COUNTY OF SAN BERNARDINO
EXECUTIVE SUMMARY
DEFINED CONTRIBUTION PLANS
3rd QUARTER 2010

	3rd Qtr	1 Yr.	3 Yr.	5 Yr.
457 Plans Performance	12.21	10.70	-4.66	3.55
Customized Benchmark	11.95	10.79	-4.68	2.16
Difference	**0.26**	**-0.09**	**0.02**	**1.39**
401(k) Plan	12.32	11.23	-4.42	3.76
Customized Benchmark	11.75	10.78	-4.61	2.21
Difference	**0.57**	**0.45**	**0.19**	**1.55**
Retirement Medical Trust	10.53	10.85	-3.31	3.74
Customized Benchmark	11.39	12.09	-2.04	3.41
Difference	**-0.86**	**-1.24**	**-1.27**	**0.33**

PORTFOLIO ANALYSIS:

ASSETS:	
457 Assets	$ 364,282,335
401(k) Assets	$ 77,523,758
401(a) Assets	$ 831,546
RMT Assets	$ 34,342,354
P/T Assets	$ 36,773,292
TOTAL Assets	**$513,753,285**

Due to the appreciation of mutual fund assets, the total assets in all of the County of San Bernardino plans have increased from $499 million at the end of the second quarter, 2010, to $514 million at the end of the third quarter, 2010.

457 PLAN CASH POSITION:
The stable value crediting rate for the third quarter was 2.25%. The fourth quarter crediting rate is 2.00%. The percentage of assets in the fixed interest bearing account has decreased from 39.89% in the second quarter to 37.59% in the third quarter. The reduction was due to the greater appreciation of the mutual funds and the transfer of $3 million out of the Stabilizer into mutual funds. This is not surprising considering the equity gains in July and September.

401(K) PLAN CASH POSITION:
The percentage of assets in the fixed interest bearing account changed very little. The assets in the Stabilizer decreased from 29.53% in the second quarter to 28.77% in the third quarter. Transfers in or out were negligible. The reason for the decreased percentage of assets in the Stabilizer was due to the appreciation of mutual fund values.

<u>RETIREMENT MEDICAL TRUST CASH POSITION</u>:
There was a small decrease in the percentage of assets in the fixed interest account with 82.51% now in the ING General account.

<u>457 PLANS MUTUAL FUNDS POSITION</u>:
The Sharpe Ratio is a tool that helps determine if the risk the fund or portfolio is taking to achieve the performance is worthwhile. The Sharpe Ratio for the 457 portfolio was -0.14. This is better than the benchmark of -0.16 (over three years).

The Standard Deviation is a measurement of the volatility of the portfolio's short term return from the average long term return. The three-year Standard Deviation for the portfolio is 22.47 which is higher than the benchmark of 21.42.

The Alpha, a measurement of the value added by the investment manager is 0.41. Beta is a measure of the degree of change in value that can be expected, given a change in value in the comparable index. The Beta is at 1.05 (over three years).

The assets in the Ameritrade self directed brokerage account are $1.7 million.

<u>401(K) MUTUAL FUNDS POSITION</u>:
The Sharpe Ratio for the 401(k) portfolio improved and is now -0.13 which is better than the benchmark of -0.16 (over three years).

The three-year Standard Deviation for the portfolio is 22.50 which is higher than the benchmark of 21.25. The Alpha is 0.66 and the Beta is 1.05.

The assets in the Ameritrade self directed brokerage account are $844,454.

<u>RETIREMENT MEDICAL TRUST (RMT) MUTUAL FUNDS POSITION</u>:
The RMT under-performed the customized benchmark due to a high mutual fund allocation to Growth Fund of America, 21.71%, and Thornburg Growth, 11.06%, which had an under performance to the benchmark.

The Sharpe Ratio for the RMT portfolio is -0.10 and is worse than the benchmark of -0.05. The three-year Standard Deviation for the portfolio is 20.75 which is higher than the benchmark of 19.53. The Alpha is -0.98 and the Beta is 1.06. The negative Alpha is caused by performance against the Beta. The performance was not as good as expected based on the portfolio risk.

PERFORMANCE OF INDEX FUNDS VS. ACTIVELY MANAGED FUNDS:

	3rd Q 10	1 year	3 year	5 year
Large Cap				
Vanguard Institutional Index	**11.29**	**10.18**	**-7.11**	**0.67**
American Growth Fund	10.7	7.79	-6.72	1.53
Columbia Marisco	9.35	7.49	-9.88	2.03
Janus Contrarian	11.91	11.51	-8.33	3.13
Parnassus Inv Eq	9.10	10.38	0.68	5.87
Main Stay ICAP Select Equity	10.34	10.95	-6.39	2.11
Columbia Div Eq Inc	12.75	10.62	-8.75	1.20
Mid Cap				
Vanguard MidCap Index Signal	**12.95**	**17.90**	**-4.40**	**2.38**
Thornburg Core Gr	9.83	2.00	-12.21	0.22
Fidelity Adv Lev Co	10.4	10.56	-8.16	2.17
Columbia MidCap Value	14.73	14.97	-6.42	2.72
Small Cap				
Vanguard Small Cap Index	**12.06**	**15.03**	**-2.97**	**2.63**
Baron Growth	8.22	13.77	-5.10	2.19
Royce Value Plus	7.93	7.93	-6.39	2.88
Perkins Small Cap Value	7.08	13.02	3.73	6.04
Invesco U.S Small Cap Value	9.01	13.87	-0.65	5.79

Until the recent rally and the correction in the second quarter, we usually illustrate that a majority of the actively managed funds outperform the passively managed index funds; with the exception of three small cap funds, that was not the case this quarter. Over the one-year period, the large cap actively managed funds are out-performing the S&P index fund, with two notable exceptions; Funds that avoid or minimize investments in high beta stocks did not fare well in this comparison to index funds.

The index funds have an advantage of low cost. Index funds cannot avoid any sector or stock that meets the capitalization boundaries. Also, unlike actively managed funds, index funds are devoid of cash holdings. This is a disadvantage in some markets but can be an advantage in other markets, like the market we have currently.

MUTUAL FUNDS

1. American Growth Fund of America — Market Cap: $36 billion

The fund continues to trail it peers and index over the one and three-year periods in terms of return. The primary reason is that this growth fund is more sensitive to stock prices than most and is simply not willing to “pay up” for growth. This fund also looks for stocks with low to medium Betas and the market has recently rewarded stocks with higher Betas. This strategy typically leads to lower fluctuation, but also leads to a higher than average cash position during extended bull markets. Currently the fund is holding nearly 11% in cash, a significant departure from its peers.

Additionally, the percentage of international investments, 14%, which is double the peer average, negatively affected performance over the one year period. On the other hand, that high position did have a positive impact on performance for the third quarter.

2. **Columbia Marsico 21st Century** Market Cap: $12 billion

This fund is the exact opposite of Growth Fund of America. It has a significantly smaller market cap, will pay for growth, has high turnover and a very concentrated style. All of these differences lead to returns that are either "shoot the lights out" or "mediocre" but rarely anything in between. The fund does hold low cash positions and is willing to take more sector risks; in this case the Financial Sector holdings are nearly four times the financial sector holdings of the peer group, demonstrating a clear bet on the economic recovery. This sector bet has significantly detracted from performance.

3. **Janus Contrarian** Market Cap: $9 billion

This fund is tough to pigeon-hole. It is categorized as Large-Cap Blend but has a market-cap closer to Mid-Cap and has over 30% in international including 18% in India. This eclectic style has served the fund well recently, but it is not immune to market swings, falling 48% in 2008. However, in every other year dating back to 2005, this fund performed in the top quartile.

Performance has suffered due to the heavy exposure to the Healthcare and Financial sectors and the low exposure to the Information Super Sector.

4. **Parnassus Equity Income** Market Cap: $21 billion

This fund is an anomaly in the socially responsible fund category. It has a high return with below average or low risk. The manager has a significant portion of his net-worth in the fund which always a good sign. The prospectus requires 75% of the portfolio be in dividend-paying stocks.

5. **Vanguard Institutional Index** Market Cap: $40 billion

This well managed index fund continues to outperform the benchmark despite the expense of 0.05%.

6. **Columbia Diversified Equity** Market Cap: $33 billion

The fund's name changed from RiverSource to Columbia as part of the Ameriprise purchase that closed earlier this year. The fund is performing well against its benchmarks and does not currently have any major sector bets on. The three year performance was affected by the poor performance in 2008, ranked in the 74th percentile.

7. **Mainstay ICAP Select Equity** Market Cap: $52 billion

The team running this fund does not have an optimistic outlook on the economy and has reduced holdings in sectors like financials and industrials. A macro-economic view is not common in most mutual funds, but this fund makes top-down decisions and is buckling down. The fund also tends toward stocks with lower leverage. Having said that, the fund remains fully invested and will not be completely immune to downturns.

8. Thornburg Core Growth Market Cap: $9.5 billion

In 2008, this fund won the Lipper Award for Consistent Return for the five-year period ending 12/31/2007. Since that time period, the fund has been very inconsistent. We have this fund categorized as a mid-cap growth fund, however, the stated objective is to be a multi-cap fund, meaning it can go anywhere to find growth. The current makeup of the fund is 24% Giant, 22% Large, 34% Mid and 19% Small Cap.

The cap average, (due to the bulk of assets in mid and a good portion in small), equals out to be in the mid-cap category, but that is a by-product of its style. A better index might be the Russell 3000 and the Russell 3000 Growth, both of which we tested against the fund to see if there was any marked improvement, there was some improvement, but it wasn't much.

Regardless of the index we compare it to, it remains on the Watch List due to performance which is hampered by the large overweight to the Financial and Healthcare sectors. The Financial sector is double the weight of either the large cap or the midcap growth peer groups. The Healthcare sector is at least 60% higher than the benchmarks.

Recommendation: **Watch List** due to Performance

9. Fidelity Advisor Leveraged Company Stock Market Cap: $5 billion

Real Estate and Utilities are the only two non-specialty funds in the Morningstar universe that have a higher debt-to-capital ratio and they only exceed this fund by a few basis points. While this fund stays true to its title (high leverage) it makes for an aggressive offering. Performance has been off for the one and three-year periods and is about even for the five-year period versus its peers (trailing its index over all periods).

After seven consecutive years of top quartile performance ending in 2007, 2009 was a top quartile performance year sandwiched between two fourth quartile performance periods.

10. Vanguard Mid Cap Index Market Cap: $4.7 billion

Performance continues to over achieve compared to other index funds.

11. Columbia MidCap Value Opportunities Market Cap: $5.8 billion

This fund was previously named RiverSource Mid Cap Value. Performance has improved with this fund; it had temporarily been tracking the index since financial crisis hit. However, the investment strategy is to look for value at the right time and now has several differences with the peer group, indicating that short term returns are being driven by the investment team more than the index.

12. Baron Growth Market Cap: $2.7 billion

Ron Baron does not chase return or "in-vogue" stocks; instead he is looking for long-term value and stocks that have the potential to double over a five-year period. This is evident in the low turnover ratio of 26%. This dedication to finding value in growth stocks will occasionally lead to under-performance in the short-term as we are seeing against the index (though it is out-performing its peers over three and five-years). The lack of investments in technology stocks has hampered short term performance.

The fund is trending more toward mid-caps right now, but still has a market-cap that allows it to be in the small-cap category. The fund also tends to be less volatile than its peers and index benchmarks. Lastly, the debt-to-capital is very low with this fund, coming in at 28%.

13. Royce Value Plus Market Cap: $1.2 billion

If you liked the low debt-to-capital ratio of Baron, you'll love this fund, which comes in at just under 15% - there are only three other domestic small growth funds with low Debt to Capital ratios. In ordinary markets this focus on quality should produce better returns with lower fluctuation, however, in a market driven by stocks with high-betas (lower quality and higher volatility stocks) a fund like this will likely suffer versus its peers and even its benchmark. In fact, this fund is trailing its peers and index over the one and three-year periods, we are not concerned. Royce has a process that produces good returns with reasonable risk over a market cycle and we think this approach, though currently out of favor, will win out over the longer-term.

14a. Keeley Small Cap Value Market Cap: $1.4 billion

This fund was voted to be replaced at the last quarterly meeting for SBC. It was replaced by Perkins Small Cap Value on November 1, 2010. Performance for Keeley is still in the fourth quartile. Morningstar has categorized this fund as having high risk and average returns. The standard deviations are 31.41 and 26.09 for the one and three-year periods

14.b Perkins Small Cap Value Market Cap: $1.36 billion

This new addition to the portfolio is categorized by Morningstar as having low risk and high returns. The expense is much lower than the Keeley fund it replaced at 1.07 versus 1.39. The standard deviations are 22.72 and 18.48 for the one and three-year periods, respectively. Performance has suffered over the past one-year due to the success of stocks with higher betas. The peer group average beta is 1.21 and the Perkins fund has a beta of 0.97. Also, the Sharpe ratio for the category is -0.01 compared to Perkins with a Sharpe ratio of 0.23. Both measurements indicate considerably less risk is taken for performance by the management of Perkins.

15. Vanguard Small Cap Index Market Cap: $1.1 billion

Performance continues to over achieve compared to other index funds.

16. Invesco U.S. Small Cap Value Market Cap: $1.1 billion

It appears that with the purchase of Van Kampen, there have been some major changes that have affected this fund. While the former management team had done a great job, they have been replaced with three new managers from the Invesco team. We are currently researching the change, but upon first glance are not impressed with the change.

Policy: **Watch List** due to Ownership and Manager Change

17. American Funds Capital World Growth and Income Market Cap: $38 billion

The positioning of the fund created difficulties in the first half of the year, but abated by the end of the third quarter. Affecting performance in the first half of 2010 was the stronger dollar. The markets impressive gains in September, (16.86% versus the peer group of 13.76%), and the appearance of Europe possibly averting another recession have boosted the fund's performance. There is an over weighting to Europe with 46% of the assets, while the peer group has only 36% of the assets dedicated to European stocks. The weaker dollar also contributed to the improved performance.

Like all American Funds, this fund is managed with a team approach and has a long term outlook. There is a very experienced team of eight managers running the fund with an average tenure of 17.6 years.

18. DFA International Small Company Market Cap: $835 million

This fund continues to do what it is designed to do, track the asset class of International Small Companies. It does hold a smaller percentage of assets in the technology sectors which has affected performance over the recent past. This fund has a lower standard deviation than the peer group and that leads to a more conservative, less volatile performance.

19. Dodge and Cox International Stock Market Cap: $24 billion

This fund continues its significant out performance of the MSCI EAFE international index but has done so with the additional risk of emerging markets. The fund holds almost a 23% weighting towards emerging markets with a surprisingly low allocation towards China. The potential volatility of the fund is evidenced by its beta of 1.16, the peer group beta is 1.01.

The fund has an occasional tendency to accumulate larger allocations to a specific sector when they feel bargains exist. This has worked well for them historically, with the exception of 2008 when large allocations to the financial companies were made. Despite the poor performance in 2008 this fund ranks in the top 12% of its peer group over three years.

20. Janus Aspen Overseas Market Cap: $9.8 billion

Manager Brent Lynn continues to manage the number one fund in his category for all measurable periods. But, we again state that it is rare for number one funds to continue posting such remarkable returns.

Current performance has been based on riding the beta-wave, essentially investing in highly leveraged stocks that have been the darling of Wall Street over the past 18 months. The beta is high at 1.17 against the peer group average of 1.02. 32% of assets are in Emerging Markets and 28% are invested in financials. At this time, the emerging markets allocation is driving performance and has overcome the lower performance of the financials.

21. Loomis Sayles Investment Grade Bond

We continue to have confidence in the managers, however, this is not to be confused with our belief about risk in this fund. This fund attempts to create excess return by investing in bonds of many different orientations. The managers are experienced, but this fund should not be confused with a bond fund that focuses on short-term preservation of capital. The managers focus on preservation of capital, but on a longer-term basis. In the short-term, the fund will fluctuate considerably. Its performance ranks in the top 10% for one-year, top 13% over three-years, (despite the poor performance in 2008), top 2% over five-years and the top 1% of bond funds over the past-ten years.

22. Oppenheimer International Bond

There has been some manager turnover at the fund. The manager who ran the developed markets portion of the portfolio departed at the end of July and the Emerging Markets manager has been overseeing that portfolio ever since; with Art Steinmetz overseeing everyone. The fund has a very good track record and held up quite well during the crisis of 2008, but it does have risks. The credit quality is low and the portfolio is sensitive to interest rate and currency changes. Performance over time has been consistent with above average returns to investors.

23. Pioneer Global High Yield

Morningstar rates this fund as "High" in the risk category but "Average" in returns. The fund sports a standard deviation (measure of past fluctuation) that is over 30% higher than the high yield peer average. The duration is currently under four years, but the average credit quality is B. The fund is beating its peers, but is trailing the index over the three and five-year periods.

24. American Funds Income Fund of America

Average Credit Quality has dropped from BBB to BB, though not because of a change in the portfolio, it was due to a change in the methodology Morningstar uses to calculate the weighted-average credit quality. This fund takes more risk on the bond side in order to boost the income yield of the fund. This additional risk (while tempered by a high-quality stock portfolio) adds to the potential downside risks during times of market dislocations. During the 2008 meltdown, this fund performed adequately at the 56th percentile. Over the past one-year the fund was in the top 7% of moderate asset allocation funds.

Though it is classified as an income fund, it is essentially a moderate allocation fund with 60% in stocks. Given the aggressive nature of the bond portion, this fund might actually be more accurately labeled a moderate-aggressive allocation fund. Its outperformance against the benchmark is explained by its more aggressive holdings. However, the standard deviation is currently a little lower than the moderate allocation peer group.

25 - 29. Vanguard Target Retirement Date Funds

Vanguard Target Retirement Income

This fund is essentially a conservative balanced fund that maintains a stable allocation. It is the eventual resting place for all other Vanguard Retirement Target Date Funds, in other words, this is the "landing" or "end" point of the glidepath. It is not technically a Target Date fund as it was created for those already in retirement, nearing retirement or those who want a conservative option in the accumulation phase. There is no changing glidepath. Fees are low, diversification is good and the underlying investment options are sound decisions.

Vanguard Target Retirement Date Funds 2020 - 2050

These funds are different than the Retirement Income fund; they are on a set glidepath that begins with an allocation to stocks of 89% for the 2050 and 2040 fund and then drops to 82% for the 2030. 2020 has a target allocation of stocks of 69%. All of these funds will get more conservative so that the allocation at retirement is about 50% in stocks. Since these are "Through" funds (meaning their glidepath continues to change in retirement) the allocation to stocks continues to fall until about ten years into retirement where it lands at 30% stocks.

These funds have an aggressive glidepath, although comparable to industry averages. The Vanguard funds suffered significant losses, as did the market in 2008, but comparable funds suffered greater losses. In fact, despite the losses in 2008, performance ranked in the top quartile. Of course these funds have snapped back since their March 2009 lows.

All of the Vanguard funds in the County of San Bernardino portfolios are four star funds. Reasonable performance with moderate risk and low cost compared to their competitors makes for good investments.

30. ING Clarion Global Real Estate

Overall, performance was below standards during a period where lower quality investments did better than the higher quality investments that Clarion prefers. Performance has lagged this past year due both to stock picking and regional allocations. Stock picking reflects 67% of the performance and regional allocations reflect the remaining 33%.

Investments in Asian office space were over weighted and investments in office space in Europe and the U.S. were under weighted, causing performance to lag. Investments overall in Europe were under weighted because of their financial crisis. It turned out that there was a surprising rally in real estate in Europe that Clarion missed out on. Likewise, office space in the U.S. did well too. They are overweight in hotels and apartments which typically perform well during economic recovery periods.

ING determined that this real estate division should be part of the banking organization rather than the investment / retirement organization. The real estate division is on the market and there has been a great deal of interest and several offers, but no decisions have been made.

Policy: **Watch List** due to potential ownership change

31 - 33. Asset Allocation Funds

Both the Aggressive and Moderate Asset Allocation Funds under performed due to the under performance of some of the mutual funds that comprise the underlying investments, e.g. Thornburg, Keeley and Growth Fund of America. Also impacting the Moderate Fund was the inclusion of the stable value fund with a 25% exposure.

The Conservative Asset Allocation Fund is under performing because of the impact of the stable value fund with a credited rate of 2% and the BarCap U.S. Aggregate Bond Index had an 8.16% one year return.

WATCH LIST

Pursuant to the County of San Bernardino Investment Policy Statement, investments must meet and/or exceed their respective peer group benchmarks for **both the three (3) and five (5) year periods**. The following investments do not meet this standard or have ownership or investment manager changes:

Remain on the Watch List:

8. **Thornburg Core Growth –** Due to Performance
16. **Invesco Small Value –** Due to ownership and manager change
30. **ING Clarion Global Real Estate** – Potential ownership change is on hold.