

Attachment 2 – Global Fixed Income Program Review

Justification for Selected External Managers

International Fixed Income Manager

Alliance Bernstein L.P.

- Alliance Bernstein (AB) has the highest beta (a measure of the sensitivity of a portfolio to the benchmark) approach of all managers with a focus on corporate credit which makes them unique. Their approach was severely punished from September 2008 to March 2009, the worst period of the crisis, with underperformance peaking at 1,100 bp. AB's year-on-year performance ending September 2009 was +237 bp and cumulative since inception -114 bp.
- AB entered the crisis with a 20% allocation to spread product (mostly corporate credit) and increased it to the maximum 30% at near the widest spread levels. This portfolio rallied significantly from March 2009 to the present. Staff believes that there is still some room for the corporate credit spreads to revert toward more normal long-term levels.
- Staff will change manager allocation based on market views, stylistic biases, and confidence in manager skill. Because the significant rally in corporate credit is most likely done, reducing exposure to AB to \$500 million on an incremental basis is justified (an underweight in the portfolio as a whole). The pace of the reduction will likely be \$100 million per month.

U.S. High Yield Managers

Nomura

- Higher beta approach was punished during the last two quarters of 2008 when the market return was -25.61%. Nomura underperformed the market by -195 bp.
- Since that time through September 30, 2009, the market returned 47.45%; Nomura outperformed the benchmark by 486 bp to earn 52.30%.
- Nomura's style should benefit from the current stage in the market cycle.

PIMCO

- Style is a conservative approach to high yield. While the market was selling off during the last two quarters of 2008 returning -25.61%, PIMCO outperformed the benchmark by 355 bp.
- Since that time through September 30, 2009, PIMCO maintained an underweight to CCC rated securities, the riskiest portion of the high yield market. While PIMCO managed to return 35.06% over this period, PIMCO's aversion to risk resulted in underperforming the benchmark return of 47.45% by 1,238 bp.
- Staff is reducing exposure to PIMCO to \$100M, but recommends renewing the contract and allocating more assets to PIMCO in the future when risk aversion is expected to produce alpha in the high yield market.