Port of Houston Authority
Pension Plan

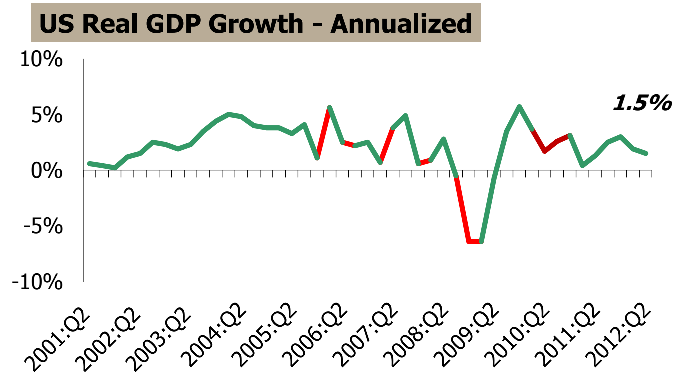
Second Quarter 2012 Report

Prepared August 10, 2012

Gregory W Group

SECOND QUARTER 2012 MARKET ENVIRONMENT

The second quarter of 2012 proved difficult for equity investors as unresolved macroeconomic risks created significant market uncertainty. Investors shed risky assets for safer ones, driving down equity prices before a dramatic recovery during June. The pattern seems to be a repeat of the past two years where risky assets rally during the first quarter of the year but falter during the summer and early autumn. The U.S. economic recovery stalled during the quarter as employment growth, consumer confidence and industrial production faltered. Europe's economic outlook is deteriorating. The U.K. has entered a recession and the rest of Europe is expected to follow during 2012. Europe's economic state remains fragile and subject to frequent setbacks. The growth prospects of the peripheral nations are extremely poor, causing varying levels of social unrest. Investor herding and the risk on/risk off mindset dominated worldwide investment markets as periods of relative calm were broken by elevated volatility and downward pressure on risky asset prices.



- Second quarter U.S. Real GDP growth was estimated to be 1.5%, a decrease from the previous quarter's 1.9% gain. The unemployment situation in the U.S. stalled during the second quarter. It was unchanged at 8.2% during the quarter. This translated to 12.7 million unemployed and 5.4 million long-term unemployed workers. Most economists believe real GDP growth must be sustained above 2.5% to meaningfully improve the U.S. unemployment situation. The Consumer Price Index moderated during the quarter, rising less than 2% for the year. U.S. housing prices showed some improvement.

- The Federal Reserve took no action on short-term interest rates, leaving them unchanged at 0.00% to 0.25%. During early June, "Operation Twist", an attempt to drive long term interest rates lower was extended.

- The S&P 500 has earned a cumulative return of +116% since reaching its bear market low on March 9, 2009. It closed the quarter 3% below its previous high reached on October 9, 2007.

- World real GDP growth expectations remain suppressed. Developed markets are expected to grow 1.2%. Emerging markets are forecast to grow just 5.4%, a sharp decrease from recent years.

- Crude oil and natural gas prices moved lower during the quarter. Crude prices moved below $100 during May for the first time since February after data suggested a U.S. economic slowdown.

- Hedge funds trailed traditional portfolios over recent periods. The Hedge Fund Research HFRX equal weighted index of hedge funds fell -2.9% for the quarter and fell -4.4% for the trailing year. Most hedge fund subcategories suffered losses over the year ended June 30, 2012. Private equity activity increased slightly during the quarter, even as risk assets sold off.

DOMESTIC AND INTERNATIONAL EQUITY SUMMARY

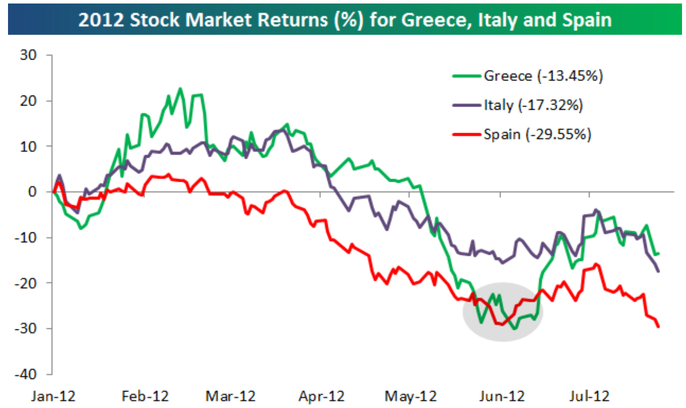
The U.S. and foreign equity markets both declined during the quarter. Domestic equities fell less than -5% during the quarter after a dramatic recovery at the end of June. International equities fell further, with emerging markets shares falling furthest, down -10% for the quarter. The U.S. equity market gained 2% on the final day of the quarter. Volatility climbed during the quarter. Eurozone unemployment remained high, especially among young workers in the peripheral nations.

- Top contributing sectors of the domestic equity market were **Telecommunication Services (+13% return), Consumer Staples (+2%), and Health Care (+2%)**. The lowest contributing index sectors were Information Technology (-7%), Financials (-6%), and Energy (-7%).

- The three largest individual contributors to the Russell 1000's second quarter return were **AT&T (+16% return), Verizon (+18%), and Wal-Mart (+15%)**.

- Value stocks outpaced growth stocks during the second quarter. **Growth led value among large caps over the trailing year period**. **Value led among mid caps and small caps**. During the quarter, performance was fairly similar among large, mid and small caps.

- Major segments of the U.S. equity market remain reasonably valued. The **Russell 1000's price/earnings ratio ended the second quarter of 2012 at 12.9,** a decrease from 16.1 as of March 31, 2012**.** The Russell Mid Cap and Russell 2000's price/earnings ratios were 14.3 and 17.2 respectively, versus 20.5 and 18.4 last quarter. The dividend yields of the three indexes were 2.2%, 1.8% and 1.6%. By comparison, the 10 year Treasury Bond ended the quarter at 1.7%. Corporate profit margins remain quite high. Financial leverage in corporate America is very low.



- The Philippines, Thailand, and Belgium were the top performing markets during the first half of 2012, gaining 25%, 14%, and 13% in U.S. Dollar terms. Poorest performing markets were Portugal (-20%), Spain (-18%), and Brazil (-10%). The U.S. ranked 7th out of 33 markets for the period.

- **Nine of ten MSCI ACWI index ex-US sectors suffered second quarter losses**. The quarter's leading performance contributors were Health Care (+1% return), Telecommunications Services (-1%), and Consumer Staples (-2%). The quarter's poorest performers were Financials (-7%), Materials (-12%), and Energy (-11%). The index ended the quarter with a P/E ratio of 11.3x. The top three contributors to the MSCI ACWI ex-U.S. index's second quarter return were **Vodafone (+6% return),**

Twelve Month Forward P/E Ratio

	Europe ex UK	UK	Japan	Asia ex Japan
Current Value	9.5	9.0	6.3	7.7
Post 1990 Average	**14.0**	**12.6**	**9.4**	**9.1**
Discount/Premium	*-32%*	*-29%*	*-33%*	*-15%*

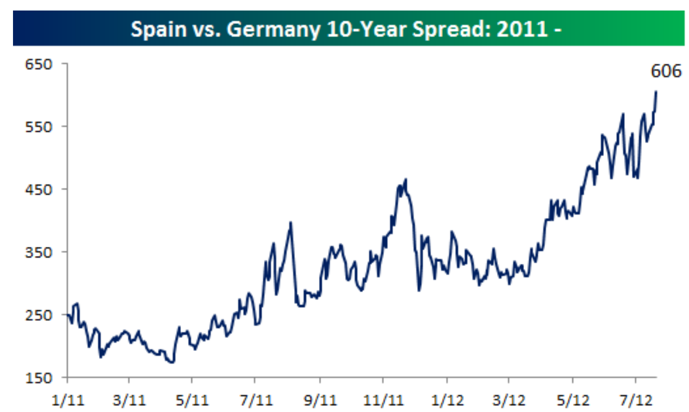
SoftBank (+25%), and Anheuser-Busch InBev (+8%). The bottom three contributors were **Petrobras (-28% return)**, **Barclays (-32%), and BASF (-17%)**. **Emerging markets stocks suffered serious losses during the quarter**. China recently announced stimulus measures to invigorate their economy. Chinese government officials restated their target growth rate at 7.5%, a decrease from their previous goal of 8.0%.

FIXED INCOME SUMMARY

Domestic and foreign bonds were influenced by investor fear stemming from the global sovereign crisis. Investor sentiment in Europe improved briefly as Greek election results and a new Spanish bank bailout package encouraged investors. However, sentiment quickly eroded as economic reports showed continued deterioration in peripheral and core European economies. European governments squabbled about future austerity programs that are both necessary and painful to the restabilization of the European banking and sovereign debt framework. Generally speaking, government bonds enjoyed substantial price gains. Long-term U.S. Treasury bonds gained more than 10% during the quarter, causing their trailing year return to soar to +31%. However, with interest rates setting cyclical lows, it is difficult to see how they will be able to recreate these returns without another major financial crisis herding investors into the asset class.

Risk Level	Time Horizon			
	One Year		Three Years (annualized)	
	Terminal Yield	**Total Return**	Terminal Yield	**Total Return**
Low				
2 Year Treasury (6.30 = 0.3%)	2.5%	-4.0%	4.0%	-2.1%
	1.3%	-1.6%	3.0%	-1.5%
	2.0%	-0.1%	2.0%	-0.8%
Medium				
10 Year Treasury (6.30 = 1.7%)	4.5%	-21.1%	5.5%	-8.8%
	3.3%	-11.9%	4.5%	-6.3%
	2.5%	-5.8%	3.5%	-3.6%
High Risk				
30 Year Treasury (6.30 = 2.8%)	5.5%	-37.4%	6.0%	-14.0%
	4.3%	-22.5%	5.0%	-9.6%
	3.5%	-11.1%	4.0%	-4.6%

- Bonds posted gains during the quarter, counterbalancing losses sustained in the equity markets. U.S. Treasury bond yields fell sharply as the yield curve flattened dramatically. The flattening was attributed to unexpected weakness in the global economy.



- Ninety-one Day T-bills ended the quarter with a yield of 0.08%, an increase of 0.01%. Ten year Treasury bond yields decreased -0.6% to 1.7% while the yield on the thirty year Treasury bond ended the quarter at 2.8%, far lower from 3.5% on March 31, 2012. Mortgage backed and asset backed issues posted modest results during the quarter. Institutional investors continued to reach for yield by expanding core fixed income mandates into more exotic fixed income instruments.

- Yield spreads expanded as investors moved into less risky bonds. Investment Grade and High Yield indexes enjoyed positive returns during the quarter despite trailing Treasury bonds' impressive gains. Emerging market debt remained a popular source of income with investors. Yield spreads were 3.7% at quarter end versus their long term average of 3.9%.

- High yield bonds trailed higher quality issues during the quarter due to the flight to less risky assets. They did produce a gain of close to 2% for the quarter and 7% for the trailing year. The yield spread between high yield issues and comparable maturity Treasuries remained stable at 6.6%. This is versus their long-term average of 5.9%. Defaults remained extremely low at 2.2% of outstanding issues. Issuance of high yield debt has declined over recent quarters.

Domestic Equity	Last Quarter	Last Year	Last Three Years Annualized	Last Five Years Annualized	Last Ten Years Annualized
S&P 500	-2.8	5.5	16.4	0.2	5.3
Russell 1000	-3.1	4.4	16.6	0.4	5.7
Russell 1000 Value	-2.2	3.0	15.8	-2.2	5.3
Russell 1000 Growth	-4.0	5.8	17.5	2.9	6.0
Russell 3000	-3.2	3.8	16.7	0.4	5.8
Russell Midcap	-4.4	-1.7	19.4	1.1	8.5
Russell Midcap Value	-3.3	-0.4	19.9	-0.1	8.2
Russell Midcap Growth	-5.6	-3.0	19.0	1.9	8.5
Russell 2000	-3.5	-2.1	17.8	0.5	7.0
Russell 2000 Value	-3.0	-1.4	17.4	-1.1	6.5
Russell 2000 Growth	-3.9	-2.7	18.1	2.0	7.4
Alerian MLP	-2.3	7.9	27.0	9.9	16.7
Fixed Income					
Barclays Capital Aggregate Bond	2.1	7.5	6.9	6.8	5.6
Barclays Capital Credit	2.5	9.5	10.1	7.6	6.5
Barclays Capital Government	2.6	8.3	5.7	6.6	5.4
Barclays Capital Govt/Credit	2.6	8.8	7.3	6.9	5.8
Barclays Capital Interm Credit	1.5	6.2	8.4	6.8	5.9
Barclays Capital Interm Govt	1.5	5.0	4.4	5.8	4.6
Barclays Capital Interm Govt/Cred	1.5	5.4	5.8	6.0	5.1
Barclays Capital Long Credit	5.0	19.2	15.1	10.0	8.6
Barclays Capital Long Term Govt	10.3	31.4	13.5	11.9	8.9
Barclays Capital Long Govt/Credit	7.3	24.6	14.4	11.0	8.8
Barclays Capital Fixed Rate MBS	1.1	5.0	5.4	6.7	5.4
Merrill Lynch US High Yield Master II	1.8	6.5	16.2	8.2	9.9
91 Day T-Bill	0.0	0.0	0.1	0.9	1.8
Consumer Price Index	0.0	1.7	2.4	2.0	2.4
International					
MSCI EAFE	-7.1	-13.8	6.0	-6.1	5.1
MSCI World ex US	-7.2	-14.1	6.2	-5.7	5.6
MSCI Europe	-7.5	-16.5	6.3	-7.0	5.1
MSCI Japan	-7.3	-7.2	1.9	-6.5	2.5
MSCI Pacific ex Japan	-4.9	-10.0	13.1	0.5	12.1
MSCI Emerging Markets	-10.0	-18.2	7.2	-2.4	11.4
Citigroup Non-$ World Gov	0.2	0.4	5.1	7.4	7.2

Portfolio Summary as of June 30, 2012

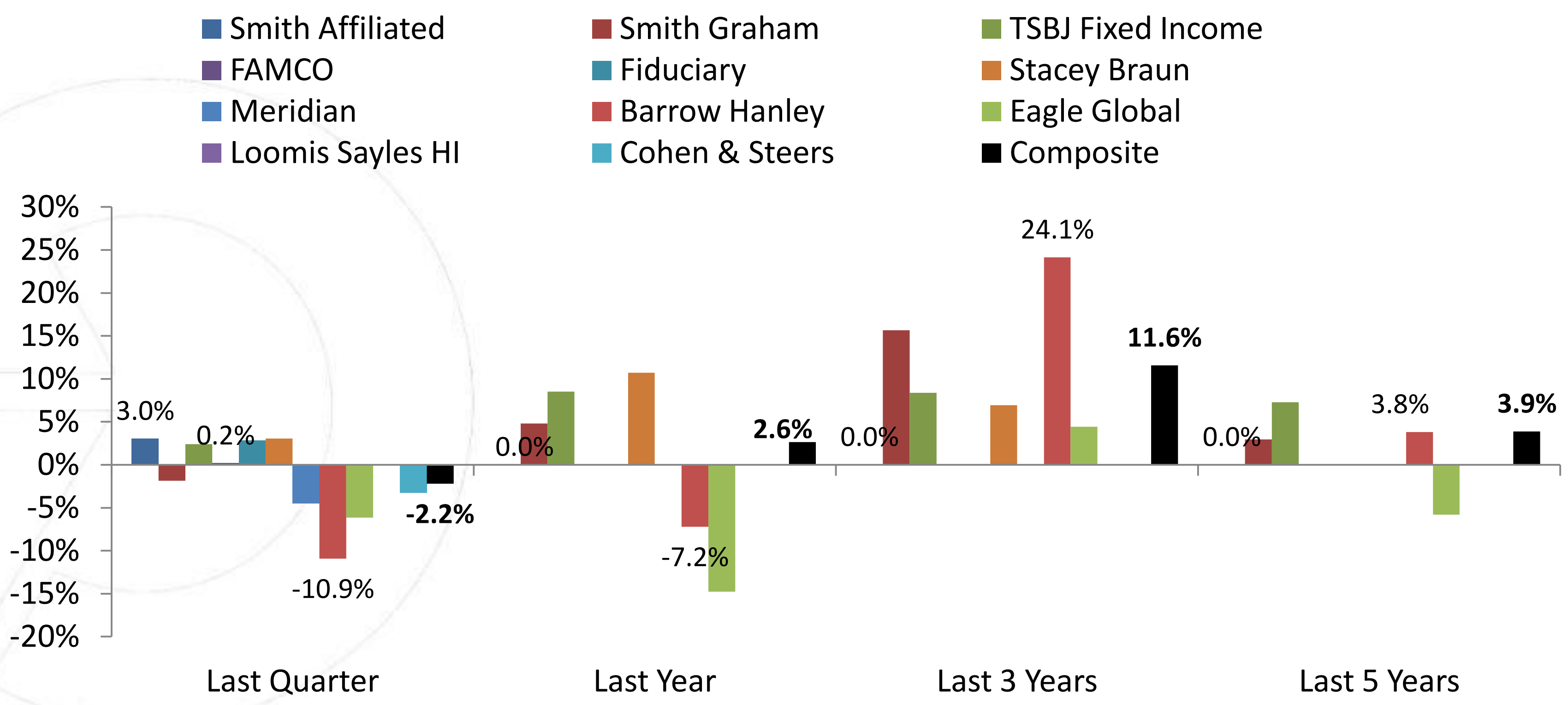
Manager	Quarter	One Year	Three Year	Five Year	Market Value	% of Total
Smith Affiliated	3.05%	10.72%	6.93%	7.41%	$10,641,635	8.4%
Smith Graham	2.39%	8.51%	8.36%	7.29%	$23,016,783	18.1%
Trevor Stewart Burton & Jacobsen	1.60%	6.60%	4.36%	5.72%	$8,473,255	6.7%
Barclays Capital Aggregate	2.06%	7.47%	6.93%	6.79%		
Loomis Sayles High Income	0.17%	-	-	-	$6,377,890	5.0%
ML High Yield	1.81%	6.49%	16.16%	8.16%		
FAMCO	-3.24%	6.87%	-	-	$6,299,256	4.9%
Alerian MLP	-2.28%	7.86%	27.03%	9.87%		
Cohen & Steers Real Estate	3.04%	-	-	-	$6,993,877	5.5%
FTSE NAREIT All REITS	4.00%	12.48%	32.40%	2.60%		
Fiduciary Management	-1.85%	4.80%	15.66%	2.95%	$11,046,001	8.7%
Russell 1000 Value	-2.20%	3.01%	15.80%	-2.19%		
S&P 500	-2.75%	5.45%	16.40%	0.22%		
Stacey Braun	-4.49%	3.67%	17.19%	-	$9,011,827	7.1%
Russell 1000 Growth	-4.02%	5.76%	17.50%	2.87%		
S&P 500	-2.75%	5.45%	16.40%	0.22%		
Meridian	-3.86%	2.90%	-	-	$16,548,348	13.0%
Russell Midcap Growth	-5.60%	-2.99%	19.01%	1.91%		
Barrow Hanley Small Cap	-10.92%	-7.22%	24.13%	3.82%	$13,425,999	10.5%
Russell 2000 Value	-3.01%	-1.44%	17.43%	1.91%		
Eagle Global	-6.14%	-14.77%	4.44%	-5.81%	$15,439,153	12.1%
MSCI EAFE	-7.13%	-13.83%	5.96%	-6.10%		
Total Plan	**-2.21%**	**2.63%**	**11.57%**	**3.88%**	**$127,376,023**	
Benchmark	-1.37%	3.85%	11.31%	2.06%		
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

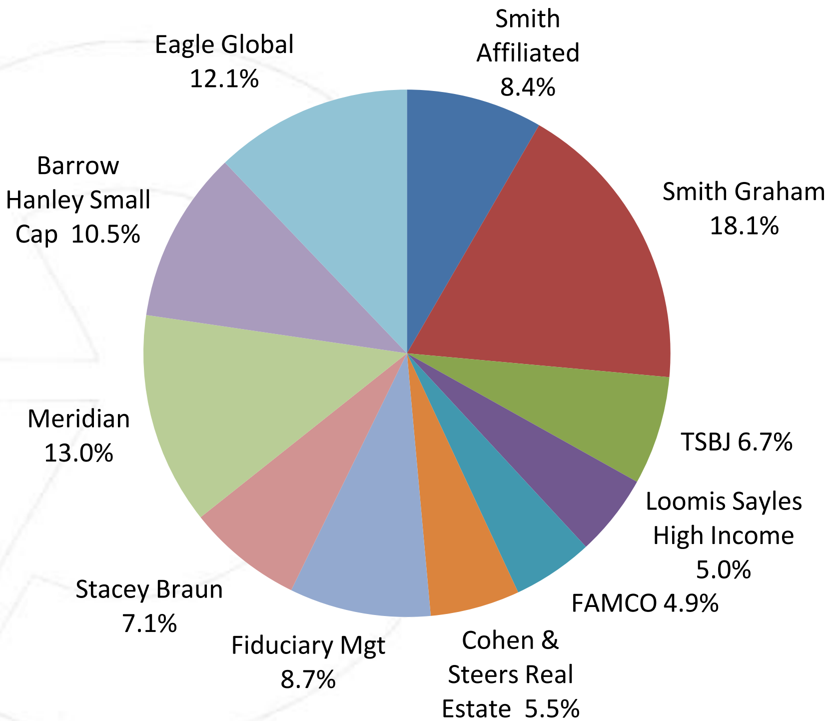
Performance Summary

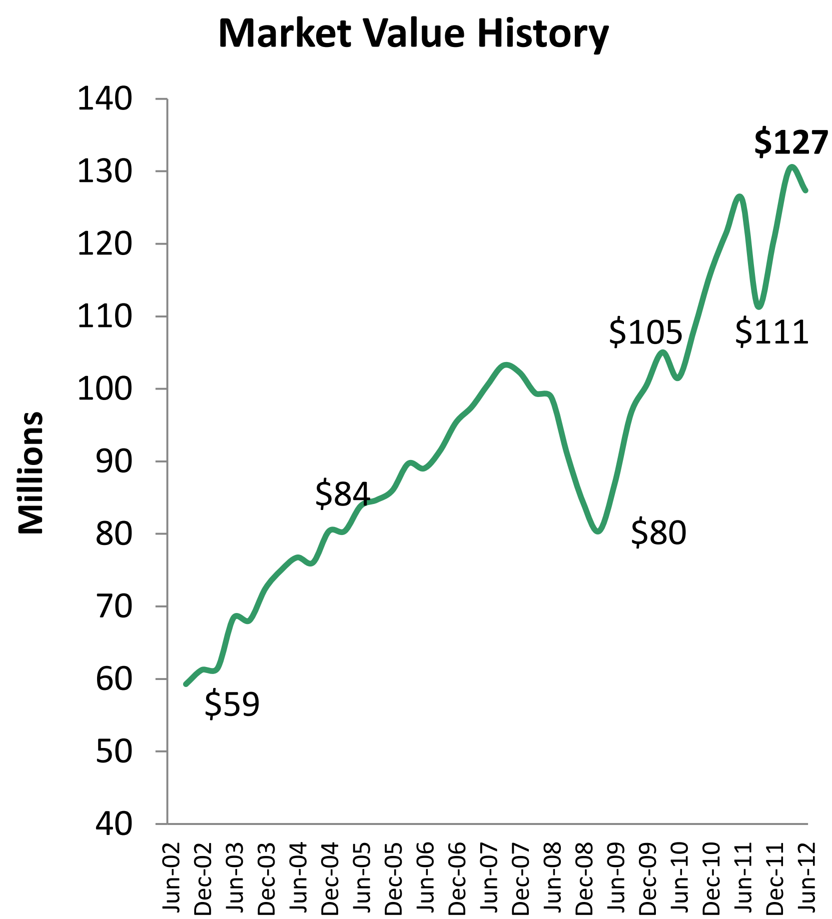
Periods ended June 30, 2012



Gregory W Group

Portfolio Review





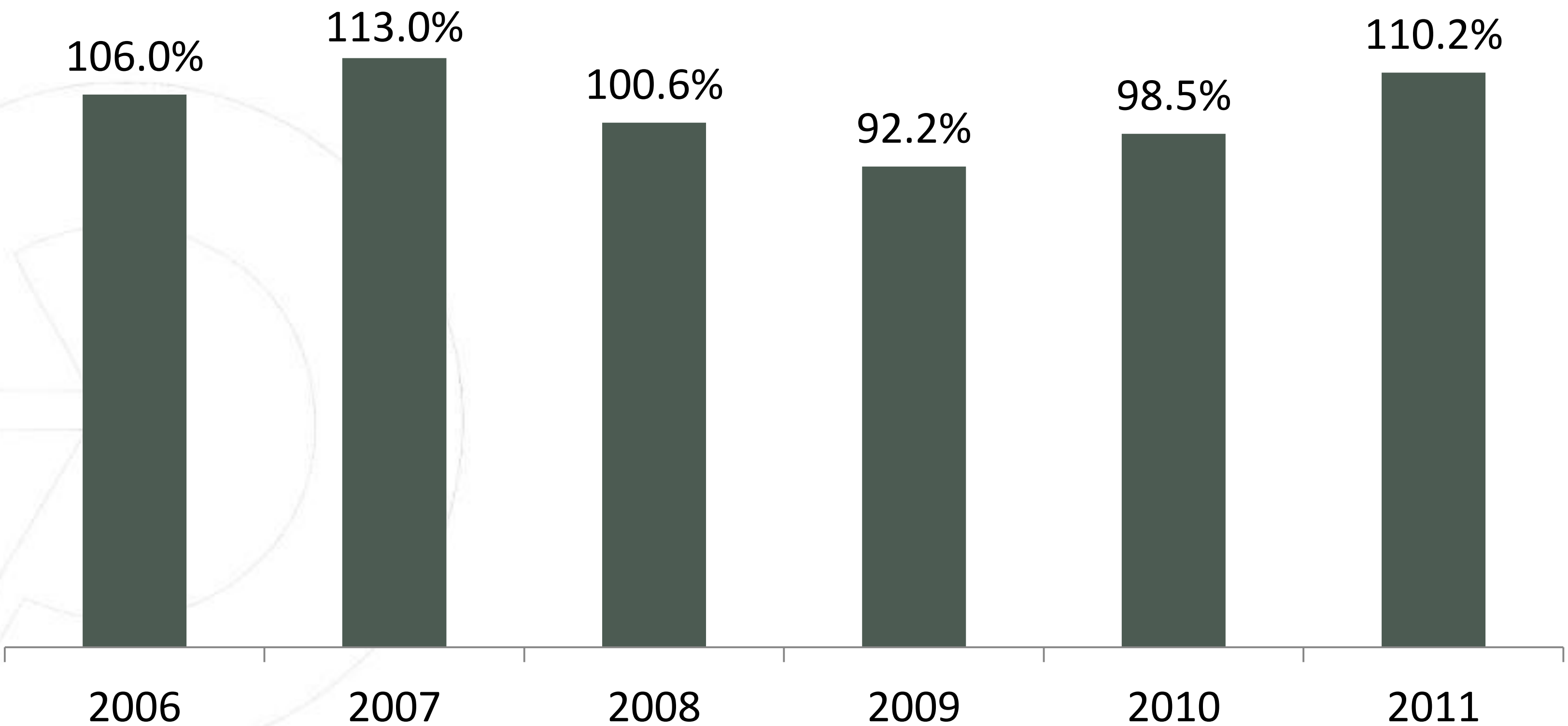
Gregory W Group

Current vs. Target Asset Allocation

Manager	Actual Portfolio[1]	Investment Policy Target	Minimum	Maximum
Large Cap Domestic Equity	15.8%	**15.0%**	10.0%	20.0%
Mid Cap Domestic Equity	13.0%	**12.5%**	7.5%	17.5%
Small Cap Domestic Equity	10.5%	**10.0%**	5.0%	15.0%
International Equity	12.1%	**12.5%**	7.5%	17.5%
Core Fixed Income	33.1%	**35.0%**	30.0%	40.0%
High Yield Fixed Income	5.0%	**5.0%**	0.0%	10.0%
Real Estate	5.5%	**5.0%**	0.0%	10.0%
Master Limited Partnerships	4.9%	**5.0%**	0.0%	10.0%
Total	100.0%	**100.0%**	100.0%	100.0%

[1] The Plan's asset allocation may not equal 100.0% due to rounding.

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 Fixed Income Core Fixed Income Core Fixed Income	In Compliance In Compliance On Alert	On Alert – Performance (3Q2011)
High Yield			
Loomis Sayles	High Yield Fixed Income	In Compliance	
MLP			
FAMCO	MLPs	In Compliance	
Real Estate			
Cohen & Steers	Real Estate	In Compliance	
Domestic Equity			
Fiduciary Stacey Braun Meridian Barrow Hanley	Large Cap Equity Large Cap Equity Mid Cap Equity Small Cap Equity	In Compliance In Compliance On Alert In Compliance	On Alert – Personnel (1Q2012)
International Equity			
Eagle Global	International Equity	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.

Gregory W Group

Fee Analysis

Manager	Mandate	Expense Ratio	Category Average	Difference
Domestic Equity				
Fiduciary Management	Large Cap Equity	0.55%	1.34%	**0.79%**
Stacey Braun	Large Cap Equity	0.45%	1.34%	**0.89%**
Meridian	Mid Cap Growth Equity	0.81%	1.40%	**0.59%**
Barrow Hanley	Small Cap Value Equity	0.87%	1.48%	**0.60%**
International Equity				
Eagle Global	International Value Equity	0.90%	1.48%	**0.58%**
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%**	**0.62%**

Discussion Items

- The Core Fixed Income portion of the Plan is currently under review.
- The International Equity portion of the Plan is currently under review.
- The Mid Cap Growth equity portion of the Plan is currently under review.
- Investment manager searches are underway for core fixed income and mid cap growth.
- Eagle Global International Equity has show recent signs of improvement.