Investment Manager Market Commentary 09-16-08

The following comments were made as a result of a request of the Administrator of the Plan to each investment manager. The comments were written for the Trustees of the Board, but in a spirit of open government, the responses are being provided to your information.

DHJ:
There is obviously a lot of uncertainty and concern over the state of the financial/credit markets given the bankruptcy of Lehman and the capital liquidity issue that AIG is currently trying to deal with. We are seeing a market very comparable to that of February and the events surrounding Bear Stearns. The market will definitely be looking to the Fed later this afternoon to offer some relief when they meet and make an announcement regarding the Fed Funds rate. Based on the futures market, there is a 90% probability priced in that the Fed will cut rates by 25bps to 1.75%. If this occurs, there will likely be some stabilization in the financial markets and a bounce in stocks. The VIX measure of volatility has spiked up to a level above that of each of the 3 prior market bottoms this year, representing a very bearish sentiment that often coincides with an oversold equity market. However, If the Fed does not cut rates and if there is no solution for AIG's troubles other than bankruptcy, there will likely be more downside pressure on the stock market.

In terms of equity portfolio exposure to the events that are presently occurring, I would characterize it as follows:

* The portfolio is basically equal-weighted Financials related to the Russell 1000 Growth index so there is minimal sector allocation exposure.

* Within Financials, we own a 55 basis point position in Bank America (which is actually still up 15% QTD) and 30 basis points in Merrill Lynch. It was announced yesterday that Merrill will be acquired by Bank America and on that news, Merrill was flat in the very negative market for financial that saw many names down double-digits.

* In terms of other Financial holdings with credit exposure, American Express has some exposure through its credit card operations (possibility of rising card balance charge-offs), but the position in the portfolio is the same as the stock's weight in the Russell so there is no relative risk.

* Industrial holding General Electric does have exposure to the credit markets through its GE Financial subsidiaries and we are currently evaluating the 1.00% position in the portfolio. At present, it would not appear that GE would be faced with any of the liquidity/capital funding issues that have plagued the likes of LEH and AIG. It is likely however that further balance sheet write-downs will be necessary.

Beth McWilliams for Janna Woods
Davis Hamilton Jackson & Associates

Buckhead:
The financial markets are experiencing extreme volatility as a result of what is occurring in the banking and financial services industries. Firms that hold mortgage backed securities are being forced to write down the value of those securities as mortgage defaults increase and housing values fall. As the value of their assets decline, they are forced to raise more capital by either raising equity, debt or selling off assets. When they sell assets at a depressed level, it only exasperates the problem.

Currently we have 15.9% of the portfolio invested in financials compared to 24.6% for our benchmark, the Russell 1000 Value. We have been decreasing our exposure to financials for the past year. As a result

we have been outperforming our benchmark and are doing so this quarter. Quarter to date, the portfolio is down 3.4% versus down 3.7% for the index. In decreasing our exposure to financials we have been conscious of reducing those stocks with the higher credit risk. One bank we are currently considering for sale is Wachovia. It is a very small holding, .7% of the portfolio. Unfortunately, the financial crisis is very fluid with the cast of characters changing by the minute. Our strategy is to upgrade the portfolio where we can and ride out the storm. The obvious risk of underperformance is if the financial crisis is all of a sudden deemed over and we are underweighted our benchmark. We are willing to take that bet in order to preserve capital.
Rest assured we are monitoring the situation and are always going to do what we think is in the best interest of the portfolio.

Thank you,

Mike Harhai

Inverness Counsel:
We think that the market is within 5% of its bottom here. We expect a couple more shocks in the next 3 months and look for a recovery in the market to begin sometime in the first half of next year and in the economy sometime in the second half. We see a number of great bargains in the stock market but don't expect to realize a profit in them till next year. We remain underweight in financials.

All the best,
Robert

Robert K. Maddock

Eagle Asset:
Below you'll find some unofficial commentary directly from our PM, which is a deeper look at the financial markets in addition to comments on what we own/think of financials in the Hollywood portfolio and why. We should also have more general commentary from Eagle available in the next week.

During the 3rd quarter so far we've been about 3% under the benchmark's financial weighting, however we've had no exposure to any of the large companies with bankruptcy or buyout issues due to subprime fall out. Our financial holdings are mainly insurance companies, small brokers that benefit form volatile markets, and a couple of small conservative banks. We've actually been ahead of the benchmark so far this month.

Mary

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1) Avoid problems as all problems have turned out to be anything but temporary. Stay away from capital raising as no one knows what the dilution will be…
    a. Major problems: AIG (capital), WB (CA real estate), BAC (big credit card), AXP (big credit card), and C (consumer credit). I think even SLM has credit issues (private student loans).

b. Stay away from leverage: this includes the well-run but over-levered GS and MS. (Leverage used to be 12-15x, now it is 30x. Where were the regulators the past few years?) I am not sure that you can run a highly levered institution in this environment. Note that a profit engine for GS and MS is gone-securitization.
c. Some will benefit. Some regional banks (we own SBNY). Some regional brokers (RJF and SF), GMT (monster balance sheet, everyone else securitizes except them). Much less clear (did they overpay for Bear Stearns even with the bailout?) is JPM. WFC is pricey but should benefit. At inflection points, it is smart not to pay too much attention to valuations as they are not reliable. The world changes too quickly to rely on the numbers.
d. Avoid agency reit names like NLY. Theoretically, they should do well, but in practice they rely on Wall Street for financing and Wall Street may run out money.
e. Most insurance names will do fine (except for AIG). Slowness in premium growth doesn't help, but many are selling near book. We own ACGL, AXS, VR, THG and AHL. They are trading up today-a relief rally since Ike damage is lighter than expected. But still, up on a bad day. We think that certain names like medical malpractice PRA, workers comp ZNT ought to benefit from the fall out of AIG as pricing pressures improve
f. Timber REITs such as PCL and PCH should do well. Yes, there is a bad home market but timber (not lumber) is a worldwide market. Note that PCL sold 450,000 acres recently at $1900 an acre. Current valuation in stock is $1500 an acre. Will buy aggressively if they trade down 10-15%. Decent yields help here.
g. Look to own brokers. We own AOC and would buy WSH. BRO is interesting. No financial or underwriting risk here. BRO is cheap but is dealing with Florida insurance prices.
h. I think AMG (a buyer of money management firms) will do well. It is flush with cash and consolidation in the industry is accelerating. BLK will do well as they manage distressed assets but are also diversified.

2) The market is behaving much better than I thought, down 2% and spreads high but not ridiculous. Lehmann owes people a lot of money and a lot of money is owed to them. Putting all these deck chairs back in place could lead to panic. I read about "netting trades" arranged yesterday by major Wall Street firms. That is, Bank A is long a Lehman short and Bank B is short a Lehman long and now A is long with B and Lehman loses two positions. It works well in theory, but who knows whether asset prices have changed in the process and someone is getting nailed in the process. Have we figured out how to dismember an investment bank in an orderly way?

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