating and annualized performance as of June 30, 2014.

Fidelity's web site, <http://plan.fidelity.com/MCG>, 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 |
| <b>Stable Value Funds:</b>             |                    |                 |        |         |
| Fidelity Managed Income                | Not Rated          | 0.91            | 1.18   | 2.49    |
| <b>Income Funds:</b>                   |                    |                 |        |         |
| Fidelity Total Bond                    | ★★★★               | 5.73            | 6.88   | 5.53    |
| Fidelity Inflation-Protected Bond      | ★★★                | 4.00            | 5.10   | 4.56    |
| SSgA U.S. Bond Index                   | Not Rated          | 4.31            | 4.80   | n/a     |
| PIMCO High Yield                       | ★★★                | 9.94            | 13.04  | 7.99    |
| <b>Target Date Funds*:</b>             |                    |                 |        |         |
| Fidelity Freedom K 2000                | ★★                 | 7.64            | 6.91   | 4.39    |
| Fidelity Freedom K 2005                | ★★                 | 10.48           | 9.26   | 5.13    |
| Fidelity Freedom K 2010                | ★★                 | 12.90           | 10.55  | 5.74    |
| Fidelity Freedom K 2015                | ★★★                | 13.87           | 10.91  | 5.98    |
| Fidelity Freedom K 2020                | ★★★                | 14.93           | 11.92  | 6.08    |
| Fidelity Freedom K 2025                | ★★★                | 17.23           | 12.97  | 6.44    |
| Fidelity Freedom K 2030                | ★★★                | 18.59           | 13.53  | 6.36    |
| Fidelity Freedom K 2035                | ★★★                | 19.97           | 14.09  | 6.54    |
| Fidelity Freedom K 2040                | ★★★                | 20.16           | 14.28  | 6.52    |
| Fidelity Freedom K 2045                | ★★★                | 20.45           | 14.45  | n/a     |
| Fidelity Freedom K 2050                | ★★★                | 20.57           | 14.56  | n/a     |
| Fidelity Freedom K 2055                | ★★                 | 20.99           | n/a    | n/a     |
| Fidelity Freedom K Income              | ★★                 | 7.70            | 6.75   | 4.39    |
| <b>Growth &amp; Income Funds:</b>      |                    |                 |        |         |
| Hartford Dividend & Growth             | ★★★★               | 23.50           | 17.41  | 8.98    |
| SSgA S&P 500 Index                     | Not Rated          | 24.45           | 18.75  | 7.78    |
| ClearBridge Appreciation Fund          | ★★★★               | 20.79           | 16.74  | 8.12    |
| <b>Growth Funds:</b>                   |                    |                 |        |         |
| ClearBridge Small Cap Growth           | ★★★★★              | 21.82           | 21.71  | 10.52   |
| Fidelity Growth Company                | ★★★★★              | 30.13           | 21.54  | 10.89   |
| Fidelity Low-Priced Stock              | ★★★★               | 22.31           | 20.25  | 10.50   |
| Fidelity Small Cap Value               | ★★★★               | 22.38           | 20.66  | n/a     |
| SSgA Russell Small/Mid Cap Index       | Not Rated          | 27.25           | 21.61  | 10.12   |
| <b>International Stock Funds:</b>      |                    |                 |        |         |
| Harbor International                   | ★★★★               | 21.57           | 13.58  | 10.01   |
| Oppenheimer Global                     | ★★★★               | 23.24           | 16.33  | 8.84    |
| SSgA Global All Cap Equity ex US Index | Not Rated          | 22.50           | n/a    | n/a     |
| <b>Specialty Funds:</b>                |                    |                 |        |         |
| Fidelity Strategic Real Return         | ★★                 | 7.42            | 8.55   | n/a     |

\* Retail share returns are shown for the Fidelity Freedom funds 5 year and 10 year periods

\*1 Year performance data for the Target Date Funds are for the Fidelity Freedom K shares. For longer time-periods and for Morningstar Star Ratings, the retail share class was used.

# Deferred Compensation Plan (DCP)

The County established the Deferred Compensation Plan for employees in 1980. 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, 2014, along with their Morningstar rating and annualized performance as of June 30, 2014. Additional information on the investment program is available on the Plan web site at <http://plan.fidelity.com/MCG> and the Board's web site at <http://www.montgomerycountymd.gov/mcerp>.

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

All non-represented employees hired after June 6, 2010 are automatically enrolled in the Plan 60 days after the date they are hired. Other 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 Fidelity's onsite representative, at 240-777-8228 or stop by the Fidelity office located in the Executive Office Building, 101 Monroe Street, 15<sup>th</sup> floor. Additional information is also available at the Fidelity website at <http://plan.fidelity.com/MCG>.

| Funds                                  | Morningstar Rating | Rates of Return |        |         |
|----------------------------------------|--------------------|-----------------|--------|---------|
|                                        |                    | 1 Year          | 5 Year | 10 Year |
| <b>Stable Value Funds:</b>             |                    |                 |        |         |
| Fidelity Managed Income                | Not Rated          | 0.91            | 1.18   | 2.49    |
| <b>Income Funds:</b>                   |                    |                 |        |         |
| Fidelity Total Bond                    | ★★★★               | 5.73            | 6.88   | 5.53    |
| Fidelity Inflation-Protected Bond      | ★★★                | 4.00            | 5.10   | 4.56    |
| SSgA U.S. Bond Index                   | Not Rated          | 4.31            | 4.80   | n/a     |
| PIMCO High Yield                       | ★★★                | 9.94            | 13.04  | 7.99    |
| <b>Target Date Funds:</b>              |                    |                 |        |         |
| BlackRock Lifepath Retirement          | ★★★                | 11.29           | 9.46   | 5.93    |
| BlackRock Lifepath 2020                | ★★★                | 13.85           | 11.22  | 6.11    |
| BlackRock Lifepath 2030                | ★★★                | 16.80           | 12.85  | 6.34    |
| BlackRock Lifepath 2040                | ★★★                | 19.16           | 14.20  | 6.48    |
| BlackRock Lifepath 2050                | ★★★                | 21.27           | 16.05  | n/a     |
| <b>Growth &amp; Income Funds:</b>      |                    |                 |        |         |
| Hartford Dividend & Growth             | ★★★★               | 23.50           | 17.41  | 8.98    |
| SSgA S&P 500 Index                     | Not Rated          | 24.45           | 18.75  | 7.78    |
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| Harbor International                   | ★★★★               | 21.57           | 13.58  | 10.01   |
| Oppenheimer Global                     | ★★★★               | 23.24           | 16.33  | 8.84    |
| SSgA Global All Cap Equity ex US Index | Not Rated          | 22.50           | n/a    | n/a     |
| <b>Specialty Funds:</b>                |                    |                 |        |         |
| Fidelity Strategic Real Return         | ★★                 | 7.42            | 8.55   | n/a     |

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