
Board of Investment Trustees



Montgomery County Employee Retirement Plans

Annual Report

Fiscal Year ending June 30, 2013

Overview

December 2, 2013

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, 2013 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 \$3,184.2 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, 2013 the ERS had 5,606 active participants and 5,961 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, 2013 the RSP had \$236.1 million in net assets and 4,336 (3,470 active and 866 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, 2013 the DCP had \$303.9 million in net assets and 3,426 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, 2013:

Net Position (Millions)						
	ERS		RSP		DCP	
	2013	2012	2013	2012	2013	2012
Assets:						
Cash and investments	\$ 3,461.1	\$ 3,233.9	\$ 235.2	\$ 197.4	\$ 303.3	\$ 270.9
Receivables	21.1	11.2	0.9	0.8	0.6	0.5
Total assets	3,482.2	3,245.1	236.1	198.2	303.9	271.4
Liabilities	298.0	308.3	-	0.1	-	-
Total net position	\$ 3,184.2	\$ 2,936.8	\$ 236.1	\$ 198.1	\$ 303.9	\$ 271.4

Change in Net Position (Millions)						
	ERS		RSP		DCP	
	2013	2012	2013	2012	2013	2012
Additions:						
Employer contributions	\$ 127.9	\$ 107.9	\$ 15.6	\$ 11.8	\$ -	\$ -
Member contributions	24.8	22.8	8.3	8.4	18.2	15.0
Net investment income	307.9	117.7	23.7	0.1	34.1	0.3
Total additions	460.6	248.4	47.6	20.3	52.3	15.3
Deductions:						
Benefits	208.9	202.8	-	-	-	-
Refunds and distributions	1.9	2.5	9.4	6.9	19.8	17.7
Administrative expenses	2.4	3.5	0.2	0.3	-	-
Total deductions	213.2	208.8	9.6	7.2	19.8	17.7
Total change in net position	\$ 247.4	\$ 39.6	\$ 38.0	\$ 13.1	\$ 32.5	\$ (2.4)

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

Board of Investment Trustees

George Willie
Chair
Public Representative
Term Expires March 2014

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

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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

Kelda J.C. Simpson
Police Bargaining Unit Designee

Gino Renne
OPT/SLT Bargaining Unit Designee

Jennifer E. Barrett
Secretary
Retired Employees Representative
Term Expires March 2015

Arjan Berkelaar
Montgomery County Council Representative
Term Expires March 2015

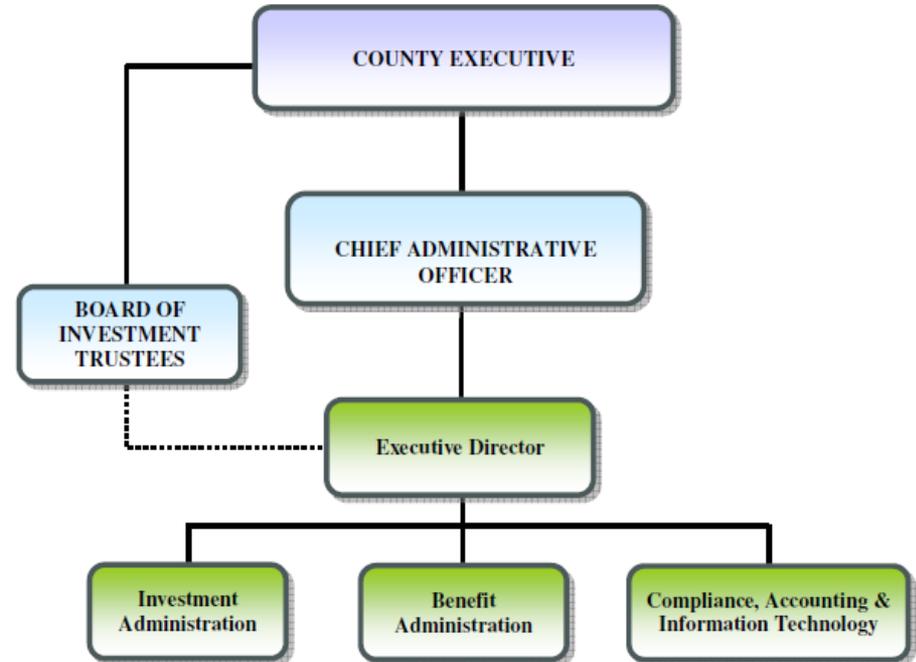
Stephen B. Farber
Montgomery County Council Administrator
Ex-Officio Member

David J. Locke
Montgomery County Council Representative
Term Expires March 2014

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

Vacant
Public Representative

Retirement Plans Administrative Organization



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, commodities and global real estate securities.*
- *Approved a structural change to the asset allocation that will result in the addition of private debt and additional opportunistic investments.*

■ ***Retirement Savings Plan & Deferred Compensation Plan***

- *Implemented the consolidation of recordkeepers across all retirement plans which resulted in lower costs for participants, improved service levels, and the streamlining of operations.*
- *Hired a consultant to assist Staff with the evaluation of the Plan's demographic data, as well as the investment products available in the market place, related to target date fund (life cycle fund) offerings.*
- *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, 2012. 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, 2013 was a gain of 10.85%. The ERS return ranked below median compared to returns achieved by similar public pension funds reporting results for the one year period due to the ERS' lower weighting in public equities than its peers. 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, 2013 50% 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 gain of 11.60%.*

■ ***Deferred Compensation Plan***

- *As of June 30, 2013, 50% 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 gain of 8.40%.*

Current Board Initiatives

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

- *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 return within an acceptable level of risk.*
- *Continue to add private equity, private real assets, and private debt fund opportunities in order to increase returns and diversification.*

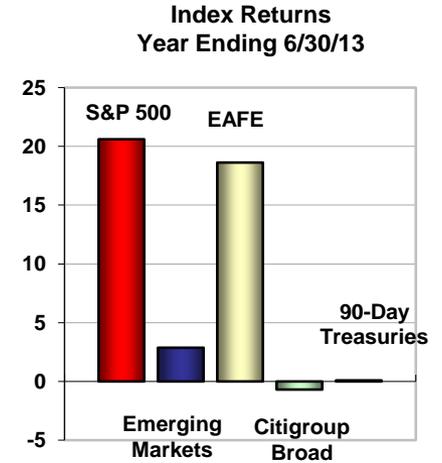
■ ***Retirement Savings Plan and Deferred Compensation Plan***

- *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.*
- *Evaluate available target date, or lifecycle fund options, including both off-the-shelf and custom, to determine which offerings best meet the needs of plan participants.*
- *Continue to expand the investment educational opportunities available to participants through third-party vendors to provide them the tools necessary to plan for retirement.*

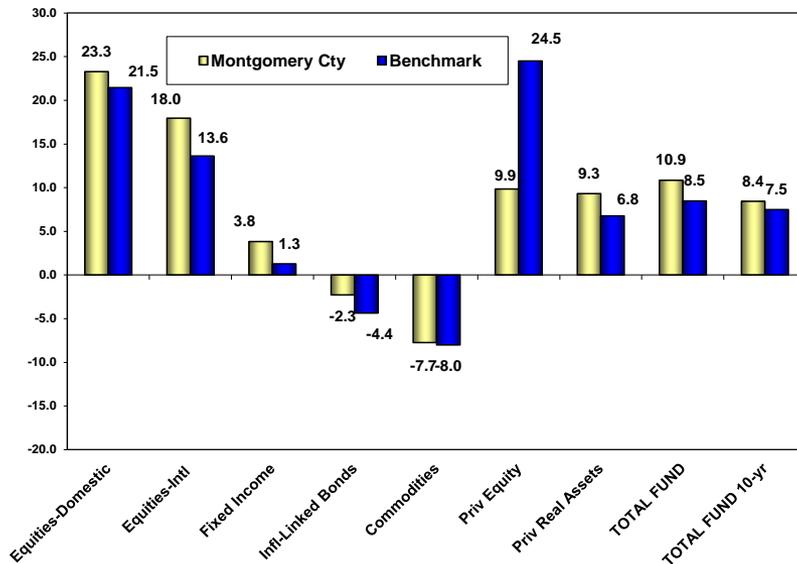
Market Highlights – ERS Investment Performance

The past twelve months can be characterized by an accommodative monetary policy and a slowly improving economy. The pace of economic growth improved with GDP rising a 2.5% annual rate. The manufacturing sector, as measured by the ISM composite, expanded throughout most of the fiscal year ending at 50.9, above the demarcation of growth and contraction, in June. CPI rose a modest 1.6%, decreasing inflationary concerns. Net new hiring remained sluggish and the unemployment rate declined to 7.6%. The Federal Reserve maintained their target range of 0% to 0.25% throughout the year and 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 strong positive performance in FY13 with the S&P 500 Index returning 20.6%. Developed International equities also posted strong positive performance with the MSCI Europe Asia Far East (EAFE) Index returning 18.6%. Emerging Markets were also positive but only returned 2.9%, underperforming their developed counterparts. Commodities, as measured by the DJ UBS Commodities Index, fell 7.74%. The Treasury yield curve steepened with long rates rising while shorter dated yields remained steady at close to zero percent. The CitiGroup Broad Investment Grade Index declined 0.7% and long duration bonds, as measured by the Barclay's Capital U.S. Long Government/Credit Index, declined 4.7%. High yield was the best performing fixed income asset class, returning 9.6% during the fiscal year.



Employees' Retirement System FY 2013 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, 2013: domestic equities 24.3%, private equity 7.5%, international equities 16.1%, global equities 2.0%, fixed income 25.5%, opportunistic 3.8%, global inflation indexed bonds 9.0%, commodities 4.3%, private real assets 5.7%, and global REITs 1.8%. The chart to the left reflects the returns for the fiscal year ending June 30, 2013 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:

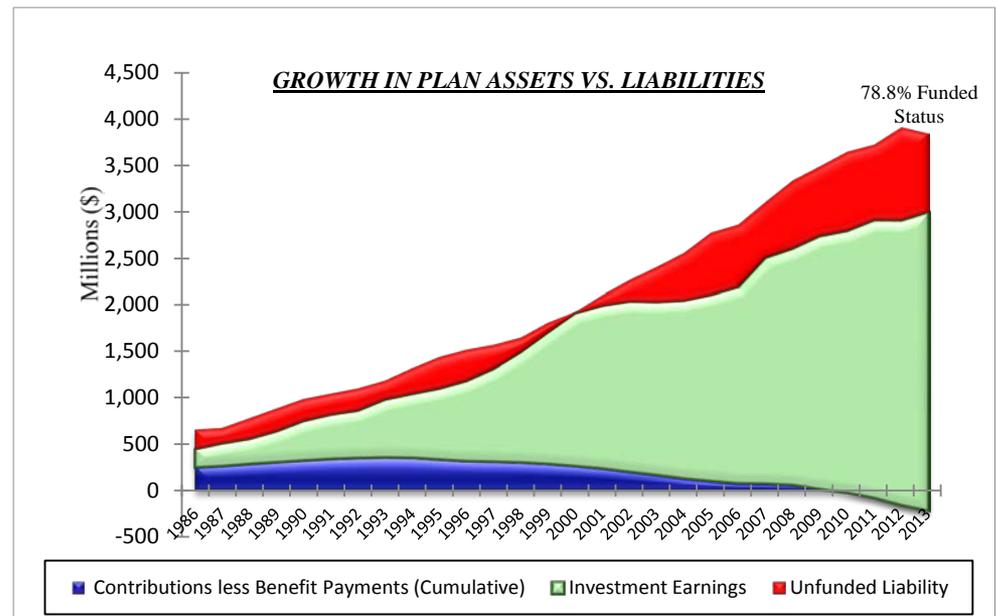
- realize the actuarial assumed rate of return of 7.5% annually, over a long term time horizon (for the 2004-2013 fiscal year decade, the annual rate of return on the ERS' investments was 8.4% before fees);
- manage portfolio risk to limit potential downside fluctuations in the value of the total ERS 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, 2013, the ERS was 78.8% funded. The area shown as the top layer reflects the additional amount required (\$809 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 FY13, 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 Jason Su, Fidelity's 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> 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 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, 2013.

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	1.12	1.53	2.82
Income Funds:				
Fidelity Total Bond	★★★★	0.65	6.46	5.01
Fidelity Inflation-Protected Bond	★★★	(5.27)	3.87	4.47
SSgA U.S. Bond Index	Not Rated	(0.79)	n/a	n/a
PIMCO High Yield	★★★	8.12	8.91	7.70
Life-Cycle Funds*:				
Fidelity Freedom K 2000	★★	3.59	3.78	4.15
Fidelity Freedom K 2005	★★★	6.11	3.77	n/a
Fidelity Freedom K 2010	★★★★	7.99	4.37	5.47
Fidelity Freedom K 2015	★★★	8.23	4.24	n/a
Fidelity Freedom K 2020	★★★	9.29	3.91	6.13
Fidelity Freedom K 2025	★★★★	11.37	4.12	n/a
Fidelity Freedom K 2030	★★★	12.03	3.54	6.33
Fidelity Freedom K 2035	★★	13.87	3.57	n/a
Fidelity Freedom K 2040	★★★	14.14	3.41	6.52
Fidelity Freedom K 2045	★★	14.57	3.48	n/a
Fidelity Freedom K 2050	★★★	14.79	3.12	n/a
Fidelity Freedom K 2055	Not Rated	15.40	n/a	n/a
Fidelity Freedom K Income	★★	3.53	3.98	4.05
Growth & Income Funds:				
Hartford Dividend & Growth	★★★★	21.60	6.84	8.59
SSgA S&P 500 Index	Not Rated	20.45	7.03	7.30
ClearBridge Appreciation Fund	★★★★★	19.05	6.86	7.82
Growth Funds:				
ClearBridge Small Cap Growth	★★★★	24.02	9.97	n/a
Fidelity Growth Company	★★★★	18.18	7.60	10.48
Fidelity Low-Priced Stock	★★★★★	27.22	9.95	11.38
Fidelity Small Cap Value	★★★★★	28.36	13.82	n/a
SSgA Russell Small/Mid Cap Index	Not Rated	25.28	8.64	10.23
International Stock Funds:				
Harbor International	★★★★	14.21	0.70	11.00
Oppenheimer Global	★★★★	25.67	6.03	9.72
SSgA Global All Cap Equity ex US Index	Not Rated	13.55	n/a	n/a
Specialty Funds:				
Fidelity Strategic Real Return	★★	1.12	2.33	n/a

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

*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 assumed 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, 2013, along with their Morningstar rating and annualized performance as of June 30, 2013. 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 Jason Su, Fidelity's 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:				
Fidelity Managed Income	Not Rated	1.12	1.53	2.82
Income Funds:				
Fidelity Total Bond	★★★★	0.65	6.46	5.01
Fidelity Inflation-Protected Bond	★★★	(5.27)	3.87	4.47
SSgA U.S. Bond Index	Not Rated	(0.79)	n/a	n/a
PIMCO High Yield	★★★	8.12	8.91	7.70
Life-Cycle Funds:				
BlackRock Lifepath Retirement	★★★★	5.04	5.23	5.61
BlackRock Lifepath 2020	★★★	7.87	4.35	6.11
BlackRock Lifepath 2030	★★★	10.73	4.04	6.25
BlackRock Lifepath 2040	★★★	13.12	3.78	6.38
BlackRock Lifepath 2050	★★	15.16	4.41	n/a
Growth & Income Funds:				
Hartford Dividend & Growth	★★★★	21.60	6.84	8.59
SSgA S&P 500 Index	Not Rated	20.45	7.03	7.30
ClearBridge Appreciation Fund	★★★★★	19.05	6.86	7.82
Growth Funds:				
ClearBridge Small Cap Growth	★★★★	24.02	9.97	n/a
Fidelity Growth Company	★★★★	18.18	7.60	10.48
Fidelity Low-Priced Stock	★★★★★	27.22	9.95	11.38
Fidelity Small Cap Value	★★★★★	28.36	13.82	n/a
SSgA Russell Small/Mid Cap Index	Not Rated	25.28	8.64	10.23
International Stock Funds:				
Harbor International	★★★★	14.21	0.70	11.00
Oppenheimer Global	★★★★	25.67	6.03	9.72
SSgA Global All Cap Equity ex US Index	Not Rated	13.55	n/a	n/a
Specialty Funds:				
Fidelity Strategic Real Return	★★	1.12	2.33	n/a

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