NEPC, LLC

**Richard M. Charlton**
Chairman and CEO

February 16, 2010

**RE:** Chairman's Annual Update

Dear Client,

As I reflected over the past few months on my annual letter to you, I ruminated at some length over the financial and emotional highs and lows of the markets since I began my investment career in 1972. Perhaps that date offers an insight to my observations, since it marked the end of the "single decision" market, otherwise known as the era of the Nifty Fifty when the 50-largest stocks in the S&P 500 outperformed the remaining 450 issues by over 25%. Concentrate in big companies, buy, hold and enjoy were the themes of the day and I probably noted in my first presentation to the Michigan Bell Board of Directors how well a pure 60/40 asset allocation met corporate and participant needs, and the simplicity of my new job as a plan sponsor.

Well, I was soon humbled and my presentation to the Board at the end of 1973 was quite different. Subsequently, we materially broadened the diversification of the Plan and it became a leader in the Bell System and the foundation of NEPC's thematic approach to investments, a model that has served our clients well.

Bubbles and euphoria, followed by inexorably greater corrections and economic dislocations have been an unfortunate component of our investment landscape over the past 40 years, as markets periodically searched for nirvana, overreached and corrected. The Nifty Fifty fade in 1973 was followed by Black Monday in 1987, Japan's Nikkei market collapse in 1990, the bursting internet bubble and "tech wreck" in the early 2000's, and the current downward spiral of the housing market and its credit underpinnings. And now, as we thankfully leave the decade of the 2000's we find ourselves at the most serious tipping point since the Great Depression, balancing between yet another recovery from a giddy high and the brink of further deleveraging and deflation. While coordinated global stimulus programs have given us a temporary respite, the private sector has yet to regain traction and it remains unclear which bend in the road the recovery will follow.
Best case, we believe it will be protracted and increasingly politicized, likely leading only to a lower standard of living and significant debt obligations for future generations.

The S&P 500 closed out the decade of the 2000's with the poorest calendar performance in its history, losing 1% per year. Nearer term, virtually all risk-bearing asset classes remain underwater over the past two years, despite the snapback of 2009. The wealth destruction has been severe in every segment of the market. Endowments face serious liquidity problems and their beneficiaries significant budget cutbacks; corporations are looking at material cost increases to restore funding levels mandated by PPA, which will detract from investment in their core businesses; most Taft-Hartley programs have fallen into the red zone; and state and municipal budgets, already under severe pressure, face dislocations previously regarded as unthinkable. Notwithstanding these issues, we do not think that this is the time to rerisk portfolios or chase returns.

Because the future remains unusually uncertain, we are encouraging our clients to focus on risk budgeting and scenario forecasting as you review and reset asset allocation guidelines for the planning period. Our research and consulting staffs have been implementing these programs across a growing portion of our client base with considerable success over the past several years. (NEPC's clients have collectively outperformed national averages in 21 of the 24 years that NEPC has been in existence.)

While equities clearly have a position in institutional investment programs, risk budgeting seeks to spread the contributions to portfolio risk more evenly over many asset classes, mitigating the dominant equity risk influence which accompanies a traditional 60% equity commitment. Scenario forecasting gives our clients the ability to model a range of outcomes and tail risks that may accompany adverse economic and market outcomes (high inflation, stagflation, delevering, etc.) which may be more likely than normal in this uncertain environment. Liability-driven Investment (LDI) programs are another tool in our arsenal and are employed by over 40% of our corporate pension clients. During 2008, this strategy limited losses, where fully implemented, to single digits while stabilizing funding ratios.

These asset allocation and interest rate hedging strategies, coupled with our emphasis on diversification, alternatives and opportunistic investments in the credit markets have improved relative returns in these times of uncertainty. As seen in our annual asset allocation letter, NEPC enters 2010 recommending investments away from the US dollar, more discrete commitments to emerging markets, real (inflation-hedging) strategies and the continued use of alternatives including hedge funds and credit opportunities. We also believe that LDI has application beyond the corporate marketplace. In the context of continued reduction of equity commitments, we believe these strategies represent a good formula to both stabilize and improve returns. As is always the case, our consultants stand ready to assist you in these trying times.

**Our Client Ratings:** During 2008, you ranked NEPC number three among the 10-largest consulting firms in the country in the most respected independent national survey of overall consultant client satisfaction. Over the five-year cumulative period through 2008, we remain the top ranked firm among the 10-largest providers of investment advice, and we thank you for your support and confidence as we continue to grow our business and improve our infrastructure, research and consultant resources. The provider of these rankings has noted for the past few years that NEPC is one of only two firms in the industry to exhibit continued growth while maintaining excellent client ratings, and we are committed to continuing to weigh our service commitment to you against the continued expansion of our firm.

**NEPC's Growth:** NEPC welcomed John Krimmel, CPA, CFA and Greg Bauer, CFA to our firm on January 1, 2010. Together, they opened our sixth office in Atlanta, Georgia. With their arrival, NEPC now has 20 former competitors from 12 different firms bolstering our ranks, enabling us to continue our tradition of featuring seasoned, experienced consulting advice to our clients. During 2009, we added over $50 billion in new assets and experienced double digit revenue growth for the 24th consecutive year. The revenue growth enabled us to add new consultants, maintaining our service margins, and to continue to expand our research resources.

**Defined Contribution:** Our Defined Contribution team continues to distinguish itself in the industry and ended 2009 with 18 professionals serving 106 defined contribution plans with collective assets of $71 billion. We added two Senior Consultants to the staff, each with decades of industry experience. Laurie Tillinghast joined from ING where she led the investment only-defined contribution business. Paul Kerry, ASA, EA joined from Fidelity where he provided strategic consulting services to many of Fidelity's corporate clients.

Reflecting our client advocacy, two of our Partners testified in the Department of Labor/Securities and Exchange Commission Joint Hearings on Target-Date Funds with a message that these portfolios are still the right answer for most participants. The team held a webinar sharing the results of our annual Plan and Fee Survey, and papers were also published on the Roth 401(k), TIPS funds and the challenges within the stable value industry. The team's attention in 2010 is on bringing our best ideas to our clients on annuity and income solutions and off-the-shelf and custom target date funds.

**Personnel and Organizational Changes:** NEPC continued to expand our research team with the addition of Eric Harnish, as the Director of Private Markets and Neil Sheth, as the Director of Hedge Funds. Eric brings fourteen years of investment experience and strong management skills to NEPC. Most recently he was the leader of The Private Edge Group at State Street. Neil Sheth has over ten years in alternatives asset management experience and joined NEPC from Berkshire Partners, where he managed both private equity and their fundamentals-based, global value hedge fund.

We continued to add talent to our regional offices, including Dion Stevens and Jeffrey Pickett to the consulting team in our Detroit office, and Don Stracke, CFA as a senior consultant in Redwood City. Dion brings valuable risk management and asset allocation experience from his roles at ArvinMeritor and Toyota Motor Credit Company. Jeff joins us from CTC Consulting where he serviced ultra high net worth clients. Don Stracke brings over twenty-five years of investment consulting and client relationship experience to NEPC from his background at Bankers Trust, Shenkman Capital Management, Attalus Capital and Dresdner RCM Global Investors.

In addition to the Cambridge staff additions cited above, we strengthened our management team with the addition of Judy Murphy, the Director of Organizational Development. Judy had performed project work for NEPC and has over twenty years of HR experience within the financial industry including Managing Director of HR at IBT and Vice President, HR at Fidelity Investments.

Dave Moore was elected into our partnership on January 1, 2010 after joining NEPC from Ford Motor Company in 2006 with thirteen years of experience. At Ford he oversaw the firm's global cash programs and the pricing of Ford Credit's global commercial paper. Previously, he managed Ford's European pension plans.

Internally, Brian Donoghue, Edward O'Donnell, CFA, Scott Perry, CAIA and James Reichert, CFA were promoted to senior consultant positions; Tim McCusker, FSA, CFA, CAIA was promoted to Director of Traditional Research; Alex Kamunya was promoted to research consultant; and, Scott Driscoll was promoted to consultant.

**NEPC's Client Conference**: Our annual client conference will be held **May 12-13**, at the Westin Boston Waterfront. Our featured speakers are Jeremy Grantham, cofounder of GMO, LLC, Bob Pozen, Chairman of MFS Investment Management and Howard Marks, Chairman of Oaktree Capital Management. Once again, we will focus on the opportunities and challenges that you face in the market today, giving you a great opportunity to interact with our consultants, other clients and outside speakers. We will follow-up soon with a more detailed agenda. **Please save the date**!

In closing, I would reiterate our sense that the markets of tomorrow will continue to be complex and volatile. NEPC has, in a sense, anticipated the growing challenge of advising institutional investment programs by investing heavily in our research and client facing resources, and I believe no firm in the industry is better prepared to partner with you in these trying times. We thank you for your confidence and stand ready to support you well as we venture forward together.

Thank you,

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