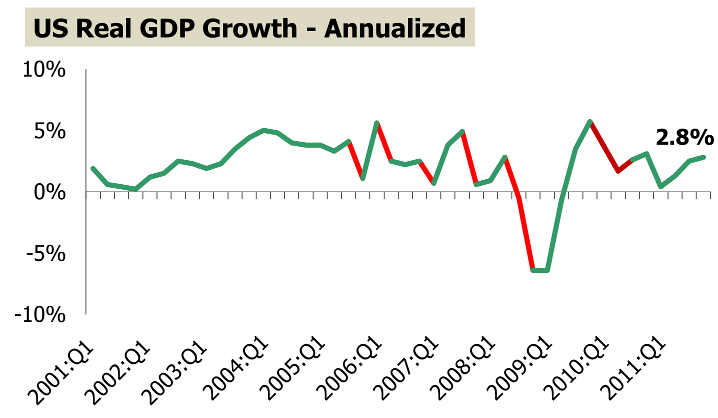
Port of Houston Authority
Pension Plan

Fourth Quarter 2011 Report

Gregory W Group

Fourth Quarter 2011 Market Environment



2011 was a memorable year for investors. Macroeconomic turmoil dominated financial markets as momentous questions remained unresolved. U.S. equity investors endured large swings in sentiment and prices before ending the year virtually flat. The largest issue throughout the year was Europe's debt crisis and economic slowdown. Although progress was made on the issue, the real test of the European union's strength will likely come in 2012 when nearly $2 trillion in Euro debt comes due. It is suspected that Greece will default on its sovereign debt, perhaps followed by other peripheral European countries. During 2011, the crisis caused the Greek and Italian governments to fall. Despite these serious challenges, the U.S. economy managed to trudge forward with slow but steady growth during 2011.

- Fourth quarter U.S. Real GDP growth was 2.8%, a notable increase from the previous quarter's gain. Total growth for the year was just 1.7%. U.S. Real GDP rose 3.0% during 2010.

- The unemployment rate started the fourth quarter at 9.1%. It is believed that unemployment declined during the fourth quarter to less than 9.0%. The Consumer Price Index rose by more than 3% for the year. The U.S. housing market remained weak.

- The Federal Reserve again took no action on short-term interest rates, leaving them unchanged at 0.00% to 0.25%. "Operation Twist", the Federal Reserve's sale of short term Treasuries and the purchase of an equal amount ($400 million) of long-term Treasury bonds, caused longer term interest rates to decline. In early 2012, the Federal Reserve stated that it expected to leave interest rates at this level *until 2014*.

- Corporate pension funded status deteriorated marginally during the quarter. For the year 2011, funded status deteriorated meaningfully as portfolio returns averaged 3% vs. liability returns of +20%. Historically low interest rates were the root cause of the near record shortfall.

- The U.S. dollar finished 2011 3% higher versus the Euro. The Japanese Yen rose 5% versus the U.S. Dollar during 2011. Converging monetary policies among Europe, Japan, and the U.S. reduced currency divergence.

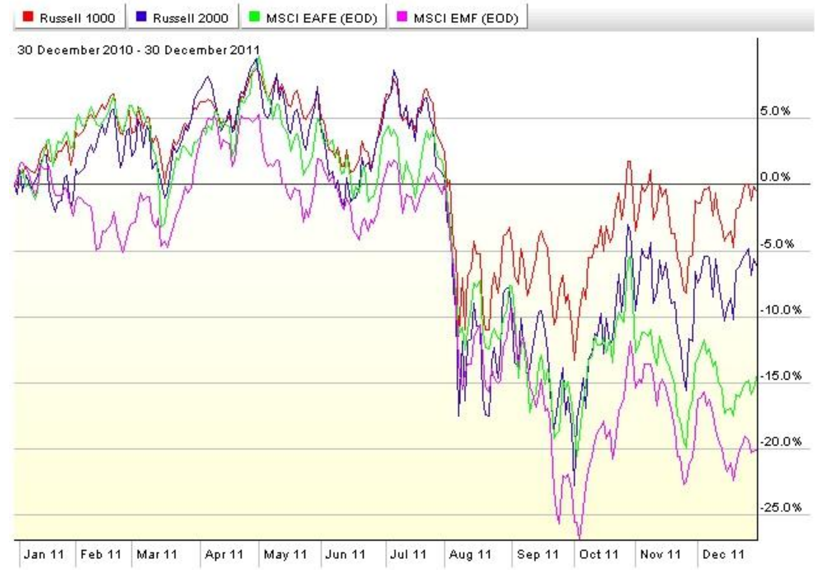
- Generally speaking, hedge funds posted disappointing returns during 2011. Several large funds endured a difficult year. The Hedge Fund Research HFRX equal weighted index of hedge funds fell -5.0% for the year.

- Precious metal prices weakened appreciably during the fourth quarter.

- World real GDP growth expectations are still positive but depressed versus historical standards. Consensus estimate for 2012 world GDP growth is 2.5%. Emerging countries are expected to outperform developed countries.

DOMESTIC AND INTERNATIONAL EQUITY SUMMARY

The U.S. and foreign equity markets generally rose during the quarter. Volatility remained treacherously high. Investors faced a bipolar market (very strong or very weak) with high correlations of returns among individual stocks. IPO activity was lackluster during the quarter. The average European unemployment rate ended the year at 10.3%. Spanish unemployment was almost 23%.



- Top contributing sectors of the domestic equity market were **Energy (18% return)**, **Industrials (16%)**, and **Information Technology (9%).** The lowest contributing index sectors were **Telecom Services (8%)**, **Utilities (8%)**, and **Materials (15%)**.

- The three largest individual contributors to the Russell 1000's fourth quarter return were **Exxon Mobil (+17% return), Pfizer (+24%), and Google (+25%)**.

- Value stocks outpaced growth stocks during the fourth quarter. Performance was mixed over the full year, with growth leading value among large caps but value leading among mid and small caps. Large caps outperformed mid and small caps across the capitalization spectrum.

- The **Russell 1000's price/earnings ratio ended the fourth quarter of 2011 at 14.1,** an increase from 12.9 at the end of the fourth**. Earnings growth remained positive as corporate America remained focused on cost control.** The Russell Mid Cap and Russell 2000's price/earnings ratios were 15.9 and 16.9 respectively, versus 14.3 and 14.9 last quarter. Corporate America continued to improve. Profits and cash holdings are near all-time highs.

- The debt crisis in Europe has depressed the growth outlook for European countries and threatens to spread from there. Consensus estimates are for Europe to suffer a modest recession during 2012. In U.S. Dollar terms, Pacific ex-Japan posted the best fourth quarter return among regional indexes. Despite structural weaknesses, Europe managed a gain. Japan suffered a loss. **For the year 2011**, **the U.S. equity market's return ranked 4th out of 33 world equity markets**.

Twelve Month Forward P/E Ratio	Europe ex UK	UK	Japan	Asia ex Japan
Current Value	9.5	9.2	11.3	11.2
Post 1990 Average	**14.2**	**12.6**	**32.3**	**13.9**
Discount/Premium	*-33.1%*	*-27.0%*	*-65.0%*	*-34.1%*

- The Philippines, Indonesia, and Ireland were the top performing markets over 2011, posting returns of 3%, 3%, and -1% in U.S. Dollar terms. Poorest performing markets were Greece (-59%), Austria (-36%), and Finland (-33%).

- **Nine out of ten sectors within the MSCI ACWI ex US index sectors posted fourth quarter gains**. The quarter's leading performance contributors were Energy (15% fourth quarter return), Consumer Staples (7%), and Industrials (5%). The quarter's leading detractors were Materials (5%), Telecom Services (4%), and Utilities (2%).

- Emerging markets stocks posted gains during the quarter. The Chinese economy showed signs of slowing growth during the second half of 2011. They suffered serious losses over the last year. For the year ended December 31, emerging markets fell -18%.

- The top three contributors to the MSCI ACWI ex-U.S. index's fourth quarter return were Royal Dutch Shell (+20% return), BP (+19%), and Samsung (+29%). The bottom three contributors were Lloyds Banking Group (-26% return), Mitsubishi UFJ Financial (-8%), and Toyota (-4%).

FIXED INCOME SUMMARY

Bond markets were again dominated by the global sovereign debt and banking crises. A polarized political situation in Washington prevented much progress on fiscal or legislative fronts. The housing market, still weak, showed some traces of improvement. Unemployment edged lower due to seasonal factors. Fears of contagion from a European debt crisis extended through year end and appear to be unsolvable anytime soon. Should the debt crisis escalate, it will likely have a contagion effect as global banks suffer from "shocks" that will be transmitted across national borders. Despite being downgraded from AAA to AA during 2011, U.S. Treasury bonds posted generous returns as investors sought "safer" investments. The U.S. Federal Reserve approved "Operation Twist" at their September meeting. The program, which bought large quantities of longer term U.S. Treasury bonds sparked a rally during the quarter but is expected to have relatively little effect on economic growth. However, the combination of low inflation and strong corporate balance sheets made 2011 another good year for bonds.

- Bonds trailed equities during the fourth quarter. U.S. Treasury yields were essentially unchanged during the quarter despite declining sharply during December. However, interest rates ended the year sharply lower. In inflation adjusted terms, the 10 year Treasury bond ended the year with a slightly negative yield. The yield on the thirty year Treasury bond ended the year at 2.9%. Viewed as a haven during volatile markets, the thirty year bond posted a return of almost 30% during the year. Most of the return came in the second half of the year. Mortgage backed bonds underperformed the broad bond market Delinquencies and foreclosures on residential mortgages remained stubbornly high. U.S. corporate debt issuance declined modestly on a year over year basis. Municipal bond issuance fell noticeably.

- Yield spreads narrowed during the fourth quarter as investors accepted risk in exchange for higher yields. Spreads of higher quality bonds improved relative to lower quality bonds.

Risk Level	**Time Horizon**			
	One Year		**Three Years (annualized)**	
	Terminal Yield	**Total Return**	Terminal Yield	**Total Return**
Low				
2 Year Treasury (12.31 = 0.2%)	2.5%	**-4.1%**	5.0%	**-2.8%**
	1.5%	**-2.2%**	4.0%	**-2.2%**
	0.5%	**-0.3%**	3.0%	**-1.6%**
Medium				
10 Year	4.5%	**-19.0%**	6.0%	**-9.1%**
Treasury	3.5%	**-11.7%**	5.3%	**-7.2%**
(12.31 = 1.9%)	2.5%	**-3.6%**	4.0%	**-4.0%**
High Risk				
30 Year	5.5%	**-35.2%**	6.5%	**-14.9%**
Treasury	4.5%	**-23.5%**	5.5%	**-10.9%**
(12.31 = 2.9%)	3.5%	**-8.4%**	4.5%	**-6.2%**

- High yield bonds posted attractive returns during the fourth quarter, leading all other fixed income market sectors. Emerging market debt and TIPS also posted notable gains for the quarter. High yield bonds were the poorest performing segment for the full year, gaining 5%. High yield spreads ended the year at 7.2% while defaults were just 1.7% of debt outstanding. High yield debt Issuance was high during the year.

Domestic Equity	*Last Quarter*	*Last Year*	*Last Three Years Annualized*	*Last Five Years Annualized*	*Last Ten Years Annualized*
S&P 500	11.8	2.1	14.1	-0.3	2.9
Russell 1000	11.8	1.5	14.8	0.0	3.4
Russell 1000 Value	13.1	0.4	11.6	-2.6	3.9
Russell 1000 Growth	10.6	2.6	18.0	2.5	2.6
Russell 3000	12.1	1.0	14.9	0.0	3.5
Russell Midcap	12.3	-1.6	20.2	1.4	7.0
Russell Midcap Value	13.4	-1.4	18.2	0.0	7.7
Russell Midcap Growth	11.2	-1.7	22.1	2.4	5.3
Russell 2000	15.5	-4.2	15.6	0.2	5.6
Russell 2000 Value	16.0	-5.5	12.4	-1.9	6.4
Russell 2000 Growth	15.0	-2.9	19.0	2.1	4.5
Alerian MLP	16.3	13.9	39.8	14.2	15.5
Fixed Income					
Barclays Capital Aggregate Bond	1.1	7.8	6.8	6.5	5.8
Barclays Capital Credit	1.7	8.4	10.9	6.8	6.4
Barclays Capital Government	0.8	9.0	4.0	6.6	5.6
Barclays Capital Govt/Credit	1.2	8.7	6.6	6.6	5.9
Barclays Capital Interm Credit	1.1	5.4	9.6	6.2	5.8
Barclays Capital Interm Govt	0.7	6.1	3.5	5.9	4.9
Barclays Capital Interm Govt/Cred	0.8	5.8	5.7	5.9	5.2
Barclays Capital Long Credit	3.2	17.1	14.8	8.6	8.1
Barclays Capital Long Term Govt	1.8	29.2	7.5	10.8	8.9
Barclays Capital Long Govt/Credit	2.6	22.5	11.2	9.7	8.5
Barclays Capital Fixed Rate MBS	0.9	6.2	5.8	6.5	5.7
Merrill Lynch US High Yield Master II	6.2	4.4	23.7	7.3	8.6
91 Day T-Bill	0.0	0.1	0.1	1.4	1.9
Consumer Price Index	-0.1	3.0	2.4	2.2	2.5
International					
MSCI EAFE	3.3	-12.1	7.7	-4.7	4.7
MSCI World ex US	3.5	-12.2	8.5	-4.1	5.1
MSCI Europe	5.4	-11.1	7.9	-5.2	4.4
MSCI Japan	-3.9	-14.3	1.7	-6.6	3.0
MSCI Pacific ex Japan	6.0	-12.8	20.8	2.7	11.6
MSCI Emerging Markets	4.1	-20.4	17.4	0.1	11.2
Citigroup Non-$ World Gov	-0.5	5.2	4.9	7.2	8.4

Portfolio Summary as of December 31, 2011

Manager	Quarter	One Year	Three Year	Five Year	Ten Year	Market Value
Smith Affiliated Smith Graham Trevor Stewart Burton & Jacobsen	0.90% 1.49% 1.74%	11.58% 7.06% 6.73%	4.97% 8.66% 3.42%	7.17% 6.61% 5.48%	- - -	$9,687,018 $21,448,407 $9,615,783
Barclays Capital Aggregate	1.12%	7.84%	6.77%	6.50%	5.78%	
Loomis Sayles High Income	-	-	-	-	-	$5,855,896
ML High Yield	6.18%	4.38%	23.72%	7.34%	8.59%	
FAMCO	16.16%	-	-	-	-	$6,456,285
Alerian MLP	16.33%	13.88%	39.75%	14.18%	15.54%	
Cohen & Steers Real Estate	-	-	-	-	-	$6,142,424
FTSE NAREIT All REITS	15.26%	8.28%	21.04%	-1.42%	10.20%	
Fiduciary Management Stacey Braun	11.45% 9.59%	1.47% 4.02%	14.10% 15.09%	2.77% -	- -	$10,131,698 $8,295,360
S&P 500	11.82%	2.11%	14.11%	-0.25%	2.92%	
Meridian	14.64%	-	-	-	-	$15,293,121
Russell Midcap Growth	11.24%	-1.65%	22.06%	2.44%	5.29%	
Barrow Hanley Small Cap	25.28%	-9.02%	29.26%	5.06%	-	$12,589,516
Russell 2000 Value	15.97%	-5.50%	12.36%	-1.87%	6.40%	
Eagle Global	7.75%	-14.23%	4.34%	-4.50%	-	$14,957,516
MSCI EAFE	3.38%	-11.73%	8.16%	-4.26%	5.12%	
Total Plan	**7.89%**	**1.94%**	**6.97%**	**10.29%**	-	**$120,557,123**
Benchmark Actuarial Assumption	6.49% 1.77%	2.67% 7.25%	10.43% 7.25%	1.95% 7.25%	4.34% 7.25%	

Please note: There was $53,349 in the short-term cash account as of quarter end.

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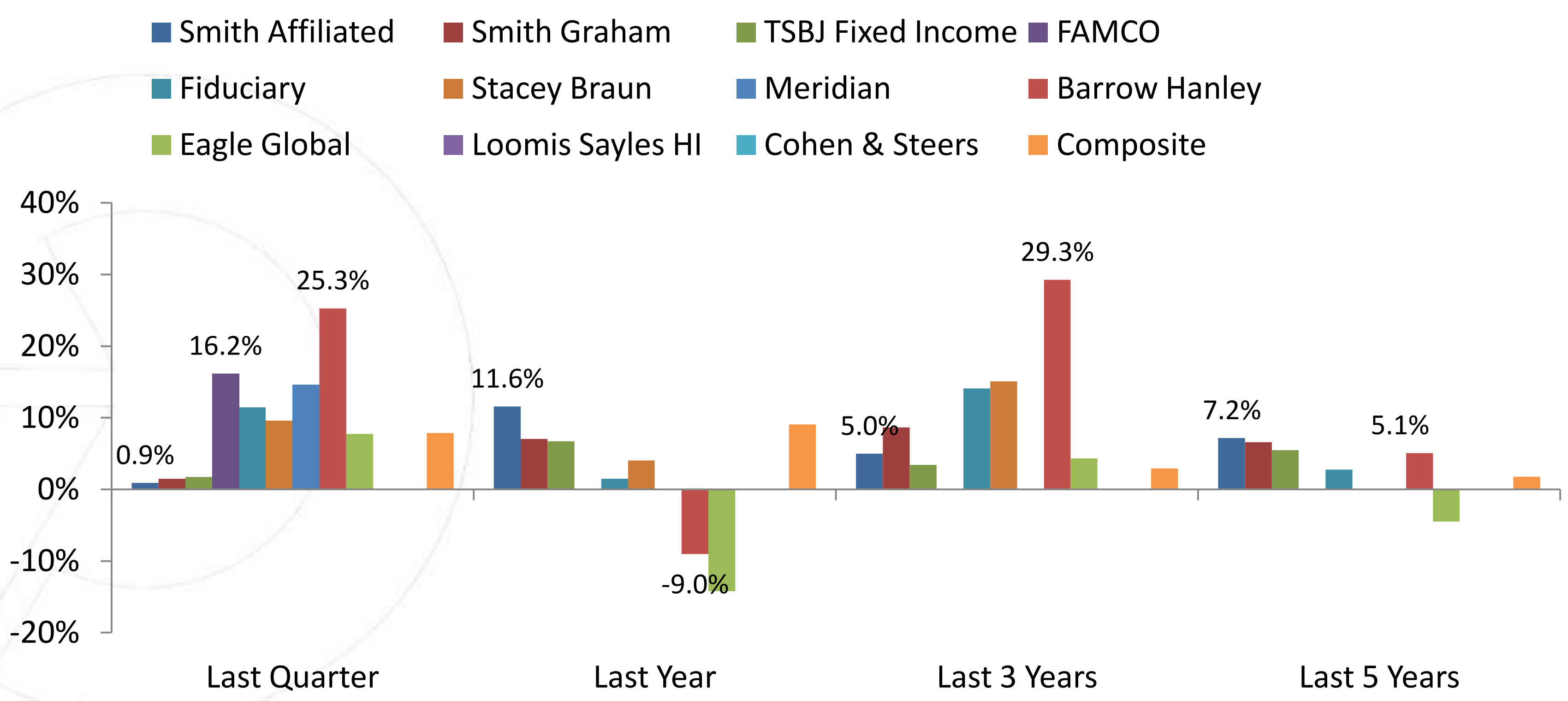
Performance Summary

Periods ended December 31, 2011



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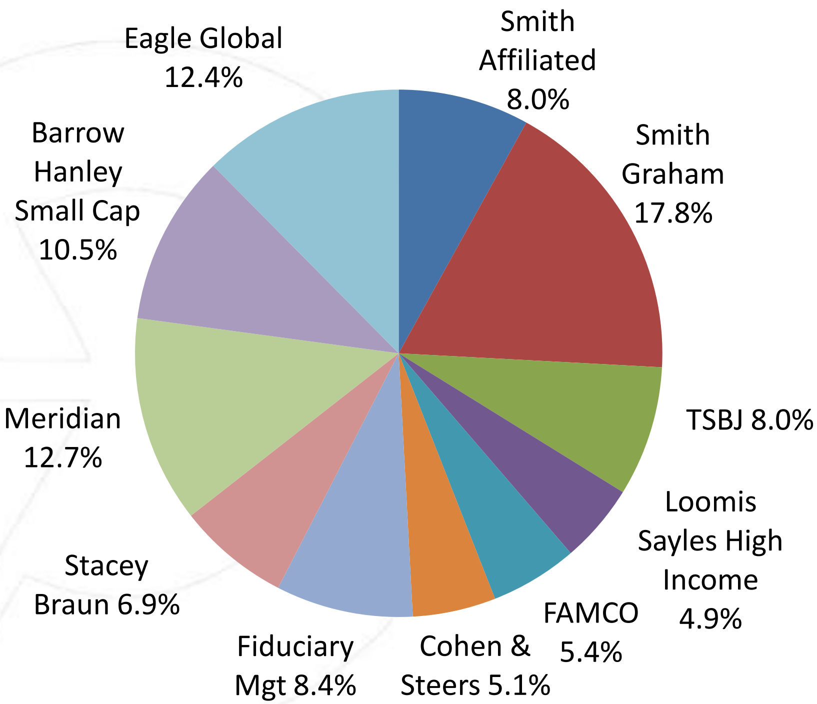
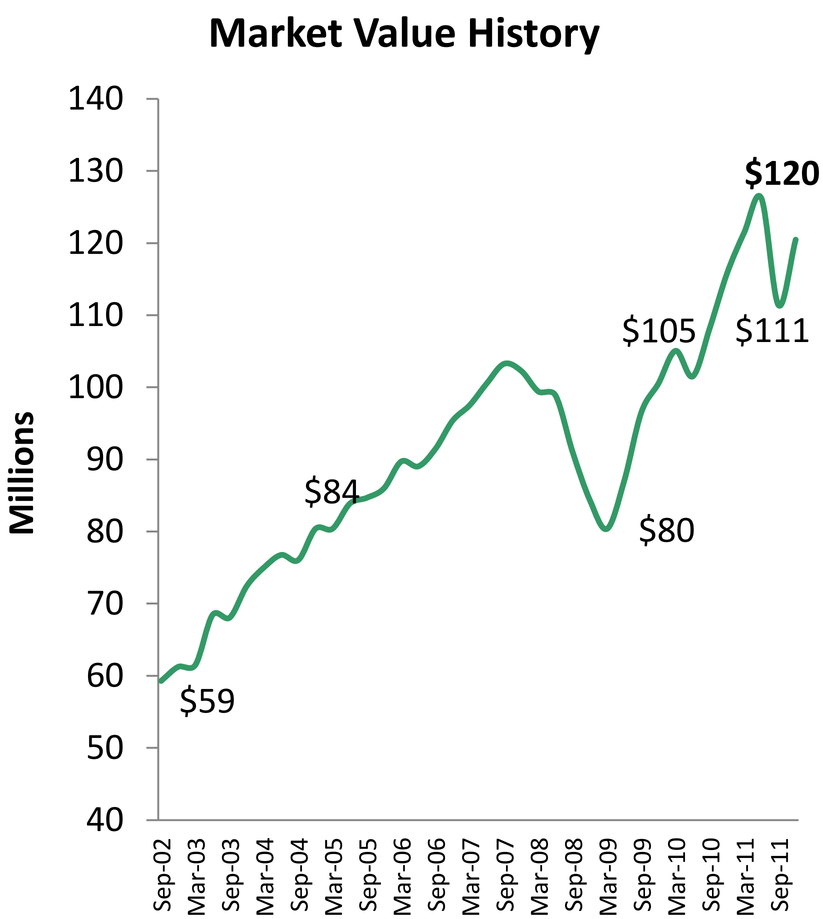
Portfolio Review





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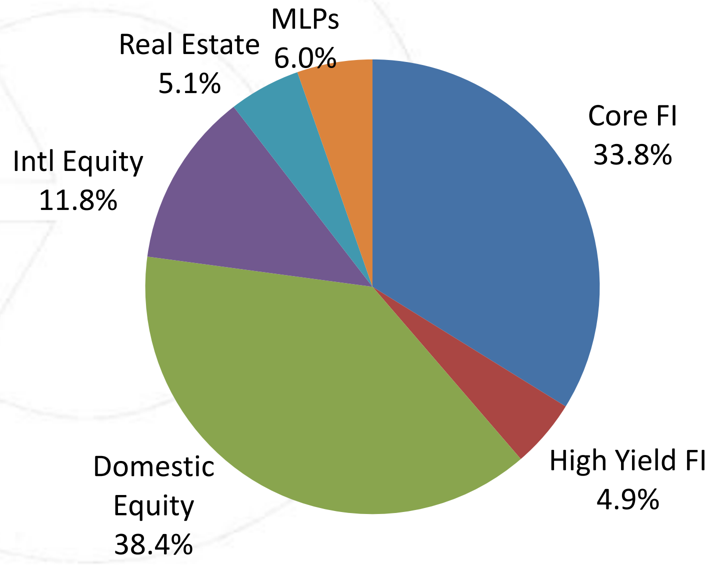
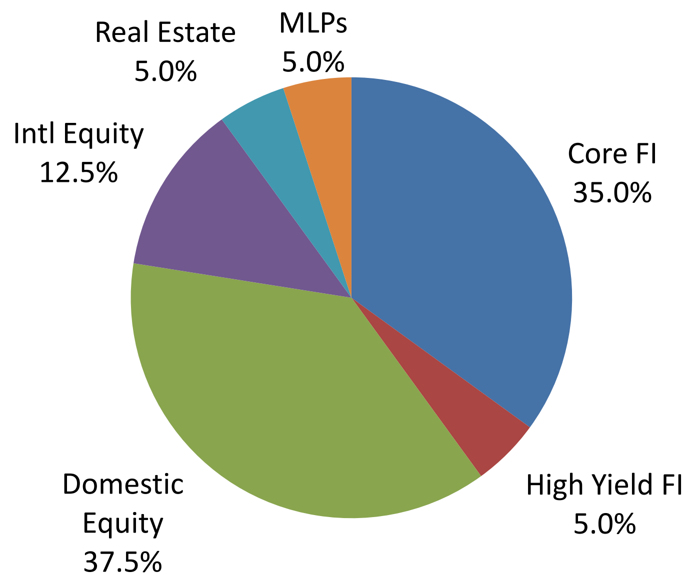
Current vs. Target Asset Allocation

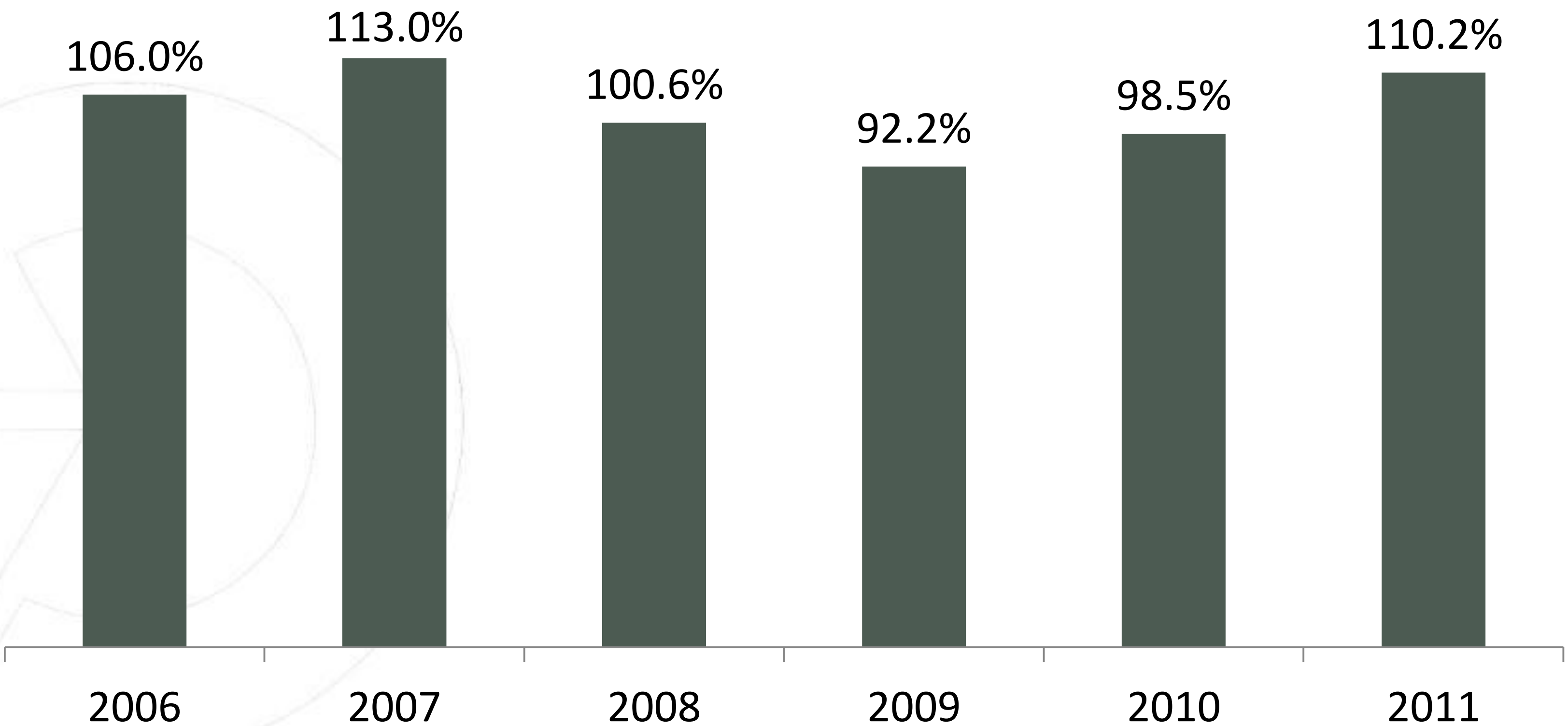
Current Asset Allocation



Target Asset Allocation



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	On Alert In Compliance On Alert	On Alert – Personnel (3Q2011) 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)

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Discussion Items

- During the quarter, two new asset classes were 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 two month period (September 2 – December 31) Loomis Sayles posted a return of -1.34%, while Cohen & Steers returned 2.68%.

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