NEPC, LLC

RICHARD M. CHARLTON
CHAIRMAN

March 2013

Dear Client:

The economy and global markets continued their gradual recovery in 2012 from their extraordinary meltdown in 2008. While considerable political and economic uncertainties remain, some sectors of the economy--particularly housing--are showing early, but encouraging signs of growth. Even more comforting, the investment markets are exhibiting welcome signs of improved stability, in sharp contrast to the steady stream of 200-point daily moves that characterized the past few years. The Fed has navigated our incredibly complex deleveraging process well thus far through its sometimes controversial stimulus programs and accommodative monetary policies. That said, Congress has been noticeably absent on matters of fiscal policy. Without meaningfully supportive legislation, perhaps encompassing near-term stimulus and longer-term entitlement reform, it is unlikely that monetary policy on its own will be adequate to produce a sustainable economic recovery and job growth.

While we still face challenges, calendar year 2012 was gratifying for NEPC's clients and our Firm on several fronts. Relative performance remained strong across our collective client base as we continued to rebalance the risk exposures of client portfolios; our Greenwich Associates Client Survey results improved from their already high levels; we further strengthened our research platform with new resources, the publication of several white papers, and meaningful global outreach with frequent trips to Europe and multiple visits to Asia; our clients, our Company and our staff were recognized for excellence on several fronts; and our Partnership, led by Mike Manning, our Executive Committee and Management Group, continued to strengthen our culture and burnish NEPC's image within the industry as The Consultant of Choice.

It is my privilege to expand on these themes, revisit the market and economic environments, recap our client recommendations, and share with you some of the year's highlights at NEPC.

<u>The Markets and the Economy:</u>
Performance was strong in 2012, particularly in the credit and equity markets, as we suggested entering the year. In fact, near-term results exceeded expectations in many respects, likely tempering future returns, absent any fiscal stimulus. Coming off the bottom of the 2008 downturn, the Fed's stimulus programs restored confidence in our economy and liquidity to our markets. Subsequent security purchase programs and forward rate guidance have kept short-term rates near zero; however, at the current pace these programs are injecting roughly one trillion dollars of new money into our system each year, surely planting seeds for inflation that will blossom once the private sector begins to expand and compete for capital. Whether these programs are constructive for the economy is a matter of some debate, but pension systems and other savers should recall that risk free assets have contributed over 50% of the total returns earned by investors since 1970, so a zero percent return on risk free assets markedly jeopardizes the likelihood of achieving target returns during the recovery period.

Looking forward, we still encourage a broad range of strategic commitments, from debt and equity in the emerging markets, to inflation-sensitive investments--such as TIPS and real assets--and less liquid, private debt investments, particularly in countries whose banking systems are stressed by a storm of deleveraging, higher collateral requirements, lower growth and weakened economies.

We believe that the global deleveraging process will be drawn out, contributing to lower GDP growth rates. In this environment, equity markets will remain sensitive to political events and surprises, and market returns will likely be below long-term averages. Therefore, risk parity and comparable programs, which mitigate the very high levels of equity risk found in most institutional investment programs, are likely to continue to earn competitive returns with lower risk levels than traditional 60/40 constructs.

NEPC Highlights from 2012:

Client Performance and Business Growth:
Our clients collectively outperformed national averages for the 24th year in our 27-year existence as our efforts to restructure the risk exposures in your investment programs continue to meet with considerable success. Our already outstanding Greenwich Client Ratings improved. And, our management team continued to reinvest in our business to further strengthen our service margins, and to add research resources and talented professionals to our ranks, growing revenues nicely while maintaining our profitability at target levels.

At year end, our client base had grown to 310 retainer relationships encompassing over $700 billion in assets. Our healthcare, discretionary consulting and high net worth market segments all experienced strong growth, complementing the continued expansion of our public, corporate, Taft-Hartley and endowment-foundation market segments in both the defined benefit and defined contribution lines of business. The marketplace has strongly endorsed our enhanced healthcare offerings; our Taft-Hartley team has migrated into the International segment of its market; and we have added attractive mandates for discretionary (outsourced CIO) family office, endowment and foundation, alternative assets and custom target-date clients. We have also attracted new business in the insurance, corporate and cash equivalent markets as our long-standing expertise in derivatives, LDI, leverage and non-traditional asset allocation strategies is gaining traction among those interested in structured solutions and mitigating the significant equity risk present in many investment programs. In addition, we have tripled our commitment to Operational Due Diligence.

Client and Industry Recognition:
We are extremely grateful for your favorable evaluations of our service commitment and consulting expertise in the annual Greenwich Associates Client Surveys. Our overall 2012 Greenwich Quality rating improved to the number two position in the industry relative to our top ten competitors, and we are now the only firm within that group to have ranked in the top three positions over nine of the past ten years. We are also very proud that we maintained the number two Greenwich ranking in alternative asset capability, a position that we have held for the past eight consecutive years.

In recognition of our expertise in alternative assets and the 40 NEPC professionals who hold the prestigious Chartered Alternative Investment Analyst designation, *InvestHedge* recognized NEPC as its 2012 Consultant of the Year, and the CAIA organization paid special tribute to NEPC. On the personal side, Kevin Leonard was recognized as the Public Fund Consultant of the Year, and *aiCIO* named Allan Martin, partner (#2) and Erik Knutzen, partner and CIO (#15) as two of the industry's most influential professionals.

Rounding out a wonderful year for client recognition, two of NEPC's public fund clients--San Antonio's Fire and Police Pension Fund and the New Mexico Educational Retirement Board--were named *Money Management Intelligence's* small- and mid-sized Public Fund of the Year, respectively.

Internal Technology and Infrastructure Initiatives:
We continue to enhance our infrastructure, with both external and internal benefits. Externally, all of our clients have been converted to the InvestorForce reports platform, significantly improving our reporting, diagnostic and analytic capabilities. Also, clients will now be able to access the notes of our due diligence meetings with their managers on-line, drawing from among our 2300 documented research meetings with investment management representatives during 2012. We are currently installing a new state-of-the art telephone system to more effectively integrate our several offices with one another, and will be moving our headquarters to the Boston waterfront in late Summer after 19-years in Cambridge. Disaster recovery systems have been nicely improved and increased redundancy has been incorporated into many of our systems.

NEPC's External Staff Growth:
NEPC continued its dual track of growing our own talent and attracting talented competitors in 2012, carefully grooming and selecting professionals who will reinforce our cultural commitment to outstanding investment expertise and client service. Two new additions to our DC practice group were Senior Consultants Kevin Cress, CFA, who joined us from Hewitt EnnisKnupp with 15 years of investment experience, and Ray Dame, a 20-year veteran from State Street Global Advisors, CitiStreet/ING. Sheila Berube, a CFA with 20 years of experience, joined as a Senior Consultant with our Philanthropic Practice group from a multi-generational family office in Florida, where she held the position of Chief Investment Officer. John Krakowiak rejoined NEPC after six years with Deroy & Devereaux Private Investment Counsel in Michigan as a Senior Consultant on our Public Funds Team (15 years of industry experience).

In addition to this expanded talent pool in our consulting ranks, we hired Amanda Karlsson as a Research Consultant on our Hedge Fund Team from Meritage Group LP, and Chris Matteini and Melissa Mendenhall as Research Consultants on our Private Equity team. Chris joins us from Alcatel-Lucent Investment Management and Melissa brings prior experience from Deutsche Bank Securities and Harbourvest Partners LLC, and operating roles at private equity-sponsored companies. Our continued ability to attract and groom some of the best and brightest in our industry further enhances our ability to differentiate NEPC from our competitors with best in class investment ideas, thought leadership and superior service.

NEPC's Internal Staff Development and Recognition:
NEPC's senior management teams remained stable during 2012. Our five-person Executive Committee consists of Mike Manning, who continues to lead NEPC as our Managing Partner, and four other members that are elected by the Partners. This year, Chris Levell opted not to remain on the Executive Committee in order to focus more efforts on his leadership of our corporate client consulting practice. Christine Loughlin was elected as the newest

member to the Executive Committee, reflecting the high regard we have for her within our partnership. Christine, who heads NEPC's defined contribution team, brings a fresh perspective and wealth of experience to her new role.

NEPC is strongly committed to identifying and mentoring the talent we attract so we can provide you with long-serving, committed professionals who understand your needs and bring a historical perspective to your challenges. We are also committed to bringing new staff members to your team to provide you with fresh and innovative approaches to your investment goals and objectives. With that in mind, I also want to recognize other professionals with longer tenure here at NEPC.

To this end, we elected two new partners from our Senior Consultant ranks this year: Brian Donoghue from our DC Team, and James Reichert from our Healthcare Team. Brian joined us in 2006 from Fidelity Investments and has over 15 years of experience working with defined contribution programs. He has played a leadership role in the development of custom target date solutions for our clients and, as those of you who have attended his presentations know, he is both an entertaining and eloquent speaker at our annual conference. James joined us in 2007 after working at State Street for over seven years. He has taken on leadership roles frequently, often on high-profile Firm-wide initiatives. He established the fixed income model that is the core of our Asset Allocation Committee assumption development. He is a talented and versatile professional with the knowledge and expertise to work with a variety of clients across the Firm.

We also promoted Ashwini Apte, Jeff Mitchell, Keith Stronkowsky, and Mike Sullivan to Senior Consultant positions, and Alex Kamunya, Jeff Roberts, and Chuck Tedeschi to Senior Research Consultant roles. These promotions recognize the capability, dedication and work ethic of our staff to deliver superior consulting services to you.

Conclusion:
In line with tradition, let me remind you of our 18th Annual Client Conference, to be held again at the Boston Convention Center on May 14th and 15th. Our keynote speakers this year are Clifford Asness, PhD, Co-founder and Managing Principal of AQR Capital Management, and Michael Hood, Global Markets Strategist for J.P. Morgan Asset Management. We look forward to hosting you for another gathering focused on you and the challenges and opportunities of your investment program.

Sincerely,