SST BENEFITS CONSULTING

COUNTY of SAN BERNARDINO
EXECUTIVE SUMMARY
DEFINED CONTRIBUTION PLANS
4th QUARTER 2009

	4th Qtr	1 Yr.	3 Yr.	5Yr.
457 Plans Performance	4.79%	34.32%	-2.98%	3.90%
Customized Benchmark	4.77%	30.08%	-4.30%	1.56%
Difference	0.03%	4.24%	1.32%	2.34%
401(k) Plan	4.87%	34.63%	-2.81%	3.99%
Customized Benchmark	4.54%	29.86%	-4.32%	1.66%
Difference	0.33%	4.77%	1.51%	2.33%
Retirement Medical Trust	4.48%	37.04%	-2.28%	4.07%
Customized Benchmark	5.10%	34.41%	-1.92%	2.63%
Difference	-0.62%	2.63%	-0.36%	1.44%

PORTFOLIO ANALYSIS

Assets:

The total assets in all of the County of San Bernardino plans have increased from $447,115,000, at quarter ended September 30, 2009 to $507,497,000 as of December 31, 2009. This includes $2,339,000 in the Self Directed Brokerage Account. The amount in the Self Directed Brokerage Account was $836,319 as of the end of the third quarter.

Based on total assets, excluding the 3121 plan assets, the total return, (including mutual fund and fixed interest assets), of the County of San Bernardino portfolio was 3.74% for the fourth quarter of 2009.

457 Plan Cash Position:

The stable value rate for the fourth quarter was 2.00%. Only $1,187,000 transferred from the Stabilizer to the mutual funds. This is half of what transferred in the third quarter. The percentage of assets in the fixed interest bearing account has decreased from 41.60% as of September 30, 2009 to 39.74%.

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 30.89% to 30.00% as of December 31, 2009.

Retirement Medical Trust Cash Position:

There was a small decrease in the percentage of assets in the fixed interest account with 83.77% now in the ING General account.

457 Plans Mutual Funds Position:

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 is -0.14 which is better than the benchmark of -0.22 (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 20.91. It is higher than the benchmark of 20.11.

The Alpha, a measurement of the value added by the investment manager, more than doubled from the second quarter to 1.69. 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 1.03 (over three years).

401(k) Mutual Funds Position:

The Sharpe Ratio for the 401(k) portfolio improved and is now -0.13 which is better than the benchmark of -0.23 (over three years).

The three-year Standard Deviation for the portfolio is 20.87. It is higher than the benchmark of 19.86. The Alpha is 1.98 and the Beta is 1.04.

Retirement Medical Trust (RMT) Mutual Funds Position:

The percentage of mutual fund assets in the RMT has grown from 14.52% as of September 30 to 16.23%, including the risk based asset allocation funds.

The RMT under performed the 457 and 401(k) portfolios due to having a higher mutual fund allocation to Growth Fund of America which had an under performance to the benchmark in the fourth quarter.

The Sharpe Ratio for the RMT portfolio is -0.12 and is the same as the benchmark. The three-year Standard Deviation for the portfolio is 19.89. It is higher than the benchmark of 19.04. The Alpha is -0.11 and the Beta is 1.04. The negative Alpha is caused by performance against the Beta. The performance was not as good as expected based on the portfolio risk.

MUTUAL FUNDS

1. **American Funds Growth Fund of America (AGTHX)**

   This fund continues to meet its objectives. While trailing both the benchmark and index over the one and three-year periods, the underperformance is slight and due mainly to the higher quality of stocks this fund tends to hold. We have seen a massive rally in the past year and the most risky stocks rallied the most. Funds that own less risky, less leveraged stocks have not kept up. We do not see this as a weakness; we see it as a strength.

2. **Columbia Marsico 21st Century Z (NMYAX)**

This fund is underperforming for the one and three-year periods versus the index and benchmark. Morningstar says the manager believes the worst of the financial crisis is over, which explains the heavy overweight to financials, nearly six times more than the index (and three times its peers). Its technology picks have outperformed, helping to offset weakness in other areas. While this fund may hug the index in certain sectors, it tends to heavily over or under-weight sectors as we see in Hardware (a 3% allocation versus 17% for the index).

The January, 2010 performance is in the top 2% of its category. There have been no announced changes in policy after the recent sale of Columbia to Ameriprise.

3. **Janus Contrarian (JSVAX)**

This fund shows dramatic out performance against its peers and index, though this may be more a function of its "go anywhere" style. This fund is tough to categorize as it holds 38% in international stocks (20% of the portfolio is emerging markets). The average global fund invests 56% of its assets in international stocks. Because of its heavy exposure to international stocks we did compare performance against a global index, (FTSE All World Index). The fund still compares well, but the out performance is not as dramatic.

4. **Vanguard Institutional Index (VINIX)**

This fund finished up in the third quartile of its large blend peer group in 2009. Net return exceeded the index.

5. **Mainstay ICAP Select Equity (ICSLX)**

This fund continues to outperform both its index and peers over all time periods. Though it runs a concentrated portfolio it manages to still maintain reasonable sector diversification. It has a slightly higher average Price-Earnings ratio than its typical peer, but it also has a lower average debt-to-capital ratio, a measure of leverage.

6. **RiverSource Diversified Equity (RSEDX)**

This deep-value management team continues to outperform. Given its focus on higher-quality stocks and dividends one might have expected it to underperform in 2009. While the fund fell a bit more than its index during the crisis it has rebounded better than both its index and peers. The manager maintained the position in stocks that did not perform as well in the bear market and his strategy was right on for the rally.

7. **Thornburg Core Growth (THGRX)**

This fund had a better 2009 than 2008. After falling more than its peers and index during the crisis this fund has rallied along with the stock market and beat its peers by almost 7% for 2009. Having said that, the fund barely beat the index for 2009 and when you look at the participant experience over the two-year period ending December 31st, 2009 you get a better picture. A participant starting with $100 would have seen a low of about $41, versus a low of roughly $47 with the peers and index.

Even with the 2009 out performance, the participant would be worse off in this fund than in the index or peer, ending with around $72 versus $79 and $82, respectively, for the index and peer.

This fund invests in larger fare than its peers, holding 23% in what Morningstar terms "Giant" stocks and its weighted-average market cap is twice that of its index and peer, though its R-Squared is 94%, meaning the majority of movement is explained by the Mid-Cap Growth index.

The fund is beating its peers for the one and five-year period, but trailing over the three year period.

8. Fidelity Advisor Leveraged Company Stock (FLVIX)

Last year we reported that this fund underperformed its peers over one (1) and three (3) years and barely outperformed over five (5) years. It also trailed its index over the one (1), three (3) and five (5) year periods. It was in the 97th percentile. This year it is in the top 7% of its category. The concern for a fund like this one is volatility. The three year standard deviation is 33.65 compared to the peer group average of 24.16. This type of fund typically does poorly in an economic downturn but rallies in bull markets.

2008 was a terrible year for stocks and even worse for managers who make bets and/or buy stocks that employ leverage. Prior to 2008 this fund was in the top quartile for seven consecutive years and returned to that top level in 2009.

As a tactical addition to a diverse portfolio this fund can add long term value, but as a standalone fund, the volatility is highlighted. Investors need to be aware of the risks.

9. Vanguard Mid Cap Index (VMISX)

Based upon the nature of mid cap indices, the Vanguard Mid Cap Index actually beats the index and is in the top quartile. That is very unusual for an index fund.

10. RiverSource Mid Cap Value (RSCMX)

This fund experiences a lot of volatility as the managers tend to concentrate their bets. These bets have paid off as the fund has beaten both its peers and benchmarks over all periods. The fund is trending toward a Mid-Blend fund, but so is the entire mid cap value category. Compared to its benchmark this fund has less exposure to value. It does, however, beat the mid cap blend peer group average.

11. Baron Growth (BGRFX)

The 2009 performance was hampered by Baron's deliberate underweighting of the Technology sector. The risks taken by Ron Baron are less than his competitors and that has kept the standard deviation below the peer group average.

The fund is trending toward mid-cap as its weighted-average market cap is nearly three times the size of its index (though only 50% larger than its peers). Comparing the fund to a mid-cap would be misleading as the mid-cap average capitalization is twice as large.

Ron Baron's buy and hold strategy has kept this fund at or near the mid cap growth category. His winners are retained in the portfolio and increased stock value drives up the market capitalization. The fund is doing well against its peers and index and is rated above average in terms of return by Morningstar versus the risk it takes. We continue to have confidence in Ron Baron.

12. Royce Value Plus (RVPHX)

We like the philosophy behind this fund and believe the focus on clean balance sheets will bode well over the coming decade. The investment style is more conservative than most actively managed small cap growth funds. The manager, Chris Skinner, will make sector bets and can occasionally be early and this strategy compromised performance in 2009 while still beat 75% of the peer group.

13. Keeley Small Cap Value (KSCVX)

This fund runs a very different strategy than its peers and this risks periods of underperformance, which this fund is experiencing now. That strategy is to invest in newly spun off units of other businesses, invest in companies emerging from bankruptcy or are trading below book value.

The fund is underperforming its peers and benchmark for the one and three-year periods, but beating them both by about 1% for the five-year period. While the manager has been having success in the larger asset classes, this fund continues to struggle. This fund will heavily under weight or over weight sectors. Currently it has almost no allocation to Information, but 61% to Manufacturing. The lack of Information stocks influenced performance in 2009.

The manager, John Keeley, is heavily invested in this fund.

14. Vanguard Small Cap Index (NAESX)

Based upon the nature of small cap indices, the Vanguard Small Cap Index is within acceptable expense and tracking error margins for the 1, 3 and 5 year periods. This index fund actually is beating the index.

15. Morgan Stanley US Small Cap Value (MCVAX)

This fund continues to outperform, though it finally showed a little weakness in the one-year period versus its peers. While some might take this as a sign the team is slipping, the fact that they only underperformed by about 1% is surprising. The fund was one of the best performers in the downturn and thus it didn't need to rally as much to make up for its losses. Yet the fund participated in the rally rather nicely, barely trailing its peers and significantly outperforming its index.

16. American Funds Capital World Growth and Income (RWIEX)

Recent underperformance is mainly due to the extended rally in the most risky assets, while this fund invests in more conservative higher-quality stocks. Affecting performance was the significant over weighting to international stocks. This fund invests almost 71% of the assets in international stocks and the average global fund is at 56%.

The fund has experienced outflows that would decimate most mutual funds, but the asset size to begin with was huge, so this has not affected returns negatively. We think those investors fleeing the fund are making a mistake.

We like the management, the philosophy of this fund, as well as the low turnover and diversification. It is a good global stock fund. It is going to fluctuate and its going to have times of under-performance, but this is a quality mutual fund for those looking for relative return global stock exposure.

17. DFA International Small Company (DFISX)

This fund is designed to be an index for small-mid size international companies and provides excellent exposure to an asset class that ten years ago barely existed. This fund has existed since 1996.

18. Dodge and Cox International Stock (DODFX)

Despite this fund's mistakes in 2008, it now has a winning record against its peers and benchmark for all time periods measured. The fund has benefited from its hefty stake in Emerging Markets, which also hurt performance in 2008, but provided a boon for 2009. This fund rebounded to be in the top 6% of its category in 2009.

Ordinarily we would be a bit wary of a large emerging markets stake (nearly double the peer) with a portfolio that holds less than 100 stocks on average, but Dodge and Cox has shown they can handle it. This is a core international fund for those looking for such exposure.

19. Janus Aspen International Growth (JAIGX)

This fund had one of the best returns of all mutual funds that Morningstar tracks. Its "go anywhere" style and focus on Emerging Markets, along with some savvy stock picking and good timing, combined for the perfect year for manager Brent Lynn. This spectacular performance is unlikely to be repeated again, but for those people looking for a gutsy manager and who can withstand the inevitable downturns this fund might be a good complement to an International portfolio. We would advise participants to be careful about chasing performance here.

In four of the last five years this fund finished the year in the top 1% of its category and it is in the top 1% for the one, three, five and ten year performance periods.

20. Loomis Sayles Investment Grade Bond (LSIIX)

We like the team over at Loomis Sayles. They didn't lose their heads during the financial crisis despite a huge outflow from their funds. This cool headedness paid off in spades in 2009 with the fund rocketing up 27%. During the downturn this fund lost 19% from its high to its low, so it can be aggressive, but it was ranked in the top 1% for 2006 and 2007.

We caution participants to be careful with this fund as it looks tempting to get into given its recent return and its mouth watering yield of over 5%. In a world of near zero interest rates 5% sounds like an oasis in a desert, yet the easy money has been made and during a financial crisis this fund will seize up again and investors will experience some fluctuation. This fund has an average credit quality of A. There are five higher levels of quality ratings above A.

Lastly, the average duration is just over six years, which suggests that for each interest rate increase of 1%, this fund will experience a capital loss of about 6% (perhaps less depending on the decisions of the managers). Given that we are at historic interest rate lows, the rate is likely to be up at some point (of course that is what Japan thought 18 years ago, so nothing is certain). We like this fund, we like these managers, but this fund has some bond risks that should be understood before investing.

21. Oppenheimer International Bond (OIBYX)

This is a unique fund and very few like it exist. There is almost no tool not at the manager's disposal and he uses those tools in an attempt to uncover value while holding down risk. As we've said before, this is not a traditional bond fund that looks for good credits and then potentially hedges out currency risks – this fund actively pursues currency bets based on their macro view for each economy. To give you a good example of their acumen they have almost zero exposure to Greece right now. This strategy will not always work, and it is an aggressive one, but for those looking for additional diversification and are willing to accept some risk in the bond asset class, this fund should prove to be useful in a portfolio.

22. Pioneer Global High Yield (GHYYX)

A 63% return in 2009 is impressive, but still not enough to outperform its peers over three-years (barely beat over five) and this fund trails its index over the three and five-year periods. High Yield as an asset class rallied heavily in 2009, but this fund rallied even more, partially due to its exposure to currency and emerging markets (about 11% is in non-dollar denominated credits).

While the 2009 performance is impressive, it should be put in perspective. From its high to its low the fund dropped nearly 38%. A participant who started with $100 would be left with just under $63. Over the two-year period ending December 31, 2009 an investor in the Pioneer fund who started with $100 would have ended up with a tad over $105.

23. American Funds Income Fund of America (RIDEX)

This fund continues to fulfill its objective, which is to provide income from stocks and bonds. This strategy forces it to be more heavily invested in value stocks (as these stocks are where the dividends are) and this might lead it to look different than most "balanced" funds. With an allocation of 60% to stocks and 40% to bonds it will fluctuate with the market, but we believe for those looking for stock exposure, dividends and who are willing to be more concentrated in one asset class (large value) this fund will be a good choice. The managers are experienced and have a good record.

24. PAX World Balanced Fund (PAXIX)

This fund continues to underperform its peers. We believe this is partially due to its social mandate. This is the third consecutive quarter where it under performed the three and five year comparisons.

Recommendation: Remain on the Watch List

25. (25 – 29) Vanguard Target Retirement Income, 2020, 2030, 2040 & 2050

We like Vanguard and we like the underlying funds within the Target Date portfolios. Despite their underlying composition of index funds they are beating their custom benchmarks. However, they are trailing the target fund indexes due to their more conservative investment style and inability to over or under weight sectors. In terms of asset mix, bonds/stocks, they have a moderate risk profile but most important, they are more conservative at retirement compared to the average universe of target funds.

30. ING Clarion Global Real Estate (IRGIX)

After a strong 2007 and 2008 this fund performed in the third quartile in 2009. The difference in performance to the benchmark was due to the international holdings. The Price to Earnings ratio is higher than the benchmark and this is due to investments with smaller capitalizations. Morningstar rates the risk as average with high performance.

(31- 33) Risk Based Asset Allocation Funds – They are performing as designed with a composition of funds that are performing well.

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 investment does not meet that standard:

24. Pax World Balanced – This is the third quarter on the Watch List. We recommend that this fund stay on the Watch List for another quarter.

Remove the Stabilizer from the Watch List