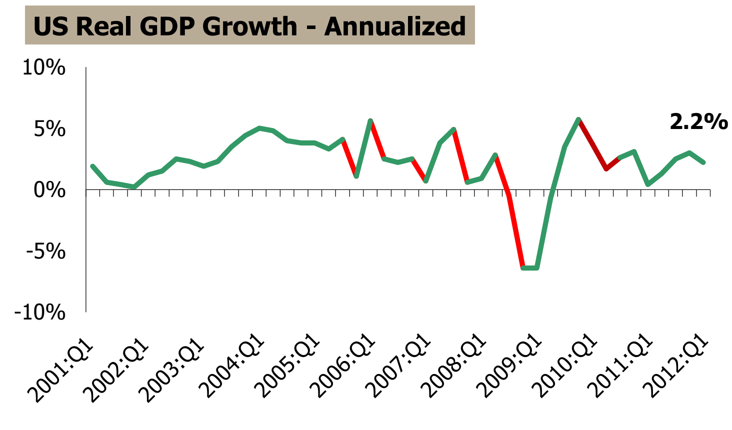
Port of Houston Authority
Pension Plan

First Quarter 2012 Report

Gregory W Group

FIRST QUARTER 2012 MARKET ENVIRONMENT

The first quarter of 2012 was quite good in terms of performance – especially for equities. It provided welcome relief after a tumultuous late summer and early fall of 2011. Macroeconomic issues dominated the financial markets again, but the sense of worry that dominated periods of 2011 abated. Europe is expected to endure a mild recession during 2012. However, its economic state remains fragile and subject to shocks. The growth prospects of the peripheral nations are extremely poor and there have been signs that Germany and France could be worsening. Technically, a Greek debt default may have occurred during the quarter as investors were forced to write down the value of their holdings. But, the much feared spillover effect among Eurozone banks was averted – for the time being. The U.S. economy managed to hobble forward with admittedly slow growth during the first quarter. Risk on/Risk off remained the theme of markets worldwide as periods of relative calm were punctuated with bouts of volatility and losses on more risky assets.



- First quarter U.S. Real GDP growth was 2.2%, a decrease from the previous quarter's 3.0% gain.
- U.S. unemployment rate moved slightly lower during the quarter. It ended the quarter at 8.2% versus 8.5% to start the quarter. Most economists believe that real GDP growth must be sustained above 2.5% to meaningfully improve the U.S. unemployment situation. The Consumer Price Index rose by more than 3% for the year. U.S. housing prices were stable to slightly lower.
- For the year ended March 31st, S&P 500 profits were estimated to have grown 20.5%. Corporate America continues to generate profit growth despite the weak economic recovery.
- The Federal Reserve took no action on short-term interest rates, leaving them unchanged at 0.00% to 0.25%. The Eurozone's most recent effort to ease their financial crisis, the so-called "Long Term Refinancing Operation" encouraged some investors while others decried it as yet another version of "kick the can down the road". Markets were nonetheless stabilized as 800 Eurozone banks participated in the program that provided low cost funds. Investors are closely watching the June elections in France as an important signal into the viability of continuing this and other similar programs.
- The S&P 500 has earned a cumulative return of +122% since reaching its bear market low on March 9, 2001. It remained 1% below its previous high reached on October 9, 2007.
- Hedge funds trailed traditional portfolios during the first quarter. The Hedge Fund Research HFRX equal weighted index of hedge funds gained 4.9% for the quarter and fell -2.3% for the trailing year.
- World real GDP growth expectations remain suppressed, primarily due to the European debt crisis. The consensus estimate for 2012 world real GDP growth is 2.5% with a 2.9% inflation assumption. This compares to the 2010 actual growth of 3.9% and inflation of 2.5%.

Domestic and International Equity Summary

The U.S. and foreign equity markets enjoyed remarkably strong returns during the first quarter. Domestic and international equities posted double digit gains as fears of a major debt default decreased during the quarter. Volatility declined as equity prices climbed. Total Eurozone unemployment was more than 10% while youth unemployment was over 21%. Total Spanish unemployment was almost 23% while 48% of young Spanish workers were out of work.

- Top contributing sectors of the domestic equity market were **Information Technology (21% return), Financials (21%), and Consumer Discretionary (17%)**. The lowest contributing index sectors were Utilities (-2%), Telecom Services (3%), and Energy (4%).
- The three largest individual contributors to the Russell 1000's first quarter return were **Apple (+48% return), JPMorgan Chase (+39%), and Microsoft (+25%)**.
- Growth stocks outpaced value stocks during the first quarter. Growth also led over the one year period. Performance was very similar among large, mid and small caps during the first quarter.
- In terms of valuation, major equity markets remain reasonably priced. The **Russell 1000's price/earnings ratio ended the first quarter of 2012 at 16.0,** an increase from 14.1 at year end**.** The Russell Mid Cap and Russell 2000's price/earnings ratios were 20.5 and 18.4 respectively, versus 15.9 and 16.9 last quarter. Profits and cash holdings remain near all-time highs.
- Consensus estimates are for Europe to suffer a modest recession during 2012. **The United Kingdom recently reported its second consecutive quarter of negative GDP growth, indicating that it had slumped back into a recession.**
- Thailand, the Philippines, and Germany were the top performing markets during the first quarter of 2012, gaining 21%, 20%, and 19% in U.S. Dollar terms. Poorest performing markets were Spain (-4%), Portugal (2%), and Canada (5%). The U.S. ranked 19th overall for the period.

Twelve Month Forward P/E Ratio

	Europe ex UK	UK	Japan	Asia ex Japan
Current Value	10.8	10.2	13.4	12.5
Post 1990 Average	**14.2**	**12.6**	**32.3**	**13.9**
Discount/Premium	*-23.9%*	*-19.0%*	*-10.1%*	*-26.8%*

- **All ten sectors of the MSCI ACWI index sectors posted first quarter gains**. The quarter's leading performance contributors were Financials (18% return), Information Technology (20%), and Consumer Discretionary (17%). The quarter's poorest performers were Utilities (3%), Telecom Services (3%), and Energy (5%).

- Emerging markets stocks posted gains during the quarter. Chinese government officials lowered their target growth rate to 7.5% from their previous goal of 8.0%. This contrasts with their peak growth rate of just over 14% in 2007. The reduced growth rate illustrates the attempts of Chinese authorities to arrange a “soft landing” or a reasonable slowdown, rather than a more punishing boom/bust cycle.

- The top three contributors to the MSCI ACWI ex-U.S. index’s first quarter return were **Toyota Motor (+31% return), HSBC Holdings (+18%), and Samsung (+23%)**. The bottom three contributors were Tesco (-16% return), Royal Dutch Shell, class B (-7%), and Royal Dutch Shell, class A (-4%).

Fixed Income Summary

Bond markets were heavily influenced by the global sovereign crisis. Europe remained on the brink as the peripheral nations (Greece, Spain, Portugal and Ireland) showed signs of deterioration and/or improvement. Governments fell, even in large European nations, as the Eurozone took some painful steps toward austerity and rationalization of their debt to GDP ratios. The Eurozone’s LTRO had the biggest impact during the quarter, shifting investors from “risk off” to “risk on”, an event that favored equities at the expense of bonds. Bond investors favored corporate and mortgage-backed bonds during the quarter. Generally speaking, government bonds suffered price declines. Long-term U.S. Treasury bonds fell more than -5% during the quarter, causing their trailing year return to fall to +23%. Despite the uncertainty over the trailing year, bonds posted attractive returns on a risk adjusted basis. Looking forward, with interest rates touching cyclical lows, it is difficult to see how they will be able to recreate these returns without a major financial crisis herding investors into the asset class.

- Bonds underperformed equities during the first quarter. U.S. Treasury bond yields rose while the yield curve steepened. The steepening was attributed to unexpected strength in the U.S. economy. Ninety-one Day T-bills ended the quarter with a yield of 0.07%, an increase of 0.06%. Ten year Treasuries rose 0.33% to 2.21% while the yield on the thirty year Treasury bond ended the quarter at 3.3%, up from 2.9% one quarter earlier. Mortgage backed bonds posted lackluster returns during the quarter as late payments and foreclosures on residential mortgages remained unfortunately high. Institutional investors have started to reach for yield by expanding their reach into more unusual fixed income instruments.

- Yield spreads compressed as investors moved into riskier bonds. Investment Grade and High Yield fixed income posted impressive gains as did Emerging Market debt.

Risk Level	Time Horizon			
	One Year		Three Years (annualized)	
	Terminal Yield	**Total Return**	Terminal Yield	**Total Return**
Low				
2 Year Treasury (3.31 = 0.3%)	2.5%	**-3.9%**	5.0%	**-2.7%**
	1.5%	**-2.0%**	4.0%	**-2.0%**
	0.5%	**-0.0%**	3.0%	**-1.4%**
Medium				
10 Year	4.5%	**-16.1%**	6.0%	**-7.7%**
Treasury	3.5%	**-8.6%**	5.3%	**-5.9%**
(3.31 = 2.2%)	2.5%	**-0.3%**	4.0%	**-2.7%**
High Risk				
30 Year	5.5%	**-28.2%**	6.5%	**-11.6%**
Treasury	4.5%	**-15.6%**	5.5%	**-7.6%**
(12.31 = 3.3%)	3.5%	**0.4%**	4.5%	**-2.9%**

- High yield bonds were the top performing sector during the first quarter, gaining 5%. They were the poorest sector of the trailing one year, posting a gain of under 6%. High yield spreads contracted during the quarter while defaults remained very low by historical standards. Issuance of high yield debt remained elevated during the quarter.

Domestic Equity	*Last Quarter*	*Last Year*	*Last Three Years Annualized*	*Last Five Years Annualized*	*Last Ten Years Annualized*
S&P 500	12.6	8.5	23.4	2.0	4.1
Russell 1000	12.9	7.9	24.0	2.2	4.5
Russell 1000 Value	11.1	4.8	22.8	-0.8	4.6
Russell 1000 Growth	14.7	11.0	25.3	5.1	4.3
Russell 3000	12.9	7.2	24.3	2.2	4.7
Russell Midcap	12.9	3.3	29.1	3.0	7.9
Russell Midcap Value	11.4	2.3	29.2	1.3	8.0
Russell Midcap Growth	14.5	4.4	29.2	4.4	6.9
Russell 2000	12.4	-0.2	26.9	2.1	6.5
Russell 2000 Value	11.6	-1.1	25.4	0.0	6.6
Russell 2000 Growth	13.3	0.7	28.4	4.2	6.0
Alerian MLP	2.0	9.6	35.8	11.9	16.0
Fixed Income					
Barclays Capital Aggregate Bond	0.3	7.7	6.8	6.3	5.8
Barclays Capital Credit	2.0	9.6	12.3	6.9	6.6
Barclays Capital Government	-1.1	7.9	4.0	6.0	5.5
Barclays Capital Govt/Credit	0.1	8.5	7.1	6.3	5.9
Barclays Capital Interm Credit	2.5	7.0	10.5	6.4	6.1
Barclays Capital Interm Govt	-0.4	5.7	3.4	5.5	4.9
Barclays Capital Interm Govt/Cred	0.6	6.1	5.9	5.7	5.3
Barclays Capital Long Credit	0.8	17.3	17.9	8.5	8.3
Barclays Capital Long Term Govt	-5.6	23.0	7.4	9.3	8.5
Barclays Capital Long Govt/Credit	-2.1	19.9	12.8	9.0	8.4
Barclays Capital Fixed Rate MBS	0.6	6.2	5.3	6.3	5.7
Merrill Lynch US High Yield Master II	5.2	5.6	23.8	7.8	9.0
91 Day T-Bill	0.0	0.1	0.1	1.1	1.8
Consumer Price Index	0.6	2.9	2.4	2.3	2.5
International					
MSCI EAFE	10.9	-5.8	17.1	-3.5	5.7
MSCI World ex US	10.4	-6.7	17.6	-3.0	6.1
MSCI Europe	10.7	-7.5	17.6	-4.0	5.4
MSCI Japan	11.3	0.3	11.9	-5.2	3.9
MSCI Pacific ex Japan	11.3	-5.6	26.1	3.4	12.4
MSCI Emerging Markets	13.7	-11.1	22.3	2.3	11.5
Citigroup Non-$ World Gov	-0.2	3.9	6.9	7.0	8.5

Portfolio Summary as of March 31, 2012

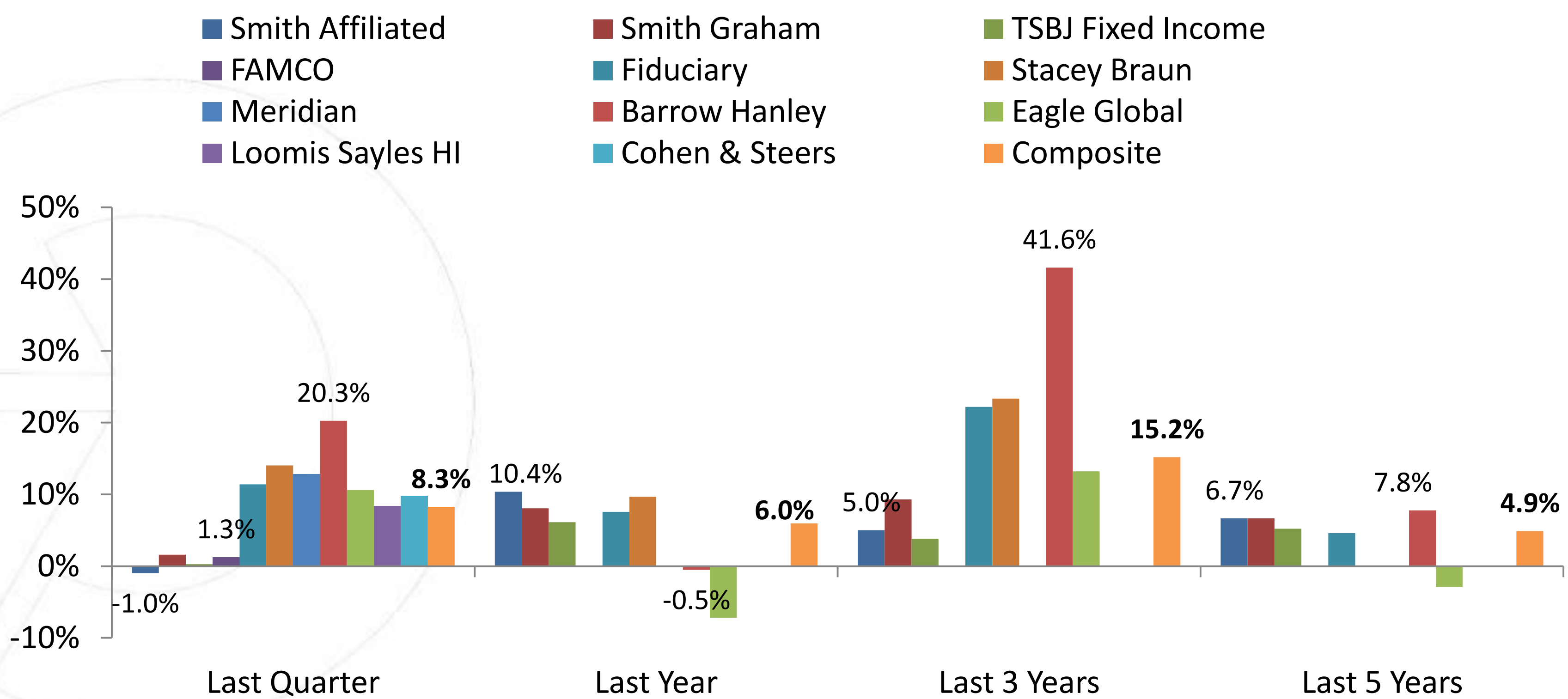
Manager	Quarter	One Year	Three Year	Five Year	Market Value
Smith Affiliated	-0.96%	10.38%	5.02%	6.66%	$9,960,518
Smith Graham	1.60%	8.06%	9.31%	6.65%	$22,137,507
Trevor Stewart Burton & Jacobsen	0.26%	6.13%	3.80%	5.22%	$8,986,225
Barclays Capital Aggregate	0.30%	7.71%	6.83%	6.25%	
Loomis Sayles High Income	8.39%	-	-	-	$6,378,951
ML High Yield	5.15%	5.63%	23.78%	7.84%	
FAMCO	1.25%	-	-	-	$6,523,407
Alerian MLP	1.97%	9.55%	35.77%	11.86%	
Cohen & Steers Real Estate	9.78%	-	-	-	$6,741,870
FTSE NAREIT All REITS	10.41%	10.91%	39.98%	-0.58%	
Fiduciary Management	11.40%	7.59%	22.19%	4.60%	$11,270,695
Stacey Braun	14.03%	9.68%	23.36%	-	$9,457,652
S&P 500	12.59%	8.54%	23.42%	2.01%	
Meridian	12.81%	-	-	-	$17,252,023
Russell Midcap Growth	14.52%	4.43%	29.16%	4.44%	
Barrow Hanley Small Cap	20.26%	-0.49%	41.63%	7.78%	$15,106,967
Russell 2000 Value	11.59%	-1.07%	25.36%	0.01%	
Eagle Global	10.60%	-7.18%	13.23%	-2.91%	$16,481,825
MSCI EAFE	10.86%	-5.77%	17.13%	-3.51%	
Total Plan	**8.25%**	**5.96%**	**15.19%**	**4.90%**	**$130,297,640**
Benchmark	7.47%	6.48%	16.06%	3.07%	
Actuarial Assumption	1.77%	7.25%	7.25%	7.25%	

The Total Plan Benchmark is composed as follows; S&P 500 (47.5%), MSCI EAFE (12.5%), and Barclay's US Aggregate (40%).

Gregory W Group

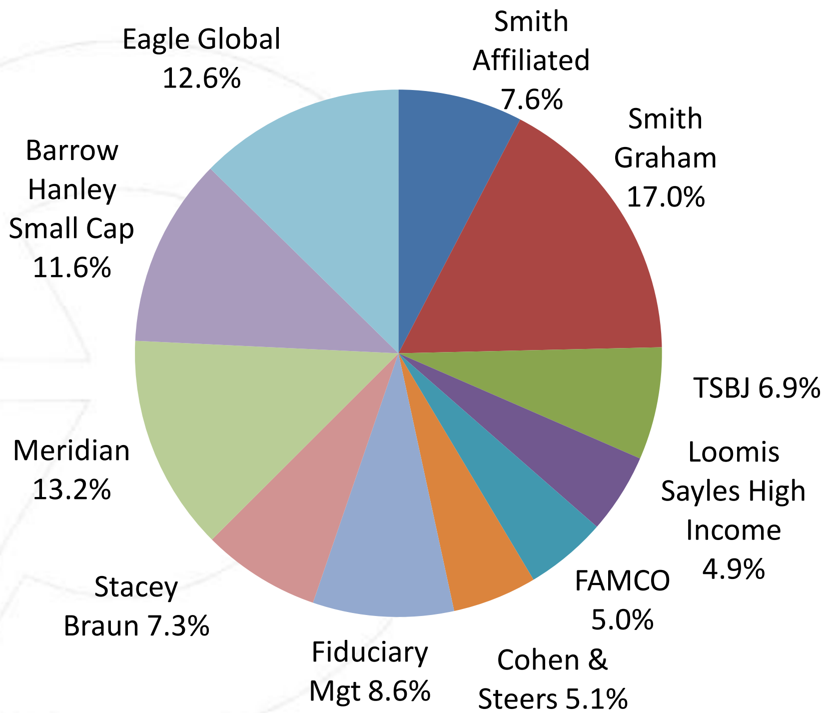
Performance Summary

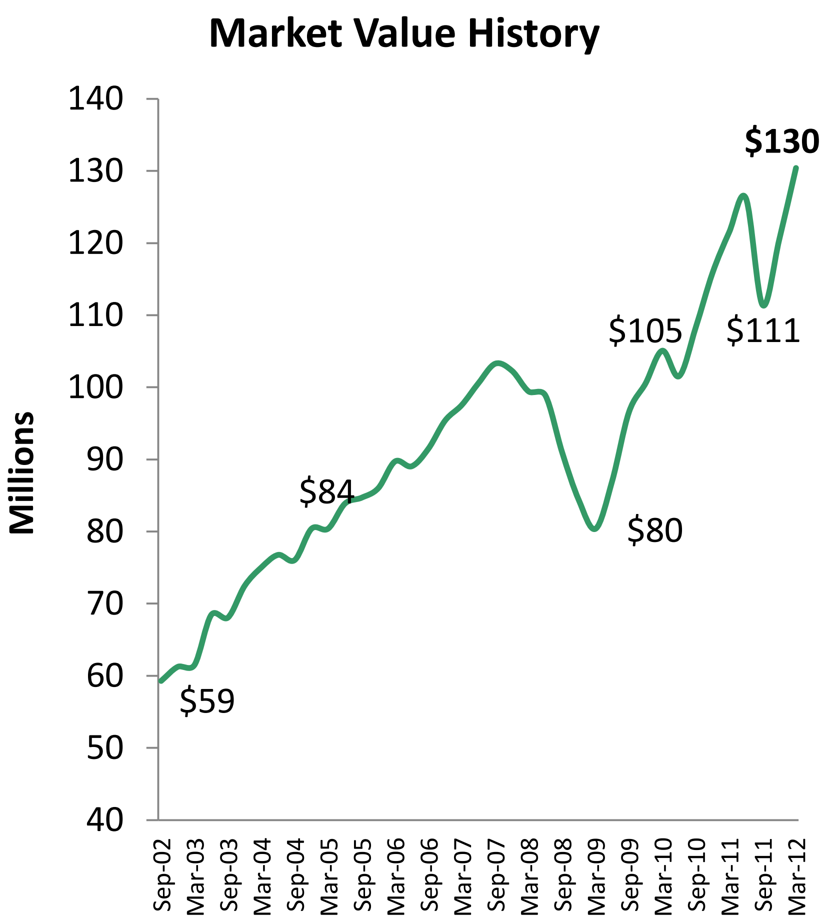
Periods ended March 31, 2012



Gregory W Group

Portfolio Review

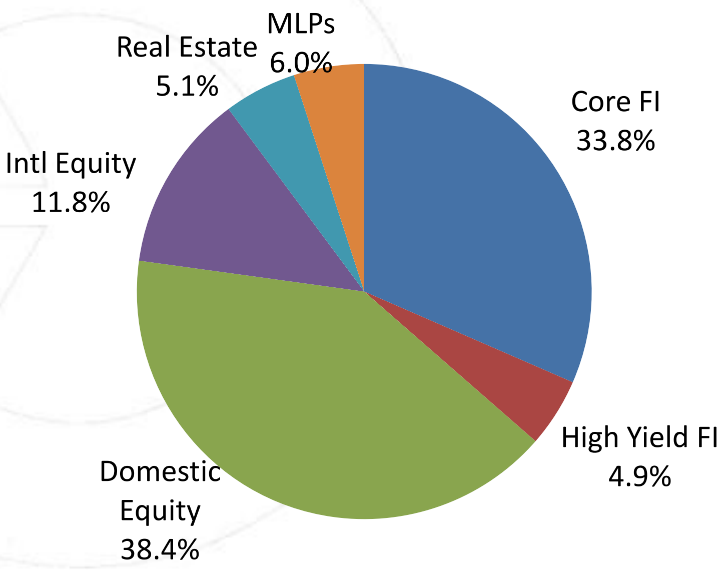




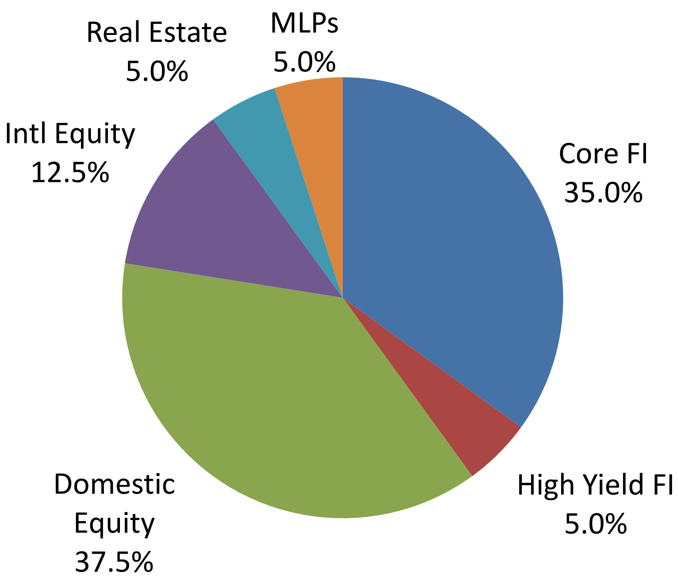
Gregory W Group

Current vs. Target Asset Allocation

Current Asset Allocation

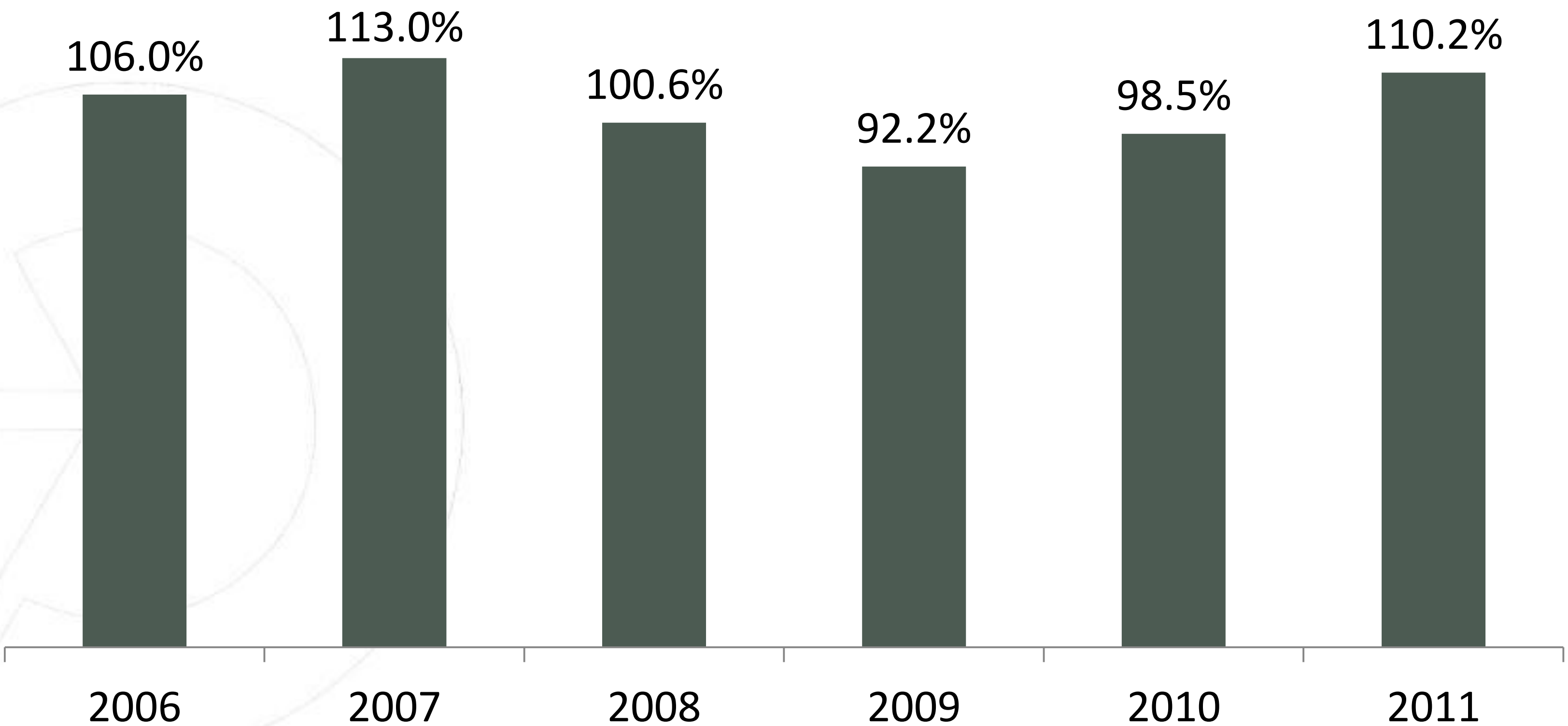


Target Asset Allocation



Gregory W Group

Funded Status Monitor



Source: Port of Houston Authority Restated Retirement Plan Actuarial Valuation Report as of August 1, 2011. Valuation method used: FASB ASC Topic 960 basis.

Manager Status Summary

Manager	Mandate	Status	Note
Fixed Income			
Smith Affiliated Smith Graham Trevor Stewart	Core Core Core	In Compliance In Compliance On Alert	On Alert – Performance (3Q2011)
High Yield			
Loomis Sayles	High Yield Fixed	In Compliance	
MLP	-		
FAMCO	MLP	In Compliance	
Real Estate			
Cohen & Steers	Real Estate	In Compliance	
Domestic Equity			
Fiduciary Stacey Braun Meridian Barrow Hanley	Large Cap Large Cap Mid Cap Small Cap	In Compliance In Compliance In Compliance In Compliance	
International Equity	-		
Eagle Global	International	On Alert	On Alert – Performance (3Q2011)

In Compliance – The portfolio is acting in full compliance with its guidelines and it is performing according to expectations.

On Alert – Concerns exist with the portfolio's performance, a change in investment characteristics, management style, ownership structure, staff or other related events.

On Notice – A continued and serious problem with any of the issues mentioned above. If the situation is not resolved to the Committee's satisfaction, a replacement will be selected and hired.

Fee Analysis

Manager	Mandate	Expense Ratio	Category Average	Difference
Domestic Equity				
Fiduciary Management	Large Cap Equity	0.55%	1.28%	**0.73%**
Stacey Braun	Large Cap Equity	0.45%	1.28%	**0.83%**
Meridian	Mid Cap Growth Equity	0.81%	1.40%	**0.59%**
Barrow Hanley	Small Cap Value Equity	0.83%	1.48%	**0.64%**
International Equity				
Eagle Global	International Value Equity	0.89%	1.45%	**0.55%**
Fixed Income				
Smith Affiliated	Fixed Income	0.25%	0.97%	**0.72%**
Smith Graham	Fixed Income	0.40%	0.97%	**0.57%**
Trevor Stewart Burton & Jacobsen	Fixed Income	0.40%	0.97%	**0.57%**
Loomis Sayles	High Yield Fixed Income	0.69%	1.18%	**0.49%**
MLP				
FAMCO	Master Limited Partnership	0.75%	1.00%	**0.25%**
Real Estate				
Cohen & Steers	Real Estate	0.75%	1.39%	**0.64%**
Total Plan		**0.62%**	**1.23%**	**0.61%**

Gregory W Group

Discussion Items

- Two new asset classes were recently funded: High Yield Fixed Income and Real Estate.

- Loomis Sayles was selected to manage the High Yield Fixed Income allocation and Cohen & Steers was selected to manage the Real Estate Allocation. During the quarter Loomis Sayles posted a return of 8.39%, while Cohen & Steers returned 9.78%.

- The Core Fixed Income portion of the Plan is currently under review.

- The International Equity portion of the Plan is currently under review.