

PUBLIC AGENDA ITEM - #18a

18a. Review, Discussion and Consideration of the Investment Performance of the System's Assets for the Second Calendar Quarter of 2009 and of the External Advisors

August 25, 2009

BACKGROUND:

In accordance with the contract for performance evaluation services and Section three of the ERS *Investment Policy*, Ennis Knupp & Associates, Inc., reviews and evaluates, on a quarterly basis, the Employees Retirement System of Texas (ERS) investment performance as calculated by the ERS custodian, JP Morgan Chase & Company.

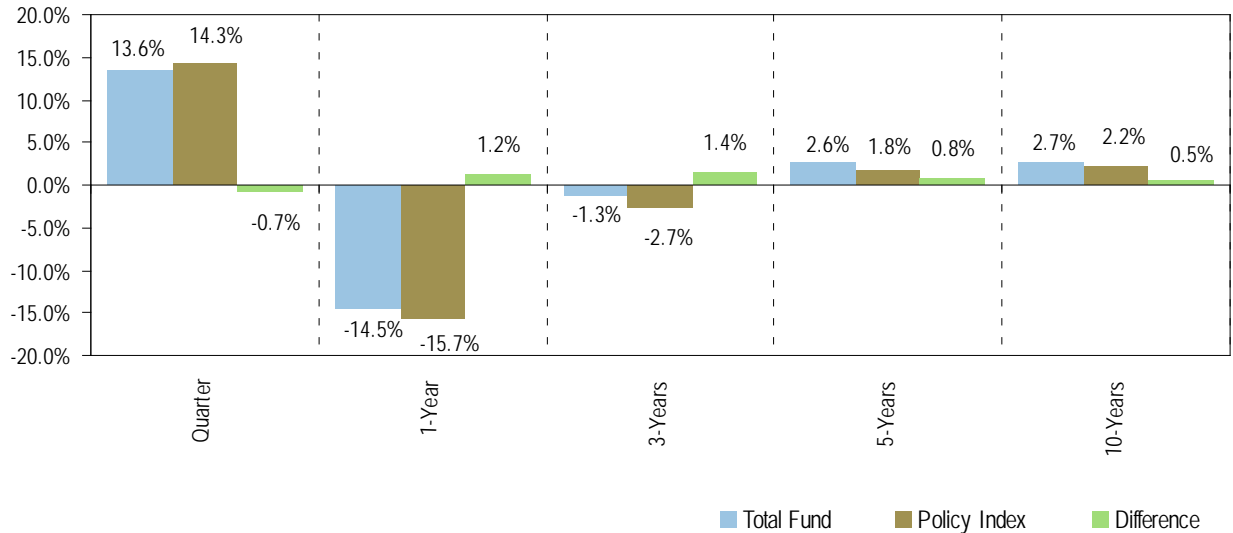
Ennis Knupp's report includes a market review and update through June 3, 2009, and notes that global markets experienced strong positive returns during the quarter, with U.S. stocks up almost 17 percent and international stocks up just less than 28 percent. Since the recession began, stock market performance has remained closely associated with perceived strength of the economy.

The stock market rally was not due to the view that a strong recovery was imminent but that a belief that a depression or financial collapse was not imminent. Better economic news including include better personal consumption measures, some signs of recovery in the housing market, and increasing industrial orders were main contributors to the rally. The market also reacted favorably to the government's measures to alleviate troubles in the financial sectors and the banking system through the TALF (term asset-backed loan facility) program, which is intended to facilitate the issuance of and improve the market for asset-backed securities in order to assist consumers and small businesses in obtaining credit and PPIP (public-private investment program), which is intended to provide financial institutions a mechanism with which to dispose of legacy securities backed by mortgages.

The fixed income market also reacted favorably to the government's actions as spreads shrank dramatically during the quarter. Year-to-date U.S. high yield is up 30 percent, asset-backed securities are up 16 percent, and investment grade credit is up 8 percent. Treasuries struggled during this time period and posted a -4.3 percent year-to-date, which did produce a slight drag on the return of the Barclays Aggregate Bond Index, which returned 1.8 percent during the quarter.

Ennis Knupp's report on ERS' investment performance for the 2009 second calendar quarter showed that the ERS Total Fund's absolute return was strong at 13.6 percent; however, the Total Fund underperformed the its policy benchmark by approximately 75 basis points (see table on page 2). Relative to a universe of its peers, the Total Fund return for the quarter and the one-year periods ending June 30, 2009, falls in the top quartile of returns. For the quarter, Domestic Equity and Core Fixed Income added the most value and contributed to the Total Fund return. International Equity, High Yield, and Private Equity detracted from performance. Ennis Knupp also noted that over the second calendar quarter, the Risk Management strategy appropriately offset most of the Total Fund's allocation effect.

Investment Results
As of 6/30/2009



All returns contained in this report are shown net of investment management fees. All returns longer than one year are annualized.

Ennis Knupp’s report on ERS’ investment performance for the second calendar quarter of 2009 is included with the agenda item under Exhibit A.

External Advisors’ Reviews:

As authorized by the Board of Trustees of the Employees Retirement System of Texas (ERS), and in accordance with the ERS *Investment Policy*, the Executive Director shall provide to the Trustees in writing, on a quarterly basis, a summary of the advisor performance of each actively managed portfolio evaluated on the following objectives:

- Performance relative to benchmark and peer group
- Consistent adherence to stated management style
- Discipline of investment decision-making process
- Stability of staff
- Consistent adherence to investment policies and objectives as adopted by Trustees

Staff recently concluded reviews on the following advisors, and the staff reports are attached:

- AllianceBernstein, LP
- UBS Global Asset Management
- Fisher Investments Institutional Group
- AIG Global Investment Group

The Deputy Executive Director of Investments will discuss and answer questions related to the advisors’ performance and policy objectives as detailed in each review.

STAFF RECOMMENDATION:

The staff recommended motion is attached to this agenda item.

ATTACHMENTS – 5

Exhibit A – Employees Retirement System of Texas Performance Report, Period Ending
June 30, 2009 by Ennis Knupp & Associates, Inc. (*Included under separate cover.*)

Exhibit B – ERS Review of AllianceBernstein, LP

Exhibit C – ERS Review of UBS Global Asset Management

Exhibit D – ERS Review of Fisher Investments Institutional Group

Exhibit E – ERS Review of AIG Global Investment Group

RECOMMENDED ACTION - #18a

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The ERS staff recommends the following motion to the Investment Advisory Committee:

I move that the Investment Advisory Committee recommend that the Board of Trustees of the Employees Retirement System of Texas approve termination of its contract with UBS Global Asset Management effective September 30, 2009.

Contingent upon adoption of the above motion by the Investment Advisory Committee, staff recommends the following motion to the Board of Trustees:

I move that the Board of the Trustees of the Employees Retirement System of Texas approve termination of its contract with UBS Global Asset Management effective September 30, 2009.