
Board of Investment Trustees



Montgomery County Employee Retirement Plans

Annual Report

Fiscal Year ending June 30, 2012

Overview

December 20, 2012

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, 2012 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 \$2,936.8 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, 2012 the ERS had 5,554 active participants and 5,824 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, 2012 the RSP had \$198.1 million in net assets and 4,279 (3,564 active and 715 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, 2012 the DCP had \$271.4 million in net assets and 3,421 participants.

Shown below is a condensed presentation of the Net Assets and Change in Net Assets from the Comprehensive Annual Financial Report for the retirement plans for the period ending June 30, 2012:

Net Assets (Millions)						
	ERS		RSP		DCP	
	2012	2011	2012	2011	2012	2011
Assets:						
Cash and investments	\$ 3,233.9	\$ 3,153.5	\$ 197.4	\$ 183.4	\$ 270.9	\$ 272.3
Receivables	11.2	28.8	0.8	1.7	0.5	1.6
Total assets	<u>3,245.1</u>	<u>3,182.3</u>	<u>198.2</u>	<u>185.1</u>	<u>271.4</u>	<u>273.9</u>
Liabilities	<u>308.3</u>	<u>285.1</u>	<u>0.1</u>	<u>0.1</u>	<u>-</u>	<u>-</u>
Total net assets	<u>\$ 2,936.8</u>	<u>\$ 2,897.2</u>	<u>\$ 198.1</u>	<u>\$ 185.0</u>	<u>\$ 271.4</u>	<u>\$ 273.9</u>

Change in Net Assets (Millions)						
	ERS		RSP		DCP	
	2012	2011	2012	2011	2012	2011
Additions:						
Employer contributions	\$ 107.9	\$ 109.3	\$ 11.8	\$ 16.0	\$ -	\$ -
Member contributions	22.8	18.6	8.4	8.7	15.0	17.0
Net investment income	117.7	510.0	0.1	32.9	0.3	43.0
Total additions	<u>248.4</u>	<u>637.9</u>	<u>20.3</u>	<u>57.6</u>	<u>15.3</u>	<u>60.0</u>
Deductions:						
Benefits	202.8	178.8	-	-	-	-
Refunds and distributions	2.5	1.5	6.9	5.9	17.7	16.2
Administrative expenses	3.5	3.1	0.3	0.2	-	-
Total deductions	<u>208.8</u>	<u>183.4</u>	<u>7.2</u>	<u>6.1</u>	<u>17.7</u>	<u>16.2</u>
Total change in net assets	<u>\$ 39.6</u>	<u>\$ 454.5</u>	<u>\$ 13.1</u>	<u>\$ 51.5</u>	<u>\$ (2.4)</u>	<u>\$ 43.8</u>

For detailed information on all three retirement plans, please visit the Board's web site at <http://www.montgomerycountymd.gov/mcerp>. For questions, please call the Board office at 240-777-8220.

Board of Investment Trustees

Jeffrey Sharpe
Chair

Montgomery County Council Representative
Term Expires March 2014

George Willie
Vice Chair
Public Representative
Term Expires March 2014

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

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

Jeffrey D. Buddle
Fire & Rescue Bargaining Unit Designee

Vacant
Public Representative

Kelda J.C. Simpson
Police Bargaining Unit Designee

Sunil Pandya
Secretary
Montgomery County
Department of Liquor Control
Non-Bargaining Unit Representative
Term Expires March 2014

Jennifer E. Barrett
Retired Employees Representative
Term Expires March 2015

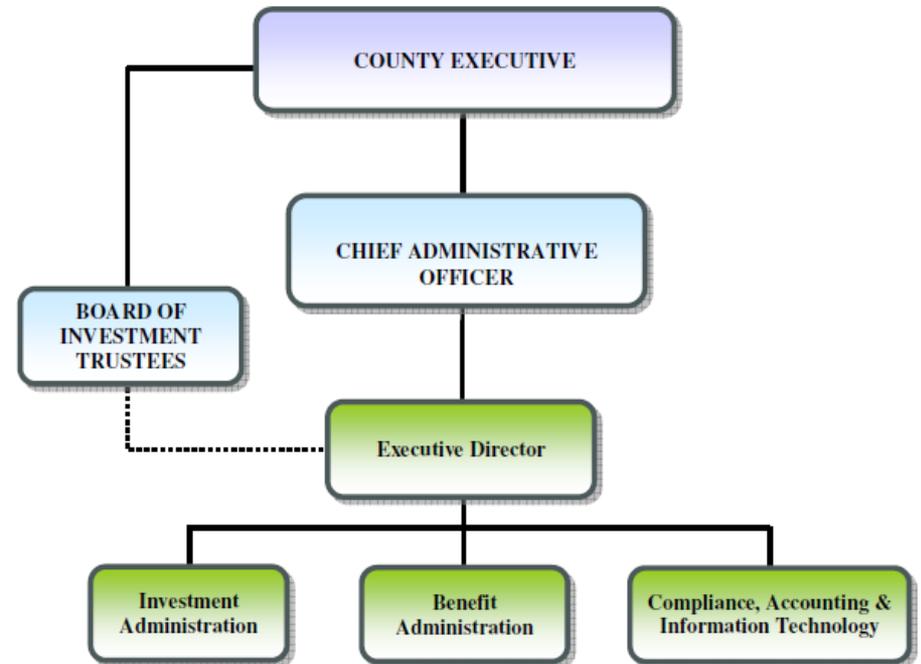
Arjan Berkelaar
Montgomery County Council Representative
Term Expires March 2015

Stephen B. Farber
Montgomery County Council Staff Director
Ex-Officio Member

Gino Renne
OPT/SLT Bargaining Unit Designee

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

Retirement Plans Administrative Organization



Board Actions

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

- *Continued to add new investments in both the private equity and private real assets portfolios, which should enhance returns and add diversification.*
- *Added new investment managers in both the domestic equities and opportunistic portfolios.*
- *Approved a structural change to the asset allocation that will result in the addition of global public real estate securities to the portfolio.*

■ ***Retirement Savings Plan***

- *Hired a consultant to provide assistance to Staff in consolidating recordkeepers across all retirement plans with the goal of minimizing fees paid by participants and offering a diversified menu of high quality fund options.*
- *Reviewed capital preservation strategies, including custom stable value solutions.*

■ ***Deferred Compensation Plan***

- *Held annual benefit fair to provide a forum for participants to ask questions about the Plan and gain additional information on investment options directly from investment firms.*
- *Hired a consultant to provide assistance to Staff in consolidating recordkeepers across all retirement plans with the goal of minimizing fees paid by participants and offering a diversified menu of high quality fund options.*

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, 2011. 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 twelve years that it has published its own CAFR.*

■ ***Employees' Retirement System***

- *The ERS' investment return for the year ended June 30, 2012 was a gain of 5.30%. The ERS return ranked in the top decile, or better than over 90% of 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 its investment universe.*

■ ***Retirement Savings Plan***

- *As of June 30, 2012 24% of the funds offered through Fidelity were rated as four or five star funds by Morningstar (five star is the highest rating). The one year return for the Plan was a loss of 0.1%.*

■ ***Deferred Compensation Plan***

- *As of June 30, 2012, 50% of the funds offered through ING were rated as four or five star funds by Morningstar (five star is the highest rating). The one year return for the Plan was a gain of 0.1%.*

Current Board Initiatives

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

- *Expand our investment opportunity set by adding global equities and global real estate securities to the portfolio.*
- *Pursue methodologies for attaining direct exposure to opportunistic investment managers in order to improve the portfolio's risk adjusted return and diversification.*
- *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 risk adjusted return within an acceptable level of risk.*
- *Continue to add private equity and private real assets fund opportunities in order to increase returns and diversification.*

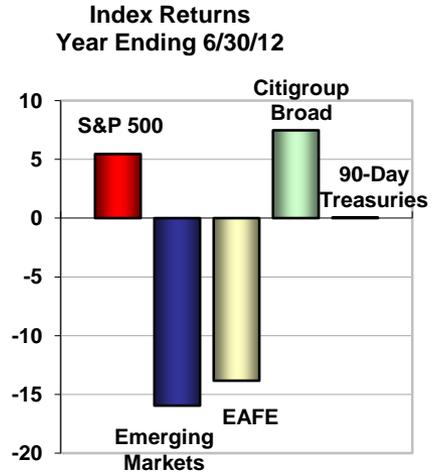
■ ***Retirement Savings Plan and Deferred Compensation Plan***

- *Transition the assets to the new recordkeeper resulting in: streamlined investment offerings across the Plans, reduced fees for participants, and expanded investment counseling.*
- *Enhance 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.*
- *Assess available lifecycle fund options, including both off-the-shelf and custom, to determine which offering best meets the needs of plan participants.*

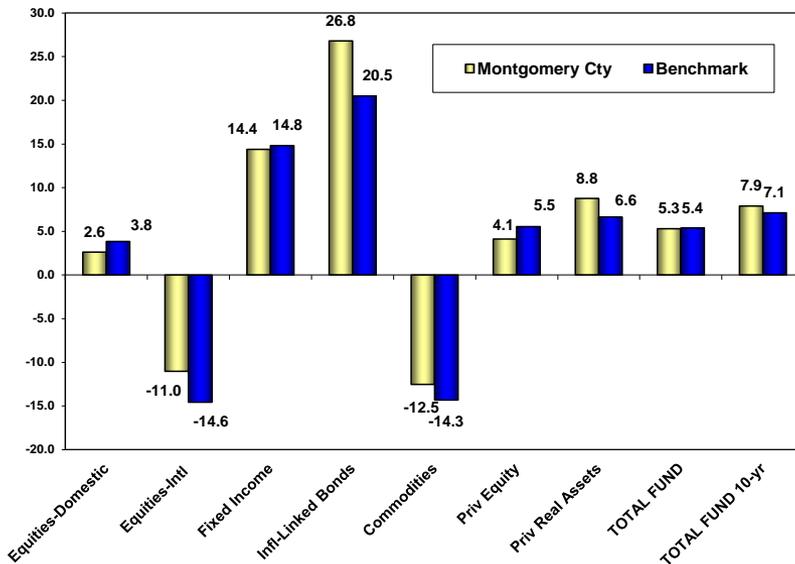
Market Highlights – ERS Investment Performance

The past twelve months can be characterized by slower economic growth and accommodative monetary policy. The pace of economic growth remains slow with GDP rising at just a 2.1% annual rate. The manufacturing sector, as measured by the ISM composite, expanded throughout most of the fiscal year before dropping below 50, the demarcation of growth and contraction, in June. CPI rose a modest 1.6%, decreasing inflationary concerns. The unemployment rate declined to 8.2%. The Federal Reserve maintained their target range of 0% to 0.25% throughout the year and announced that they would likely extend their “exceptionally low levels of the federal funds rate at least through mid-2014.” The Fed also took other measures to add liquidity to the markets through the purchase of Treasury and mortgage securities to help stimulate the economy.

U.S. equity markets posted positive performance in FY12 with the S&P 500 Index returning 5.45%. However, both non-US developed and emerging market equities declined on continued concerns over the European debt crisis and a slowdown in China. The MSCI Europe Asia Far East (EAFE) Index and MSCI Emerging Markets Index declined 13.8% and 15.9%, respectively. Commodities, as measured by the DJ UBS Commodities Index, fell 12.5%. The Treasury yield curve flattened with long rates falling while shorter dated yields remained steady at close to zero percent. The CitiGroup Broad Investment Grade Index increased 7.5% and the Merrill Lynch High Yield Index gained 6.5%. Long duration bonds, as measured by the Barclay’s Capital U.S. Long Government/Credit Index, were the best performing asset class, returning 24.6% during the fiscal year.



Employees' Retirement System FY 2012 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, 2012: domestic equities 25.3%, private equity 7.8%, international equities 15.5%, fixed income 27.5%, opportunistic 3.7%, global inflation indexed bonds 10.5%, commodities 4.6% and private real assets 5.1%. The chart to the left reflects the returns for the fiscal year ending June 30, 2012 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 2003-2012 fiscal year decade, the annual rate of return on the ERS’ investments was 7.9% 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?**

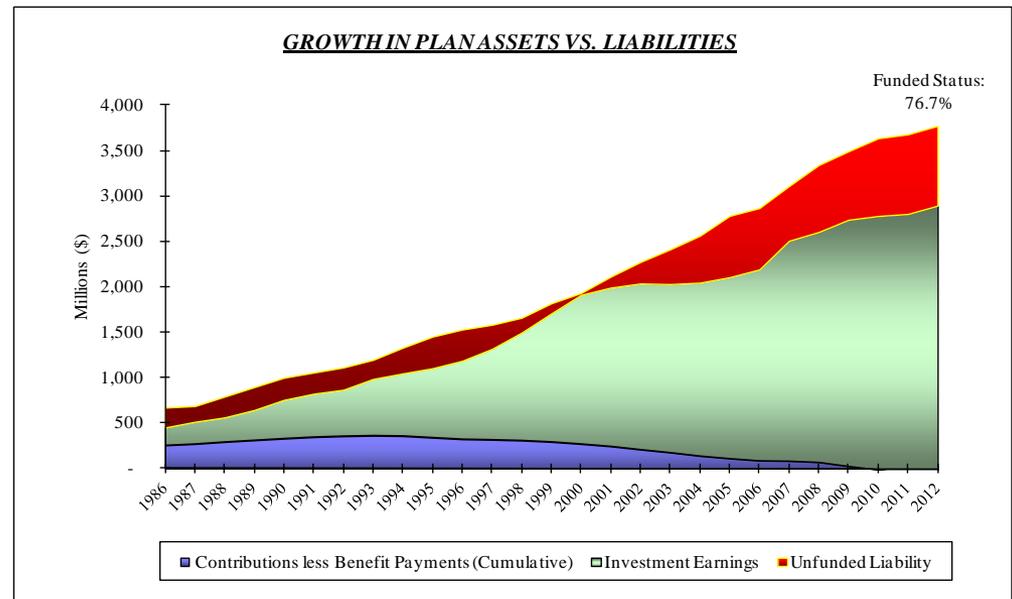
Contact the Montgomery County Employee Retirement Plans at 240-777-8230.

- **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 26-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, 2012, the ERS was 76.7% funded. The area shown as the top layer reflects the additional amount required (\$877 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 FY12, the County contributed 6% and 8% 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 Investments at 1-800-343-0860 or visit their web site at <http://plan.fidelity.com/MCG>.

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 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, 2012.

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
Stable Value Funds:				
Fidelity Managed Income	not rated	1.37	2.18	3.19
Income Funds:				
Fidelity Capital & Income	★★★★	0.63	7.35	12.11
Fidelity Intermediate Bond	★★★★	5.87	5.84	5.03
Spartan US Bond Index Investor	★★★	7.55	6.21	5.44
Fidelity Inflation-Protected Bond	★★★	11.37	7.47	6.50
Balanced Funds:				
Fidelity Puritan	★★★★	3.71	2.22	6.11
Life-Cycle Funds:				
Fidelity Freedom 2000	★★★	2.44	2.90	4.30
Fidelity Freedom 2005	★★★	1.24	1.83	n/a
Fidelity Freedom 2010	★★★★	1.13	2.07	5.30
Fidelity Freedom 2015	★★★	1.02	1.69	n/a
Fidelity Freedom 2020	★★★★	0.32	0.84	5.67
Fidelity Freedom 2025	★★★	(0.50)	0.51	n/a
Fidelity Freedom 2030	★★★	(0.98)	(0.50)	5.44
Fidelity Freedom 2035	★★★	(2.17)	(0.85)	n/a
Fidelity Freedom 2040	★★★★	(2.38)	(1.13)	5.36
Fidelity Freedom 2045	★★★	(2.57)	(1.23)	n/a
Fidelity Freedom 2050	★★	(3.01)	(1.68)	n/a
Fidelity Freedom 2055	not rated	(3.37)	n/a	n/a
Fidelity Freedom Income	★★★	2.51	3.27	4.18
Growth & Income Funds:				
Fidelity Equity-Income	★★	(1.37)	(3.41)	3.99
Davis New York Venture	★★★	(0.44)	(2.21)	5.53
Spartan Extended Market Index	★★★★	(2.10)	1.77	8.60
Spartan Total Market Index	★★★★	3.95	0.56	6.03
Spartan 500 Index	★★★	5.40	0.20	5.28
Growth Funds:				
Fidelity Contrafund	★★★★★	6.11	2.93	8.17
Fidelity Growth Company	★★★★★	3.41	4.73	9.18
Fidelity Low-Priced Stock	★★★★	(1.00)	1.72	8.69
Fidelity Small Cap	★★	(14.02)	(0.41)	6.74
Artisan Small Cap	★★★★	2.82	2.07	7.17
Northern Small Cap Value	★★★★	(0.16)	0.98	7.34
Fidelity Value	★★	(3.63)	(2.64)	6.32
International Stock Funds:				
Fidelity Diversified International	★★★	(11.58)	(5.46)	6.08
Templeton World - A Class	★★★	(7.61)	(3.04)	5.37
Spartan International Index	★★★	(13.74)	(5.89)	5.15
Specialty Funds:				
Fidelity Strategic Real Return	★★★	2.53	3.84	n/a
Fidelity Real Estate Investment	★★★	13.35	2.55	10.26

*1 Year performance figures for the Life-Cycle 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. In June 2004, the Board selected ING (formerly CitiStreet) to provide mutual and commingled fund investment vehicles for participants. Effective January 2013, Fidelity will assume the role of providing recordkeeping services to the Plan. 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, 2012, along with their Morningstar rating and annualized performance as of June 30, 2012. 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 the Fidelity onsite representative at 240-777-8228 or stop by the Fidelity office located in the Executive Office Building, 101 Monroe Street, 15th 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
Stable Value Funds:				
SSgA US Government MMF	not rated	0.00	0.85	1.66
Income Funds:				
Fidelity Inflation-Protected Bond	★★★	11.37	7.47	6.50
Goldman Sachs Short Gov't Fund	★★★★	0.76	4.22	3.63
Hartford Bond	★★★	7.78	5.62	5.59
PIMCO High Yield	★★★★	6.35	7.14	8.84
SSgA U.S. Bond Index	not rated	7.45	6.84	5.56
Life-Cycle Funds:				
BlackRock Lifepath Retirement	★★★★	4.06	4.12	5.57
BlackRock Lifepath 2020	★★★	1.87	1.63	5.46
BlackRock Lifepath 2030	★★★★	0.16	0.18	5.20
BlackRock Lifepath 2040	★★★	(0.94)	(1.03)	5.04
BlackRock Lifepath 2050	★★★	1.12	n/a	n/a
Growth & Income Funds:				
Hartford Dividend & Growth	★★★★	2.95	0.58	6.21
SSgA S&P 500 Index	not rated	5.36	0.16	5.23
SSgA Mid Small Index	not rated	(2.69)	1.23	7.93
Growth Funds:				
Legg Mason Appreciation	★★★★★	6.95	2.44	6.11
Hartford Capital Appreciation	★★★★	(6.77)	(1.60)	8.33
Amer. Funds: Growth Fund	★★★	0.18	(0.18)	6.70
Fidelity Low-Priced Stock	★★★★	(1.00)	1.72	8.69
Fidelity Small Cap	★★	(14.02)	(0.41)	6.74
Legg Mason Sm Cap Grwth	★★★★	4.81	4.35	8.36
Northern Small Cap Value	★★★★	(0.16)	0.98	7.34
International Stock Funds:				
Fidelity Diversified International	★★★	(11.58)	(5.46)	6.08
ING Oppenheimer Global I	★★★	(10.48)	(1.77)	6.32
SSgA International Index	not rated	(13.25)	(5.96)	4.45
Specialty Funds:				
Fidelity Strategic Real Return	★★★	2.53	3.84	n/a
SSgA Tuckerman Active REIT	★★	12.79	0.53	9.38

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