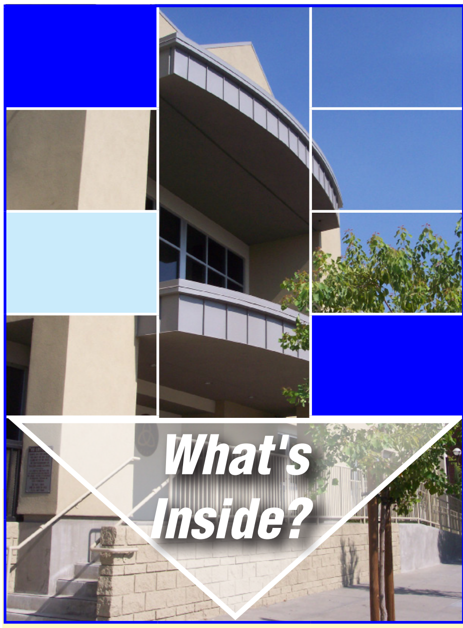


CITY OF FRESNO
FIRE & POLICE RETIREMENT SYSTEM

Retirement Quarterly

JULY 2012

VISIT US MONDAY-FRIDAY, 8 AM TO 5 PM
2828 FRESNO STREET SUITE 201
FRESNO CA 93721

CALL FOR AN APPOINTMENT AT (559) 621-7080.

VISIT OUR WEBSITE AT WWW.CFRS-CA.ORG

E-MAIL YOUR QUESTIONS OR COMMENTS TO
RETIRE@FRESNO.GOV.

REMINDER NOTICE TO ACTIVE EMPLOYEES

NEWSLETTERS WILL BE E-MAILED TO YOUR @FRESNO.GOV EMAIL ADDRESS.

Active members will receive an e-mail alert with a link to the latest newsletter. If you do not receive an e-mail alert, please send your e-mail address to Retire@Fresno.gov.

ANNUAL DROP INTEREST RATE FOR FY 2013

At the Retirement Board meeting in July, the Board approved the Annual Net Effective DROP Interest Rate for Fiscal Year 2013 at 2.01 percent. The interest rate is based on the System's average net investment earnings over the prior five years. The Board is required under the Fresno Municipal Code to annually adopt an effective DROP interest rate, which shall apply to each DROP account during the Retirement System's fiscal year in which the Board sets the rate. Because the DROP program has previously been determined to be cost neutral to the Retirement System, it is not necessary for the Board to consider any adjustments to the rate to maintain cost neutrality of the System for fiscal year 2012.

To read full report to the Retirement Board visit the System's website at http://www.cfrs-ca.org/Events/Documents/FP/12July24_FP/E1.pdf.

What is the DROP?

The DROP option simply enables an employee to freeze their retirement benefit calculation while continuing to work and accrue pension benefits. Had the employee not entered the DROP, they would still continue to earn additional retirement benefits under the base retirement formula times the employee's final average compensation. Therefore, the DROP member is accruing a similar benefit in an alternative fashion with different distribution options rather than accruing retirement service credit for the years they work while participating in the DROP. The employee will accumulate a DROP account balance consisting of monthly DROP amounts credited to their DROP account including interest credits based on the actual five year average investment earnings of the retirement system less investment costs. The DROP deposit also receives an annual cost of living increase based on the formula in the Code.

Upon retirement, the DROP member has the following distribution options:

- lump sum payment, or
- roll-over to an IRA account; or
- an annuity of the DROP account balance or
- any combination of the first three distribution options.

The City continues to make retirement contributions for all employees of the system whether or not the employee is in the DROP in order to fully fund their overall pension obligation over an average period of time. DROP accounts are invested in the same diversified portfolio as the systems' other pension funds.

INVESTMENT NEWS

Quarterly Investment Report by Stanley McDivitt, Retirement Administrator

STATUS OF INVESTMENT PROJECTS

The Boards reviewed analysis of high yield manager candidates, conducted interviews, appointed an On-Site Due Diligence Site Visitation Committee to meet with search finalists, and reviewed and approved the Committee's recommendation to retain MacKay Shields in New York to manage a High Yield Active Core portfolio commencing July 1, 2012. In addition, the Boards reviewed and adopted modifications to its Investment Objectives and Policy Statement.

During the latter half of fiscal year 2012, the Boards have conducted an evaluation of Global REITs with educational presentations from both of the Systems' current REIT managers to gain further information and knowledge about global REIT opportunities.

The Boards plan to resume evaluation of real estate opportunities given the current market conditions and expect to complete these efforts during the next fiscal year.

THE ECONOMY

The world is experiencing the cumulative effects of a global economy and financial markets that hit bottom in 2009. Since then, every year – 2010, 2011 and 2012 – has opened with a note of optimism. Stock markets rallied as economic indicators improved. And improving equity prices gave businesses the confidence to ramp up investment spending and start hiring.

In each year, instead of things warming up with the Spring months, optimism has been dashed. In 2010, it was largely the first Greek debt crisis. It derailed European sentiment, and quickly wounded the U.S. By the end of May 2010, the stock market was down for the year, and there was widespread talk of a double-dip recession. Fortunately, by year end the outlook brightened.

The world's economies and stock markets entered 2011 gaining traction. But the Spring again brought gloom. The Japanese disaster set off a global supply chain disruption, energy costs spiked and the Eurozone debt crisis re-emerged. By the Summer, U.S. sovereign debt issues were laid bare by the S&P downgrade of the nation's credit rating, and fears of a double dip were again rampant.

Following the script of the previous year, by the Fall 2011 the world's economy began healing. After a tumultuous 2011, stock prices erased their mid-year losses. Entering 2012, global growth was gaining steam, and equity markets rallied impressively during the first quarter. The European Central Bank's Long-Term Refinancing Operations pumped the financial system with liquidity. This calmed nerves and encouraged hope that the problems on the continent's periphery would be managed. In China, a deceleration in economic activity seemed to be managed, in fact desirable. Fears that the economy in general, and the residential markets in particular, were overheating were alleviated as the country looked on track for a more sustainable, balanced expansion pace. The U.S. appeared to be on a particular roll. Job gains surprised on the upside, retail and auto sales were buoyant, and manufacturing accelerated. There was widespread speculation that the nation was finally in a "virtuous cycle" supporting a self re-enforcing expansion. The primary worry was spiking oil prices.

What a difference a couple of months make. For the third year in a row, the world's economic resiliency is being severely tested. Europe has re-entered crisis mode. Recent election results amply demonstrate "austerity fatigue" in the South and "bailout fatigue" in the North. Data coming out of China are increasingly indicating a slowdown. The December – February growth spurt in the U.S. now appears to have been largely driven by unusually warm weather, and it's now payback time. The country's own debt issues are re-simmering with talk of the "Fiscal Cliff" – if unresolved by early 2013, tax cuts will disappear and spending cuts will be triggered pushing the U.S. into an extreme austerity mode.

The world is more integrated than ever – through trade and financial flows, and perhaps more importantly through sentiment which ebbs and flows globally. The world's correcting equity markets are now signaling a breakdown in confidence. Double dip fears are rising. The hopeful outlook is that the world's current slowdown will be temporary, and like in the past two years, growth will re-ignite by the Fall of 2012. After all, corporations remain flush with cash, they and households have de-levered, and low interest rates and declining commodity prices give the most stressed developed nations some breathing room.

INVESTMENT PERFORMANCE OF THE SYSTEMS

For the twelve months ending June 30, 2012, our System's cumulative investment returns were (0.12) percent. Our one year results were average, despite the overwhelming challenges of the economy. For the past five years our System's annualized return was 1.38% which compares somewhat favorably with the five year return of the Weighted Domestic Equity Index return of 0.37 percent; SP 500 return of 0.22%, the Russell 2000 return of 0.54%, MSCI EAFE International Index return of (5.63)% and the BC U.S. Aggregate bond index of 6.71%.

Despite the severe and continued volatility in the investment markets over the past five years, the Systems' annualized returns are 6.57 percent over the past fifteen years, 0.33 percent above the Systems' weighted benchmark return of 6.24 percent and 1.43 percent below the target investment rate of 8.00 percent. More importantly, the System's annualized twenty-year return is 8.46%; twenty-five year return is 8.54% and from inception to date, since October 31, 1985, the annualized return is 9.36% as of June 30, 2012 .

As of June 30, 2012, the Retirement System's portfolio had 57.85 percent in equities, 31.16 percent in fixed income, 10.91 percent in public and private open-ended real estate investment funds. The investments were further diversified into the following asset classes and target percentages:

	Actual	Target
Large-Cap equities	21.60%	22.5%
Small-Cap equities	8.02%	7.5%
International equities	21.16%	25.0%
Emerging Market equities	7.06%	5.0%
Domestic fixed income	24.66%	25.0%
High Yield fixed income	6.51%	7.0%
Real estate	10.91%	10.0%
Cash	0.08%	0.0%
Total	100.00%	100.0%

This asset class diversification along with portfolio investment style diversification is all part of the Retirement Board's Investment Risk Management Program.

Comments by City of Fresno Retirement Boards to the City's Fiscal Sustainability Policy Update

Recently, the Retirement Boards expressed their commitment to providing the most accurate information to the Mayor and City Council concerning the complex issues involved in retirement matters.

The Retirement Boards reviewed the May 29, 2012 report by City Manager to the City Council, entitled "Fiscal Sustainability Policy Update" and provided their response. The Boards understand that the City Manager was addressing a wide range of issues in his report and that many issues were discussed besides retirement issues. Retirement issues were considered on pages 7 – 11 of his 13 page report. They thus form a significant portion of his consideration of fiscal sustainability issues.

The Retirement Boards appreciate the kind words expressed by the Manager on page 7 of his report. He correctly reminds us that the two city retirement systems are separate from the City, are administered by two independent boards who serve as fiduciaries toward system member, retirees, and beneficiaries.

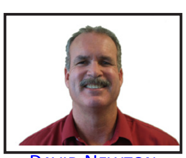
The Manager also notes the sound funding status of the two retirement systems. It is important to supplement his funding observations by noting that his statements reflect a single point in time. Saying that the systems are fully funded really means that the systems are traveling along a funding path and that, at this particular point in time, we are at a level that is slightly above our funding target. But fully funded today does not mean fully funded forever. On the contrary, as financial markets fluctuate, so too does the funded status of each system. The low returns this fiscal year in the financial markets and the consequent effect on the investment returns of the systems illustrate this reality all too well.

So the Boards respectfully disagreed with any suggestion that the systems are overfunded and can settle for a lower funded ratio. The ever-present undeniable truth is that despite the Boards best efforts to try to remain fully funded, external circumstances can alter in an adverse manner our current state of funding.

While the City Manager suggests that aiming for a 90% funded status would be reasonable under the present circumstances, the Retirement Boards consider such a course of action very unwise as a matter of fiduciary principle. By doing so, the Boards would be creating a material unfunded liability that would require new City unfunded liability contributions to be made by the City. The additional unfunded liability contributions would also include interest at an eight (8%) percent rate. Additionally, underestimating our investment rate assumption, whether deliberately or inadvertently, would only create additional funding difficulties by generating an unfunded liability which the City will then be obligated to fund.

The City Manager also suggests that perhaps assets in the systems can be returned to the City. This is not a viable option as we previously stated in our response to the Harvey Rose & Associates Report (Our response to the Harvey Rose & Associates Report is on lead page of our website at www.cfrs-ca.org). The Fresno Municipal Code ("FMC") prohibits such a payment. The Municipal Code contains such a provision because the federal Internal Revenue Code requires such a provision. Without such a provision in the FMC, the systems would no longer be tax qualified, resulting in immediate taxation of the systems' investment earnings and adverse tax consequences for employees. It is difficult to express strongly enough the negative consequences that would follow from implementing this suggestion.

BOARD MEMBER ELECTION RESULTS

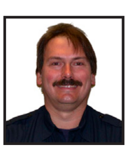


David Newton

In May 2010, a Notice of Election was distributed to all Police Members of the City of Fresno Fire and Police Retirement System. Only one valid petition was received, therefore no election was held and Mr. David Newton was certified as the qualified candidate and re-elected as Police Member of the Fire & Police Retirement Board.

David is a Lieutenant for the City of Fresno Police Department. For the past two years, David served as the elected Police member. David was elected to complete the term due to the retirement of the Police Board member. His new term ends in June 2016.

Also at the Board meeting in June, the annual elections were held for the Chair and Vice Chair of the Board. See the results below:

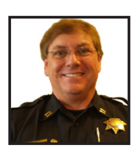


Elected Member
Fire Members
Term Expires
June 2014

Paul Cliby
Chair

Board Appointed
Outside Member
Term: Continuous

Oscar Williams
Vice-Chair



Mayor Appointed
Member
Term: Continuous

Michael Reid

Mayor Appointed
Member
Term: Continuous

Tim Henry

RETIREMENTS
APRIL 1 THROUGH JUNE 30, 2012

Richard Christopherson
Raymond Hernandez
James Lewis
Henry Monreal
Michael Taylor
Paul Urbano
Franklin Cogburn
Shannon Lyon

Next Quarter Retirement Benefit Pay Dates

July 31, 2012
August 31, 2012
Sept 28. 2012

TIER 1 COST OF LIVING INCREASES FOR FY 2013

Effective July 1, 2012, the Cost of Living increases for Retirees and DROP participants in the Fire and Police Retirement System have been calculated and are as follows:

- Tier 1 Fire retirees and DROP participants under the Final 3 Year Average who were retired or in DROP on June 30, 2012 will see a 2.5% increase in their July 31, 2012 retirement benefit payment/DROP deposit.
- Tier 1 Fire retirees and DROP participants under the Career Rank Average, who were retired or in DROP on June 30, 2012 will see up to a 2% increase in their July 31, 2012 benefit payment/DROP deposit depending on the ranks held and time in each rank.
- Tier 1 Police retirees and DROP participants under Final 3 Year Average method who were retired or in DROP on June 30, 2012 will see a 0.1% increase in their July 31, 2012 benefit payment/DROP deposit.
- Tier 1 Police retirees and DROP participants under the Career Rank Average method will not see an increase this year.

City of Fresno Retirement Systems
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Fresno CA 93721-1327