



“Advancing Your Investments”

NEW ENGLAND PENSION CONSULTANTS

RICHARD M. CHARLTON
CHAIRMAN AND CEO

February 17, 2006

RE: Chairman’s Annual Update

Dear Client:

It is with considerable pride in our firm and its professionals that I write to you on the occasion of NEPC’s 20th anniversary as an independent investment consulting firm.

The past 20 years have been eventful, to say the least, ranging on the upside from the unprecedented equity bull markets of the 80’s and 90’s to the current decade, off to the poorest start through its first six-years of any decade in the history of the S&P 500.

The market sell-off of October 1987 gave us great pause along the way, even though equities recovered to earn over 5% that year. The New Paradigm and the tech bubble were next, followed by one of the most severe equity market corrections in history. As painful as that event was, its impact was magnified by a simultaneous decline in interest rates, increasing retirement liabilities while asset values were being depleted.

Pensions are now recognized as the true cost centers they have always been, rather than the “profit centers” some believed them to be during the market run-up, and the weight of the pension promise bears more heavily on our society than ever before. Large corporations, including Verizon, Sprint, IBM and now General Motors have taken steps to freeze their defined benefit pension plans, and others will likely follow. Alicia Munnell, director of the Center for Retirement Research at Boston College, believes the move “forebodes a collapse in the social welfare benefits provided by employers. As GM follows in the footsteps of other large companies, a sea change is afoot.”

These changes will materially increase the need for corporate employees to more effectively use their participant-directed defined contribution programs, and the burden on corporations themselves to step up their employee educational efforts.

Corporations are not alone in their concerns, as public budgets are under increasing pressure to fund benefit promises made in better times. Adding to the burden are the enormous future cost increases of our national social programs, Medicare, Medicaid and Social Security. Clearly, funding private and public sector retirement and medical programs will challenge our entire society for years to come. However, new products and financial innovations are coming to market with encouraging prospects for improved returns, even in an environment of subdued expectations.



In these difficult times, NEPC's clients continue to lead, collectively outperforming national averages in 17 of our 20 years. We have invested heavily in our research resources for both traditional and alternative investments as we work to identify opportunities for our clients to continue their outperformance. This commitment now represents almost 20% of our overall staff and has put us well ahead of the curve in the three areas that we believe will be critical to our clients' future success:

- 1) *Relaxation of Portfolio Constraints*—the use of multi-asset and global allocation strategies to capitalize on market anomalies created by constraining managers to narrowly defined “consultant boxes;”
- 2) *Portfolio Construction*—the separation of alpha from beta, and the “porting” of alpha onto the more efficient asset classes to improve returns from benchmark levels; and,
- 3) *Asset/Liability Management*—hedging assets and liabilities to minimize funding volatility.

We have begun implementing these strategies over the past few years with excellent results and our consultants will be telling you more in the near future.

Our Client Ratings: Your ratings of NEPC continued to be most favorable, and we thank you for your continued support and feedback. Over the past three years, none of the industry's 10-largest firms has received consecutive-year Greenwich Quality Ratings as strong as NEPC's, and we remain committed to continuing to enhance our service delivery to you and to bringing you the very best investment solutions available.

The SEC Investigation of the Consulting Industry: As most of our clients are aware, NEPC was the first, and thus far one of only four, of the 24 consulting companies investigated by the SEC to be advised by them that their review was completed with “no deficiencies and no findings.” We are extraordinarily pleased with this outcome and reaffirm our commitment to you to act exclusively in your best interests in all that we do.

NEPC's Competitive Experience: Our controlled growth continued in 2005 under the leadership of Mike Manning and our managing partners, as we increased our overall client base to 238 retainer relationships and grew our client revenues in double digits for the 20th consecutive year. We fared well in all major market segments: Public, Corporate, Endowments & Foundations, Taft-Hartley and Defined Contribution, and we increased our Private Client presence to 10 individuals and family offices with collective assets of \$3 billion at year-end. Each of our four principal offices, Detroit, San Francisco, Las Vegas and Cambridge, expanded nicely and we continued to respond to the personal needs of our professionals by accommodating family-related relocations of senior personnel to Cincinnati (Craig Svendsen), Charlotte (Rhett Humphreys) and Buffalo (Rich Harper).



Alternative Assets: Our commitments to alternative assets and portable alpha continue to materially benefit our clients and we had placements in excess of \$14 billion at year-end. We anticipated very significant client interest in this area by increasing our dedicated staff to 12 full time professionals and four full-time equivalents by year-end, one of the foremost research commitments in the industry. Importantly, five members of this group hold the CAIA (Chartered Alternative Investment Analyst) designation, further attesting to the capability of our alternative asset research commitment. Additional members of our professional staff are sitting for the CAIA exam at this writing.

Defined Contribution: Assets under advisement by our DC Team grew to \$40 billion at year-end, as plan sponsors continue to recognize the increased importance of defined contribution plans and the need to upgrade their oversight and educational efforts to promote good investment behavior, provide good investment options and improved participant education. The scandals within the mutual fund industry have further heightened the awareness of trustees and corporate officers to their fiduciary responsibilities (and liability). NEPC's capability in this market segment is increasingly recognized as "best in class" and features some of our best and brightest consultants. That capability was recently augmented by the hiring of Carolyn Smith, Watson Wyatt's former West Coast Practice Leader.

Personnel and Organizational Changes: We recently expanded our partnership to 16 professionals with the addition of Sean Gill, CFA, CAIA, Rhett Humphreys, CFA and John Elliot, manager of our Las Vegas Office. Each has significantly enhanced NEPC's reputation for excellence. During the year, our Research Group was realigned under Dr. John Minahan, CFA further sharpening its focus on both basic and applied research, and reinforcing the career path opportunities that exist for our research professionals. Melissa Perel, CFA was also promoted to Director, Manager Research, and is now leading the traditional manager research team.

Molly Auth was promoted to Senior Consultant, while Marty Coughlin, John Krakowiak, Jon Mandle, CFA, Matt Lamberti, CFA, Ben Simonds and Kevin Kondry were promoted to Consultant. Jeff Markarian and Tony Peng were promoted to Senior Analyst, and Heather Martone to Manager of Market Research. Rounding out our recognition of superior performers, Matt Tepper, Joel Paula, Shane Burke and Alex Kamunya were promoted to research and consultant support analyst positions.

NEPC's competitive advantages continue to draw the attention and envy of our competitors, and our internal growth has been augmented by the addition of 10 professionals who have joined our firm from seven other consulting firms: Marco Consulting Group, Mercer, Watson Wyatt, Hewitt, A. D. Biller, Cambridge Associates and CRA RogersCasey. Among our 2005 additions from other consulting firms were Chris Levell, CFA, one of Mercer's top actuarial consultants, Ross Breman, CFA and Steve Gargano. Additionally, Jack McManmon, Jon Mandle, CFA and Andrew O'Brien joined us from investment manager firms and Carolyn Smith, formerly the head of the West Coast Practice for Watson Wyatt, will be joining us next month, as noted above.



Finally, Peter Gerlings, Dutch by birth, will be relocating to the Netherlands for at least three months to preserve his dual citizenship and to evaluate the possibility of continuing his PhD pursuit in Europe. In 2005, Peter reduced his workload to prepare for these new challenges and will be scaling back his role even further, effective April 1st. While overseas, he will remain a part-time employee with a focus on special projects and hedge fund research, particularly with European managers. While we are disappointed that Peter cannot devote more time to NEPC in the near future, we are certainly pleased that he will continue on a limited basis. We are excited for him as he begins this new chapter and wish him the best of luck.

NEPC's Client Conference: In recognition of the increasingly national footprint of our client base and the differing needs of the market segments that we serve, we are modifying both the format and venues for our annual Client Conference. Effective this year, we will be hosting a series of two-day, multicity educational seminars in even years and our traditional Boston-based conference in odd years.

While plans are not yet complete, we currently anticipate the 2006 sessions to be Detroit, likely in May; in Las Vegas, likely in June; and Boston, likely in July. Main issues to be covered will be **New Issues in Pension Management** (afternoons on the first day) and **Alternatives/Defined Contribution** (breakout sessions on the mornings of the second day). Stay tuned for more, shortly.

In summary, we are quite clearly entering the most challenging environment for retirement programs in the history of our country. Subdued market expectations, burgeoning social programs, new regulatory requirements and rapidly evolving investment products present both challenges and opportunities for the government, plan sponsors, investment managers and consultants alike.

Our responsibility to you is to anticipate and be prepared for these challenges, and to continually merit the confidence that you have accorded to NEPC to help you navigate these new horizons. You have our commitment, and we appreciate yours.

Sincerely,

A handwritten signature in black ink, appearing to read 'Michael', is located below the 'Sincerely,' text.