



**UNIVERSITY OF WISCONSIN SYSTEM
TRUST FUNDS**

**Quarterly Investment Review
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**SECTION 1:
MARKET OVERVIEW**

Quote for the Quarter

“By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens.... The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose.”

John Maynard Keynes

MARKET OVERVIEW

Major Geopolitical Developments

The Middle East and Iran

For much of the 2nd quarter of 2009, Iran continued to be rocked by large-scale protests and street demonstrations, stemming from the disputed presidential election which ostensibly reelected Ahmadinejad. Surprisingly, some of the dissent came from elements of the religious leadership itself. And although the hard-line, theocratic government ratcheted up its suppression of street demonstrators, many observers believe that recent events have exposed serious fault lines within Iranian society that will be difficult or impossible to repair.

Meanwhile, hopes for reining in Iran's nuclear arms ambitions seemed to dim once again. At period end, the U.S. and diplomats from five other countries were set to meet with Iranian officials in Geneva, following a U.S. visit of the Iranian foreign minister, the first of its kind in a decade. However, just a week earlier, the U.S., France and the U.K. accused Iran of building a covert uranium enrichment facility, saying Tehran is directly challenging global non-proliferation rules. And once again, Israel warned of a possible strike against Iran's nuclear facilities. Israeli/Iranian tensions also intensified when Ahmadinejad, at the annual rally for Jerusalem Day (also known as Quds Day), delivered a fiery anti-Israel speech in which he again called the Holocaust “a lie.”

Hopes dimmed too for any progress between Israel and the Palestinians. Although Hamas stated in late July that it would work with the U.S. to resolve the conflict if Israel freezes settlements and lifts the Gaza blockade, the Netanyahu government resisted growing external pressures to do either.

The military and political situation in Iraq continued to show signs of improvement. In mid-September the U.S. administration suggested that the U.S. is on track to remove all combat troops by August 2010. Furthermore, there was growing evidence that in beginning to prepare for January elections, Iraqi parties were embracing more of a “national unity” theme. A New York Times article at the end of the quarter reported this: “Across the political spectrum – Sunni and Shiite, secular and Islamic – party leaders have jettisoned explicit appeals to their traditional followers and are now scrambling to reach across ethnic and sectarian lines. In some cases, the shift is nothing less than extraordinary.”

Europe and Russia

The Russia – U.S. relationship, chilled for some time now, showed signs of warming during the 2nd quarter of 2009. Early in the period, Russia opened its airspace to the U.S. for the Afghan war. And a few days later, Obama and Medvedev signed a preliminary agreement to work toward reducing the world's two largest nuclear weapons stockpiles by as much as a third. Obama also said the two leaders “resolve to reset U.S. – Russian relations so that we can cooperate more effectively in areas of common interest.” Later in the quarter, Russian leaders hailed the U.S.'s decision to cancel its planned missile defense system in Eastern Europe. On the other hand, Russia's relationship with former Soviet republics iced up further, as some of these states continue their paths toward more allegiance to the West. Tensions between Russia and Ukraine in particular flared up anew. Medvedev condemned Ukraine's bid for NATO membership and its support for Georgia, and said he would not send an ambassador to Ukraine. Meanwhile, Putin gave a clear signal that he is considering a return to his former job as Russian president. And on a positive note, Putin suggested that a return to privatization of big businesses is called for, as Russia faces its first budget deficit in a decade. On a minor positive note for this autocracy, it was reported that Solzhenitsyn's “Gulag Archipelago” was to become required reading in Russian high schools.

In Germany, Merkel's center-right alliance won in parliamentary elections late in the period. Deutsche Welle reported that, “Business leaders in Germany cheered the re-election of Chancellor Angela Merkel and her pro-business center-right coalition and urged her to press ahead with long-needed economic reform.”

Africa, Asia and the Indian Sub-Continent

Afghanistan continued to confound in its efforts to democratize and fight the resurgent Taliban. The “re-election” of President Karzai was as disputed as the election in Iran. Virtually all external observers concluded that the Afghani election was plagued by so much fraud, violence, and low turn-out, that the winner would likely be seen as illegitimate by most Afghans. Meanwhile, the Taliban continued to resist and even strengthen, and U.S. military commanders first began their call for an additional surge of U.S. troops, from an initial estimate of 17,000 up to as many as 40,000 (on top of the 62,000 troops already there).

There was little new development in efforts to rein in Kim Jong Il's North Korea. This in spite of some hope generated in early August, when former President Bill Clinton won the release of two U.S. journalists, who had been sentenced to 12 years of hard labor for alleged spying.

Meanwhile, a stalwart American ally in Asia, Japan, seemed to take a few steps back from its unquestioned allegiance to and reliance on the U.S. For only the second time in post-war history, parliamentary elections resoundingly swept out the long-ruling Liberal Democratic Party, “handing a landslide victory to a party that campaigned on a promise to reverse a generation-long economic decline and redefine Tokyo's relationship with Washington.... Mr. Hatoyama [the new prime minister]...has spoken of the end of American-dominated globalization and of the need to reorient Japan toward Asia. His party's campaign manifesto calls for an ‘equal partnership’ with the United States and a ‘reconsidering’ of the 50,000-strong American military presence here.” [New York Times, Aug. 31, 2009]

On the African continent, there were some positive developments in Somalia. In mid-September, American commandos killed one of the most wanted Islamic militants in a daylight raid in southern Somalia. The militant had been the ringleader of an al Qaeda cell in Kenya responsible for the bombing of an Israeli hotel on the Kenyan coast in 2002, and was also suspected of having played a role in the attacks on American embassies in East Africa in 1998. Also positive, has been the growing grass-roots support for and relative stability of Somalia's moderate Islamist government led by Sheik Sharif. A New York Times article noted, “Much of the world is counting on Sheik Sharif to tackle piracy and beat back the spread of militant Islam, two Somali problems that have flared into major geopolitical ones. Al Qaeda appears to be drawing closer to Somali insurgents in an effort to turn this country into a launching pad for global jihad.... After years of ambivalence about Somalia, The United States is playing an increasingly active role here, and recently shipped 40 tons of weapons to Somalia to keep Sheik Sharif's government alive.”

The Americas

The Obama administration certainly began some significant geopolitical and foreign policy initiatives (some already alluded to) during this period. First, President Obama began “pushing for new global rules, treaties and alliances to establish a nuclear-free world, a vision he developed as a college student.” [New York Times, Jul. 5, 2009] With the impending expiration of the 1991 Strategic Arms Reduction Treaty, there was a clear opportunity for progress here, and Russia responded very favorably to making significant further reductions. Second, the Bush administration's proposed Eastern European-based missile defense system, with its focus on longer-range intercontinental missiles, was scrapped. Obama proposed in its place, a reconfigured system designed to shoot down the short- and medium-range missiles Iran is more likely to develop in the nearer term. This system would first be based aboard ships and later in Europe. The Bush administration's proposed system had provoked the ire of the Russians, who saw it more as a defense against their own long-range missiles, and some observers saw the Obama plan as a concession to the Russians. And although the U.S. administration denied this, Russia's Medvedev signaled for the first time a week later at the UN, that Russia would be amenable to significantly toughen sanctions against Iran if upcoming nuclear talks made no progress. (Russia has close economic and other ties to Iran and has long decried sanctions against its neighbor.) At that same UN meeting, the opening of the UN General Assembly, “Obama told leaders that the United States intended to begin a new era of engagement with the world, in a sweeping address to the General Assembly in which he sought to clearly delineate differences between himself and the administration of President George W. Bush.” [New York Times, Sep. 24, 2009] (Also, much earlier in the quarter, the White House signaled its support of a UN doctrine that calls for collective military action to halt genocide.)

The Environment

Global warming and other environmental issues continue to garner more and more attention in the media and among global policymakers, if not the general public. There were certainly substantive dialogues and even some concrete decisions announced during the 3rd quarter of 2009. At meetings of the G-8 and developing nations held in early July, the two biggest developing nations, India and China, once again refused to commit to specific goal or targets for reducing greenhouse gas emissions, undercutting the drive to build a global consensus by year-end. And although President Obama remained keen on forging a climate treaty soon, the U.S. Congress is still far more

restrained; this is in contrast to Europe, which presses ahead for aggressive actions. For example, in mid-September, French President Sarkozy said that France would begin taxing carbon emissions by households and companies in 2010. Japan too appeared set to take strong measures, as their new prime minister stated that the country now plans to cut greenhouse gas emissions 25% from 1990's level by 2020. In late September, the UN held a climate change summit as a prelude to negotiations scheduled for December in Copenhagen. Importantly, "the G-20 countries agreed to phase out government subsidies for the production and consumption of fossil fuels, and directed finance ministers to complete by November a 'range of possible options' to fund climate change mitigation in developing countries. But their communiqué came up short on producing a target figure for financing climate change mitigation and control. And the subsidy phase-out did not include a deadline." [New York Times, Sep. 25, 2009] Finally, on the very last day of the quarter, the Obama administration did take some action that required no Congressional involvement. The president authorized the EPA to begin moving toward regulation of greenhouse gases. "The proposed rules, which could take effect as early as 2011, would place the greatest burden on 400 power plants, new ones and those undergoing substantial renovation, by requiring them to prove that they have applied the best available technology to reduce emissions or face penalties. [The EPA administrator] describe d the proposal as a common-sense rule tailored to apply to only the largest facilities – those that emit at least 25,000 tons of carbon dioxide a year – which are responsible for nearly 70 percent of greenhouse gas emissions in the United States." [New York Times, Oct. 1, 2009]

In addition to these somewhat promising developments, the New York Times published a fascinating but frightening article on August 8, 2009, entitled "Climate Change Seen as Threat to U.S. Security." The following are excerpts from the article: "The changing global climate will pose profound strategic challenges to the United States in coming decades, raising the prospect of military intervention to deal with the effects of violent storms, drought, mass migration and pandemics, military and intelligence analysts say. Such climate-induced crises could topple governments, feed terrorist movements or destabilize entire regions, say the analysts, experts at the Pentagon and intelligence agencies who for the first time are taking a serious look at the national security implications of climate change. Recent war games and intelligence studies conclude that over the next 20 to 30 years, vulnerable regions, particularly sub-Saharan Africa, the Middle East and South and Southeast Asia, will face the prospect of food shortages, water crises and catastrophic flooding driven by climate change that could demand an American humanitarian relief or military response.... [A] growing number of policymakers say the world's rising temperatures, surging seas and melting glaciers are a direct threat to the national interest. If the United States does not lead the world in reducing fossil-fuel consumption and thus emissions of global warming gases, proponents of this view say, a series of global environmental, social, political and possibly military crises loom that the nation will urgently have to address." And adding to mounting evidence of climate change, the U.S. weather-data agency said that the world ocean temperature rose to a record in July 2009. Also, the World Wildlife Fund estimated that sea levels could rise by double previous estimates, to three feet, by 2100 due to melting Arctic ice.

Other Broad Global Developments

The heads of state of the G-20 nations announced at their meeting in late September, that the G-20 would become the permanent council for international economic cooperation, supplanting the long-standing Group of Eight. (The G-8 consists only of the major developed economies, plus Russia, and has a decidedly Western bias.) And also late in the period, the UN Security Council announced that it was set to adopt a resolution proposing actions against nations using civilian nuclear technology for military purposes.

Major Economic Developments

Economic Growth and Employment

Even in the very first part of the 3rd quarter of 2009, many economists, including the IMF's, began commenting that the global economy was showing signs of recovery from the worst recession since World War II. Nevertheless, most if not all also suggested that the recovery would be sluggish and lengthy, and that governments will need to maintain their supportive policies for some time to come.

In general, for developed Western economies, the fall in gross domestic production looked to be bottoming out and, in some cases, modest expansion resumed. While the U.S., U.K., Italy and Spain still reported modest contraction during the 2nd quarter of 2009, Germany, France, Australia and New Zealand reported modest expansion; all following, on average, five quarters of more significant contraction. For the Eurozone overall, there was essentially no change in GDP during the 2nd quarter.

By contrast, developing and other Asian economies either rebounded more strongly or continued their fairly robust expansion. China reported annualized growth for the 2nd quarter of nearly 8%, India registered roughly +6%, while

South Korea and Singapore grew at annualized rates in excess of 10%. The Boston Globe made this interesting observation in late August: "In previous worldwide downturns, it always the U.S. that led the recovery. This time, China and its Asian neighbors are fulfilling that role. 'The economic center of gravity has been shifting for some time, but this recession marks a turning point,' said Neal Soss, chief economist at Credit Suisse in New York."

There was little doubt that fiscal stimulus and even monetary policy programs in most if not all of these economies contributed to growth (or slowed contraction). In the case of the developing nations, these programs helped stimulate nascent domestic demand, while their export business remained surprisingly resilient (probably due to more intra-regional exports). And by the end of the 3rd quarter, the IMF had issued a more optimistic forecast for world economic growth in 2010, up from an earlier estimate of +2.5% to +3%.

Unfortunately, the improving economic output picture did not yet translate into an improving global employment picture during this period. In the U.S., the unemployment rate hit 9.7%, its highest rate since June 1983. Of course some areas in the U.S. remain especially vulnerable; Detroit's unemployment soared from 14.9% in May to 17.1% in June, and the state of California (the country's most populous) posted a 12.2% jobless rate, its highest level in nearly 70 years. (Fed Reserve Chairman Bernanke noted that for the nation, GDP has to expand about 2.5% to just hold overall unemployment steady.)

There was more sobering U.S. employment-related news reported during the quarter. For instance, the Treasury Department reported that 40% of those unemployed describe themselves as "permanent job losers" (i.e., not temporarily "laid off"), a much higher percentage than in previous recessions. And in mid-August, a Washington Post article stated bluntly: "Economic indicators suggesting the U.S. recession is ending are increasing by the day, but those same indicators point to the likelihood that recovery will not mean good times for many Americans. The statistics indicate a recovery with no new jobs, no pay increases, and no growth in tax receipts for cash-strapped state and local governments." It was also reported that job seekers now outnumber openings six to one, the worst ratio since the government began tracking open positions in 2000; and that new business start-ups, a key to new job creation, continue to decrease. A New York Times article in early September, entitled "A Reluctance to Retire Means Fewer Openings," made these interesting observations on the U.S. jobs scene: "To the long list of reasons American companies aren't hiring – business losses, tight credit, consumer retrenchment – add the fact that many older workers are unable, or afraid, to retire. In other parts of the developed world, people are retiring as planned, because of relatively flush state and corporate pensions that await them. But here in the United States, financial security in old age rests increasingly on private savings, which have taken a beating in the last year. Prospective retirees are clinging to their jobs despite some cherished life plans. As a result, companies are not only reluctant to create new jobs, but have fewer job openings to fill from attrition." The same newspaper reported that the teenage employment rate reached 25.5% (i.e., the percent of teenagers who wanted a job but could not find one); this is the highest level since the government began keeping track of such statistics in 1948.

A couple of other sobering observations were made during the 3rd quarter: State governments in the U.S. continued to suffer, given their balanced budget constraints and an overall decrease in tax revenues of 12% in the 1st quarter, the steepest decline on record. It was also reported that, having surged by 2% in May, a record 34.4 million – or one in nine – Americans are receiving food stamps now.

Employment in other developed regions also continued to struggle. Germany's unemployment rate held steady at roughly 8.2% for the period. U.K. joblessness jumped to 7.9%, while Ireland's reached 12.4%, both the highest levels seen in 14 years. Spain continued to be even more challenged, as joblessness rose further to 18.5%. Overall EU unemployment reached a decade-high 9.6%. Meanwhile, Japan's unemployment rate continued to rise, from 5.2% to 5.4%; this remains low by other developed economy standards, but the projected peak expected of nearly 6% will be a record for post-war Japan.

In early-to-recover Australia, the jobless rate was reported as having held steady at 5.8%, and economists there began suggesting a peak of only 6%, compared to earlier government estimates of a mid-2010 peak of 8.5%. In China too, there was no longer much talk about a jobless recovery. A New York Times report from late-September noted the following: "China's aggressive lending to businesses, direct spending on stimulus projects, and attractive tax breaks for exporters have given the nation an economic rebound so powerful that even the real estate market is heating up. The well-capitalized banking system got through the credit crunch with only minimal losses, then ramped up lending dramatically in response to government stimulus policy. Many laid-off workers are being called back to their jobs."

Overall, developments during the 3rd quarter of 2009 suggested that the severe global recession was beginning to end. Nevertheless, almost all economists and policymakers seemed to concur that the economic rebound now

beginning, will be much slower and less robust than “normal” recoveries, and that employment levels will remain below “full employment” for much longer than normal.

The Great Recession of 2007-09 was indeed caused by an unusual confluence of events: a global glut of liquidity, lax credit standards, and cheap, easy money; subsequent asset valuation bubbles (especially residential real estate, but virtually all asset classes); increasing connectedness between major financial institutions (with ballooning use of OTC derivatives); regulatory failings and deficiencies; and unsustainable global trade and financial imbalances. It did not take much – the bursting of the sub-prime mortgage and housing markets – to send this poorly-built edifice crumbling. As in all recessions and depressions, it is not that there is a sudden vacuum of brainpower, manpower, technological innovation, and general economic capability. Rather, it’s that “suddenly,” the institutions and individuals that facilitate economic activity freeze up, there is a pervasive loss of confidence and trust, and long-built-in global imbalances begin to right themselves. Regarding the latter problem, which is perhaps the least understood by most folks, the Financial Times noted the following at the very end of the quarter: “The Group of 20 nations should act to end severe trade and financial imbalances that caused the economic crisis, said U.S. President Barack Obama. As U.S. consumers cut back, other countries need to boost spending to become engines of growth and give the world a more balanced economy, he said. World Bank President Robert Zoellick and International Monetary Fund Managing Director Dominique Strauss-Kahn made nearly identical calls for ‘rebalancing of growth’ and more consumption in emerging markets as a G-20 meeting in the U.S. draws near.”

Inflation

Inflation remained subdued in the developed economies once again. In the U.S., the latest figures reported during this period showed an annual change in headline CPI of -1.5% and +1.4% for core inflation, which excludes food and energy. Although there continues to be widespread concern about higher future inflation due to ballooning government deficits, there had also been concern that inflation could heat up in the shorter term due to governments essentially printing too much money. “Paradoxically, the latest statistics show a shrinkage in the broadest measures of money.... To fight the recession, the Federal Reserve has vastly increased the amount of reserves that banks have on deposit at the Fed. In a healthy economy, banks would take advantage of those reserves to increase their lending. Instead, they’re hoarding the money, so the Fed’s loose monetary policy isn’t resulting in more loans. It’s the process of lending that expands the amount of money in the economy.” [Business Week, Sep. 22, 2009] In fact, in August the broadest measure of money fell at an annual rate of 2.2%. These developments, in combination with still-low capacity utilization, subdued job and wage growth, and resumption of only moderate economic expansion, portend still weak inflationary pressures in the near term.

Oil and Other Commodities

Oil prices remained volatile, but over the course of the quarter, prices mainly rose. Oil was in the \$60 per barrel range at the beginning of the period and ended in the \$70 range (and it is interesting to recall that oil had hit a low of \$34 in December 2008). Some observers began to speculate that rising oil prices could eventually choke off the budding economic recovery, while others noted that \$60-\$70 oil is probably the level needed to encourage continued exploration and higher-cost extraction efforts. And in fact, it was noted that the oil industry is setting a brisk pace of new discoveries; more than 200 discoveries have been reported so far this year in dozens of countries spanning five continents.

Another interesting development regarding oil and other energy commodities was the apparent about-face position taken by the U.S. Commodity Futures Trading Commission (CFTC) during this period. In a contentious report last year, following volatile price movements that saw oil peak at \$145 in July 2008, the CFTC pinned the oil price swings primarily on supply and demand. Now, coming around to the viewpoint of many other observers, the CFTC issued a report suggesting that speculators played a significant role in driving wild swings in oil prices. In fact, the commodities regulators indicated that they were planning to propose sweeping trading limits on oil, natural gas and possibly other commodities “of finite supply.” Adding fuel to the fuel debate, a study from Rice University showed that during the past seven years, speculators have grown from being 20% of all traders in the main U.S. oil market to 50%, and that the growth coincided with the recent historic rise in the price of crude oil.

Housing

Although the U.S. housing market showed some signs of stabilization and hope, there were still many troubling developments. Sales of new and existing homes, and new mortgage applications did register month-to-month increases, but, nevertheless, their numbers reflected significant declines versus the same periods a year ago. And existing home prices continued to decline, driven by the glut of distressed sales and the growing glut of rental properties. “The decline of U.S. home prices has slowed, the number of houses sitting on the market is down and affordability is better than it has been in years. But many houses do not show up in those figures because they were put on the rental market instead of the sales market. In many areas, that has caused a glut on the rental market, one of several factors likely to prevent a quick recovery any time soon.” [Wall Street Journal, Aug. 16,

2009] For July 2009, the median price for an existing home was \$178,400, a 15% decline from the July 2008 median price of \$210,100. And falling prices continued to expand the number of “underwater homeowners,” those with outstanding mortgage debt in excess of their home’s value. Zillow.com forecasted that as much as 30% of U.S. homeowners could be underwater by mid-2010, which is not so surprising, as nearly 25% of owners are already there. So the wave of mortgages delinquent or going through foreclosure may surge further, especially if employment does not begin to show definite improvement. Certainly now, joblessness has replaced sub-prime mortgages as the biggest force driving home foreclosures. The Mortgage Bankers Association reported during the period that the percentage of U.S. home mortgages delinquent or in foreclosure reached the highest level since records began in 1972. In the 2nd quarter, 9.24% of mortgages were delinquent, and 4.3% already were in the process of foreclosure. And prime loans, made to the most desirable borrowers and considered the least risky by lenders, accounted for more than half of the foreclosures. In Europe too, there were reports that the number of mortgages in arrears continues to increase, suggesting more looming defaults.

A final disconcerting observation is that overall, the U.S. housing market remains on government life support. What sales are occurring are surely being aided by various government programs: the \$8,000 tax credit for first-time home buyers; the fact that Treasury-backed entities are guaranteeing around 85% of new mortgages, while the Fed buys 80% of the securities into which these taxpayer-backed mortgages are packaged; and the fact that these and other Fed activities are helping to keep mortgage rates exceptionally low (at the end of the quarter, the nationwide average rate on a 30-year fixed rate mortgage declined to 4.97%).

Personal Consumption/Savings and Business Investment

In the U.S., consumer confidence ticked up, back down, and back up again during the 3rd quarter of 2009, primarily as a result of volatile employment fears and expectations. But even the final number reported during the period – the Conference Board Consumer Confidence Index – surged to 54.1 for August from 47.4 for July, the index still remains miles from a mark of 90, which suggests the economy is in good shape. And although confidence bounced around and ended with a strong uptick, actual consumption remained at very depressed levels with very few exceptions. As the Wall Street Journal noted in late August, “Big retailers reported that U.S. consumers are continuing to hunker down, casting a cloud over the durability of the U.S. recovery and underscoring the importance of overseas demand in restoring the world economy to health.” Consumption of gasoline and autos did show some improvement, the latter due largely to the government’s “cash for clunkers” program.

Regarding “overseas demand,” there was little evidence to suggest that consumption in other developed economies such as Western Europe and Japan would pick up the slack, even though consumer confidence showed some improvement as in the U.S. There continued to be indications that Chinese consumption is expanding. In late September, The China Post and Bloomberg reported that, “A survey by MasterCard shows that China’s household spending will increase, thanks to the government’s \$586 billion economic stimulus. A survey of 6,300 families shows that 41% of urban households and 59% of rural households intend to spend more during the next year than they did in the previous 12 months. ‘The short- to medium-term income and employment stimulus may well develop into longer-term structural improvement that supports a higher level of household spending,’ said Yuwa Hedrick Wong, an economic adviser at MasterCard Worldwide.”

Meanwhile, new business investment, which represents a far smaller proportion of global GDP than does private consumption, remains tepid in developed economies. For instance, both the U.K. and Japan reported further declines in business spending during the period. The Financial Times reported in late August that, “[U.K.] companies are scaling back investment spending at the fastest rate since records began in 1966. ‘The further sharp decline in business investment signals serious threats to Britain’s long-term recovery,’ said David Kern, chief economist at the British Chamber of Commerce.”

A question heard often these days is, what exactly will be the driving force of a resurgent global economy? It will likely not be consumer spending in developed economies; nor housing and residential construction; perhaps not business investment spending; and certainly not cheap-money, easy-credit borrowing. It seems increasingly likely that only increased consumption in developing economies, and perhaps infrastructure and clean/more-efficient energy investments will have to be the drivers. The muted growth now being experienced, largely from businesses restocking inventories, will be short-lived.

The Financial System, Credit and Liquidity

Generally, credit conditions continued to improve and normalize during the 3rd quarter of 2009, at least for large, established corporate borrowers. For instance, the so-called “TED spread” (the yield difference between 3-month LIBOR and Treasury Bills) fell to some 25 basis points early in the period, much more in-line with normal conditions (the spread is an indicator of the perceived risk for global banks to lend among themselves). Also, corporate

issuance of new bonds soared during the quarter. In early August, the Financial Times reported that for the first time in a single year, global issuance exceeded \$1 trillion. "The boom partially has been because of investor demand as well as tightening of loan standards by banks. Dollar-, yen-, euro- and sterling-denominated deals have all experienced an increase in issuance, most at record levels. And by mid-September, the Financial Times reported that just European bond issuance had reached \$2 trillion this year. Also, the Wall Street Journal noted that Europe's high yield bond market is beginning to take on a central role: "The high yield bond market in Europe is moving closer to its U.S. counterpart as it becomes increasingly important for companies that are rated below investment grade. In the past five months, more than €8 billion worth of high yield bonds have been issued in Europe. The market had been frozen since summer of 2007. Industry observers expect companies to continue issuing high yield bonds as a way of funding themselves while bank lending remains tight. Gilbey Strub, managing director of the trade body European High Yield Association, said 'rediscovery of the public capital markets' is similar to the early stages of the U.S. high yield market in the 1980s."

Meanwhile, the banking system continued to be hugely challenged in its role as a major source of credit. Bank lending in the U.S. and the Eurozone continued to contract, despite all the governmental aid to the banking system. As one example, it was reported that the total amount of loans held by 15 large U.S. banks shrank by almost 3% in the 2nd quarter, and more than half of the loan volume during that period came from refinancing mortgages and renewing credit to businesses, not new loans.

Bank failures also continued to mount in the U.S., providing further challenges to the FDIC, which protects more than \$4.5 trillion in U.S. bank deposits. In late August, it was reported that the FDIC's insurance fund had fallen to just \$10.4 billion, the lowest level seen since the savings and loan crisis and almost guaranteeing that the banking industry will be hit by another special fee to recapitalize the fund. At that same time, the FDIC said it had 416 banks (with combined assets worth nearly \$300 billion) on their "problem list" (compared to just 117 a year ago), and that 84 banks had failed so far in 2009 (compared to 25 in 2008 and only three in 2007). Among the larger failures during the 3rd quarter were Colonial Bank in the southern U.S. (which was the 6th largest bank failure in U.S. history) and Chicago-based Corus Bank, the first major bank to be undone by deteriorating construction and commercial real estate loans. It was estimated that the Corus Bank failure alone would cost the government between \$1.5 billion and \$2.4 billion in losses.

It was further noted that U.S. banks that have failed over the past two years were in far worse shape than those that died during the savings and loan crisis. [Wall Street Journal, Aug. 17, 2009] A New York Times article in late August noted too that most failing banks now are doing it the "old-fashioned way:" they made loans that will never be repaid. "As the number of banks closed by the [FDIC] has grown rapidly this year, it has become clear that most of them had nothing to do with the strange financial products that seemed to dominate the news when the big banks were nearing collapse and being bailed out by the government. There were no CDOs, SIVs or AAA-rated 'super-senior tranches' that turned out to have little value. Certainly there were no 'CDO-squareds.'.... The severity of the current string of bank failures shows that many of the proposed remedies batted about since the financial crisis erupted would have done nothing to stem this wave of closures. These banks did not get in over their heads with derivatives or hide their bad assets in off-balance sheet vehicles. Nor did their traders make bad bets; they generally had no traders. They did not make loans that they expected to sell quickly, so they had plenty of reason to care that the loans would be repaid. What they did do is see loans go bad, in some cases with stunning rapidity, in volumes they never thought possible. The fact that so many loans are souring is a testament to how bad the recession, and the collapse in property prices, has been." [New York Times, Aug. 20, 2009]

By the end of the 3rd quarter of 2009, although the IMF was reducing their estimate of total world-wide bank losses due to rising prices of global securities held by financial institutions, they nevertheless issued another sobering number. "Overall, the IMF calculate[d] that the financial crisis will produce \$3.4 trillion in losses for financial institutions, between 2007 and 2010, a chunk of which already has been recognized." [Wall Street Journal, Sep. 30, 2009]

Finally, there was one major economy where banks remained in solid shape and new lending was surging: China. In contrast to most developed economies, the Chinese government's efforts to stimulate (or demand, in the case of state-owned institutions) bank lending have been very successful. In fact, many observers, and now the Chinese government itself, are becoming concerned about the volume and quality of the new lending. By quarter-end, China was beginning to phase in stricter capital requirements for banks to help rein in lending and improve the quality of bank assets and capital.

Interest Rates and Other Central Bank/Governmental Activities

During the 2nd quarter of 2009, central banks of all developed economies maintained their accommodative monetary policies to combat the recession. Short-term interest rates were maintained at record lows, from 0%-

0.25% in the U.S. to 1.0% in the EU; and the major central banks indicated that there will likely be no increase in these rates "for an extended period of time" (in the words of the U.S. Federal Reserve). Most governments also maintained their "quantitative easing" and other credit market support programs, but signaled that some programs would soon be winding down as economic and credit conditions have improved. These programs have generally involved central bank purchases of government bonds and/or mortgage-backed securities, as one tool to help drive down longer-term interest rates and indirectly reduce the cost of home mortgages and corporate borrowing. For example, in the U.S., these programs included plans to purchase \$300 billion in Treasury bonds and \$1.25 billion in mortgage-backed securities (MBS). The latter program directly affects home mortgage rates, and it has had a much more noticeable impact than the Treasury purchase program. Consequently, the Treasury program has ended while the MBS program continues. And in England, the BOE decided against expanding its £125 billion program to purchase government and corporate bonds.

Regarding direct capital injections into financial institutions and programs to take troubled assets off their books, the need for these efforts also diminished greatly during the 3rd quarter. In fact, repayment of billions of TARP loans in the U.S. intensified. By mid-September, \$70 billion had been repaid and \$50 billion more was expected over the ensuing 12 to 18 months. And to date, the government has earned a profit on these loans: profits collected from eight of the biggest banks that fully repaid their obligations amounted to \$4 billion, or the equivalent of about a 15% annualized return. [New York Times, Aug. 31, 2009] And while the Treasury Department's long-delayed program to purchase toxic assets from financial firms (the Public-Private Investment Partnership or PPIP) was launched on the last day of the quarter, it seems very likely that this program will be scaled down significantly from what the Treasury first envisioned. (Briefly, PPIP works as follows: A fund is set up with private investment dollars, which are matched by government funds. The fund is then eligible for a government loan on very favorable terms, increasing the total capital the fund can use to purchase toxic assets. In theory, these assets are purchased at attractive prices, and the favorable government-backed loan provides low cost leverage on fairly "low-risk" assets, leading to high returns.)

Regarding efforts to enhance regulation and help prevent future crises, there was once again considerable discussion but little action. Some observers claimed it was back to "business as usual" already at large financial firms, and many expressed skepticism that any regulatory reforms would be enacted by year-end.

The Obama administration did send to Congress in mid-August, its proposal to overhaul the over-the-counter (OTC) derivatives market. The sweeping plan involves forcing many derivative products to trade on exchanges or alternative trading platforms. (Globally, OTC derivatives are a \$450 trillion market.) And shortly thereafter, a number of major financial firms, including JPMorgan, Barclays, UBS and Citigroup, agreed voluntarily to accelerate their use of central clearinghouses for OTC derivatives such as credit default swaps and interest-rate derivatives.

Also, it was reported that the U.S. Securities and Exchange Commission will create the Division of Risk, Strategy and Financial Innovation, which will track risks that develop as financial markets innovate and undergo rapid change. University of Texas law professor Henry T.C. Hu will head the division, which will encompass several previous divisions of the SEC along with some other functions. "The derivatives revolution, the rise of hedge funds and institutional investors, technological change and other factors have transformed both capital markets and corporate governance," Hu said. [Investment News, Sep. 16, 2009] But whether regulation can keep pace with market innovations is an on-going question.

The SEC did begin moving toward elimination of "flash orders" (a form of high-frequency trading where powerful computers are used to glimpse at investors' orders) as part of a broader effort to tighten regulation of "dark pools." As an example of how much volume such trading now represents, a September 19 New York Times article provided these observations: "In July, flash orders represented 2.8 percent of the roughly 9 billion shares of stocks traded in the United States. According to Richard H. Repetto, an analyst at Sandler O'Neill who studies stock exchanges, the average trade is executed, or completed, in less than 10 milliseconds and often as fast as 5 milliseconds. The proliferation of high-frequency trading has pushed up average daily volume on the nation's stock exchanges by 164 percent since 2005. Proponents of the practice argue such trading enhances the liquidity and greases the wheels of the markets. "

And as part of the administration's efforts to set guidelines for executive compensation at banks that received government aid (standards which could be taken up by the entire industry), U.S. Treasury Secretary Timothy Geithner proposed having bankers paid largely in stock, in a form that can be "clawed back" if the bank does not perform well. "You want compensation to come substantially in the form of equity in the firm that vests over time, that is at risk, that can be clawed back if returns don't materialize," Geithner told CNBC in mid-September.

Regarding global efforts to re-regulate and make policy in a coordinated fashion, finance ministers from the Group of 20 nations gathered in Pittsburgh for a two-day summit at the very end of the quarter. At the conclusion of the summit, G-20 leaders announced that they plan to cooperate on an overhaul of financial regulations. By the end of next year, banks will be required to hold more capital; compensation policies will need to be linked to longer-term performance; systems will be created for winding down large, cross-border financial institutions (so-called "living wills" may be required of these institutions); and banks will be required to retain a percentage of the asset-backed securities they originate. The G-20 also released a statement about its plans for maintaining stability in financial markets and encouraging economic growth, among other goals. [Bloomberg, Sep. 26, 2009]

Currencies

The big story in the currency markets for the 3rd quarter of 2009 continued to be the falling value of the U.S. dollar and calling into question, the dollar's perpetual status as the world's reserve currency. Also, given the low to non-existent short-term U.S. interest rates, the dollar has suddenly become the perfect funding choice for "carry trades" (which involve borrowing in a low-cost currency and investing in a higher-yielding currency perceived to be stable). In fact, in the weeks leading up to the end of the quarter, the dollar carry trade outstripped the Japanese yen carry trade. And as with the long-employed yen carry trade, traders "looking for a stable currency, resurgent economy and elevated interest rates [found] such a target in familiar territory: Australia." [Wall Street Journal, Sep. 17, 2009]

Another currency issue brought into focus involved the euro and at least one limitation of a trans-national, common-currency union. In this case, more depressed economies within the union, such as Spain and Italy, cannot devalue their currency to boost their competitiveness. Rather, their common currency, the euro, is actually doing the opposite: it is appreciating relative to the U.S. dollar. The divergence of economic performance among the euro-zone nations could at some point threaten the survival of their single currency.

Globalization and Trade

As the global economy began to show more signs of stabilization and recovery, there seemed to be diminishing concerns that nations would introduce more measures to protect their own industries at the expense of free trade. There was one significant trade dispute, however, involving the U.S. and China once again. In mid-September, the U.S. imposed tariffs on imports of Chinese-made tires. The Chinese retaliated days later by announcing an investigation into whether U.S. exports of chicken meat and automotive products constitute an "unfair competition" under international anti-dumping and anti-subsidy trade rules. This was followed by the Chinese government requesting that the World Trade Organization oversee efforts to resolve the tire trade dispute with the U.S.

There also continued to be indications that Asia is beginning to build a large, powerful trade bloc, as there have been 19 free-trade agreements signed in recent years between major economic powers in the region. "Taiwan is reaching trade accords with China, and the fresh Japanese regime is seeking greater economic integration in Asia. Should a bloc be created, it could rival the North American Free Trade Agreement and could make it more difficult for U.S. companies to get the same terms as Asian ones in regional trade." [TIME, Sep. 7, 2009]

Finally, there were efforts to revisit the failed Doha trade talks. "Senior government officials from most of the major trading nations [met] at the World Trade Organization's headquarters this week to restart the stalled Doha Development Round of trade talks. The negotiations broke down 14 months ago when the richest nations refused demands from poorer countries that they reduce subsidies for farmers. Developing nations also want some protection for their fledgling industries until they get on their feet." [Rediff and Far Eastern Economic Review, Sep. 14, 2009]

Financial Market Developments and Performance

Growth and High-Yielding Assets

For risky growth and high-yielding assets, the 3rd quarter was almost an exact replay of the 2nd quarter. But the 3rd quarter started off with a significant sell-off of equities and other risk assets, primarily due to the weaker-than-expected jobs reports coming out at that time. However, by mid-July, a dramatic reversal ensued, driven largely by upbeat 2nd quarter earnings expectations and improving economic data. Nevertheless, equities and other risk assets remain well below their October 2007 peak values. For example, the S&P 500 fell 55.3% from its peak to its trough in March 2009. While the S&P 500 has rebounded 58.2% from March 2009 through the end of the 3rd quarter, this still leaves the index 29.1% below its October 2007 peak. And, in local currency terms, emerging market equities fell 58% from their peak to their March 2009 trough, but have rebounded 83.3% since, leaving them still 23% below peak valuations. (Foreign equities, both developed and emerging market, outperformed U.S. equities primarily due to the falling dollar.) By most standard historical measures, however, publicly-traded equities globally now appear to be somewhat overvalued. But within the global markets, European stocks are trading at a

significant discount to U.S. stocks, and emerging market equities at a small premium. And overall, the stocks of lower-quality, higher-risk companies have rebounded more strongly than their high-quality brethren, suggesting again that higher-quality, large- company stocks remain relatively more attractive.

Private equity and venture capital continued to lag the public markets, but these markets did reverse course from their 2nd quarter write-downs to post modest returns for the 3rd quarter. Nevertheless, these private markets remain particularly challenged. While the large buyout market remains perhaps most challenged because debt is less available and more costly if obtainable, venture capital too is struggling. "Weakness in the market of initial public offerings and uncertainty about economic recovery led to a 51% drop in venture capital funding for U.S. startups in the second quarter, the National Venture Capital Association and PricewaterhouseCoopers said. Investment by venture capital firms totaled \$3.67 billion, compared with \$7.56 billion in the same quarter last year. Money for startups will be tight until the IPO market makes a comeback, said Ray Rothrock, a venture capitalist at Venrock." [Bloomberg, Jul. 21, 2009] In private equity space, "[t]he buyout business is focusing on acquiring units of bigger corporations, known as carve-outs, and giving a second look at smaller companies skipped when credit was almost limitless for financing huge transactions, said Paul Schaye, managing director of Chestnut Hill Partners. "You're seeing private equity go back to its roots with carve-outs," he said." [Bloomberg, Sep. 2, 2009]

High-yielding bonds also staged another huge rally during the 3rd quarter. Option-adjusted spreads (over comparable maturity Treasuries) for U.S. high yield bonds narrowed from 9.5% to 7.6% during the quarter. Since the end of 2008, junk bonds' absolute yields have fallen from an astounding 19.4% to 10.3% as of the end of the 3rd quarter. Obviously, many investors are now stretching for more yield than that available from paltry-yielding developed market government bonds and investment-grade corporate bonds that have experienced ever-tightening spreads. There were also large flows into emerging market bonds: "Bond issuance by emerging-market governments has reached its highest level since record-keeping started in 1962. The surge was spurred by increased investor appetite for risk, prompting many to shift to securities with more attractive yields. 'From an investor's point of view, it does make sense to buy emerging-market bonds because there is a safety net,' said Shahin Vallee, an emerging-market strategist at BNP Paribas. 'Since the [Group of 20] committed extra money to the International Monetary Fund in April, it has become clear that the governments will not let an emerging-market country default.'" [Financial Times, Jul. 26, 2009]

The table that follows provides recent as well as longer-term performance for asset classes and markets within the general category of higher risk "growth and high-yielding assets," which includes public and private equities and lower-quality, higher-yielding fixed income.

Performance – Periods Ended September 30, 2009

<u>Growth and High-Yielding Assets</u>	3 rd Qtr	Year To Date	1 Year	3 Years	5 Years	10 Years	<i>Risk</i> ¹
U.S. Large Cap Equity (S&P 500)	15.6%	19.3%	-6.9%	-5.4%	1.0%	-0.2%	16.2%
U.S. Small Cap Equity (Russell 2000)	19.3%	22.4%	-9.5%	-4.6%	2.4%	4.9%	26.5%
Non-U.S. Equity – Dev Markets (MSCI EAFE)	19.5%	29.6%	3.8%	-3.1%	6.6%	3.0%	18.0%
Non-U.S. Equity – Emerging Mkts (S&P/IFCI)	20.9%	66.6%	20.1%	8.3%	18.3%	12.8%	25.3%
Private Equity (Cambridge Private Equity) ²	4.3%	-15.2%	-22.0%	2.8%	12.2%	8.8%	13.1%
Venture Capital (Cambridge Venture Capital) ²	0.2%	-14.9%	-17.3%	2.1%	6.5%	4.9%	32.3%
U.S. High Yield (Merrill Lynch High Yield)	14.8%	48.5%	22.4%	5.2%	6.0%	6.0%	11.2%
Emerging Markets Debt (JP Morgan EM Debt)	10.2%	24.2%	18.3%	7.5%	9.2%	12.1%	10.9%

¹ Risk is measured by the annualized standard deviation of monthly returns over the past ten years.

² Private equity and venture capital returns are for periods ended one quarter earlier.

Event Risk- and Deflation-Hedge Assets

Corporate bonds also staged a remarkable rally during the 3rd quarter. Option-adjusted spreads for investment-grade U.S. bonds narrowed from 3.6% to 2.7% during the quarter. Non-financial investment-grade bonds are now yielding only some 4.5%, and AA- and A-rated bonds are yielding below 4%. Since the end of 2008, investment-grade bond yields have fallen from an extremely attractive 7.5% to just 4.9%, which is near historic lows in absolute yield terms.

Surprisingly, U.S. Treasuries also rallied, rebounding from their 2nd quarter decline. The 10-year Treasury started the period yielding 3.54% and the 2-year at almost 1.00%; they finished the quarter at 3.31% and 0.95%, respectively. Generally, one would expect that given a rallying stock market and improved economic data, Treasury yields would rise rather than fall. The fact that they fell during this period suggests that not only does

foreign demand for Treasuries remain strong, but government efforts to keep longer-term rates low have been successful. Non-U.S. government bonds rallied even more strongly in U.S. dollar terms, but most of the extra juice came from appreciation of foreign currencies as the dollar fell.

Ultra-low short-term interest rates in the U.S. continued to provide virtually nothing to holders of “cash.” Many money market funds are likely showing positive returns only because their managers are waiving some fund fees. Finally, Hedge Funds as a whole have apparently held up relatively well (and certainly on a risk-adjusted basis) over shorter and longer-term timeframes.

The following table provides performance data on asset classes and markets falling within the broad category of “event risk- and deflation-hedge assets,” which includes high-quality bonds, cash, and hedge funds.

Performance – Periods Ended September 30, 2009

Event Risk- and Deflation-Hedge Assets	3 rd Qtr	Year To Date	1 Year	3 Years	5 Years	10 Years	Risk
U.S. Broad Market Bonds (Barclay’s Aggregate)	3.7%	5.7%	10.6%	6.4%	5.1%	6.3%	3.8%
U.S. Treasuries (Citigroup Treasury 1-10 Year)	1.6%	-0.9%	5.5%	6.6%	4.8%	5.5%	3.4%
Non-U.S. Bonds (JP Morgan Global/Govt)	5.9%	3.9%	14.0%	9.4%	6.7%	6.7%	6.9%
U.S. Cash (CG 1-month U.S. Treasury Bill)	0.0%	0.1%	0.1%	2.4%	2.8%	2.8%	0.5%
Hedge Funds (MSCI Diversified Hedge Funds)	5.6%	10.7%	11.3%	7.9%	8.3%	9.1%	5.4%

Real and Inflation-Hedge Assets

U.S. TIPS provided also provided a strong return for the quarter, and year to date, they have been the best performing investment-grade bond sector. The yield on 10-year TIPS declined from 1.78% to 1.56% during the 3rd quarter.

Commodities provided a respectable return for the quarter, but it did not come from the energy complex, which fell by 4.3%, but by industrial metals, which were up 20.1%. Also, whereas year to date the DJ-UBS index of commodity futures returned +9.2%, spot prices of commodities were actually up 24%; this conundrum was due to the fact that commodity futures have been in “contango” again (contango is when the futures price is above the expected future spot price; consequently, the price will decline to the spot price before the delivery date).

Regarding commercial real estate, public markets retained their high correlation to public equity markets and rebounded very strongly for the quarter. However, a Wall Street Journal article in mid-August made these observations: “Share prices for real estate investment trusts have posted spectacular gains in recent months, climbing 60% from their 18-year low in March. But the REIT industry faces some formidable challenges. A mountain of debt is scheduled to mature during the next two years, and refinancing remains extremely difficult to obtain. Rent and occupancy rates continue to decline, undercutting earnings.” In contrast to REITs, privately-held real estate experienced further write-downs in property valuations for the quarter, continuing its catch-up with longer-term REIT returns. Most observers believe that underlying commercial real estate values, regardless of the investment structure, will fall further for some time to come, particularly if economic recovery is a significantly “jobless” one.

The table that follows presents performance data for asset classes categorized as “real and inflation-hedge assets,” which includes Treasury Inflation Protection Securities (TIPS), public and private real estate, timber, and commodities. Inflation, as measured by “headline” CPI which includes energy and food, is also shown.

Performance – Periods Ended September 30, 2009

Real and Inflation-Hedge Assets	3 rd Qtr	Year To Date	1 Year	3 Years	5 Years	10 Years	Risk
U.S. TIPS (Citigroup Inflation Linked)	3.1%	7.9%	5.4%	5.5%	4.7%	7.5%	6.7%
Commodities (DJ-UBS Commodity Index)	4.2%	9.1%	-23.7%	-4.9%	-0.7%	6.3%	17.4%
Private Real Estate (NCREIF Property)	-3.3%	-15.1%	-22.1%	-1.3%	6.2%	7.8%	N/A ¹
Public Real Estate (MSCI U.S. REIT)	34.6%	17.9%	-28.2%	-12.7%	1.3%	9.4%	24.8%
Timber (NCREIF Timberland)	0.3%	-0.2%	2.5%	11.3%	13.2%	8.5%	N/A ¹
CPI (Consumer Price Index)	0.6%	2.0%	-1.3%	2.1%	2.6%	2.5%	N/A ¹

¹Due to the infrequency of market-based valuations of these asset classes, standard deviations of monthly returns are not meaningful.

Potential Investment Implications of Current Market and Economic Conditions

The objective of this section is to provide some possible broad, high-level investment implications given the foregoing discussions and assessments of global markets and economics. Given a strong underlying belief in “reversion to the mean” in all things economic (assuming essentially free and competitive capital markets), the value of this exercise is to provide some basis for perceiving current market-level risks and opportunities.

In many ways, it is becoming a very challenging investment environment again. Equities have appreciated to levels that now seem somewhat overvalued, while credit assets have appreciated to the point that they are providing historically low absolute returns which may be further reduced by default losses. Various “alternative” assets also seem still challenged, assets such as private equity, venture capital, and commercial real estate. This, coupled with the desire for most institutional investors to continue to de-risk and provide for more portfolio liquidity, would seem to suggest that more “cash,” Treasuries, and other low-risk assets and strategies should be employed. But cash returns are essentially zero, and Treasuries continue to provide paltry nominal returns and potentially even negative real returns over much of the yield curve. Meanwhile, inflation will likely remain muted over the near term, but will probably accelerate beyond the near term. Therefore, there seems now to be substantial opportunity cost from holding low risk assets, which may actually turn out to be higher risk if inflation eventually ignites.

Equities then, despite their somewhat overvalued status overall, are likely to perform *relatively* well going forward and over the longer-term versus low-risk assets, although absolute returns from equities may still disappoint. As mentioned over the past few quarters, in equity space, more concentration in high-quality stocks both in U.S. and non-U.S. markets continues to be advisable. Non-U.S. developed market stocks continue to be valued more attractively than U.S. stocks, but the extra juice from foreign currency appreciation against the dollar may no longer be there and may even begin to reverse course. The huge year-to-date rally in emerging market stocks have left them trading at a slight premium to developed market stocks; while this is cause for concern, emerging market currencies may very well continue to appreciate against the dollar, providing benefits to U.S. investors.

In pure Treasury space, given somewhat higher yields on the shorter part of the yield curve (e.g., 2-year maturities) and still virtually nothing on “cash,” it may be time to consider stepping out a bit on the curve while keeping duration and interest-rate price sensitivity low. U.S. TIPS offer low real yields (certainly far short of the 4% to 5% pay-out requirements of most endowments), but given the longer-term outlook for higher and less certain inflation in the U.S. and the diversification/correlation benefits of TIPS, a neutral (or strategic, long-term) weighting seems warranted.

Regarding various alternative assets and strategies, it may still be too early for a first-time entry into core-type commercial real estate, though “opportunistic” real estate vehicles and strategies may be of much more tactical interest. Some attractive opportunities in timber are beginning to crop up now as well. And absolute return-oriented hedge funds continue to provide a potentially attractive source of diversifying, lower risk, reasonable rates of return.

SECTION 2: FUND OVERVIEWS

FUND OVERVIEWS

Total Trust Fund Assets		
<i>Quarter Ended September 30, 2009</i>		
	<i>As of September 30, 2009</i>	<i>As of June 30, 2009</i>
Long Term Fund	\$ 294,975,557	\$ 268,973,144
Intermediate Term Fund	\$ 75,025,520	\$ 66,220,986
Income Fund	<u>\$ 45,490,704</u>	<u>\$ 44,557,211</u>
	\$ 415,491,781	\$ 379,751,341

Long Term Fund

The change in the net assets of the Long Term Fund is summarized below.

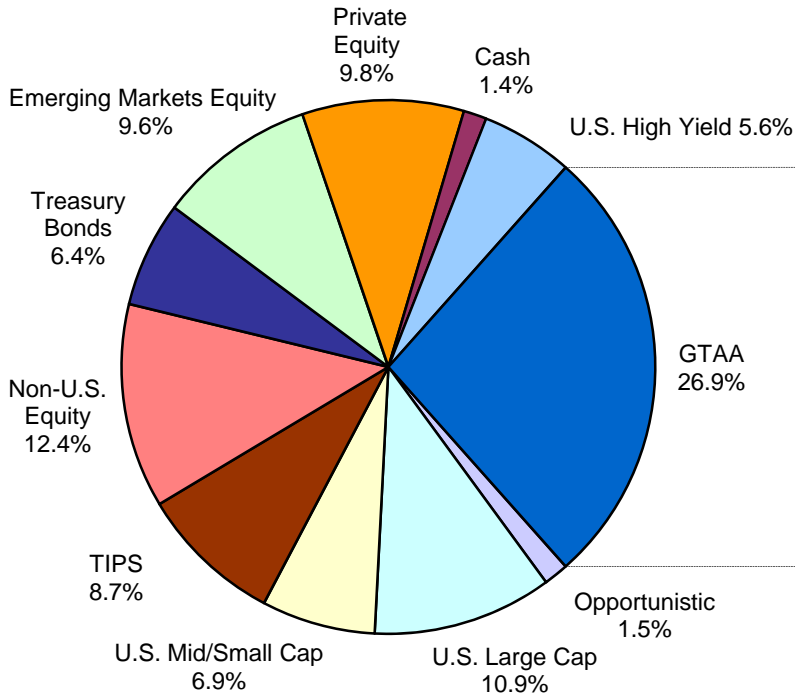
Long Term Fund:	
Change in Net Assets	
<i>Quarter Ended September 30, 2009</i>	
Beginning Market Value (6/30/09)	\$ 268,973,144
Net Contributions/(Withdrawals)	(3,036,471)
Investment Management and Administrative Expenses	(235,321)
Realized Investment Gains/(Losses)	(10,683,784)
Unrealized Gains/(Losses)	<u>39,957,989</u>
Ending Market Value (9/30/09)*	\$ 294,975,557

*Note: Net contributions/withdrawals and investment management expenses are those processed "as of" the prior quarter-end but processed early in the current quarter; therefore the ending market value shown equals the custodian's market value and does not reflect net contributions/distributions and expenses to be processed "as of" the current quarter-end.

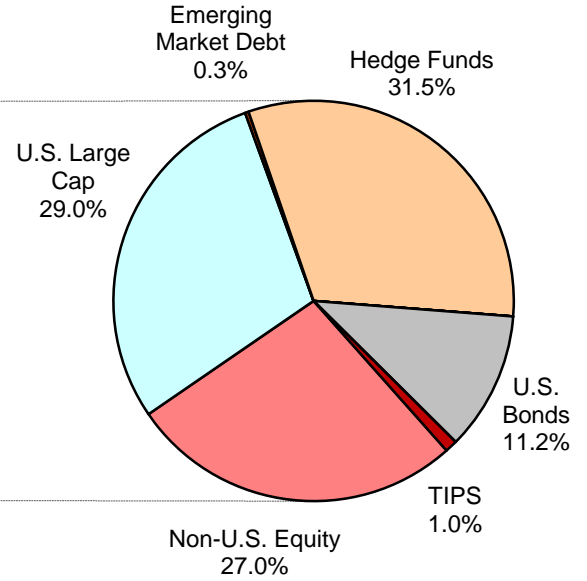
Long Term Fund: Asset/Strategy Allocations

Quarter Ended September 30, 2009

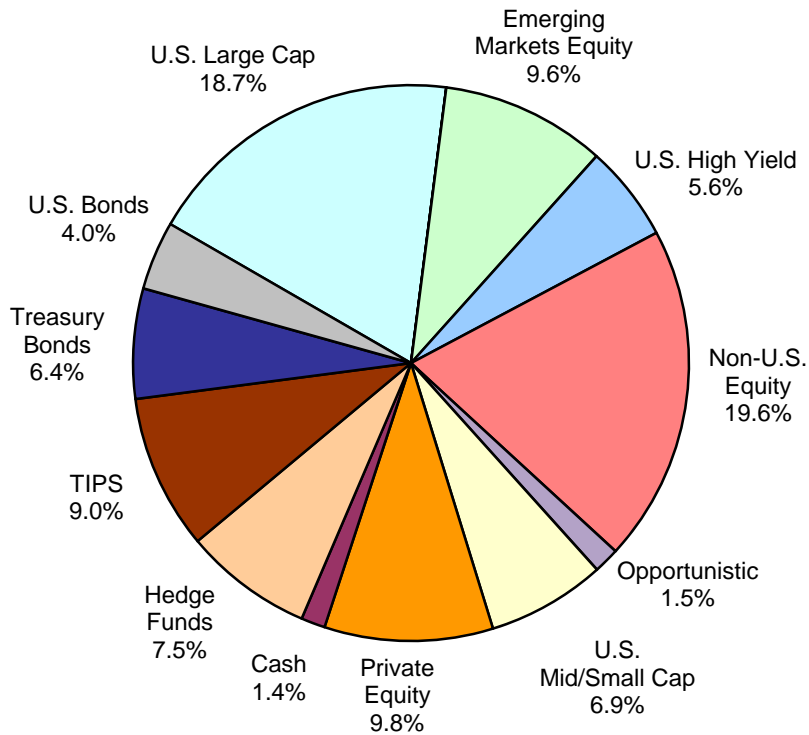
Total Portfolio Asset/Strategy Allocation



Global Tactical Asset Allocation



Total Effective Portfolio Asset Allocation



Long Term Fund: Actual Versus Target Asset/Strategy Allocation

Quarter Ended September 30, 2009

Asset Class/Strategy	Target Allocation (%)	Allowable Ranges (%)	Current Allocation (%)	Current Allocation (\$MM)
Global Tactical Asset Allocation	25.0%	20% - 30%	26.9%	\$79.3
Growth/High Yield Assets				
U.S. Equities	10.0%	7% - 13%	17.7%	\$52.3
Non-U.S. Equities	8.0%	6% - 10%	12.4%	\$36.5
Emerging Market Equities	6.5%	5% - 8%	9.6%	\$28.3
Private Equity	10.0%	5% - 15%	9.8%	\$28.9
High Yield Debt	<u>5.0%</u>	<u>3% - 7%</u>	<u>5.6%</u>	<u>\$16.6</u>
	39.5%	30% - 50%	55.1%	\$162.5
Event Risk- and Deflation-Hedge Assets				
U.S. Bonds	6.5%	5% - 8%	6.4%	\$18.9
U.S. Cash	0.0%	0% - 10%	1.4%	\$4.1
Absolute Return	<u>6.5%</u>	<u>5% - 8%</u>	<u>0.0%</u>	<u>\$0.0</u>
	13.0%	10% - 25%	7.8%	\$23.0
Real and Inflation-Hedge Assets				
U.S. TIPS	5.0%	3% - 7%	8.7%	\$25.6
Real Assets	<u>17.5%</u>	<u>12% - 23%</u>	<u>0.0%</u>	<u>\$0.0</u>
	22.5%	15% - 30%	8.7%	\$25.6
Opportunistic	0.0%	0% - 10%	1.5%	\$4.5
TOTALS	100%	100%	100%	\$295.0

3rd Quarter 2009 Fund-Level Transactions

The net cash drawdown requirement for the Fund (to cover the 2nd quarter 2009 spending distribution, net of new gifts/withdrawals, interest and dividends collected, and expenses) was \$3.055 million. To provide cash for this distribution and to conduct some portfolio re-balancing, the following transactions were conducted at the end of July and beginning of August: \$7 million was drawn from the GMO GTAA account; and \$1 million each was added to U.S. Large Cap Equities, Non-U.S. Equities, Emerging Market Equities, and U.S. TIPS. For the Private Equity program, the net cash flow for the 3rd quarter was lower than normal and remained negative, with \$329,777 more drawn than returned (\$426,601 drawn; \$96,824 returned).

Current and Upcoming Fund-Level Activities

These key investment activities are planned within the next three to six months:

- Conduct analysis and due diligence to support a potential first-time investment in a timber fund, the GMO Forestry Fund 9, which is expected to close in the 1st quarter of 2010.
- Conduct further research and analyses regarding investment strategies and portfolio structuring for commercial real estate and absolute return asset classes.
- Issue first-time RFPs/RFIs for commercial real estate and absolute return investment managers.
- Issue a new RFP for U.S. small/mid cap equity investment managers.
- Revisit/revise Investment Guidelines for separate account managers.
- Conduct investment manager due diligence meetings.
- Seek out and investigate opportunistic investment offerings.

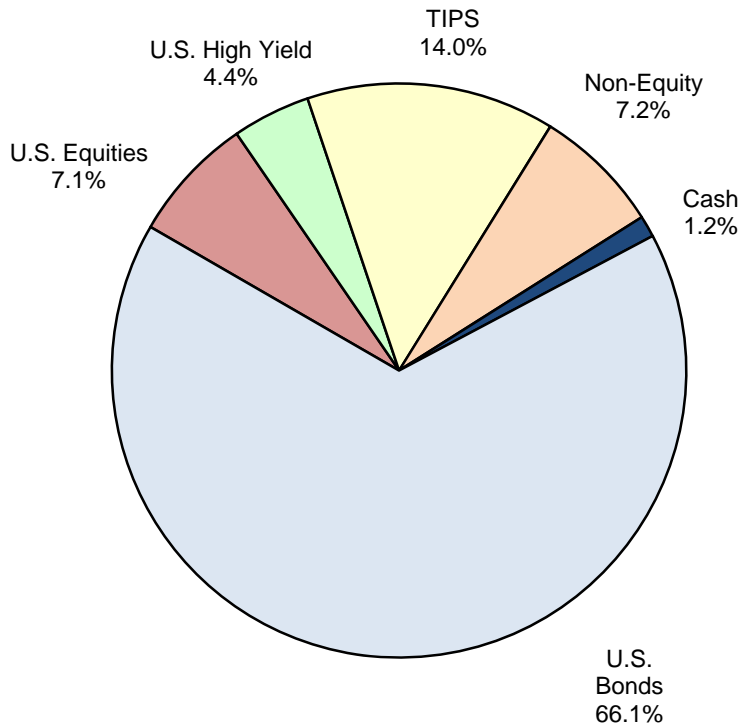
Intermediate Term Fund

The change in the net assets of the Intermediate Term Fund is summarized below.

Intermediate Term Fund: Change in Net Assets <i>Quarter Ended September 30, 2009</i>		
Beginning Market Value (6/30/09)	\$	66,220,986
Net Contributions/(Withdrawals)		4,189,955
Investment Management and Administrative Expenses		(17,496)
Realized Investment Gains/(Losses)		1,206,620
Unrealized Gains/(Losses)		<u>3,425,455</u>
Ending Market Value (9/30/09)*	\$	75,025,520

**Note: Net contributions/withdrawals and investment management expenses are those processed "as of" the prior quarter-end but processed early in the current quarter; therefore the ending market value shown equals the custodian's market value and does not reflect net contributions/distributions and expenses to be processed "as of" the current quarter-end.*

Intermediate Term Fund: Asset Allocation <i>Quarter Ended September 30, 2009</i>
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Intermediate Term Fund: Actual Versus Target Asset/Strategy Allocation				
<i>Quarter Ended September 30, 2009</i>				
Asset Class/Strategy	Target Allocation (%)	Allowable Ranges (%)	Current Allocation (%)	Current Allocation (\$MM)
Growth/High Yield Assets				
U.S. Equities	7.5%	6% - 9%	7.1%	\$5.3
Non-U.S. Equities	7.5%	6% - 9%	7.2%	\$5.4
Emerging Market Equities	0.0%	0% - 3%	0.0%	\$0.0
High Yield Debt	<u>5.0%</u>	<u>4% - 6%</u>	<u>4.4%</u>	<u>\$3.3</u>
	20.0%	15% - 25%	18.7%	\$14.0
Event Risk- and Deflation-Hedge Assets				
U.S. Bonds	40.0%	30% - 50%	66.1%	\$49.6
U.S. Cash	10.0%	5% - 15%	1.2%	\$0.9
Absolute Return	<u>10.0%</u>	<u>8% - 12%</u>	<u>0.0%</u>	<u>\$0.0</u>
	60.0%	45% - 75%	67.3%	\$50.5
Real and Inflation-Hedge Assets				
U.S. TIPS	<u>20.0%</u>	<u>15% - 25%</u>	<u>14.0%</u>	<u>\$10.5</u>
	20.0%	15% - 25%	14.0%	\$10.5
TOTALS	100%	100%	100%	\$75.0

3rd Quarter 2009 Fund-Level Transactions

The net 2nd quarter 2009 cash flow for the Fund (net new contributions/withdrawals, interest and dividends collected, and expenses) conducted in mid-August required investment of \$4.745 million, due primarily to the annual sweep of certain unspent Income Fund balances into the Intermediate Term Fund. This amount was allocated as follows: \$3.345 million to actively-managed U.S. Bonds (\$2.645 million to Reams and \$700,000 to ASAP); \$350,000 each to U.S. Equities and Non-U.S. Equities; and \$700,000 to U.S. TIPS. No other asset class reallocations/rebalancings were conducted during the 3rd quarter.

Current and Upcoming Fund-Level Activities

These key investment activities are planned within the next three to six months:

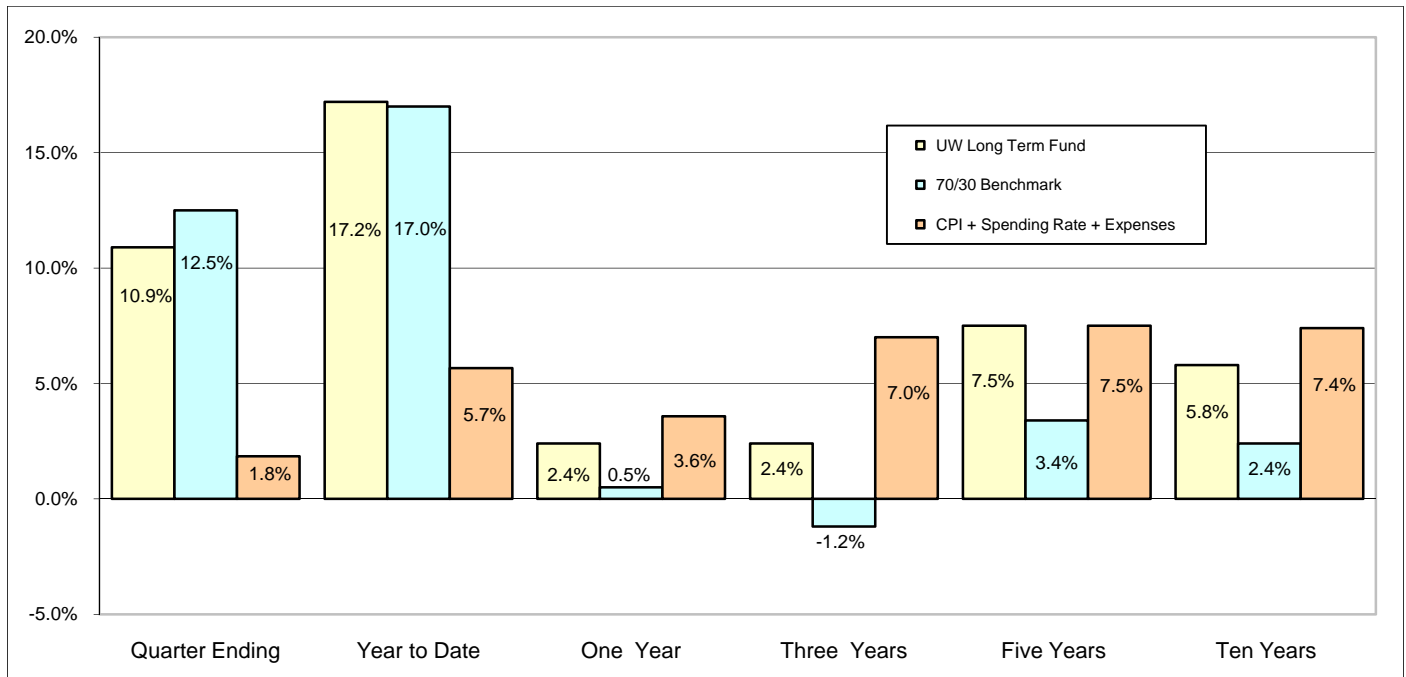
- Determine permanent investment manager/vehicle selections for the Fund's new asset classes.
- Revisit/revise Investment Guidelines for separate account managers.
- Conduct investment manager due diligence meetings.

SECTION 3: PERFORMANCE ANALYSIS

INVESTMENT PERFORMANCE REVIEW

Long Term Fund: Composite

Performance results for the Long Term Fund are shown below, both graphically and in table format.



Long Term Fund: Composite						
<i>Investment Performance: Periods Ended September 30, 2009</i>						
	Quarter Ending	Year To Date	One Year	Three Years	Five Years	Ten Years
Long Term Fund	10.9%	17.2%	2.4%	2.4%	7.5%	5.8%
70/30 Benchmark ¹	12.5%	17.0%	0.5%	-1.2%	3.4%	2.4%
Allocation Index ²	12.1%	20.5%	5.2%	3.3%	7.7%	5.5%
CPI + Spending Rate + Expenses ³	1.8%	5.7%	3.6%	7.0%	7.5%	7.4%
Peer Median ⁴	10.8%	16.5%	-1.5%	-0.5%	4.7%	4.4%
Peer Ranking: Percentile	49 th	49 th	32 nd	8 th	4 th	23 rd

¹ The "70/30 benchmark" represents a more "traditional" asset allocation of 70% stocks/30% bonds, comprised of 55% S&P 500, 15% MSCI EAFE (unhedged), and 30% Lehman Aggregate Bond indexes.

² The allocation index measures active manager performance by replacing active manager returns with their benchmark returns. The private equity portion of the allocation index uses actual manager returns.

³ The annual spending rate is currently 4.0% and expenses are assumed to average 0.75% per year. The Consumer Price Index (CPI) is used as the inflation indicator, although the Higher Education Price Index (HEPI) may be more appropriate.

⁴ Peer data is from the Russell Mellon Analytical Services trust universe database based on the "Foundations and Endowments < \$1 Billion" classification.

Long Term Fund: Growth and High-Yielding Assets

The tables that follow provide investment performance data by individual investment manager/portfolio.

Long Term Fund: Growth and High-Yielding Assets						
<i>Investment Performance: Periods Ended September 30, 2009</i>						
Asset Class/Strategy	Quarter Ending	Year To Date	One Year	Three Years	Five Years	Since Mgr Inception
Global Tactical Asset Allocation						
GMO Real Return Global Balanced¹	7.0%	9.2%	3.0%	3.9%	N/A	4.4%
Benchmark	11.1%	16.3%	1.9%	-0.3%	N/A	1.0%
U.S. Large-Cap Equity						
UBS Global Asset Mgt²	19.0%	28.7%	-3.6%	-3.4%	3.4%	3.1%
S&P 500	15.6%	19.3%	-6.9%	-5.4%	1.0%	1.4%
Peer Median ³	15.3%	21.6%	-4.9%	-4.0%	2.2%	N/A
Peer Ranking	12 th	23 rd	38 th	40 th	30 th	N/A
U.S. Mid/Small-Cap Equity						
Russell Mid-Cap ETF⁴	20.4%	32.7%	-2.8%	N/A	N/A	-11.5%
Russell Mid-Cap	20.6%	32.6%	-3.5%	N/A	N/A	-11.5%
Russell 2000 ETF⁵	18.6%	23.5%	-9.9%	N/A	N/A	-10.9%
Russell 2000	19.3%	22.4%	-9.5%	N/A	N/A	-10.9%
300 North Capital⁶	14.1%	27.0%	-1.0%	-5.1%	1.2%	3.3%
Russell 2000 Growth	16.0%	29.1%	-6.3%	-2.6%	2.9%	1.6%
Peer Median	17.1%	32.2%	-4.6%	-2.1%	-3.6%	N/A
Peer Ranking	81 st	72 nd	42 nd	75 th	82 nd	N/A
Developed Market Non-U.S. Equity						
UBS International Fund⁷	21.1%	36.4%	7.8%	-3.0%	5.2%	5.1%
MSCI EAFE (Unhedged)	19.5%	29.6%	3.8%	-3.1%	6.6%	4.9%
MSCI EAFE (Hedged)	14.4%	18.7%	-2.3%	-8.6%	2.3%	1.3%
Peer Median	19.1%	28.9%	4.1%	-2.2%	7.1%	N/A
Peer Ranking	22 nd	32 nd	32 nd	69 th	85 th	N/A
Emerging Market Equity						
GMO Emerging Markets Fund⁸	23.7%	60.0%	11.2%	4.9%	18.2%	17.0%
MSCI Emerging Markets	21.0%	64.8%	19.4%	8.3%	17.7%	18.4%
S&P/IFC Investable Composite	20.9%	66.6%	20.1%	8.3%	18.3%	18.6%
Peer Median	22.4%	64.3%	14.7%	7.0%	17.5%	N/A
Peer Ranking	16 th	74 th	93 rd	93 rd	37 th	N/A
U.S. High Yield						
Seix Advisors U.S. High Yield⁹	10.5%	29.7%	11.0%	3.2%	N/A	3.5%
Merrill Lynch High Yield Master	14.8%	48.5%	22.4%	5.2%	N/A	5.6%
Merrill Lynch High Yield BB/B	11.2%	40.0%	17.6%	4.3%	N/A	5.0%
Peer Median	17.1%	23.3%	-2.7%	2.6%	N/A	N/A
Peer Ranking	94 th	91 st	82 nd	82 nd	N/A	N/A
Opportunistic						
GMO Emerging Illiquid Fund¹⁰	11.3%	53.3%	7.1%	N/A	N/A	2.1%

¹ The inception date for the GMO Real Return Global Balanced Fund is February 1, 2006. The benchmark consists of 60% MSCI World, 20% Citigroup 3 month T-Bill, and 20% Lehman Aggregate. No peer data is currently available.

² The inception date for UBS Global Asset Mgt is December 1, 1997. Peer data is for "Equity Composite" classification.

³ The source for all peer data is the Russell Mellon Analytical Services trust universe database.

⁴ The inception date for the Russell Mid-Cap ETF is May 4, 2007. Peer data is for "Mid-Cap Equity" classification.

⁵ The inception date for the Russell 2000 ETF is May 4, 2007. Peer data is for "Small-Cap Equity" classification.

⁶ The inception date for 300 North Capital (formerly "Provident") is December 1, 1997. Peer data is for "Small-Cap Growth" classification.

⁷ The inception date for the UBS International Fund is December 1, 1997. Peer data is for "Core Non-U.S. Equity" classification.

⁸ The inception date for the GMO Emerging Markets Fund is November 1, 2003. Peer data is for "Emerging Markets Equity" classification.

⁹ The inception date for the Seix Advisors U.S. High Yield Fund is April 17, 2006. Peer data is for "High-Yield Bond" classification.

¹⁰ The inception date for the GMO Emerging Illiquid Fund is March 9, 2007. No peer data is available.

Long Term Fund: U.S. Equity Composite						
<i>Investment Performance: Periods Ended September 30, 2009</i>						
	Quarter Ending	Year To Date	One Year	Three Years	Five Years	Since Inception
Long Term Fund U.S. Equity	18.2%	28.3%	-3.7%	-4.0%	2.4%	3.8%
Russell 3000	16.3%	21.2%	-6.4%	-5.1%	1.5%	2.2%

¹ As the Long Term Fund's allocation to U.S. Equity is comprised of allocations to various equity subclasses (e.g., large-, mid-, small-cap), performance and risk data are also shown for a composite of the Fund's U.S. equity exposure versus a broader market benchmark.

² The inception date for the Long Term Fund U.S. Equity composite is February 28, 1998.

Performance data on Private Equity, presented in a different fashion and lagged by one quarter due to the nature of this unique asset class, is provided below. Note too that each of the investment managers and "funds" listed below are in fact "funds-of-funds," comprised of many underlying private equity limited partnerships/funds.

Private Equity						
<i>Investment Results: As of June 30, 2009</i>						
Fund of Funds	Commitments	Dollars Drawn	Remaining Unfunded Commitments	Dollars Returned	Investment Value (Equity)	Equity + Dollars Returned
Adams Street Partners						
2002 Funds	\$ 10,000,000	\$9,002,250	\$997,750	\$4,030,056	\$10,764,028	\$14,794,084
2004 Funds	15,000,000	11,889,750	3,110,250	2,401,840	11,757,031	14,158,871
2008 Funds	5,000,000	1,034,750	3,965,250	0	1,093,176	1,093,176
2009 Funds	4,000,000	665,443	3,334,557	0	111,541	111,541
	\$34,000,000	\$22,050,150	\$11,407,807	\$6,431,896	\$23,725,776	\$30,157,672
J.P. Morgan						
Corporate Finance II (2002)	\$10,000,000	\$9,225,611	\$774,389	\$4,268,860	\$7,559,355	\$11,828,215
Corporate Finance III (2006)	2,000,000	1,126,749	873,251	75,567	939,994	1,015,561
Venture Capital III (2006)	8,000,000	2,973,972	5,026,028	137,268	2,664,034	2,801,302
Corporate Finance IV (2008)	9,000,000	180,024	8,819,976	0	208,580	208,580
Venture Capital IV (2008)	3,000,000	171,510	2,828,490	0	246,203	246,203
	\$32,000,000	\$13,677,866	\$18,322,134	\$4,481,695	\$11,618,166	\$16,099,861
TOTALS	\$66,000,000	\$35,728,016	\$29,729,941	\$10,913,591	\$35,343,942	\$46,257,533

Private Equity			
<i>Investment Performance¹</i>			
	Three Years	Five Years	Since Mgr Inception ²
Adams Street Partners	2.3%	6.6%	6.8%
J.P. Morgan	-0.2%	2.9%	3.1%
Venture Economics Benchmark ³	-3.4%	-0.5%	N/A
S&P 500	-8.2%	-2.2%	N/A

¹ Investment performance for Adams Street Partners, Venture Economics benchmark, and the S&P 500 are as of June 30, 2009. Investment performance for JP Morgan is as of March 31, 2009.

² The inception date for Adams Street Partners is March 21, 2003. The inception date for JP Morgan is January 14, 2003.

³ The Venture Economics Benchmark is a customized global private equity benchmark calculated by Adams Street Partners.

Long Term Fund: Event-Risk and Deflation-Hedge Assets

Long Term Fund: Event-Risk and Deflation-Hedge Assets						
<i>Investment Performance: Periods Ended September 30, 2009</i>						
Asset Class/Strategy	Quarter Ending	Year To Date	One Year	Three Years	Five Years	Since Inception
U.S. Treasurys						
Applied Security Analysis Program¹	0.1%	0.4%	0.8%	3.2%	N/A	3.7%
Citigroup U.S. Treasury 1-10 Year ²	1.6%	-1.0%	5.5%	6.6%	N/A	6.0%
Cash (1 month Treasury Bill)	0.0%	0.1%	0.1%	2.4%	N/A	2.9%

¹ On a tactical basis, this portfolio has been maintained in "cash" since former portfolio holdings were liquidated in the transition away from a broad-market bond portfolio benchmarked to the Lehman Aggregate Bond Index. This portfolio transition began on December 1, 2005 and liquidations to cash were largely completed by June/July 2006. Eventually, the portfolio will be structured as a passive, laddered portfolio of U.S. Treasurys.

² Performance is compared only to market indexes. Comparison to a "peer" group of active managers is not appropriate as this is a passively-managed portfolio.

Long Term Fund: Real and Inflation-Hedge Assets

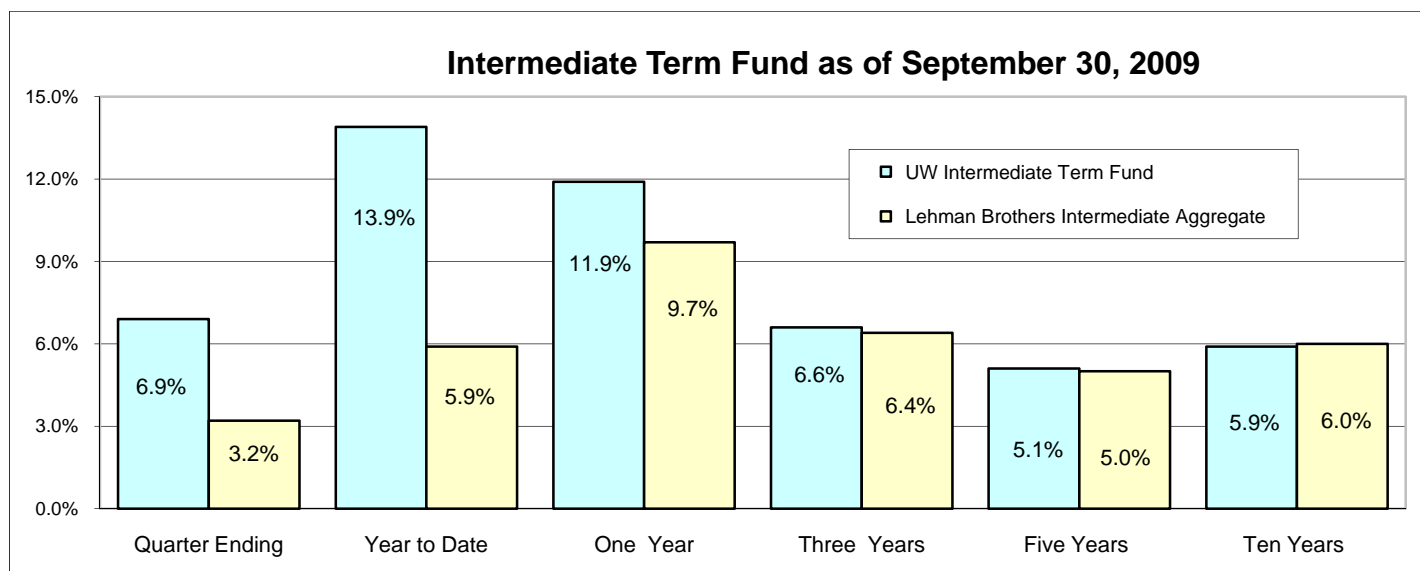
Long Term Fund: Real and Inflation-Hedge Assets						
<i>Investment Performance: Periods Ended September 30, 2009</i>						
Asset Class/Strategy	Quarter Ending	Year To Date	One Year	Three Years	Five Years	Since Inception
U.S. TIPS						
Applied Security Analysis Program¹	2.8%	9.3%	5.8%	5.5%	N/A	5.1%
Citigroup Inflation Linked Securities ²	3.1%	7.9%	5.4%	5.5%	N/A	5.1%

¹ This portfolio was transitioned away from a broad-market bond portfolio benchmarked to the Lehman Aggregate Bond Index beginning on December 1, 2005. The portfolio is now structured as a passive, laddered portfolio of U.S. TIPS.

² Performance is compared only to market indexes. Comparison to a "peer" group of active managers is not appropriate as this is a passively-managed portfolio.

Intermediate Term and Income Funds

Returns for the Intermediate Term Fund overall and by individual manager are provided below.



Intermediate Term Fund: Composite						
<i>Investment Performance: Periods Ended September 30, 2009</i>						
	Quarter Ending	Year To Date	One Year	Three Years	Five Years	Ten Years
Intermediate Term Fund	6.9%	13.9%	11.9%	6.6%	5.1%	5.9%
Allocation Index ¹	5.4%	10.4%	9.9%	5.8%	4.7%	5.9%
Barclay's Intermediate Aggregate ²	3.2%	5.9%	9.7%	6.4%	5.0%	6.0%
CPI	0.6%	2.0%	-1.3%	2.1%	2.6%	2.5%

¹ The allocation index measures active manager performance by replacing active manager returns with their benchmark returns.

² The Barclay's Intermediate Aggregate benchmark, consisting of 100% investment-grade bonds, represents a more "traditional" asset allocation for a portfolio with an intermediate investment "duration."

The following table provides performance data by individual investment manager/portfolio.

Intermediate Term Fund						
<i>Investment Performance: Periods Ended September 30, 2009</i>						
Asset Class/Strategy	Quarter Ending	Year To Date	One Year	Three Years	Five Years	Since Mgr Inception*
Intermediate U.S. Fixed Income						
Reams Asset Management¹	6.3%	14.7%	15.4%	7.9%	6.0%	6.1%
Applied Security Program¹	2.7%	5.8%	9.9%	6.7%	5.1%	5.9%
Barclay's Intermediate Aggregate	3.2%	5.9%	9.7%	6.4%	5.0%	5.9%
Peer Median ²	4.0%	7.9%	12.2%	7.1%	5.4%	N/A
Peer Ranking: Reams Asset Management	10 th	13 th	22 nd	16 th	16 th	N/A
Peer Ranking: Applied Security Program	94 th	85 th	76 th	55 th	58 th	N/A
Multi-Asset Portfolio³	7.9%	16.3%	4.9%	N/A	N/A	-2.4%

¹ Inception date for Reams and Applied Securities is February 1998.

² Peer data is for "Intermediate Bond" classification.

³ The Intermediate Term Fund's Multi-Asset Portfolio, which began March 31, 2008, consists of U.S. and Non-U.S. Equities, U.S. TIPS, and High Yield Debt. These investments are primarily managed through ETF's.

The Income Fund, which is SWIB's short-term investment fund for the State, performed as follows:

Income Fund						
<i>Investment Performance: Periods Ended September 30, 2009</i>						
	Quarter Ending	Year To Date	One Year	Three Years	Five Years	Ten Years
Income Fund	0.1%	0.4%	0.8%	3.1%	3.4%	3.2%
Cash (1 month Treasury Bill)	0.0%	0.1%	0.1%	2.4%	2.8%	2.8%

The current yield for the Income Fund is 0.33%.

SECTION 4: RISK ANALYSIS

REVIEW OF PORTFOLIO CHARACTERISTICS, RISK AND COMPLIANCE

Long Term Fund: Composite

Fund-Level Constraints

One fund-level constraint is set by statute. Compliance with this statute is demonstrated below. Fund-level asset allocation constraints are given in the “Fund Overviews” section.

	Maximum Permitted	Allocation as of September 30, 2009
Allocation to public equities:	85%	56.3% ¹

¹Note: This percent does not include Private Equity or any net long equity position within GMO's Multi-Strategy hedge fund-of-funds.

Risk Measures

Currently, the only statistical measurement made of overall risk is annualized standard deviation of monthly returns. Standard deviations of overall Fund returns for various timeframes are shown below. Also shown are the resulting Sharpe ratios, or return per unit of risk, a common measurement of portfolio efficiency.

Standard Deviation: Periods Ended September 30, 2009				
	1 year	3 year	5 year	10 year
Long Term Fund	16.2%	11.5%	10.3%	11.3%
70/30 Benchmark ¹	21.4%	14.5%	11.8%	11.4%
Allocation Index ²	18.8%	13.3%	11.5%	11.6%

¹The 70/30 benchmark represents a more “traditional” asset allocation comprised of 55% S&P 500, 15% MSCI EAFE (unhedged), and 30% Lehman Aggregate.

²The allocation index measures manager performance by replacing manager returns with benchmark returns. The private equity portion of the allocation index uses actual manager returns.

Sharpe Ratio ¹ : Periods Ended September 30, 2009				
	1 year	3 year	5 year	10 year
Long Term Fund	N/A	N/A	0.36	0.17
70/30 Benchmark	N/A	N/A	N/A	N/A
Allocation Index	N/A	N/A	0.35	0.15

¹Note: The Sharpe measure of risk-adjusted performance is calculated by subtracting the risk-free rate from the rate of return for a portfolio and dividing the result by the standard deviation of the portfolio returns. The greater a portfolio's Sharpe ratio, the better its risk-adjusted performance. Sharpe ratios for periods where portfolio returns less the risk free rate are negative or zero are not meaningful and are shown as N/A.

Long Term Fund: Individual Manager Portfolios

The tables that follow provide various portfolio characteristics of individual manager portfolios, and in the case of separately-managed accounts, information as to compliance with current investment constraints. These constraints are as follows:

Equity Separate Accounts:

- Maximum of 5% in cash
- Maximum of 15% in any one industry (SIC Classification)
- Maximum of 7% in any one company

Fixed Income Separate Accounts (Investment-Grade):

- The only fixed income separate accounts managed within the Long Term Fund currently are the U.S. Treasuries and U.S. TIPS portfolios. These portfolios are being managed passively to mirror their respective market benchmarks.

Growth and High-Yielding Assets

Global Tactical Asset Allocation

GMO Real Return Global Balanced Asset Allocation Strategy

This strategy is comprised of two components: 1) GMO's Strategic Opportunities Allocation Fund, a mutual fund-of-funds comprised of underlying GMO mutual funds; and 2) GMO's Multi-Strategy Fund, an internal hedge fund-of-funds comprised of underlying GMO hedge funds. The overall asset allocation of the combined GMO Real Return Global Balanced Strategy is given on page 8. Given below are some broad characteristics for this strategy.

Global Tactical Asset Allocation		
<i>Portfolio Characteristics as of September 30, 2009</i>		
	GMO	Benchmark¹
Standard deviation ²	6.7%	12.2%
Sharpe ratio	N/A	N/A
<u>Fund allocations:</u>		
<i>U.S. Equity</i>	29.0%	26.0%
<i>U.S. Quality</i>	25.8%	
<i>U.S. Core</i>	3.2%	
<i>Non-U.S. Equity</i>	27.0%	34.0%
<i>International Intrinsic Value</i>	11.7%	
<i>International Growth Equity</i>	11.7%	
<i>Flexible Equity</i>	2.2%	
<i>International Small Companies</i>	1.4%	
<i>Fixed Income</i>	12.5%	20.0%
<i>Strategic Fixed Income</i>	3.8%	
<i>Asset Allocation Bond</i>	2.0%	
<i>Domestic Bond</i>	1.8%	
<i>Strategic Opportunities Allocation</i>	1.7%	
<i>Special Situations</i>	1.6%	
<i>Inflation Indexed Plus</i>	1.0%	
<i>World Opportunity Overlay</i>	0.3%	
<i>Emerging Country Debt</i>	0.3%	
<i>Multi Strategy Fund</i>	27.8%	0.0%
<i>Mean Reversion</i>	4.4%	
<i>U.S. Tactical Opportunities</i>	3.6%	
<i>Completion Fund</i>	3.9%	
<i>Pan-European Long/Short</i>	2.5%	
<i>Fixed Income Hedge</i>	2.9%	
<i>Global Tactical</i>	2.5%	
<i>Short Term Market Opportunities</i>	1.9%	
<i>Emerging Country Debt</i>	2.2%	
<i>Currency Hedge</i>	1.2%	
<i>Emerging Currency Hedge</i>	1.4%	
<i>U.S. Aggressive Long/Short</i>	1.3%	
<i>Other Market Neutral Hedge Funds</i>	3.7%	0.0%
<i>Alpha Only</i>	3.7%	
TOTAL	100.0%	100.0%

¹ The benchmark index is comprised of 60% MSCI World, 20% Citigroup 3-month Treasury Bill, and 20% Lehman Aggregate.

² Sharpe ratio and standard deviation are as of September 30, 2009, for the period beginning September 30, 2004, the fund inception.

U.S. Large Cap Equity

UBS Global Asset Management

Investment is made via a separately-managed account for UW Trust Funds.

U.S. Large Cap Equity		
<i>Portfolio Characteristics as of September 30, 2009</i>		
	UBS Asset Mgt	S&P 500
Standard deviation ¹	17.2%	16.5%
Sharpe ratio	0.05	N/A
P/E ratio ²	27.5	23.6
Price to book ratio	1.9	2.2
Five-year EPS growth	10.3	9.8
Asset turnover ³	54.7%	N/A
Number of holdings	92	500
% of portfolio held in cash	1.2%	N/A
Average market capitalization (\$mm)	\$59,728	\$77,058
Median market capitalization (\$mm)	\$23,420	\$41,481
<u>Major sector positions:</u>		
<i>Financials</i>	15.1%	15.2%
<i>Consumer Discretionary</i>	14.8%	9.1%
<i>Information Technology</i>	13.6%	18.7%
<i>Consumer Staples</i>	12.5%	11.5%
<i>Health Care</i>	11.1%	13.1%
<i>Energy</i>	11.0%	11.7%
TOTAL	78.1%	79.3%

¹ Where standard deviations and Sharpe ratios are given, the time period used for computation begins December 1, 1997.

² P/E is calculated as the last 12 months of primary earnings per share before extraordinary items, divided by current market price.

³ Asset turnover is based on a one-year period.

UBS Asset Management: Top Ten Equity Holdings		
<i>As of September 30, 2009</i>		
Company	Market Value	Percent of Portfolio
DISCOVER FINANCIAL	\$ 1,098,771	3.5%
APPLE INC	797,091	2.5%
AT & T	796,795	2.5%
PROCTER & GAMBLE CO COM	735,584	2.3%
COMCAST	729,648	2.3%
COVDIEN	696,486	2.2%
CHEVRON	683,171	2.2%
JPMORGAN CHASE	661,682	2.1%
HEWLETT PACKARD	618,451	2.0%
PEPSICO INC	574,868	1.8%
TOTAL IN TOP TEN HOLDINGS	\$ 7,392,547	23.4%

U.S. Small and Mid-Cap Cap Equity

300 North Capital - Small Cap Growth

Investment is made via a separately-managed account for UW Trust Funds.

Small Cap Equity: Growth		
<i>Portfolio Characteristics as of September 30, 2009</i>		
	Provident	Russell 2000 Growth
Standard deviation ¹	28.3%	26.0%
Sharpe ratio	N/A	N/A
P/E ratio ²	22.6	23.8
Price to book ratio	4.9	4.9
Five-year EPS growth	27.3	24.4
Asset turnover ³	109.9%	N/A
Number of holdings	57	1,261
% of portfolio held in cash	0.9%	N/A
Average market capitalization (\$mm)	\$1,399	\$970
Median market capitalization (\$mm)	\$1,030	\$412
<u>Major sector positions:</u>		
<i>Information Technology</i>	35.9%	26.8%
<i>Industrials</i>	14.9%	14.8%
<i>Health Care</i>	12.6%	24.1%
<i>Financials</i>	10.5%	6.4%
TOTAL	73.9%	72.1%

¹ Where standard deviations and Sharpe ratios are given, the time period used for 300 North Capital begins December 1, 1997.

² P/E is calculated as the last 12 months of primary earnings per share before extraordinary items, divided by current market price.

³ Asset turnover is based on a one-year period.

300 North Capital:		
Top Ten Equity Holdings		
<i>As of September 30, 2009</i>		
Company	Market Value	Percent of Portfolio
MERCADOLIBRE INC	\$ 459,597	4.8%
EQUINIX INC	400,200	4.2%
NETLOGIC MICROSYSTEMS	346,500	3.6%
LASALLE HOTEL PROPERTYS	332,254	3.5%
NEUTRAL TANDEM INC	316,364	3.3%
EVERCORE PARTNERS	283,434	3.0%
J CREW GROUP	281,187	3.0%
CYBERSOURCE CORP	274,222	2.9%
ARCSIGHT INC	268,381	2.8%
OLD DOMINION FREIGHT LINES	260,177	2.7%
TOTAL IN TOP TEN HOLDINGS	\$ 3,222,316	33.8%

Small Cap Core ETF

Investment is made via a small cap core exchange-traded index fund (“ETF”), pegged to the Russell 2000 Index.

Small-Cap Equity: Core		
<i>Portfolio Characteristics as of September 30, 2009</i>		
	Russell 2000 ETF	Russell 2000
Standard deviation ¹	25.8%	26.5%
Sharpe ratio	N/A	N/A
P/E ratio ²	25.7	N/A
Price to book ratio	3.0	N/A
Number of holdings	2,007	2,003
% of portfolio held in cash	0.0%	N/A
Average market capitalization (\$mm)	\$ 920	\$ 918
Median market capitalization (\$mm)	\$ 386	N/A
Major sector positions:		
<i>Financials</i>	20.6%	19.8%
<i>Consumer Discretionary</i>	15.2%	19.3%
<i>Information Technology</i>	17.1%	13.8%
<i>Health Care</i>	14.1%	14.3%
<i>Materials</i>	7.1%	4.4%
TOTAL	74.1%	71.6%

¹ Where standard deviations and Sharpe ratios are given, the time period used for the Russell 2000 ETF begins May 4, 2007. Negative Sharpe ratios have been excluded.

² P/E is calculated as the last 12 months of primary earnings per share before extraordinary items, divided by current market price.

Russell 2000 ETF:		
Top Ten Equity Holdings		
<i>As of September 30, 2009</i>		
Company	Market Value	Percent of Portfolio
HUMAN GENOME SCIENCES	\$ 18,905	0.3%
PEROT SYSTEMS	16,125	0.3%
TUPPERWARE BRANDS	15,569	0.3%
PALM INC	15,013	0.3%
POLYCOM INC	13,901	0.3%
MFA FINANCIAL	13,901	0.3%
HIGHWOODS PROPERTIES	13,901	0.3%
SKYWORKS SOLUTIONS INC	13,901	0.3%
SOLERA HOLDINGS	13,345	0.2%
BALLY TECHNOLOGIES	12,789	0.2%
TOTAL IN TOP TEN HOLDINGS	\$ 147,350	2.8%

Mid Cap Core ETF

Investment is made via a mid cap core exchange-traded index fund ("ETF"), pegged to the Russell Mid Cap Index.

Mid-Cap Equity: Core		
<i>Portfolio Characteristics as of September 30, 2009</i>		
	Russell Mid-Cap ETF	Russell Mid-Cap
Standard deviation ¹	25.6%	26.0%
Sharpe ratio	N/A	N/A
P/E ratio ²	23.9	N/A
Price to book ratio	3.2	N/A
Number of holdings	773	772
% of portfolio held in cash	0.0%	N/A
Average market capitalization (\$mm)	\$ 5,870	\$ 5,879
Median market capitalization (\$mm)	\$ 3,230	N/A
Major sector positions:		
<i>Financials</i>	20.3%	19.0%
<i>Consumer Discretionary</i>	16.3%	15.2%
<i>Information Technology</i>	12.5%	14.6%
<i>Utilities</i>	8.7%	7.4%
<i>Health Care</i>	8.5%	13.0%
TOTAL	66.3%	69.2%

¹ Where standard deviations and Sharpe ratios are given, the time period used for the Russell 2000 ETF begins May 4, 2007. Negative Sharpe ratios have been excluded.

² P/E is calculated as the last 12 months of primary earnings per share before extraordinary items, divided by current market price.

Russell Midcap ETF:		
Top Ten Equity Holdings		
<i>As of September 30, 2009</i>		
Company	Market Value	Percent of Portfolio
TJX COMPANIES	\$ 28,879	0.5%
AVON PRODUCTS	27,244	0.5%
PRECISION CASTPARTS	26,699	0.5%
MARSH & MCLENNAN	23,975	0.4%
HJ HEINZ	23,430	0.4%
LORILLARD INC	23,430	0.4%
SPECTRA ENERGY	22,885	0.4%
SEMPRA ENERGY	22,885	0.4%
T ROWE PRICE GROUP	21,795	0.4%
NOBLE ENERGY	21,250	0.4%
TOTAL IN TOP TEN HOLDINGS	\$ 242,472	4.3%

U.S. Equity Composite

As the Long Term Fund's allocation to U.S. Equity is comprised of allocations to various equity subclasses (e.g., large-, mid-, small-cap), characteristic and risk data are shown for a composite of the Fund's U.S. equity exposure versus a broader market benchmark. The composite includes all current and prior U.S. Equity managers since April 1, 1998, the composite inception date.

U.S. Equities		
<i>Portfolio Characteristics as of September 30, 2009</i>		
	U.S. Equity Composite	Russell 3000
Standard deviation ¹	19.2%	16.9%
Sharpe ratio	0.00	N/A
P/E ratio ²	26.2	23.5
Price to book ratio	2.1	2.2
Five-year EPS growth	10.1%	9.8%
Average market capitalization (\$mm)	\$ 45,838	\$ 63,746
Median market capitalization (\$mm)	\$ 14,659	\$ 28,821
Major sector positions: ³		
<i>Information Technology</i>	19.1%	18.7%
<i>Financials</i>	14.0%	15.2%
<i>Consumer Discretionary</i>	13.3%	10.2%
<i>Industrials</i>	11.9%	10.9%
<i>Health Care</i>	11.5%	13.0%
<i>Energy</i>	9.9%	10.8%
TOTAL	79.7%	78.8%

¹ Where standard deviations and Sharpe ratios are given, the time period used begins April 1, 1998.

² P/E is calculated as the last 12 months of primary earnings per share before extraordinary items, divided by current market price.

³ Sector positions for the U.S. Equity Composite are approximations due to the unavailability of Commingled fund data.

Developed Markets Non-U.S. Equity

UBS Global Asset Management

Investment here is made through UBS's institutional commingled fund, the UBS International Equity Fund.

Developed Markets Non-U.S. Equities		
<i>Portfolio Characteristics as of September 30, 2009</i>		
	UBS Intl Equity	MSCI EAFE
Standard deviation ¹	17.3%	17.7%
Sharpe ratio	0.08	0.07
P/E ratio ²	29.1	23.1
Price to book ratio	1.5	1.7
Five-year EPS growth	9.6%	12.7%
Asset turnover ³	62.0%	N/A
Number of holdings	74	1,694
% of portfolio held in cash	1.2%	N/A
Average market capitalization (\$mm)	\$ 35,408	\$ 11,965
Median market capitalization (\$mm)	\$ 18,544	\$ 5,458
<u>Major sector positions:</u>		
<i>Financials</i>	27.5%	25.9%
<i>Consumer Staples</i>	9.1%	11.2%
<i>Industrials</i>	10.7%	10.5%
<i>Energy</i>	9.8%	9.6%
<i>Health Care</i>	7.5%	9.4%
<i>Materials</i>	10.2%	9.4%
TOTAL	74.8%	76.0%

¹ Where standard deviations and Sharpe ratios are given, the time period used begins December 1, 1997.

² P/E is calculated as the last 12 months of primary earnings per share before extraordinary items, divided by current market price.

³ Asset turnover is based on a one-year period. UBS calculates turnover annually.

UBS International Equity Fund:		
Top Ten Equity Holdings		
<i>As of September 30, 2009</i>		
Company	Market Value	Percent of Portfolio
ROCHE HOLDINGS	\$ 1,127,785	3.1%
VODAPHONE GROUP	1,105,887	3.0%
BNP PARIBAS	970,844	2.7%
JAPAN TOBACCO INC	897,849	2.5%
TOTAL	843,102	2.3%
E.ON GROUP	795,654	2.2%
MITSUBISHI CORP	755,507	2.1%
BARCLAYS	751,857	2.1%
SUMITOMO MITSUI FINANCIAL GROUP	729,958	2.0%
BRITISH SKY BROADCASTING	689,810	1.9%
TOTAL IN TOP TEN HOLDINGS	\$ 8,668,253	23.8%

UBS International Equity Fund: Top Country Holdings <i>As of September 30, 2009</i>			
Country	Market Value	Percent of Portfolio	Percent of Benchmark
UNITED KINGDOM	\$ 8,832,494	24.2%	18.9%
JAPAN	6,825,109	18.7%	19.5%
GERMANY	3,284,812	9.0%	7.4%
SWITZERLAND	2,919,833	8.0%	7.0%
FRANCE	2,445,360	6.7%	10.0%
CANADA	2,080,381	5.7%	9.1%
TOTAL	\$ 26,387,989	72.3%	71.9%

Emerging Market Equity

GMO

Investment here is made through GMO's institutional mutual fund, the GMO Emerging Markets Fund III.

<u>Emerging Market Equities</u> <i>Portfolio Characteristics as of September 30, 2009</i>		
	GMO Emerging Markets	S&P/IFCI
Standard deviation ¹	26.6%	26.3%
Sharpe ratio	0.23	0.62
P/E ratio ²	14.4	18.8
Price to book ratio	1.7	2.0
Return on equity (1 year)	12.2%	10.3%
Asset turnover	99%	N/A
Number of holdings	458	1,610
% of portfolio held in cash	1.1%	N/A
Median market capitalization (\$mm)	\$ 3,700	\$ 6,500
<u>Major sector positions:</u> ⁴		
<i>Financials</i>	23.5%	22.6%
<i>Energy</i>	18.0%	13.9%
<i>Information Technology</i>	15.1%	14.8%
<i>Materials</i>	13.9%	13.9%
<i>Telecommunication Services</i>	8.3%	8.2%
TOTAL	78.8%	73.4%

¹ Where standard deviations and Sharpe ratios are given, the time period used begins November 1, 2003.

² P/E is calculated as the last 12 months of primary earnings per share before extraordinary items, divided by current market price.

³ Asset turnover is based on a one-year period. GMO calculates turnover annually.

⁴ The "Sectors" used are GICS classifications.

GMO Emerging Markets Fund: Top Ten Equity Holdings <i>As of September 30, 2009</i>		
Company	Market Value	Percent of Portfolio
GAZPROM	\$ 1,356,093	4.8%
SAMSUNG ELECTRONICS	1,186,582	4.2%
PETROLEO BRASILEIRO	904,062	3.2%
VALE SA	762,802	2.7%
LUKOIL OIL	649,795	2.3%
TURKIYE GARANTI BANKASI	480,283	1.7%
HON HAI PRECISION	395,527	1.4%
BANK OF CHINA	367,275	1.3%
MOBILE TELESYSTEMS	339,023	1.2%
BANCO BRADESCO	339,023	1.2%
TOTAL IN TOP TEN HOLDINGS	\$ 6,780,465	24.0%

GMO Emerging Markets Fund: Top Country Holdings <i>As of September 30, 2009</i>			
Country	Market Value	Percent of Portfolio	Percent of Benchmark
KOREA	\$ 5,537,381	19.6%	14.9%
RUSSIA	3,955,272	14.0%	6.8%
BRAZIL	3,701,004	13.1%	14.6%
CHINA	2,881,698	10.2%	16.4%
TAIWAN	2,712,186	9.6%	12.6%
TURKEY	2,542,675	9.0%	1.6%
TOTAL	\$ 21,330,216	75.5%	66.9%

U.S. High Yield

Seix Advisors

Investment here is made through Seix's institutional commingled fund, the Seix U.S. High Yield Fund.

U.S. High Yield		
<i>Portfolio Characteristics as of September 30, 2009</i>		
	Seix High Yield	Merrill Lynch High Yield
Standard deviation	11.9%	13.6%
Sharpe ratio	N/A	N/A
Average quality	BB-	BB-
Duration (years)	4.2	4.4
Yield to maturity	8.6%	8.9%
Average coupon	8.4%	8.1%
Number of holdings	311	1,305
<u>Major industry positions:</u>		
<i>Telecom</i>	12.7%	10.1%
<i>Energy</i>	11.5%	13.4%
<i>Utilities</i>	9.9%	7.2%
<i>Health Care</i>	9.5%	6.5%
<i>Banking/Finance</i>	8.4%	10.5%
<i>Capital Goods</i>	5.6%	5.5%
TOTAL	57.6%	53.2%

Where standard deviations and Sharpe ratios are given, the time period used for the Seix High Yield Fund begins April 17, 2006. Negative Sharpe ratios have been excluded.

Seix Advisors U.S. High Yield Fund:			
Top Ten Fixed Income Holdings			
<i>As of September 30, 2009</i>			
Issuer	Coupon/Final Maturity	Market Value	Percent of Portfolio
NRG ENERGY	7.375% 02/01/2016	\$ 316,744	1.9%
COMMUNITY HEALTH	8.875% 07/15/2015	247,288	1.5%
FORD MOTOR CREDIT	8.700% 10/1/2014	231,956	1.4%
HERTZ CORP	8.875% 01/01/2014	225,744	1.4%
TECK RESOURCES	10.75% 05/15/2019	219,842	1.4%
WIND ACQUISITION INC	11.75% 07/15/2017	196,466	1.2%
ASHLAND INC.	9.125% 06/01/2017	173,995	1.1%
HCA INC	9.125% 11/15/2014	161,450	1.0%
DELTA AIRLINES	12.25% 3/15/2015	160,221	1.0%
AMERICAN GEN FINANCE	6.900% 12/15/2017	154,195	1.0%
TOTAL IN TOP TEN HOLDINGS		\$ 2,087,901	12.9%

Private Equity

Adams Street Partners and J.P. Morgan

Shown below are some key characteristics of the private equity funds-of-funds in which the Long Term Fund is invested. Note that the data is as of the prior quarter-end.

Private Equity <i>Portfolio Characteristics</i>		
	Adams Street Partners	J.P. Morgan
Total amount invested	\$ 17,288,162	\$ 11,629,178
Percentage of private equity program	59.8%	40.2%
Percent of commitments funded	65.9%	40.3%
Number of underlying partnerships	280	140
Number of underlying companies	5,742	1,333
<u>Primary/Secondary positions:</u>		
<i>Primary Investments</i>	86.8%	94.2%
<i>Secondary Investments</i>	13.2%	5.8%
<u>Subclass diversification:</u>		
<i>Buyouts</i>	52.0%	47.7%
<i>Venture Capital</i>	29.0%	21.7%
<i>Special Situations</i>	14.0%	11.9%
<i>Restructured/Distressed Debt</i>	3.0%	18.6%
<i>Mezzanine/Subordinated Debt</i>	2.0%	0.1%
<u>Geographic positions:</u>		
<i>United States</i>	77.8%	77.0%
<i>Western Europe</i>	16.5%	18.0%
<i>Asia</i>	3.4%	4.4%
<i>Other</i>	2.3%	0.6%
<u>Industry positions:</u>		
<i>Medical/Health</i>	17.0%	19.2%
<i>Consumer</i>	15.0%	20.0%
<i>Computer</i>	14.0%	13.0%
<i>Finance/Insurance/Real Estate</i>	11.0%	9.3%
<i>Communications</i>	10.0%	6.5%
<i>Other</i>	9.0%	1.3%
<i>Energy</i>	7.0%	4.1%
<i>Consulting/Other Services</i>	4.0%	6.4%
<i>Industrial Products</i>	4.0%	0.0%
<i>Manufacturing</i>	4.0%	13.1%
<i>Biotechnology</i>	3.0%	0.0%
<i>Electronics</i>	2.0%	2.1%
<i>Transportation</i>	0.0%	5.0%
TOTAL	100.0%	100.0%

¹ Investment characteristics for Adams Street Partners are as of June 30, 2009. Investment characteristics for JP Morgan are as of March 31, 2009.

Event-Risk and Deflation-Hedge Assets

U.S. Treasurys

Applied Security Analysis Program

This portfolio is to be a passively-managed separate account benchmarked to the Citigroup U.S. Treasury 1-10 Year Index. For tactical reasons, the portfolio has been maintained in “cash” since it was transitioned over from a broad-market bond portfolio in early 2006.

U.S. Treasurys		
<i>Portfolio Characteristics as of September 30, 2009</i>		
	ASAP Treasurys	Citigroup U.S. Treasury
Standard deviation	1.2%	3.5%
Average quality	AAA	AAA
Duration (years)	0.1	3.7
Yield to maturity	0.2%	1.9%
Average coupon	0.1%	3.1%
Number of holdings	N/A	114

Applied Security – U.S. Treasurys: Holdings Report		
<i>As of September 30, 2009</i>		
Mellon Custodial Short Term Fund	Market Value	Percent of Portfolio
CASH	\$ 18,881,589	100.0%

Real and Inflation-Hedge Assets

U.S. TIPS

Applied Security Analysis Program

This portfolio is a passively-managed separate account benchmarked to the Citigroup Inflation Linked Securities Index.

U.S. TIPS		
<i>Portfolio Characteristics as of September 30, 2009</i>		
	ASAP TIPS	Citigroup ILS
Standard deviation	8.0%	7.9%
Average quality	AAA	AAA
Duration (years)	3.1	3.7
Yield to maturity	3.2%	3.5%
Average coupon	2.1%	2.3%
Number of holdings	24	28

Applied Security - U.S. TIPS:			
Top Ten Holdings			
<i>As of September 30, 2009</i>			
Holding	Coupon/Final Maturity	Market Value	Percent of Portfolio
US TREAS-CPI INFLATION INDEX	2.375% 01/15/2027	\$ 2,253,311	8.8%
US TREAS-CPI INFLATION INDEX	1.875%007/15/2013	2,239,495	8.8%
US TREAS-CPI INFLATION INDEX	3.000% 07/15/2012	1,862,164	7.3%
US TREAS-CPI INFLATION INDEX	2.000% 07/15/2014	1,725,271	6.8%
US TREAS-CPI INFLATION INDEX	2.375% 01/15/2027	1,681,263	6.6%
US TREAS-CPI INFLATION INDEX	1.375% 07/15/2018	1,637,061	6.4%
US TREAS-CPI INFLATION INDEX	1.625% 01/15/2015	1,433,825	5.6%
US TREAS-CPI INFLATION INDEX	1.875% 07/15/2015	1,296,301	5.1%
US TREAS-CPI INFLATION INDEX	3.625% 04/15/2028	1,157,520	4.5%
US TREAS-CPI INFLATION INDEX	2.000% 01/15/2016	1,044,781	4.1%
TOTAL IN TOP TEN HOLDINGS		\$ 16,330,992	64.0%

Opportunistic

GMO Emerging Illiquid Fund, L.P.:

Investment here is made through GMO's Emerging Illiquid Fund.

GMO Emerging Illiquid Fund, L.P.: <i>Portfolio Characteristics as of September 30, 2009</i>	
Number of holdings	GMO Emerging Illiquid Fund 86
<u>Major sector positions:</u>	
<i>Domestic Consumption</i>	39.6%
<i>Infrastructure</i>	18.2%
<i>Real Estate</i>	13.1%
<i>Technology</i>	11.8%
<i>Financial Services</i>	9.3%
TOTAL	92.0%

GMO Emerging Illiquid Fund, L.P.: Top Ten Equity Holdings <i>As of September 30, 2009</i>		
Company	Market Value	Percent of Portfolio
MAGNIT OJSC	\$ 253,389	5.6%
PERFECT WORLD	203,616	4.5%
CNINSURE	199,091	4.4%
RURAL ELECTRIFICATION CORP	190,042	4.2%
XINYU HENGDELI HOLDINGS	140,269	3.1%
BR MALLS PERTICIPACOES	122,170	2.7%
INDOGREEN INTL	122,170	2.7%
VISIONCHINA MEDIA	117,645	2.6%
CITY UNION BANK	99,546	2.2%
LIC HOUSING FINANCE	99,546	2.2%
TOTAL IN TOP TEN HOLDINGS	\$ 1,547,483	34.2%

GMO Emerging Illiquid Fund, L.P.: Top Country Holdings <i>As of September 30, 2009</i>		
Country	Market Value	Percent of Portfolio
INDIA	\$ 1,438,888	31.8%
CHINA	1,348,392	29.8%
BRAZIL	361,984	8.0%
RUSSIA	348,410	7.7%
THAILAND	257,914	5.7%
PHILIPPINES	185,517	4.1%
TOTAL	\$ 3,941,104	87.1%

Intermediate Term Fund: Composite

Fund-Level Constraints

There are currently no fund-level constraints for the Intermediate Term Fund other than asset allocation constraints described in the “Fund Overviews” section.

Intermediate Term Fund: Individual Manager Portfolios

The tables that follow provide various portfolio characteristics of individual manager portfolios, and in the case of active separately-managed fixed income accounts, information as to compliance with current investment constraints. These restrictions are as follows:

- Modified duration within +/- one year from the benchmark’s duration
- All securities must have a minimum quality rating of BBB (investment grade)
- Average portfolio quality of AA
- Maximum of 15% in dollar-denominated issues of foreign issuers (“Yankees”)
- Maximum of 25% in any one broad-market bond sector, U.S. Government/Agency sectors exempted (if an index has more than 25%, then up to 110% of the index weight)
- Maximum of 7% in any one issuer, U.S. Government/Agency issues exempted

<u>U.S. Fixed Income</u>			
<i>Portfolio Characteristics as of September 30, 2009</i>			
	Reams Asset Mgt	ASAP	Barclay’s Intermediate
Standard deviation	3.7%	3.2%	3.0%
Average quality	AA-	AAA	AAA
Duration (years)	3.5	3.2	3.6
Yield to maturity	4.8%	2.8%	3.4%
Average coupon	4.5%	4.6%	4.6%
Number of holdings	108	36	7,330
Yankee bond holdings	0.0%	2.3%	0.0%
<u>Sector weightings:</u>			
<i>U.S. Government</i> ¹	24.0%	33.6%	37.8%
<i>U.S. Government Mortgage</i>	11.9%	39.5%	42.1%
<i>Commercial Mortgage Backed</i>	10.0%	0.0%	3.7%
<i>Corporate & Private Placements</i>	43.8%	26.9%	15.9%
<i>Asset Backed</i>	6.9%	0.0%	0.5%
<i>Money Market</i>	3.4%	0.0%	0.0%
TOTAL	100.0%	100.0%	100.0%

¹ Note: U.S. Government includes U.S. Treasury and Agency issues.

Reams Asset Management: Top Ten Non-Government Holdings <i>As of September 30, 2009</i>			
Issuer	Coupon/Final Maturity	Market Value	Percent of Portfolio
NEW VALLEY GENERATION	5.572% 05/01/2020	\$ 1,296,496	3.3%
MASTER ALTERNATIVE	5.000% 06/25/2015	756,852	1.9%
METLIFE INC	6.750% 06/01/2016	756,852	1.9%
WACHOVIA BANK	5.506% 03/15/2045	740,013	1.9%
GENERAL ELECTRIC	6.000% 08/17/2019	620,923	1.6%
WACHOVIA BANK	4.875% 02/01/2015	601,216	1.5%
CREDIT SUISSE	VAR RT 08/15/2038	557,204	1.4%
CREDIT SUISSE	3.382% 05/15/2038	520,755	1.3%
USAA AUTO OWNER	4.630% 05/15/2012	492,166	1.3%
PROTECTIVE LIFE	5.450% 09/28/2012	488,354	1.2%
TOTAL IN TOP TEN HOLDINGS		\$ 6,830,831	17.3%

Applied Security: Top Ten Non-Government Holdings <i>As of September 30, 2009</i>			
Issuer	Coupon/Final Maturity	Market Value	Percent of Portfolio
BERKSHIRE HATHAWAY	4.600% 05/15/2013	\$ 264,337	2.6%
CANADIAN NATIONAL RAILWAY	6.800% 07/15/2018	235,274	2.3%
GENERAL ELECTRIC	5.250% 10/19/2012	211,904	2.1%
ORACLE CORP	5.000% 01/15/2011	209,259	2.0%
STAPLES	7.375% 10/01/2012	164,463	1.6%
XTO ENERGY	6.250% 08/01/2017	161,936	1.6%
UNITED HEALTH GROUP	5.375% 03/15/2016	152,174	1.5%
MONSANTO CO	7.375% 08/15/2012	114,818	1.1%
VERIZON GLOBAL	7.375% 09/01/2012	113,217	1.1%
AUTOZONE INC	6.9500% 06/15/2016	109,301	1.1%
TOTAL IN TOP TEN HOLDINGS		\$ 1,736,683	17.0%

Multi-Asset Portfolio <i>Portfolio Characteristics as of September 30, 2009</i>		
Asset Class/Vehicle	Index or Manager	Characteristics¹
U.S. Large Cap Equities/iShares S&P 500 ETF	S&P 500	Page 33
Non-U.S. Equities/iShares MSCI EAFE ETF	MSCI EAFE	Page 38
U.S. High Yield/STI Classic Seix High Yield Fund	Seix Advisors	Page 41
U.S. TIPS/iShares Lehman TIPS Bond ETF	Lehman TIPS	Page 44 ²

¹ Investment characteristics for each of these indexes or active portfolios can be found on the pages listed.

² Investment characteristics for the Lehman TIPS index are similar to those for the Citigroup ILS index.