**BOARD OF INVESTMENT TRUSTEES**

**M E M O R A N D U M**
August 7, 2014

**TO:** Participants – Deferred Compensation Plan, Retirement Savings Plan, Deferred Retirement Service Program

**FROM:** Linda A. Herman, Executive Director

**SUBJECT:** Investment Offerings

The Board of Investment Trustees, which oversees the investments offered through the County's defined contribution, deferred compensation and Police DROP plans, regularly evaluates and reviews the investment options and services available to participants. As of June 30, 2014, combined Plan participants totaled over 6,000 active employees and 2,000 retirees with combined assets over $650 million.

The Board regularly reviews the Plans' investment vehicles and service providers. Based on a recent review, the Board has been able to obtain a fee reduction for the Managed Income Portfolio (MIP) that is being implemented effective September 11, 2014.

<u>To implement this change and fee reduction,</u> MIP Class 1 will be converted to the MIP Class 2 effective as of the close of regular trading on the New York Stock Exchange on September 10, 2014. The MIP Class 2 has lower fees as shown in the table above, resulting in a higher return to participants. There is no difference in the investment objective, strategy, and risk between Class 1 and Class 2.

Absent your affirmative direction, which must be received before 4 PM ET on September 9, 2014, any amount you have invested in MIP Class 1 as of the close of regular trading on the New York Stock Exchange on September 10, 2014, will automatically be transferred to MIP Class 2. The transfer of your balance will appear as an exchange on your account history and quarterly statement. At no time will the balance of your account be uninvested. All future contributions that you have designated for the MIP Class 1 will be invested in the MIP Class 2 after September 10, 2014. Please see the attached fund fact sheet for the MIP Class 2. You may elect to transfer any amount you have invested in MIP Class 1 and/or redirect your future contributions from MIP Class 1, to any other existing* investment option, at any time prior to 4 PM ET on September 9, 2014.

The financial impact of the change from MIP Class 1 to MIP Class 2 is summarized as follows:

| **Fund Name** | **Management Fee** | **Expense Ratio %** | **Expense Ratio Per $1000** |
|---|---|---|---|
| Old Class (In Use Through September 10, 2014) : Managed Income Portfolio Class 1 | 0.55% | 0.77% | $7.70 |
| New Class (In Use Starting September 11, 2014): Managed Income Portfolio Class 2 | 0.35% | 0.57% | $5.70 |

*You are not permitted to make a direct exchange from Managed Income Portfolio Class 1 or Class II to Fidelity BrokerageLink® (considered "competing funds"). Before exchanging from Managed Income Portfolio Class 1 and Class II, you must first exchange to a "noncompeting" fund for 90 days. While these requirements may seem restrictive, they are typically imposed by issuers such as insurance companies, banks, or other approved financial institutions, as a condition for issuing investment contracts to retirement plans.

Fidelity Investments, recordkeeper service provider, is available onsite, at the Executive Office Building, 15th floor. You can also contact Fidelity by phone at 240-777-8228 or via email at fidelityonsite@montgomerycountymd.gov to assist you with your retirement planning needs and investment related questions including: asset allocation, investment fund offerings, estimates of retirement income, distributions, etc. In addition, you can register for a one-on-one meeting with the representative by visiting the Board's website at **www.montgomerycountymd.gov/bit** and clicking on Investment Education – one-on-one session.

**Questions?** Contact the Board of Investment Trustees by email at **bit@montgomerycountymd.gov** or by calling **240-777-8220**.

# Managed Income Portfolio Class 2

Portfolio Information as of 6/30/14

| | |
|---|---|
| Inception Date: | 09/07/89 |
| Total Net Assets ($Millions): | $630.15 |
| *Short-term Trading Fee /* | - |
| *Holding Period:* | - |
| Number of Holdings: | 409 |
| Annual Turnover Rate (09/30/13): | 56% |
| Unit Price: | $1.00 |
| Management Fee: | 0.35% |
| *Expense Ratio:* | *0.57%* |
| Per $1000: | $5.70 |

*If portfolio has multiple share classes, Total Net Assets includes the net assets of all share classes.*

Portfolio Manager (Tenure on Portfolio):

Rob Chan (07/12)

Performance Commentary:

The market environment was characterized by falling interest rates, a flattening U.S. Treasury yield curve, narrowing yield spreads, and declining levels of volatility, all of which combined to drive bond prices higher. Longer-dated securities generally outperformed shorter-dated securities, spread sectors outperformed U.S. Treasuries and lower-quality bonds generally outperformed higher-quality bonds.

Bond prices in the second quarter were supported by weak macroeconomic data, reassuring public statements from the Federal Reserve and by a modest “flight to safety” amid growing geopolitical tensions in many parts of the world, especially Ukraine, Syria, and Iraq.

For the quarter, the portfolio outperformed the benchmark on a market value basis (gross of fees). The portfolio’s overweight to corporates along with security selection within the sector combined to help performance. More specifically an overweight to financials, banking in particular, aided portfolio performance.

An out-of-benchmark position in investment-grade CMBS, specifically those structures with shorter maturities and a meaningful level of protection from losses in the underlying pools, benefited performance as the sector continued to see improving fundamental and technical factors.

An out-of-benchmark allocation to ABS aided performance. The additional income earned by positions in securities backed by credit card receivables and autos loans was beneficial to returns.

At quarter-end, more than half of the portfolio was held in Treasuries and Government-related debt. However, the portfolio was meaningfully underweight these sectors relative to the benchmark on a market value basis.

The portfolio maintained an overweight position in corporate debt coming largely from the banking sector. We believe that increased regulations and liquidity requirements being imposed on banks will result in them being more utility-like, making the sector attractive from a bond holder perspective, particularly relative to many industrial sectors which continue to see merger and acquisition activity, share buy backs and increased dividends which may pose a risk to bond holders.

The portfolio maintained out-of-benchmark allocations to short-dated ABS and a variety of mortgage securities, and CMBS. These positions increase portfolio diversification, provide yield pickup over Treasuries and offer sound fundamental values

## Performance as of 6/30/14

| | CUMULATIVE RET. (%) | | AVERAGE ANNUAL RET. (%) | | | | |
|---|---|---|---|---|---|---|---|
| | 3 Mo. | YTD | 1 Year | 3 Year | 5 Year | 10 Year | LOF |
| Portfolio | 0.29 | 0.56 | 1.11 | 1.23 | 1.24 | 2.52 | 4.60 |
| Barclays 3M t-bill | 0.01 | 0.04 | 0.07 | 0.09 | 0.13 | 1.67 | 3.41 |

| | CALENDAR YEAR RET. (%) | | | | |
|---|---|---|---|---|---|
| | 2013 | 2012 | 2011 | 2010 | 2009 |
| Portfolio | 1.13 | 1.28 | 1.34 | 1.31 | 1.65 |
| Barclays 3M t-bill | 0.08 | 0.12 | 0.11 | 0.15 | 0.23 |

*Returns are net of management and wrap fees, and distribution fees (if applicable). Total Returns are historical and include change in share value and reinvestment of dividends and capital gains, if any. Cumulative total returns are reported as of the period indicated. Life of Fund figures are reported as of the inception date to the period indicated. These figures do not include the effect of sales charges, if any, as these charges are waived for contributions made through your company's employee benefit plans. If sales charges were included, returns would have been lower. Past performance does not guarantee future results.*

*Management Fee includes the costs associated with managing the investments in the portfolio. The management fee does not include the wrap contract fees, which are paid to third-party wrap providers and do not result in any additional compensation to Fidelity. The wrap contract fees are not separately stated but are included in the Expense Ratio and do reduce investment options' returns.*

*Distribution Fee represents fees paid out of the plan's interest in the fund to the plan's Investment Professional for distribution services.*

*Expense Ratio is intended to reflect the total annual pool or class operating expenses and are stated as a percent of the pool’s total net assets. It includes management and wrap contract fees. For certain funds, it may also include distribution fees. They may be calculated differently than the Expense Ratio used for mutual funds and may not include all the fees that mutual fund expense ratios are required to reflect. This information has been provided by the trustee or plan sponsor. When no information is shown, it is due to the fact that none was available. Please note that the Gross and Net Expense Ratio are the same for this product and are indicated as Expense Ratio. Net Expense Ratio reflects expenses net of fee waivers or reimbursements (if any), which may be contractual or voluntary. Expense Ratio is as of 9/30 fiscal year end.*

## Yield & Portfolio Data as of 6/30/14

| | |
|---|---|
| Duration | 2.62 |
| 7-Day Yield* | 1.17% |

**The current yield of the fund listed above reflects the current earnings of the fund, while the total return refers to a specific past holding period.*

Duration estimates how much a bond's price fluctuates with changes in comparable interest rates. If rates rise 1.00%, for example, a fund with a 5-year duration would be expected to lose about 5.00% of its value. Other factors also can influence a bond fund’s performance and share price. Accordingly, a bond fund’s actual performance may differ from this example. The duration calculation takes into account any call or put option embedded in the bonds.

*Barclays U.S. 3 Month Treasury Bellwether Index is a market value-weighted index of investment-grade fixed-rate public obligations of the U.S. Treasury with maturities of 3 months, excluding zero coupon strips.*

# Managed Income Portfolio Class 2

**Objective:** The fund seeks to preserve your principal investment while earning a level of interest income that is consistent with principal preservation. The fund seeks to maintain a stable net asset value (NAV) of $1 per share, but it cannot guarantee that it will be able to do so. The yield of the fund will fluctuate.

**Strategy:** The fund invests in benefit-responsive investment contracts issued by insurance companies and other financial institutions ("Contracts"), fixed income securities, and money market funds. Under the terms of the Contracts, the assets of the fund are invested in fixed income securities (which may include, but are not limited to, U.S. Treasury and agency bonds, corporate bonds, mortgage-backed securities, commercial mortgage-backed securities, asset-backed securities, and collective investment vehicles and shares of investment companies that invest primarily in fixed income securities) and shares of money market funds. The fund may also invest in futures contracts, option contracts, and swap agreements. Fidelity Management Trust Company, as investment manager and trustee of the Fidelity Group Trust for Employee Benefit Plans, has claimed an exemption from registration under the Commodity Exchange Act and is not subject to registration or regulation under the Act. At the time of purchase, all Contracts and securities purchased for the fund must satisfy the credit quality standards specified in the Declaration of Separate Fund

**Risk:** The Contracts and securities purchased for the fund are backed solely by the financial resources of the issuers of such Contracts and securities. An investment in the fund is not insured or guaranteed by the manager(s), the plan sponsor, the trustee, the FDIC, or any other government agency. The Contracts purchased by the fund permit the fund to account for the fixed income securities at book value (principal plus interest accrued to date). Through the use of book value accounting, there is no immediate recognition of investment gains and losses on the fund's securities. Instead, gains and losses are recognized over time by periodically adjusting the interest rate credited to the fund under the Contracts. However, while the fund seeks to preserve your principal investment, it is possible to lose money by investing in this fund. The Contracts provide for the payment of certain withdrawals and exchanges at book value during the terms of the Contracts. In order to maintain the Contract issuers' promise to pay such withdrawals and exchanges at book value, the Contracts subject the fund and its participants to certain restrictions. For example, withdrawals prompted by certain events (e.g., layoffs, early retirement windows, spin-offs, sale of a division, facility closings, plan terminations, partial plan terminations, changes in laws or regulations) may be paid at the market value of the fund's securities, which may be less than your book value balance.

Certain investment options offered by your plan (e.g., money market funds, short term bond funds, certain asset allocation/lifecycle funds and brokerage window) may be deemed by the Contract issuers to "compete" with this fund. The terms of the Contracts prohibit you from making a direct exchange from this fund to such competing funds. Instead, you must first exchange to a non-competing fund for 90 days. While these requirements may seem restrictive, they are imposed by the Contract issuers as a condition for the issuer's promise to pay certain withdrawals and exchanges at book value.

All numbers are unaudited.

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## Top Five Issuers* as of 6/30/14

1. UNITED STATES TREASURY
2. FANNIE MAE
3. FREDDIE MAC
4. CHASE ISSUANCE TR
5. FNMA GTD MTG PASS THRU CTF

% of TNA:54.95

## Portfolio Composition† as of 6/30/14

| | |
|---|---|
| U.S. TREASURY | 43.8% |
| U.S. AGENCY | 7.5% |
| OTHER GOVT RELATED (U.S. AND FOREIGN) | 0.6% |
| CORPORATE | 20.7% |
| MBS PASSTHROUGH | 3.2% |
| ABS | 10.1% |
| CMBS | 9.4% |
| CMO | 2.2% |
| GUARANTEED INVESTMENT CONTRACT | 0.0% |
| CASH | 0.4% |
| NET OTHER ASSETS | 2.0% |
| Total | 100% |
| Futures, Options & Swaps | 0.0% |

† Portfolio composition categories above the Total Line represent 100% of the fund's total net assets. If futures, options and swaps are shown below the Total line, they represent the fund's full exposure value to derivatives. Portfolio composition data is as of the date indicated. It should not be construed as a recommendation for any sector and may not be representative of the portfolio's current or future investments.

## Credit Ratings£ as of 6/30/14

| | |
|---|---|
| U.S. GOVERNMENT | 56.7% |
| AAA | 19.7% |
| AA | 9.0% |
| A | 10.0% |
| BBB | 2.0% |
| BB | 0.0% |
| B | 0.0% |
| CCC & BELOW | 0.0% |
| SHORT-TERM RATED | 0.0% |
| NOT RATED/NOT AVAILABLE | 0.2% |
| CASH & NET OTHER ASSETS | 2.4% |

"Net Other Assets" includes receivables and payables and may also include notational assets/ liabilities of certain derivative instruments.

*£Credit ratings for a rated issuer or security are categorized using the highest credit rating among the following three Nationally Recognized Statistical Rating Organizations ("NRSRO"): Moody's Investors Service (Moody's); Standard & Poor's Ratings Services (S&P); or Fitch, Inc. If neither Moody's nor S&P nor Fitch publishes a rating on the issuer or security, then the security is categorized as Not Rated. All U.S. Government Securities are included in the U.S. Government category. The table information is based on the combined investments of the fund and its pro-rata share of any investments in other Fidelity funds.*

*This portfolio is not a mutual fund. It is a commingled pool managed by Fidelity Management Trust Company, a fiduciary with respect to the Fund and investing plans.*

*In order to maintain the wrap issuer's promise to pay withdrawals and exchanges at book value, the wrap contracts impose ongoing contractual commitments on the Portfolio as well as the plans invested in the Portfolio. This Portfolio is subject to certain withdrawal restrictions which are outlined in the Declaration of Separate Fund and may include a 12-month notice requirement for plan sponsor directed withdrawals.*

**The Top Five Issuers are as of the date indicated and are represented in the portfolio's holdings. They may not be representative of the portfolio's current or future investments. An Issuer is a legal entity that has the power to issue and distribute financial instruments. An issuer may be a bank, a corporation (including limited partnerships), a sovereign government, a municipality, or a mutual fund. To determine the Top Five Issuers, the legal entities associated with the portfolio's holdings are identified, common issues of an entity are then aggregated and sorted by descending portfolio weight.*

*Some investment contracts are structured solely as a general debt obligation of the issuer.*

*Other investment contracts (wrap contracts) are purchased in conjunction with an investment by the portfolio in fixed income securities, which may include U.S. Treasury bonds, corporate bonds, mortgage-backed securities, asset-backed securities, and bond funds. There is no immediate recognition of investment gains and losses on the fixed income securities. Instead, the gain or loss is recognized over time by adjusting the interest rate credited to the portfolio under the wrap contract. All investment contracts are fixed income securities purchased for the portfolio must satisfy the credit quality standards of FMTC.*

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