NEPC, LLC

RICHARD M. CHARLTON
CHAIRMAN AND CEO

February 19, 2008

RE: Chairman's Annual Update

Dear Client,

December 2007 marked the completion of our 22nd year as an independent investment consulting firm, a year that witnessed some very significant, favorable developments within our firm. The markets also extended their string of positive returns to five consecutive years, though storm clouds gathered during the fourth quarter and have picked up pace early in 2008. Our comments on the marketplace, our client recommendations and an update on NEPC follow.

Investment Markets: From Tulips to Tech, all bubbles correct, and the US housing market has proved to be no exception. Volatility and risk returned to the equity markets with a vengeance during the second-half of 2007, after an extended period of remarkable stability where easy money, lax lending practices and political expediency relegated risk to the sidelines and fueled unsustainable demand for residential real estate. The multi-year run-up in housing prices peaked during the year, triggering a far-reaching crisis in the sub-prime mortgage markets as speculators and poorly qualified buyers were no longer able to flip and/or refinance their mortgages. In the aftermath, lenders have materially tightened credit standards, housing prices are correcting significantly, and foreclosures have skyrocketed. Some $120 billion of bad loans have been written off to date, and knowledgeable estimates suggest that multiples of these write-offs are yet to be recognized by the financial industry. Credit insurers (issuers of credit default swaps) are now on the bubble, and these institutions collectively do not have the capital to back their current commitments.

Financial Service firms including Merrill Lynch, Citigroup, Morgan Stanley, Bear Sterns and UBS have secured offshore financing to shore up their weakened balance sheets; the Fed has pumped money into the system and sharply lowered short-term rates, increasing the risks of higher inflation and a further weakened dollar; and a fiscal stimulus package is being debated in Congress. Many, however, view these stimulus efforts as too little and too late. Indeed, recession is increasingly likely if the contagion from the mortgage crisis extends through the economy. Credit spreads have widened to more traditional levels, effectively offsetting rate reductions by the Fed; the retail sector has slowed, led by a 24% decline in housing starts; unemployment touched 5% in December; preliminary GDP estimates for the fourth quarter were 0.6%, impacted heavily by reductions in inventories, sharply in contrast to the 4.9% rate of the third quarter. These powerful headwinds have the potential to curtail growth in the months ahead and have focused all eyes on consumer spending, which accounts for 70% of GDP. If consumer spending declines, these headwinds will bring the storm clouds to our markets and economy, and we will be in for a rough patch.

Domestic equities are down some 15% from their fourth quarter highs at this writing, erasing all of the gains of 2007, and global equities have declined in concert. All of this comes during a calendar decade which most certainly will be the second poorest since the inception of the S&P 500, with average returns of but 1.7% per year over the past eight-years. These poor returns are in sharp contrast to the near-20% averages for domestic equities which prevailed during the 1980's and 1990's, and which established the rationale for the 60%/40% stock/bond ratios which prevail in the institutional marketplace. As seen through our risk-budgeting analyses, these concentrations raise equity-related risk levels to as high as 90% of a portfolio's total risk, enabling these plans to succeed if, and only if, stocks perform well.

Client Recommendations: For the past several years we have been counseling our clients against such concentrated bets, encouraging broadened diversification into stabilizing strategies and investments with complementary, dissimilar return patterns to the equity markets. These risk-reduction recommendations have served our clients very well, as they have facilitated good performance in a variety of market environments

Last year, we recommended the 1) relaxation of constraints through the use of strategies such as global asset allocation (GAA), 2) the use of financial engineering to improve capital efficiency and the employment of strategies like portable alpha, 3) liability-driven investment, particularly in the corporate sector, 4) better beta strategies to ease the reliance on equities as the sole drivers of return, and 5) adoption of automated investments for participant-directed programs. We remain committed to these recommendations and are gratified with their success and the improved performance they have collectively facilitated within our client base.

We believe that the same themes we have brought to clients over the last few years remain appropriate for the current uncertainty. We encourage those clients who have not yet reduced equity exposure at the policy level to reconsider their outlook from a risk perspective. The replacement and/or augmentation of traditional equity positions with better-beta, GAA and complementary, stabilizing strategies represent the road to improved performance in an increasingly uncertain market environment. We contrast the focus of yesterday versus our recommendations for tomorrow below.

The sub-prime crisis will impact markets for years to come, and the industry will accelerate its move to these diversification and investment concepts. NEPC is pleased to remain in the forefront advocating these diversification principles to our clients.

Yesterday	Tomorrow
Peer/universe rankings	Performance versus target
Efficient frontier asset modeling	Risk budgeting, capital efficiency, and surplus modeling
Style/capitalization boxes	Relaxed constraints and multi-asset portfolios
Manager risk & return	Manager alpha and information ratio
5-year track record	Record of innovative alpha
Long-only mandates	Derivatives, leverage & shorting
Asset-based fees	Performance-oriented fees

Our Client Ratings: We again thank you for your very strong confirmation of our consulting efforts on your behalf. Your ratings of our efforts for 2006, the most recent data available, place NEPC in the top position among the 10-largest firms in the industry. Additionally, none of the 10-largest firms has earned Greenwich Quality Ratings as high as you have accorded us over the trailing four-year period. We are incredibly grateful for your strong support and remain committed to enhancing our service delivery to you and maintaining the quality of our investment advice.

NEPC's Growth: Calendar year 2007 marked NEPC's 22nd consecutive year of double digit client revenue growth. Additionally, our five offices in Cambridge, Charlotte, Detroit, Las Vegas and San Francisco and each of the market sectors that we service, Corporate, Public, Taft-Hartley, Endowment/Foundation and Defined Contribution also grew in double digits, and we thank you for your support for our consulting efforts. Importantly, as the demand for our services has grown, we have become very selective in our new business efforts, declining roughly 100 new business requests in each of the past two years. We have also increased our fees somewhat over the past several years to ensure that our growth does not outpace our servicing commitment to you.

Alternative Assets: Our commitments to alternative assets, portable alpha and the diversification concepts outlined above continue to set NEPC apart in the marketplace and materially benefit our clients. We added over $7 billion in these strategies in 2007, broadening the diversification deemed so important to excellent performance and risk aversion, and we were overseeing roughly $34 billion in alternatives at year-end. Our alternatives group has grown to 16 professionals, and we expect continued growth.

Defined Contribution: Our DC team continued to gain stature and industry recognition during the year, as it grew to 15 professionals. Advisory assets grew to $67 billion at year-end, representing over 100 clients. The team was featured in PIMCO's inaugural DC Dialogue and was a factor in the DoL's decision to preserve the ability of consultants to render customized asset allocation advice for QDIAs. We are gratified that many of the action items we have been advocating for years were codified by the Pension Protection Act. The PPA gives us a roadmap to enhance employee savings using automated plan features like auto-enrollment, auto-deferral escalators, managed accounts, and QDIA defaulting to lifecycle and other types of diversified funds.

Personnel and Organizational Changes: NEPC implemented two very important organizational changes during 2007: the establishment of a new management group reporting directly to Mike Manning, our president; and our reorganization into a Limited Liability Corporation. The new management group consists of MaryBeth Tobin, who joins us from the Boston Stock Exchange as our first CFO; Ellen Griggs' promotion to COO, overseeing human resources, marketing, our information technology group, and our performance analytics group; the promotion of Steve Charlton to Director of Consultant Services; and a new Chief Investment Officer, who will be added from outside the firm. We believe that this added infrastructure will improve our overall management oversight efforts and is consistent with our longer-term growth.

The corporate reorganization enables us to grant more meaningful ownership to our newer partners going forward. As such, it puts in place more appropriate financial incentives to this talented group of partners, greatly improving our ability to compensate them at levels commensurate with their growing responsibilities within the firm.

We also added three new partners: Ross Bremen, Carolyn Smith and Chris Klapinsky, representing our defined contribution, pension and endowment/foundation consulting groups. Bill Bogle was named our chief compliance officer, reporting to me. He also took over the lead role for operational due diligence, responsible for the back office reviews of alternative asset providers. Also, Rich Harper and Joe O'Byrne were promoted to senior consultant, Terri Sacramone to senior human resources manager, Tim McCusker to consultant and Isabella Kalia to portfolio analyst manager.

NEPC's Client Conference: Our annual client conference will be held **May 14-15**, once again at the Westin Boston Waterfront. Our keynote speaker will be John Powers, the President & CEO of Stanford Management Company. We'll expand on the topics in this letter, and you'll have an opportunity to interact with NEPC consultants, researchers, and other clients and outside speakers. Save the date.

Sincerely,

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