



RICHARD M. CHARLTON
CHAIRMAN AND CEO

February 24, 2011

RE: Chairman's Annual Update

Dear:

January 1, 2011 marked NEPC's 25th anniversary as an independent investment consulting firm, and we thank you for entrusting to us the privilege and responsibility of advising your investment programs during the most diverse investment markets in history. From the "single decision" buy and hold era of the 1980's and 1990's, when stocks simply went up, to the decade of the 2000's, the poorest in the history of the S&P 500, we collectively have been challenged to build investment programs that function well, regardless of the prevailing economic and market environments.

Most of you are aware that we have tracked the performance of our overall DB/Endowment/Foundation client base against national averages since the inception of our firm. We are pleased that our clients have collectively outperformed the \$1.9 trillion ICC median in 22 of the 25 years that we have been in existence, earning overall returns that we believe to be the finest of any consultancy in the industry.

You have accorded NEPC the industry's top rankings relative to our ten largest competitors over all cumulative periods ranging from one to seven years in length through 2009, enabling us to grow our client revenue at double digit levels for 25-consecutive years; enabling us to grow our dedicated research team to fully 25% of our professional headcount; enabling us to strengthen our service commitment; and, enabling us to maintain excellent financial health. We thank you for your strong support and recommit ourselves to meeting and surpassing your investment needs with a revenue model that remains conflict-free.

Our initial 25 years have been personally satisfying and rewarding and, as I advised you recently, I have decided to step back from the active management of NEPC on March 31st. I will remain Chairman for the next four years, spending more of my time with our clients, my first passion. Mike Manning, who has successfully managed NEPC as its President over the past seven years, will continue as our Managing Partner, supported by a five-person Executive Committee comprised of himself, Chris Levell, Sean Gill, Allan Martin and Jay Roney. To ensure the continued delivery of excellent investment advice to you, we have spent considerable time and expense over the years to effect an orderly distribution of the firm's equity and a seamless management transition. I believe we have succeeded better in these two critical areas than any of our competitors, and by a wide margin. We are deep in resources, talented and committed, and the financial incentives are in place to embellish these critical cornerstones to serve you even better in the years to come.

The Markets and the Economy: As I write this letter, the domestic stock markets have essentially doubled off their March 2009 lows, and investor sentiment is beginning to improve. Signs of improving economic growth and correspondingly better investment markets are emerging on many fronts, including: improved corporate profits, better-than-

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expected GDP growth, a modest improvement in the unemployment rate and some stabilization of the housing markets. However, we have dug ourselves into a tremendous economic hole and we believe it will take years, not months, to fully recover. While Washington's stimulus packages have been more successful in the short term than most would have guessed, the enormous incremental borrowing necessary to reestablish liquidity and restore near term investor confidence has sharply narrowed future options. Restoring state and federal budgets to reflect our means rather than our wants, and weaning ourselves from an ultimately destructive reliance on the debt markets will challenge every American as never before in our history.

Willie Sutton was once asked, "Why do you rob banks?" And his response was, "Because that's where the money is." This compelling but simple logic has a strong parallel in our growing fiscal dilemma. Entitlements, including Medicare, Medicaid and Social Security at the federal level, are the elephant in the room, yet there is precious little appetite to address this issue, but address it we must, "because that's where the money is." Perhaps naively, we do not see this as a political issue, but rather a question of intergenerational equity, or more simply, a question of striking an affordable, equitable balance between current compensation (jobs and wages) and deferred compensation (retiree benefits and healthcare). Left unchecked, federal entitlement spending will more than double by 2050 and consume all tax revenue by 2052, leading to unthinkable economic penalties on our nation, our children and their children. The President's Deficit Reduction Commission may have offered us our last, best chance to get our house in order in a reasonably apolitical manner. One way or another, there will be a good deal of pain to both taxpayers and the beneficiaries of these programs, but the longer we ignore the problem, the worse it will get, with increasingly harsh penalties to our economy, our standard of living, our global competitiveness and our legacy.

Client Recommendations While NEPC's longer-term 30-year return assumptions are reasonably comparable to those of previous years, our currently low interest rate environment, high levels of unemployment and our unprecedented national debt levels have crystallized the economic challenges which we face and heavily influenced the somewhat lower forecasts which we recently published for the next five to seven years. Over this period, we believe that the traditional 60/40 portfolio construct which performed so well in the growth era of the 80's and 90's will continue to underperform, though perhaps not as badly as in the decade of the 2000's.

The Fed's quantitative easing program has given us some breathing room and is dominating current market psychology, but the stimulus programs will wane, deleveraging will run its course and fundamentals will return to the forefront at some juncture. The Fed and our elected officials would seem to have precious little time to chart a course to permanent recovery. Needless to say, we do not believe this to be the time to re-risk investment programs, but rather advise the continued broadening of the diversification and risk budgeting which have served our clients so very well over the past decade, with an eye to hedging inflation risk and, as rates rise, the phased implementation of liability hedges. We also believe that less liquid credit opportunities, risk parity products, global asset allocation, and emerging market investments remain relatively attractive, notwithstanding the inflationary pressures which are building in several areas. Our annual Asset Allocation Letter, posted on our website, has considerably more detail in this regard and I encourage you to read it in detail. Your consultant and all of the members of our management team stand ready to respond to any questions which you might have.



Alternative Assets: To the considerable benefit of our clients, our alternative asset commitment continues apace, and at year end we were overseeing over \$61 billion in hedge funds, private equity, real estate and real assets. These non-traditional asset classes can be employed to enhance returns (private equity and real assets) and dampen investment risk (hedge funds), enabling investors to moderate the significant influence of equity risk, while improving and stabilizing investment returns in these uncertain markets. Coupled with our opportunistic recommendations in the distressed credit markets, these placements enabled our overall client base to protect capital better in 2008 and outperform during the recovering markets of 2009 and 2010. The excellent oversight and guidance of Erik Knutzen, Sean Gill, Neil Sheth and Eric Harnish continue to strengthen our research commitment nicely.

Defined Contribution: Our DC team continues to enhance its industry-leading reputation under the leadership of Christine Loughlin. Our annual fee surveys are growing in importance, our custom target-date funds are performing very well and we are exploring income solutions, all while maintaining a strong presence on Capitol Hill through Ross Bremen's efforts.

NEPC's Professional Staff Growth: During 2010, we continued our longstanding practice of complementing the growth and advancement of our "home-grown" professionals with the selective addition of highly qualified consulting talent from the ranks of our competitors. In April, we welcomed KC Connors, CAIA, CFA as a Partner. KC brings industry-leading capabilities to NEPC in alternative assets, endowments, foundations and healthcare, and she has assumed a leadership position within our firm in these vital areas. We also welcomed Kristin Finney-Cooke, Sr. Consultant, in September to our newly-opened Chicago office. Kristin has expertise and experience with public and corporate clients, coupled with specialist knowledge of both emerging markets and emerging managers. KC and Kristin add to our talent and capacity in several growth areas within the marketplace and our firm, and we welcome them to NEPC.

My annual letter to you would not be complete without special recognition and a heartfelt thanks to Doris Ewing, who retired from NEPC in September. Doris made a difference during her many years with us; internally, with many of our clients and within the industry. While I am pleased that she will now have time to polish up her golf game, I am even more pleased that she will continue to represent us on a contractual basis with selected clients. Fore!

We continued to expand our research commitment, adding Sean Ruhmann, Sr. Consultant in Real Estate/Private Markets as well as John Casano, CAIA, Sr. Consultant and Kamal Suppal, CFA, Consultant to our Hedge Fund team. Sean joined us from Goldman Sachs where he was Vice President in their Real Estate Investment Banking Group; John joined us from Cambridge Associates where he was their primary global macro hedge fund analyst; and Kamal joined from US Trust Private Wealth Management Group where he was responsible for quantitative and qualitative manager research across a variety of hedge fund strategies.

We also recognized the strength and contributions of three of our key Senior Consultants by electing Michael Cairns, CEBS, Kevin Leonard, and Tim McCusker, FSA, CAIA, CFA into our partnership. Mike joined us in 2007 from Marco Consulting and has 23 years of investment and benefits consulting experience primarily servicing our Taft Hartley clients. He will join Kristin Finney-Cooke in our Chicago office in 2011. Kevin also joined us in 2007 from Segal



Advisors where he was Vice President and Partner. He has over 20 years of investment experience with a focus on public and corporate clients. Tim joined us in 2006 and is our Director of Traditional Research. He works across a variety of client types and specializes in asset allocation and multi-asset class research.

In addition, Frank Barbarino, CAIA in our Hedge Fund group was promoted to Sr. Consultant and a number of our analysts in both research and consulting were recognized with promotions to the consulting role including Joel Paula, CAIA, Dulari Pancholi CAIA, CFA, Jeff Roberts, Tim Bruce, Eric Vallo, Keith Stronkowsky, Kelly Cummings, Sebastian Grzejka and Dan LeBeau.

In concluding, I thank you again on behalf of our entire staff here at NEPC for the privilege of working with you and your investment programs. As is my custom, I encourage you to circle the dates for our approaching Client Conference, May 18th and 19th in sunny Boston, and to join us as we look back and into the future. Featured speakers this year will be Bob Prince, Co-CIO of Bridgewater Associates, Dan Och, Chairman and CEO of Och-Ziff Capital Management Group and Edward Ladd, Chairman Emeritus, Standish Mellon Asset Management Company. It promises to be a great conference and we hope to see you there.

Regards,

A handwritten signature in black ink, appearing to read 'Michael', written in a cursive style.