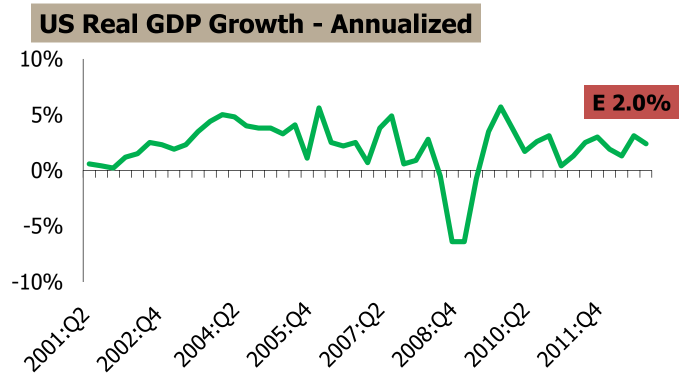
Port of Houston Authority
Pension Plan

Fourth Quarter 2012 Report

Gregory W Group

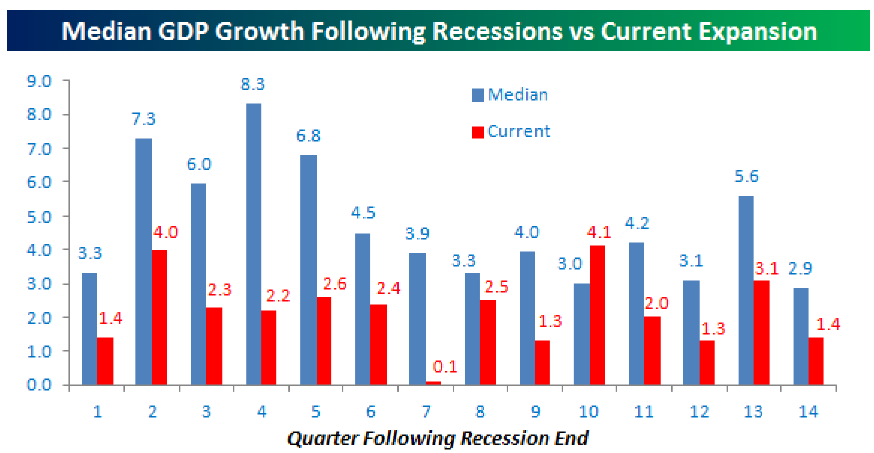
Market Environment - Fourth Quarter 2012



From an investor's standpoint, the fourth quarter of 2012 may be remembered for the uncertainty that faced investors as they waited for the results of the U.S. Presidential election and resolution of the so-called "fiscal cliff". Post-election, the uncertainty of looming spending cuts and across the board tax increased undermined consumer and business confidence, likely slowing GDP growth. This uncertainty saw equity prices in the U.S. decline during December. Foreign equities outperformed domestic shares. Full year returns, by almost any measure, were better than what news headlines would have led investors to believe. Europe officially entered a recession during the third quarter. Weak global demand combined with governemnt austerity programs in the peripheral countries is expected to extend the slowdown through 2013. Eurozone area unemployment rose further, reaching 11.7% by the end of October. Young worker enumployment across the region was observed at 24.4% at the end of November. U.S. economic growth expectations are stubbornly low. Consensus estimates of U.S. real GDP growth declined to 1.6% and 2.1% for the fourth quarter of 2012 and the full year 2013. The best measure of U.S. national indebtedness, federal debt to GDP, rose to 104% at year end and is poised to climd to 107% by year end 2013. Disappointedly, recent tax legislation failed to address the looming expansion in entitlement spending. The U.S. Dollar declined against major foreign currencies as Quantitative Easing III/Infinity kept downward pressure on interest rates. A "deal" was reached to avert the spending cuts and tax increases mandated by the "fiscal cliff" just after year end. Post deal, market consensus is for GDP growth to slow to around 1% during the first half of 2013.

- Fourth quarter U.S. Real GDP growth is currently estimated to be less than 2.0%. The unemployment situation showed little improvement during the quarter. It remained at 7.8% during the quarter. The national labor participation rate, a measure of how many working age individuals are working or looking for work, remained low compared to historical levels (63.6% vs. 65.0% long-term average). Inflation, measured by the Consumer Price Core Index, remained modest, rising 1.9% over the last year. Producer Prices rose 1.5% over the same period. There is no meaningful price inflation in the U.S. economy at this time. U.S. housing prices showed welcome improvement. The Case Shiller Housing Price index rose 4.3% for the year ended October, 2012.

- The Federal Reserve took no action on short-term interest rates, leaving them at 0.00% to 0.25%. They did embark on another Quantitative Easing program, dubbed QE Infinity, intending to pin interest rates low, increase stock prices, and inspire consumer spending. The market took a skeptical view of the program.



- Worldwide economic growth expectations, especially among the developed markets, remain suppressed. Unemployment will likely remain near current levels unless economic growth accelerates.

- Crude oil and natural gas prices were mixed during 2012. Crude prices (West Texas Intermediate) ended the year at $90.80 a barrel (WTI) while natural gas prices closed at $3.40. Crude oil ended 2011 at $99.36 while natural gas closed the year at $3.07.

- Hedge funds underperformed traditional assets during 2012. The Hedge Fund Research HFRX Global Hedge Fund index gained 3.5% for the year versus 16.0% for the S&P 500. While most hedge fund subcategories earned single digit returns for the year ended December 31, 2012, several suffered losses. Private equity investors increased their activity during 2012. Valuations were higher than 2011, but reasonable compared to 2006-2007.

DOMESTIC AND INTERNATIONAL EQUITY SUMMARY

The U.S. equity market posted mixed returns during the final quarter of 2012. Full year returns were strong, with the Russell 1000 up 16%. Foreign equity markets enjoyed a rebound for U.S. Dollar based investors during 2012. International equities gained nearly 7% during the fourth quarter, bringing their trailing year gain to 16%, despite significant economic uncertainty. Foreign stocks, as measured by the MSCI ACWI ex-US index, nearly doubled the return of the S&P 500 during the second half of 2012. Share price volatility, as measured by the VIX index, declined -23.99 over the course of 2012. Correlations between individual equities also declined during 2012. However, during periodic volatility spikes, correlations increased similar to the pattern seen since 2007.

EQUITY MARKET VALUATION MEASURES: S&P 500

Valuation Measure	Latest	1 Year Ago	10 Year Average	15 Year Average
Price/Earnings (fwd)	12.5x	11.8x	14.2x	16.7x
Price/Book	**2.3x**	**2.1x**	**2.5x**	**3.0x**
Price/Earnings to Growth	1.3x	1.2x	1.5x	1.5x
Dividend Yield	**2.4%**	**2.3%**	**2.1%**	**1.9%**

- Top contributing sectors of the domestic equity market during the quarter were **Financials (+5% return), Industrials (+5%), and Consumer Discretionary (+3%)**. The lowest contributing index sectors were Technology (-6%), Energy (3%), and Telecommunications Services (-6%).

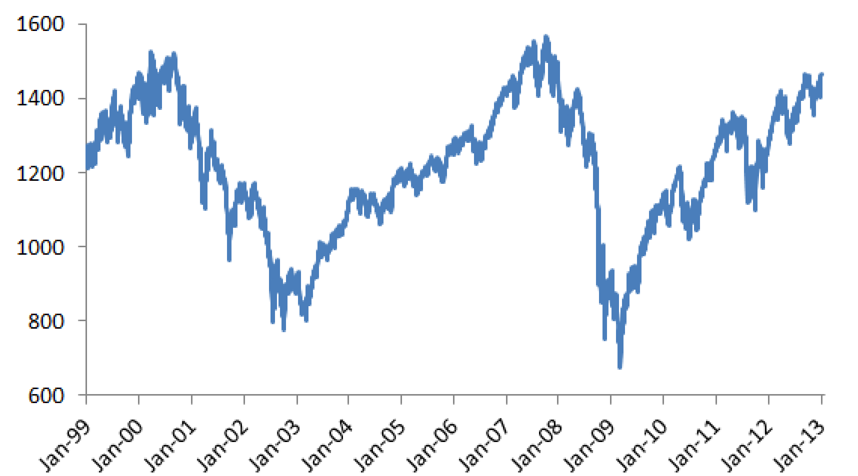
- The three largest individual contributors to the Russell 1000's fourth quarter return were **Bank of America (+32% return), Citigroup (+21%), and JPMorgan Chase (+9%)**. The index's three largest positions were Apple (3% of the index after a -20% quarterly loss), Exxon Mobil (3%) and General Electric (2%)

- Value stocks narrowly outperformed growth stocks during the fourth quarter and the full year period. Their margin of outperformance was fairly significant.

- Most segments of the U.S. equity market remain relatively cheap. The **Russell 1000's price/earnings ratio ended the fourth quarter of 2012 at 15.7, a small** decrease from 15.9 as of September 30, 2012**.** The Russell Mid Cap and Russell 2000's price/earnings ratios were both 17.5 and 17.5 respectively, versus 17.3 and 17.2 last quarter. The dividend yields of the three indexes were 2.2%, 1.7%, and 1.5%. By comparison, the 10 year Treasury Bond ended the quarter at 1.8%.

- The Philippines, Thailand, and Belgium were the top performing markets for the year, gaining 42%, 39%, and 31% in U.S. Dollar terms. Poorest performing markets were Brazil (-3%), Spain (-1%), and Portugal (+1%). The U.S. ranked 22nd out of 33 markets for the period. Western Europe posted a one year gain of 16%

S&P 500: 1999-Present



vs. 13% for Asia/Pacific and 6% for Latin America.

- Eight out of ten MSCI ACWI ex-US sectors enjoyed fourth quarter gains. The quarter's leading performance contributors were Financials (11%), Consumer Discretionary (10%), and Industrials (8%). Telecommunication Services (-2%), Energy (-1%), and Utilities (2%) were the leading detractors during the quarter. The index ended the quarter with a P/E ratio of 13.0 versus 13.3 last quarter. The top three individual contributors to the index's fourth quarter return were HSBC Holdings (+15% return), Samsung Electronics (+17%), and Toyota Motors (+19%). The bottom three contributors were Vodafone Group (-10% return), BG Group (-19%), and E.ON (-22%). Emerging markets stocks underperformed developed markets during the quarter with a 5.2% return.

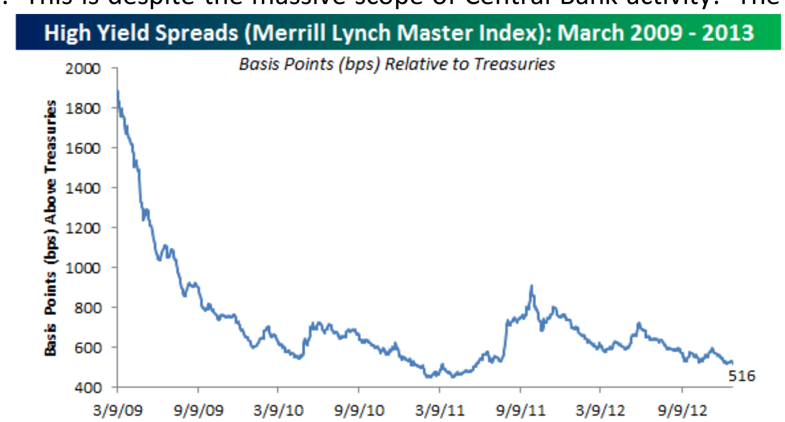
- For the full year, the domestic IPO market saw 138 companies completing their IPOs, raising total proceeds of $41 billion, compared with 134 companies that had completed their IPOs for all of 2011 raising $35.5 billion.

Fixed Income Summary

Fixed income returns were modest during 2012, dampened by historically low Treasury bond interest rates. However, spread sectors of the bond market: corporate bonds, mortgage-backed and high yield bonds earned significantly higher returns. During December, the U.S. Federal Reserve announced that it would double the amount of government securities it would buy to $85 million per month as long as inflation remained below 2.5% and unemployment above 6.5%. This announcement, along with the uncertainty swirling around the "fiscal cliff", caused Treasury bond interest rates to rise during the quarter. Only short term Treasury issues (two years or less) enjoyed positive gains during the quarter. Long-term Treasuries suffered a loss of -1.3% for the period. However, all maturities enjoyed gains for the trailing year.

Risk Level	Time Horizon			
	One Year		Three Years (annualized)	
	Terminal Yield	**Total Return**	Terminal Yield	**Total Return**
Low Risk				
2 Year Treasury (12.31 = 0.25%)	2.50%	**-4.1%**	4.00%	**-2.2%**
	1.25%	**-1.7%**	3.00%	**-1.5%**
	0.50%	**-0.2%**	2.00%	**-0.9%**
Medium Risk				
10 Year Treasury (12.31 = 1.76%)	4.50%	**-20.1%**	5.50%	**-8.4%**
	3.00%	**-8.9%**	4.50%	**-5.8%**
	2.00%	**-0.4%**	3.50%	**-3.2%**
High Risk				
30 Year Treasury (12.31 = 2.95%)	5.50%	**-34.3%**	6.00%	**-12.5%**
	4.00%	**-15.3%**	5.00%	**-8.1%**
	3.00%	**2.0%**	4.00%	**-3.1%**

Europe officially entered a recession during the fourth quarter of 2012. The subpar U.S. recovery and the European slowdown will dampen worldwide growth during 2013. This is despite the massive scope of Central Bank activity. The European Union's member nations will continue to argue about who will carry the burden of the region's over-indebtedness. The U.S. economy and financial markets will also be highly dependent on policy actions. Debt ceiling negotiations are expected to take center stage during the first quarter of 2013.



- Government bonds underperformed during the last two quarters as long-term interest rates rose as investors moved into riskier assets.

- Most segments of the bond market posted meager returns during the fourth quarter. The risk trade was on, which translated into lower quality issues outperforming higher quality issues. The Government bond index showed a modest fourth quarter loss. The Mortgage backed index also suffered a fourth quarter loss. Yield spreads among corporate bonds tightened during the quarter. Mortgage backed yield spreads widened. High yield bonds ended with a strong fourth quarter return. U.S. Treasury bond yields rose as the Federal Reserve launched QE3. The Treasury yield curve steepened as short term interest rates rose less than long term rates.

- 90 Day T-bills ended 2012 with a yield of 0.04%, a decrease of -0.05%. It seems unlikely that they can move lower although given Fed Policy, it is also difficult to see yields rising significantly. Five year Treasury bonds rose from 0.62% to 0.72% during the quarter. Ten year Treasury bond yields increased to 1.76% from 1.62% while the yield on the thirty year Treasury bond ended the quarter at 2.95%, compared to 2.81% on September 30, 2012. All investment grade sectors except for Mortgage-Backeds outperformed Treasuries during the quarter. Trailing year returns of all domestic bond indexes were positive for the year.

- High yield bonds led investment grade issues during the fourth quarter. Returns showed negative correlation with credit quality. The top performing credit rating was B, which gained 3.60%. AAA rated bonds posted a modest gain of 0.17% for the quarter. The High Yield Bonds Index posted a gain of 3.39% for the quarter and 15.81% for the trailing year. Current yield spreads are near their long-term averages. Defaults remained well below their long term averages. Inflows to the asset class remain elevated. New issuance of high yield bonds continues to be strong. Almost 60% of new issue proceeds were used to refinance existing debt. One troubling fact about the asset class was the average bond price: at $104.35, meaning that the average bond will suffer a price decline as it approaches maturity.

- Residential real estate showed early signs of improvement during the second half of 2012. Commercial real estate portfolios performed well during the quarter and trailing year.

Domestic Equity	Last Quarter	Last Year	Last Three Years Annualized	Last Five Years Annualized	Last Ten Years Annualized
S&P 500	-0.4	16.0	10.9	1.7	7.1
Russell 1000	0.1	16.4	11.1	1.9	7.5
Russell 1000 Value	1.5	17.5	10.9	0.6	7.4
Russell 1000 Growth	-1.3	15.3	11.4	3.1	7.5
Russell 3000	0.3	16.4	11.2	2.1	7.7
Russell Midcap	2.9	17.3	13.2	3.6	10.7
Russell Midcap Value	3.9	18.5	13.4	3.8	10.6
Russell Midcap Growth	1.7	15.8	12.9	3.2	10.3
Russell 2000	1.9	16.4	12.3	3.6	9.7
Russell 2000 Value	3.2	18.1	11.6	3.6	9.5
Russell 2000 Growth	0.5	14.6	12.8	3.5	9.8
Alerian MLP	-3.4	4.8	17.5	12.5	16.5

Fixed Income					
Barclays Capital Aggregate Bond	0.2	4.2	6.2	6.0	5.2
Barclays Capital Credit	1.0	9.4	8.7	7.7	6.2
Barclays Capital Government	-0.1	2.0	5.5	5.2	4.7
Barclays Capital Govt/Credit	0.4	4.8	6.7	6.1	5.3
Barclays Capital Interm Credit	1.0	8.1	7.1	6.7	5.6
Barclays Capital Interm Govt	0.0	1.7	4.3	4.5	4.1
Barclays Capital Interm Govt/Cred	0.4	3.9	5.2	5.2	4.6
Barclays Capital Long Credit	1.3	12.7	13.5	10.4	8.2
Barclays Capital Long Term Govt	-0.7	3.8	13.6	9.6	7.6
Barclays Capital Long Govt/Credit	0.5	8.8	13.7	10.2	8.0
Barclays Capital Fixed Rate MBS	-0.2	2.6	4.7	5.7	5.1
Merrill Lynch US High Yield Master II	3.2	15.6	11.6	10.0	10.4
91 Day T-Bill	0.0	0.1	0.1	0.5	1.7
Consumer Price Index	0.4	1.8	2.1	1.9	2.4

International					
MSCI EAFE	6.6	17.3	3.6	-3.7	8.2
MSCI World ex US	5.9	16.4	3.7	-3.4	8.6
MSCI Europe	7.0	19.1	3.3	-4.3	8.4
MSCI Japan	5.8	8.2	2.3	-4.3	4.9
MSCI Pacific ex Japan	6.1	24.6	8.3	1.7	14.9
MSCI Emerging Markets	5.2	15.2	2.2	-3.3	13.7
Citigroup Non-$ World Gov	-2.4	1.5	4.0	5.2	6.4

Portfolio Trailing Year Performance

+13.33

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Portfolio Summary as of December 31, 2012

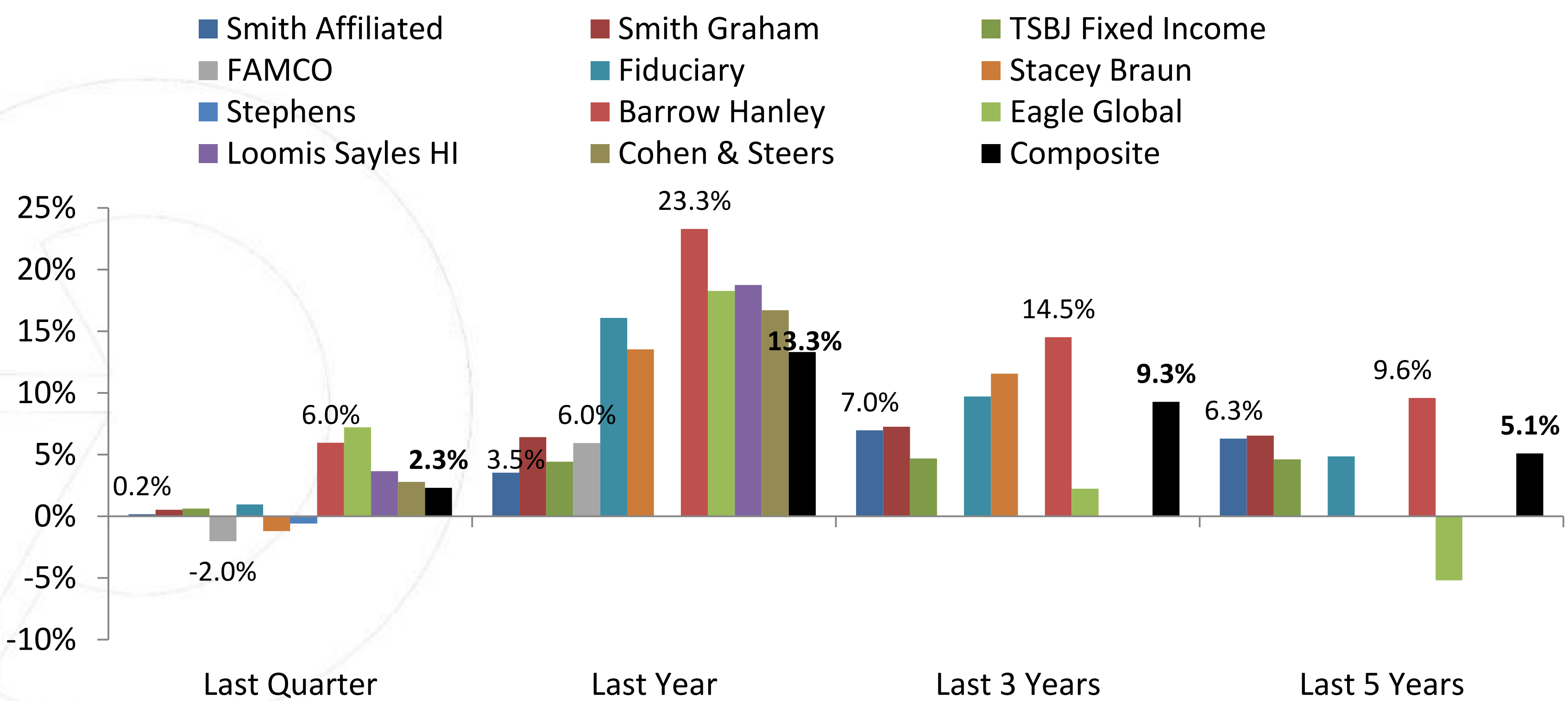
Manager	Quarter	% Rank	One Year	% Rank	Three Year	% Rank	Five Year	% Rank	Market Value	% of Total
Smith Affiliated	0.18%	79	3.53%	96	6.98%	69	6.31%	78	$22,767,239	16.5%
Smith Graham	0.53%	45	6.42%	41	7.28%	62	6.54%	70	$23,197,356	16.8%
Barclays Capital Aggregate	0.21%		4.22%		6.19%		5.95%			
Loomis Sayles High Income	3.67%	21	18.76%	18	-		-		$6,939,676	5.0%
ML High Yield	3.23%		15.59%		11.60%		10.01%			
FAMCO	-2.01%		5.96%		-		-		$6,785,248	4.9%
Alerian MLP	-3.41%		4.80%		17.48%		12.53%			
Cohen & Steers Real Estate	2.81%		15.88%		-		-		$7,115,091	5.2%
FTSE NAREIT All REITS	3.11%		19.70%		18.37%		5.74%			
Fiduciary Management	0.98%	58	16.10%	49	9.72%	61	4.87%	3	$11,692,682	8.5%
Russell 1000 Value	1.52%		17.51%		10.86%		0.59%			
S&P 500	-0.38%		16.00%		10.87%		1.66%			
Stacey Braun	-1.19%	66	13.53%	77	11.57%	23	-		$9,369,869	6.8%
Russell 1000 Growth	-1.32%		15.26%		11.35%		3.12%			
S&P 500	-0.38%		16.00%		10.87%		1.66%			
Stephens	-		-		-		-		$17,222,410	12.5%
Russell Midcap Growth	1.69%		15.81%		12.91%		3.23%			
Barrow Hanley Small Cap	5.96%	5	23.31%	2	14.53%	18	9.60%	2	$15,382,159	11.1%
Russell 2000 Value	3.22%		18.05%		11.57%		3.23%			
Eagle Global	7.22%	22	18.27%	60	2.25%	88	-5.18%	85	$17,521,254	12.7%
MSCI EAFE	6.57%		17.32%		3.56%		-3.69%			
Cash									$126,320	0.1%
Total Plan	**2.31%**	**24**	**13.33%**	**36**	**9.29%**	**25**	**5.10%**	**6**	**$138,119,317**	**100.0%**
Benchmark	1.53%		11.95%		8.71%		3.48%			
Actuarial Assumption	1.77%		7.25%		7.25%		7.25%			

Benchmark was updated on 12/1/12 to reflect new long-term asset allocation. Current benchmark reflects IPS that was formally approved on January 22, 2013.

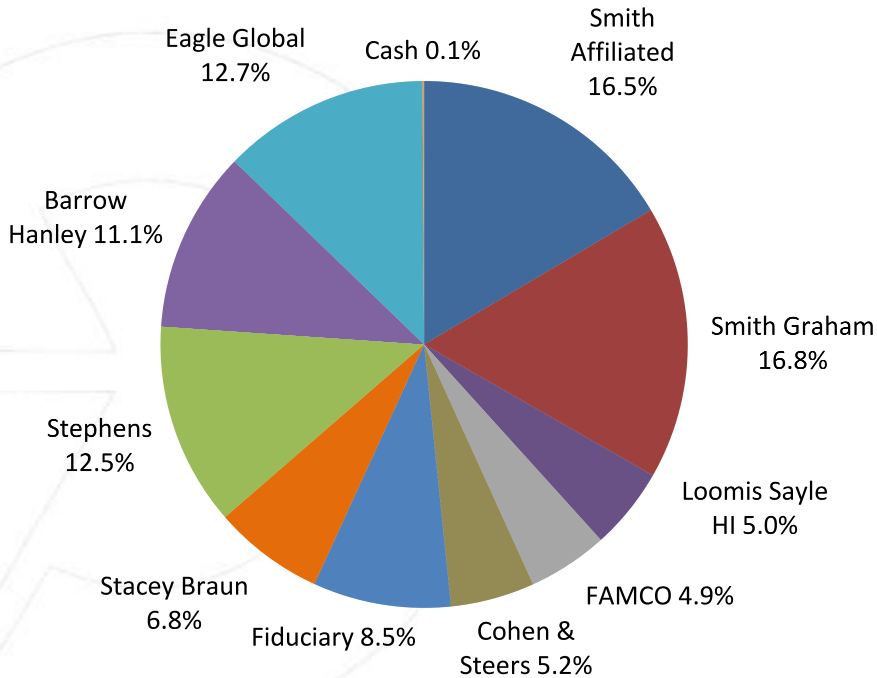
The Total Plan Benchmark is composed as follows; S&P 500 (15%), Russell Mid Cap (12.5%), Russell 2000 (10%), MSCI EAFE (12.5%), Barclays US Aggregate (35%), Merrill Lynch US High Yield Master II (5%), NAREIT ALL REITS (5%), and the Alerian MLP (5%)

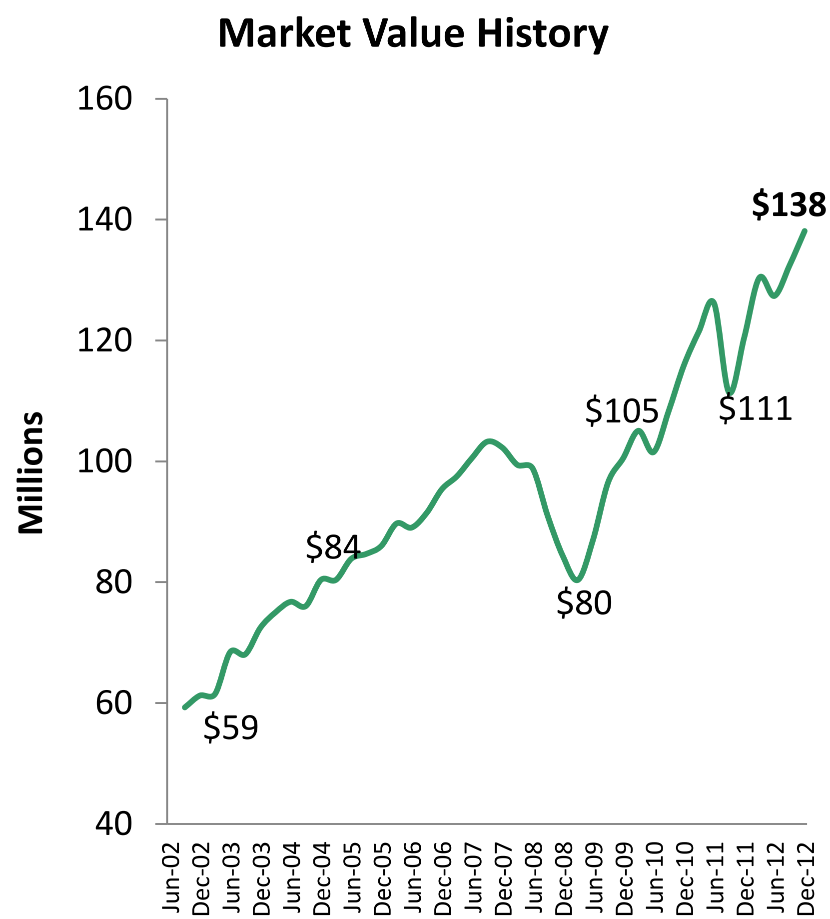
Performance Summary

Periods ended December 31, 2012



Portfolio Review





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Current vs. Target Asset Allocation

Manager	Actual Portfolio[1]	Investment Policy Target	Difference	Minimum	Maximum
Large Cap Domestic Equity	15.2%	**15.0%**	0.2%	10.0%	20.0%
Mid Cap Domestic Equity	12.5%	**12.5%**	0.0%	7.5%	17.5%
Small Cap Domestic Equity	11.1%	**10.0%**	1.1%	5.0%	15.0%
International Equity	12.7%	**12.5%**	0.2%	7.5%	17.5%
Core Fixed Income	33.3%	**35.0%**	-1.7%	30.0%	40.0%
High Yield Fixed Income	5.0%	**5.0%**	0.0%	0.0%	10.0%
Real Estate	5.2%	**5.0%**	0.2%	0.0%	10.0%
Master Limited Partnerships	4.9%	**5.0%**	-0.1%	0.0%	10.0%
Cash	0.1%	**0.0%**	0.1%	-	-
Total	100.0%	**100.0%**		100.0%	100.0%

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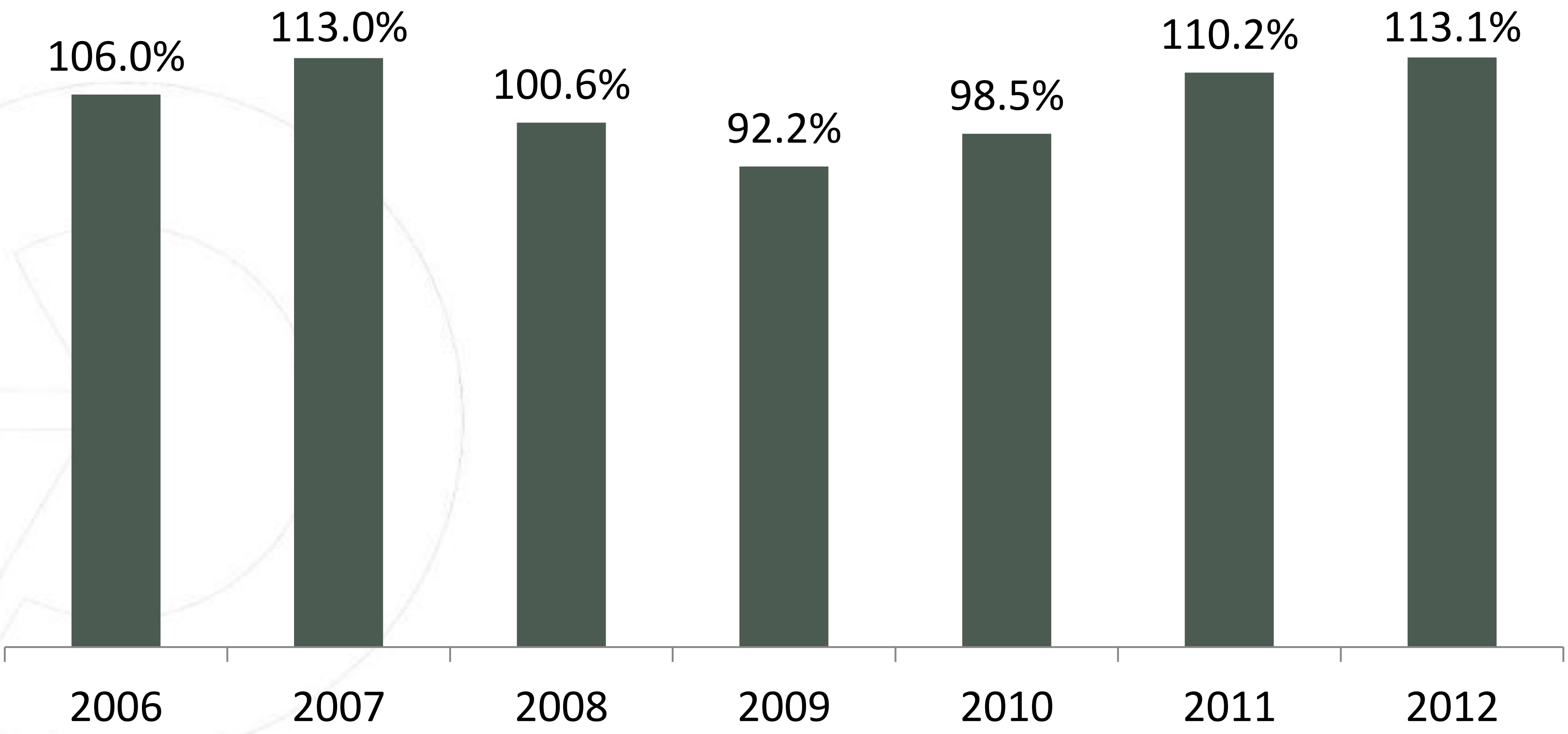
Funded Status Monitor



Source: Port of Houston Authority Restated Retirement Plan Actuarial Valuation Report as of August 1, 2012. Valuation method used: FASB ASC Topic 960 basis.

Manager Status Summary

Manager	Mandate	Status	Note
Fixed Income			
Smith Affiliated Smith Graham	Core Fixed Income Core Fixed Income	In Compliance In Compliance	
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 Stephens Barrow Hanley	Large Cap Equity Large Cap Equity Mid Cap Equity Small Cap Equity	In Compliance In Compliance In Compliance Non Compliance	Beta was 1.31 vs. policy guideline of 1.20
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.

Fee Analysis

Manager	Mandate	Expense Ratio	Category Average	Difference
Domestic Equity				
Fiduciary Management	Large Cap Equity	0.55%	1.31%	**0.76%**
Stacey Braun	Large Cap Equity	0.45%	1.31%	**0.86%**
Stephens	Mid Cap Growth Equity	0.76%	1.40%	**0.65%**
Barrow Hanley	Small Cap Value Equity	0.83%	1.48%	**0.65%**
International Equity				
Eagle Global	International Value Equity	0.89%	1.45%	**0.56%**
Fixed Income				
Smith Affiliated	Fixed Income	0.25%	0.97%	**0.72%**
Smith Graham	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		**0.59%**	**1.23%**	**0.63%**

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Discussion Items

- The International Equity portion of the Plan continues to improve.

- The Meridian Growth fund was liquidated during the quarter due to organizational concerns. The proceeds were used to fund the Stephens Mid Cap Growth portfolio.

- The TSBJ Fixed Income fund was liquidated during the quarter due to performance and organizational issues. The proceeds were allocated to the Smith Affiliated fixed income portfolio.