OFFICES OF THE COUNTY EXECUTIVE

Isiah Leggett
County Executive

Timothy L. Firestine
Chief Administrative Officer

May 16, 2011

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 March 31, 2011. 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. There were approximately 5,625 active members and 5,775 retirees participating in the ERS as of March 31, 2011.

Performance Results

The total return achieved by the ERS assets for the quarter was a gain of 4.02%, 42 basis points ahead of the 3.60% gain recorded by the policy benchmark. For the one year period ending March 31, 2011 the ERS' gross return (before fees) was a gain of 15.26%, 193 basis points ahead of the 13.33% gain recorded by the policy benchmark. The one-year return, after fees, places the ERS' performance in the top 40% 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 4.40%, after fees, ranking in the top 30% of the universe and the five-year return, a gain of 5.28% ranked in the top 10%. The asset allocation at March 31, 2011 was: Domestic Equities 27.5%, International Equities 18.2%, Fixed Income 24.4%, Inflation Linked Bonds 10%, Commodities 5.8%, Private Equity 6.7%, Private Real Assets 3.7%, Opportunistic 2.9%, and Cash 0.8%. We estimate that the funded status of the ERS was 78.1% as of March 31, 2011, a slight increase from the June 30, 2010 level. 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.

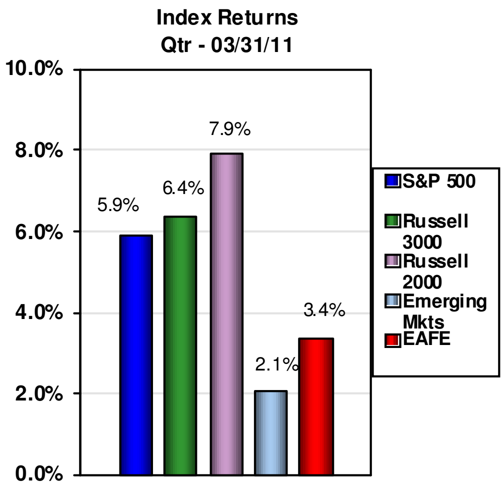
Major Initiatives

During the quarter, the Board approved the recommended 2011 commitment pace for both private equity and private real assets resulting in similar levels to 2010. Within the private equity sector, the Board approved an investment of $12,000,000 in Charterhouse Equity Partners V, L.P and a $12,000,000 investment in Wicks Capital Partners IV, L.P.

Capital Markets and Economic Conditions

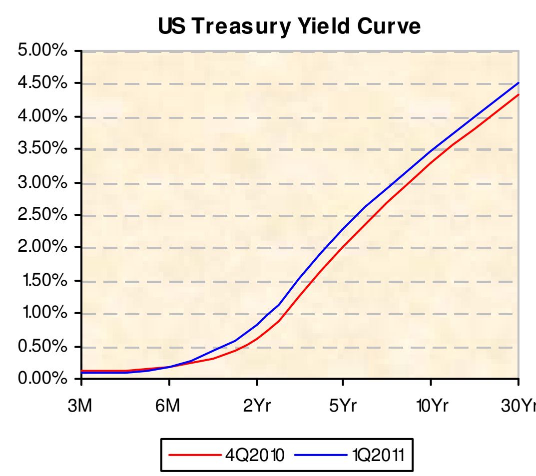
Employment improved significantly during the quarter with the unemployment rate dropping 0.6% to 8.8%; falling below 9% for the first time in nearly two years. The participation rate was unchanged indicating that unemployment declined mainly on job growth rather than a reduction in the labor force. The spike in gasoline prices caused by the unrest in the Middle East and North Africa increased inflation expectations near quarter end and weighed on consumer confidence. Inflation, as measured by the CPI, was up 2.1% on an annual basis pushed higher by gas prices, however, core inflation, which does not include food or energy, remains tame. Housing data remains depressed, and given high employment, existing inventory, higher mortgage rates and uncertainties from foreclosure delays, the sector is not expected to recover in the near term. Gains in the manufacturing sector continued from the previous quarter (more than 6%), which is par with the growth rates seen in the mid 1990s. Despite the negative impact of rising commodity prices, and the disrupting events overseas, the U.S. economy continues to gain traction.

Public Equity Markets: The U.S. equity markets rallied strongly during the first quarter on better-than-expected corporate earnings and reports showing an improving U.S. labor market. All major domestic indexes rallied as shown in the chart below with smaller capitalization (as represented by the Russell 2000 Index) stocks outperforming their larger counterparts. All sectors of the S&P 500 posted positive returns during the quarter with Energy, Industrials and Telecom Services advancing the most. Our combined domestic equity performance was a gain of 6.55%, outperforming the 6.38% gain recorded by the Russell 3000 benchmark.



Within the international markets, all major regions, except Japan, ended the quarter in positive territory. Developed markets, as measured by the MSCI EAFE Index, were up 3.36% advancing on strong earnings releases and improving business confidence despite events such as the earthquake in Japan, political uprising in North Africa and the Middle East, and the ongoing debt crises in Europe. Emerging markets gained 2.05% during the quarter underperforming their developed counterparts, as their relative attractiveness decreased due to rising inflation concerns in these countries. Our combined international equity performance was a gain of 2.80% for the quarter, underperforming the 3.41% gain recorded by the MSCI ACWI ex-US Index due the international portfolio's underweight positions to Russia and Korea, an overweight to Turkey, and stock selections in Europe.

Fixed Income: Treasury yields rose during the first quarter as economic data continued to show signs of gradual improvement. Although the Fed maintained its target rate at a 0% - 0.25% range, while reiterating its view that current economic conditions warrant exceptionally low levels for an extended period, there were some policymakers saying the central bank should consider ending its additional stimulus program of debt purchases, known as QEII, prior to the original June 30th end date. The yield curve (shown in the chart to the right) flattened as the 2 year Treasury bond rose 23bps to 0.83% while the 10 year Treasury bond rose 18 bps to 3.47%. Credit spreads tightened over the quarter, led by high yield. For the quarter, the Merrill Lynch High Yield Master II Index rose 3.90% while the Barclays Aggregate Bond returned 42bps and the Barclays Long Govt/Credit Indexes declined 2bps. Our combined fixed income performance for the quarter was a gain of 1.82%, outperforming the custom benchmark which returned 1.44%. Our global inflation-linked bond portfolio, combined with the portable alpha overlay, returned 3.78% for the quarter, compared to the 2.00% gain recorded by the benchmark.

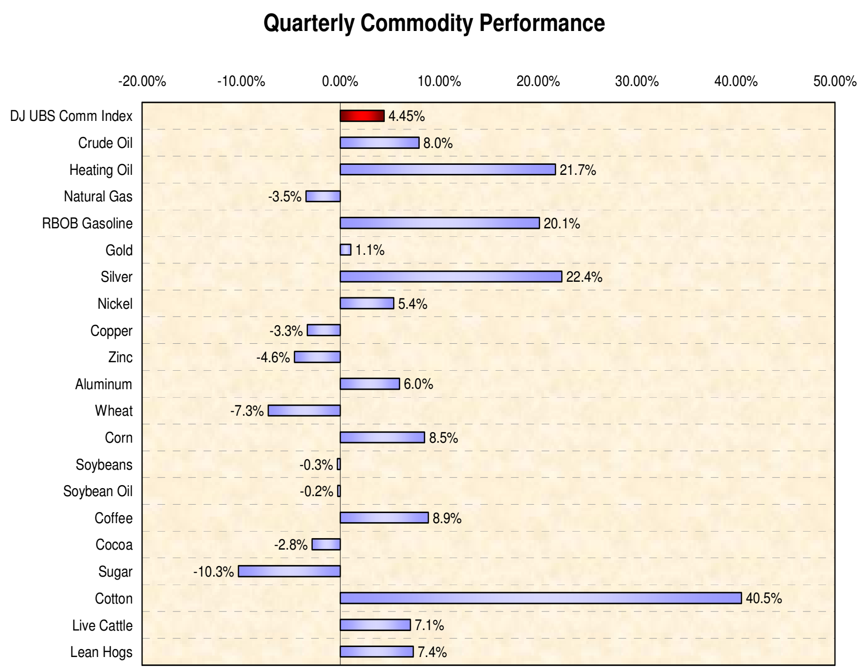


Opportunistic: Long biased credit, convertible bond and fixed income arbitrage strategies performed well in the first quarter due to spreads tightening. Merger and acquisition activity continued to increase amid numerous high profile transactions helping event driven strategies. Long/short equity strategies were generally positive amid strong corporate earnings and a rallying equity market. Macro strategies were also positive from long commodity positions, certain higher yielding, higher beta currencies and relative value trades as emerging equities underperformed developed market equities and smaller capitalization stocks outperformed large cap equities. Short biased and tail risk protection strategies detracted from performance. The return of the opportunistic allocation was a gain of 2.11%, outperforming the 0.89% return of HFRI Fund-of-Funds benchmark.

Private Equity: After a strong fourth quarter driven by a desire to execute transactions prior to a new tax regime, private equity investment activity moderated during the first quarter, though was still 56% higher versus the same period in 2010. Exit activity continues to be encouraging with a good mix of strategic and financial buyers, plus a healthy initial public offering market. Private equity fundraising also improved after trailing off during the last two quarters of 2010. During the quarter, our private equity managers called a combined $4.1 million and paid distributions of $7.4 million. Our current allocation to private equity is 6.7%, with a market value of $190.4 million. From its 2003 inception through September 30, 2010, the private equity program has generated a net internal rate of return of 3.5% versus a 3.3% return for the dollar-weighted public market equivalent (the Russell 3000 Index plus 300 basis points).

Private Real Assets: The Moody's/REAL U.S. Commercial Property Price Index has fallen for two consecutive months after encouraging upward movements at the end of 2010. However, the index has been oscillating around the same level for several months, suggesting that perhaps a market bottom has been found. Real estate transaction activity was up a healthy 10% versus the same quarter of last year. While China was a dominant driver of global activity during 2009 and 2010, the U.S., Brazil, and Eastern Europe contributed prominently the last several quarters. In energy investing, the high level of 2010 activity has carried into the first quarter, still driven largely by companies selling conventional assets in order to acquire unconventional ones (generally, energy reserves trapped in previously inaccessible areas often requiring newer drilling techniques). During the quarter, our managers called a total of $8.2 million and paid distributions of $0.7 million. Our current allocation to private real assets is 3.7%, with a market value of $103.4 million. From its 2006 inception through September 30, 2010, the private real assets program has generated a net loss of 14.5% versus a 14.9% loss for a comparable index (the Moody's/REAL U.S. Commercial Property Price Index).

Commodities: The DJ UBS Commodity Index rallied 4.45% during the quarter driven by a weak dollar, geopolitical turmoil, and headline inflation in emerging markets which caused investors to look for real assets (rather than traditional safe havens e.g. gold). Softs were the best performing sector with cotton rallying 40.5% on extremely low global inventories and strong import demand from Asia. The Livestock sector benefited from increasing global demand, most notably from Japan in the aftermath of the earthquake. In the Energy sector, heating oil delivered strong returns, rising 21.7% due to an unseasonably cold winter and supply constraints. Among precious metals, gold rose just 1% while silver climbed 22% (besides its industrial usage, silver has a high beta or in other words is a volatile commodity, therefore is expected to advance faster in up-markets) in the first quarter, reaching a new 31-year high. Industrial metals were the laggard in the first quarter, rising less than 1%, as investors tempered their expectations for global growth following the oil price spike, the Japanese earthquake, and Portugal's worsening financial crises. During the quarter, our commodities portfolio advanced 7.05%, outperforming the 4.45% gain recorded by the DJ UBS Commodities Index.



Additions

The primary sources of additions for the ERS include contributions from members and employers and investment income. The following table displays the source and amount of additions for the quarter ending March 31, 2011 and fiscal year-to-date.

Employees' Retirement System
Contributions and Investment Income (millions)

	Qtr 3/31/2011		Fiscal YTD	
Employer Contributions	$	28.6	$	88.4
Member Contributions		4.6		14.1
Net Investment Income		105.5		448.2
	$	138.7	$	550.7

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 3/31/2011		Fiscal YTD	
Benefits	$	45.4	$	134.3
Refunds		0.5		1.4
Administrative Expenses		1.0		2.3
	$	46.9	$	138.0

Outlook

At the end of the quarter, equity markets remained amid a tug of war. Downside uncertainties were at odds with fairly robust economic and stock market news, including: solid corporate profits, improving labor markets, reasonably upbeat leading economic indicators, and ongoing high levels of share buybacks, dividend increases and merger/acquisition activity. Most investment managers are adopting a view that stocks will remain in a sideways pattern for some time before upside momentum will resume. As company managers gain confidence in the upward direction of the economy, capital spending and hiring should continue to move higher, which is good for the economy but also means corporate profits will shrink. Inflation will also take its share of the profits as raw materials and energy costs escalate.

Other factors continue to be in the forefront of investor concerns, including unresolved sovereign debt issues in Europe and the threat of the economies of emerging countries, such as China, overheating. One must also remember that the uptick in the U.S. economy is taking place in the context of a massive level of monetary and fiscal stimulus. At some point interest rates will have to rise, the Fed's QE2 initiative will end, and government spending will need to moderate.

Sources: Bloomberg, Northern Trust, MSCI, S&P, Pyramis Global Advisors, FRM, Bridgewater, JP Morgan, BlackRock, PE Hub, Private Equity Analyst, Pitchbook, Real Capital Analytics, RE Alert, Schroder, Oil & Gas Investor.

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF PLAN NET ASSETS
March 31, 2011

Assets		
Equity in pooled cash and investments	$	2,685,653
Investments:		
Northern Trust		2,827,937,728
Aetna		15,028,368
Fidelity - Elected Officals Plan		736,877
Fidelity - DRSP		7,997,452
Total investments		2,851,700,425
Contributions receivable		7,435,589
Total assets		2,861,821,667
Liabilities		
Benefits payable and other liabilities		6,329,035
Net assets held in trust for pension benefits	**$**	**2,855,492,632**

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF CHANGES IN PLAN NET ASSETS
March 31, 2011

	Quarter	Fiscal YTD
Additions		
Contributions:		
Employer	$ 28,565,325	$ 88,419,631
Member	4,617,657	14,108,309
Total contributions	33,182,982	102,527,940
Investment income	110,069,707	463,954,607
Less investment expenses	4,586,901	15,734,884
Net investment income	105,482,806	448,219,723
Total additions	138,665,788	550,747,663
Deductions		
Retiree benefits	33,119,018	97,822,787
Disability benefits	10,292,990	30,501,875
Survivor benefits	1,998,877	5,925,363
Refunds	514,083	1,403,594
Administrative expenses	969,914	2,293,735
Total deductions	46,894,882	137,947,354
Net increase (decrease)	**91,770,906**	**412,800,309**
Net asset held in trust for pension benefits		
Beginning of period	**2,763,721,726**	**2,442,692,323**
End of period	**$ 2,855,492,632**	**$ 2,855,492,632**