

Graystone  
Consulting

A business of Morgan Stanley Smith Barney LLC.



# Port of Houston Authority

Presentation to the Investment Committee

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VISIT US AT: <http://institutionalconsulting.citi.com/thekelseygroup/>

» **February 25, 2010**  
*John Kelsey CIMA, AIFA*  
*Norman Nabhan CIMA, AIF*  
*John Granger, CIMA*  
*Victoria Polinski CIMA, AIF*



# Graystone Consulting

## Your Experienced Service Team

### » **John Kelsey, CIMA, AIFA-Houston, TX**

- Accredited Investment Fiduciary Auditor
- 40 years industry experience; 31 years consulting experience
- University of Texas-JD
- 90 Years experience on Non-Profit boards
- Founding Member and Past Board Member of Investment Management Consultants Association

### » **Norman Nabhan, CIMA, AIF- Houston, TX**

- 37 years in the industry; 31years consulting experience
- Managing Director of Citigroup
- Former National Director of Smith Barney Consulting Group & Director of Institutional Services
- On team that built Graystone Consulting
- 2 Years on Citigroup Pension Fund Audit Committee
- Past President of Investment Management Consultants Association
- President elect of Association of Professional Investment Consultants

### » **John Granger, CIMA-Houston, TX**

- 12 years in Industry --
- 10 years specializing in Taft-Hartley plans, Foundations/Endowments, Religious, and Healthcare organizations
- Chartered Alternative Investment Analyst, Level 1
- Methodist Hospital Young Leader's Committee

### » **Victoria Polinski, CIMA, AIF- Houston, TX**

- Vice President
- 13 years in Industry - 7 at Graystone Consulting or Predecessor
- Named Analyst of the Year 2005
- Significant Experience in Alternative Investments



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## Your Regional Graystone Consulting Team

### Organization Chart

**John W. Kelsey**

Institutional Consulting Director

**Norman E. Nabhan**

Institutional Consulting Director

**John Granger**

Institutional Consulting Director

**Victoria Polinski**

Senior Investment Management  
Consultant

### Support Staff

**Elese Jackson**

Group Administrator

**Diana Quintana**

Registered Associate

### Analysts

**Kristina Recker**

Institutional Consulting  
Analyst

**Alicia Moore**

Institutional Consulting  
Analyst

**Karen Sotallaro**

Institutional Consulting  
Analyst

**Kavitha Thomas**

Technical Analyst



## Issues Confronting Today's Institutional Investors

- » Market volatility
- » Regulatory requirements and procedures
- » Court cases and press highlighting conflicts of interest and missteps in fiduciary conduct
- » Difficulty integrating alternative investments and associated audit and risk issues

Regulations	Fiduciary Conduct	Alternative Investments
Funding & Compliance	Investment Decisions & Process	Audit & Risks
Pension Protection Act of 2006 (funding requirements, plan design, changes in actuarial standards for pension plans, new participant features)  Sarbanes-Oxley Act of 2002 (reporting requirements, whistleblower policies)	Uniform Prudent Investor Act and the Uniform Management of Public Employee Retirement Systems define legal requirements of investment fiduciaries	American Institute of Certified Public Accountants (AICPA) AU Section 332: Auditing derivative investments, hedging activities and investments in securities (where a readily determinable fair value does not exist)



## How We Confront Those Issues

### Graystone Consulting Leadership

- » We are experienced providers of institutional investment consulting advice
- » Our asset allocation advice and portfolio modeling capabilities are customized to your needs.
- » We deliver a broad range of traditional, alternative, mutual funds and exchange traded fund options.
- » Our depth of manager research professionals follow a consistent, disciplined process review for every strategy evaluated.
- » We deliver published research reports to help document fiduciary decisions.
- » We have access to one of the world's largest teams of strategy, technical and research analysts.
- » Our parent company, Morgan Stanley Smith Barney, offers a broad range of investment strategy and financial resources at our disposal.



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## Graystone Consulting

### Founded in 1973 as the Institutional Arm of Morgan Stanley Smith Barney

- » Became the Number one Consulting Organization on Wall Street according to Cerrulli Associates

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  - » 304 Employees solely dedicated to supporting the Client Experience.

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  - » 32 teams in U.S. dedicated to Institutional Consulting.

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  - » Our compensation tied to client satisfaction and retention.

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  - » Structured to eliminate any potential Conflicts of interest.

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  - » Fee only - No soft dollars
-



## Graystone Consulting

### Significant Resources Dedicated to Client Support

- » 60 Professionals dedicated to traditional manager research.\*
- » 50 Professional dedicated to alternative manager research.\*\*
- » Access to Capital market research and Global Asset Allocation Committee.
- » Annual budget in excess of \$80 Million to support the business.
- » Total revenues in excess of \$2 Billion allows us to amortize the expenses of the consulting business across a broad client base and be a high touch-low cost service provider.

### National Organization with Local Delivery of Service

- » Service delivered by highly trained and experienced local and regional teams.
- » Teams are tailored with local service component and highly trained partners with experience in clients with similar issues.
- » Graystone does not change Consultants on an assignment.

\* See Tab 4 -Traditional Research Report

\*\* See Tab 5- Alternative Research Report



## We are Nationally-Ranked

### Graystone Consulting An Industry Leader....<sup>1</sup>

» 2<sup>nd</sup> in the Nation in Number of Consulting Clients over \$100 Million in Assets

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» 2<sup>nd</sup> in the Nation by number of endowment/foundation clients <sup>2</sup>

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» 3<sup>rd</sup> in the Nation by number of defined benefit plan clients

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» Consulting Group, the managed account unit of Morgan Stanley Smith Barney, holds the largest single share of total managed account assets in the U.S. marketplace, accounting for 21.3% of assets.<sup>3</sup>

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<sup>1</sup> Plan Sponsor, August 2009

<sup>2</sup> Annual Report of Pension Fund Consultants 2006, Thomson Financial

<sup>3</sup> Cerulli Associates, June 2009



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## 2009 Greenwich Survey of Consultants

What Do Our Clients Think of Us Versus Our Competition?

### Knowledge of Investment Managers-2008 Satisfaction Score by Clients

	Knowledge of Investment Managers-2008 Satisfaction Score by Clients	Satisfaction with Manager Recommendations-2008
UBS	50%	42%
Cambridge	71%	50%
NEPC	77%	59%
LCG	70%	69%
Russell	82%	64%
RV Kuhns	69%	71%
Graystone/Citi Institutional	88%	93% #1 in Survey

Source: 2009 Greenwich Survey of Consulting Firms

(1) The Greenwich Survey is a survey of 1,261 institutional clients and their satisfaction with their consultant.



## 2009 Greenwich Survey of Consultants

Credibility with Investment Committee-2008 Satisfaction Score by Clients		Provision of Proactive Advice & Innovative Ideas
UBS	67%	42%
Cambridge	71%	52%
NEPC	71%	68%
LCG	73%	63%
Russell	77%	68%
RV Kuhns	81%	75%
Graystone/Citi Institutional	94%	82%

**Source: 2009 Greenwich Survey of Consulting Firms**

(1) The Greenwich Survey is a survey of 1,261 institutional clients and their satisfaction with their consultant.



## 2009 Greenwich Survey of Consultants

Advice on Long Term Asset Allocation-2008 Satisfaction Score by Clients		Investment Consultant Credibility
UBS	75%	75%
Cambridge	63%	72%
NEPC	77%	76%
LCG	70%	83%
Russell	71%	71%
RV Kuhns	93%	75%
Graystone/Citi Institutional	81%	94%

**Source: 2009 Greenwich Survey of Consulting Firms**

(1) The Greenwich Survey is a survey of 1,261 institutional clients and their satisfaction with their consultant.



# Graystone Consulting

## Our Function

- Act as your CIO – “Chief Investment Officer” for Regions Retirement Plans

## Our Mission

- “Our Job is to help the Trustees Fulfill their Fiduciary Responsibility”

## Our Process

- To help you execute and document the functions that you need to be prudent fiduciaries
  - Investment Policy Review & Development
  - Asset Allocation Strategy
  - Manager Searches documented with both Quantitative data and detailed written reports on Qualitative issues
  - Quarterly Performance Evaluation customized to client needs
  - Ongoing Committee education on current topics relevant to the capital markets and the pension world





## Our Benefits: Solutions and Advice

Investment Consulting	Fiduciary Advice and Guidance	Investment Advisor Research	Solutions and Advice
<ul style="list-style-type: none"><li>• We help set the industry standard in investment advice.</li><li>• We empower our clients to make informed decisions.</li><li>• We are committed to complete objectivity, transparency and an open-architecture approach to investments.</li></ul>	<ul style="list-style-type: none"><li>• We provide board and committee advice.</li><li>• We deliver published research reports and customized performance reports.</li><li>• We are trained through the Accredited Investment Fiduciary® designation, awarded by the Center for Fiduciary Studies.</li></ul>	<ul style="list-style-type: none"><li>• We have access to one of the world's largest teams of research analysts, currently more than 50.</li><li>• We cover approximately 1,300 traditional and alternative investment products each quarter.</li><li>• Our team has the ability to conduct its own research on traditional and alternative firms.</li></ul>	<ul style="list-style-type: none"><li>• We are free from potential conflicts of interest in all aspects of our business.</li><li>• We have global capabilities but deliver local service.</li><li>• We are associated with one of the industry's leaders in wealth management and advisory services.</li></ul>



## Our Benefits: Tailored Investment Policy Development

Development	Experience	Integration	Oversight
<ul style="list-style-type: none"><li>• Our team helps you develop and customize every aspect of investment policy</li><li>• This tailored statement becomes central to every fiduciary and investment decision</li></ul>	<ul style="list-style-type: none"><li>• Members of our firm and its institutional consulting community have written and published investment policy statement articles and advice</li><li>• Our team members are frequent speakers on investment policy</li></ul>	<ul style="list-style-type: none"><li>• We integrate every aspect of investment policy into our asset allocation, manager search projects, investment capabilities and portfolio construction</li></ul>	<ul style="list-style-type: none"><li>• We regularly oversee the maintenance of your investment policy statement to help ensure it provides a prudent roadmap to fiduciary decisions</li></ul>



## Our Benefits: Depth and Customization

Asset Allocation Strategies	Depth of Research	Alternative Investments	Customized Advice
<ul style="list-style-type: none"><li>Ability to draw on the world-wide research and analytics of the Global Investment Committee</li><li>Empowered to customize the Committee's advice and tailor it to our clients' needs</li></ul>	<ul style="list-style-type: none"><li>We leverage the strength and capabilities of the Investment Advisor Research team</li><li>This team currently has more than 50 experienced research analysts*</li><li>Ability to conduct our own team-based traditional strategies analysis</li></ul>	<ul style="list-style-type: none"><li>Ability to draw on the review and recommendations of our alternative analysts</li><li>Ability to conduct our own proprietary team-based alternative investment analysis</li></ul>	<ul style="list-style-type: none"><li>We believe investment consulting advice should be customized to the unique needs of each client</li><li>Customization is central to our core values and pervasive across every aspect of our business model</li></ul>

\*As of September 2009



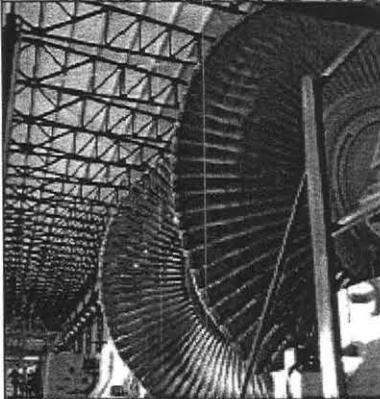
## The Global Investment Committee and Advisory Council

- » Global Investment Committee consists of approximately 18 senior investment professionals\*
- » Global Investment Committee Advisory Council consists of approximately 13 senior investment professionals to supplement investment and economic research\*
- » Detailed strategic and tactical asset allocation recommendations
- » Published monthly research bulletins
- » Regular asset allocation review; periodic adjustments as needed
- » Ability to tailor recommendations to client's unique needs

\*As of September 2009

Graystone Consulting

### » INVESTORS' MONTHLY



AUGUST 2009 INVESTMENT OUTLOOK

- QUESTIONS ABOUT THE STOCK MARKET PAGE 4
- CREDIT MARKETS ENJOY MOMENTUM PAGE 6
- BUILDING A HOUSING RECOVERY PAGE 8
- NINE SIGNS POSTS FOR 2009: AN UPDATE PAGE 9
- HEDGE FUND RETURNS AT MID YEAR PAGE 10
- Q&A: WHARTON'S RICHARD MARSTON PAGE 12
- TOO MUCH DEMAND FOR MUNI SUPPLY PAGE 14

When Profits Turn

As the economy recovers, markets look to earnings growth to drive stocks

BY JEFF APPLEGATE AND CHARLES REINHARD

» In recent months, the global recession has shown signs of abating and many economists have moved up their estimates on when it will end. Leading economic indicators have improved significantly since last October and suggest a recovery may be near. Indeed, eight of our "Nine Signs for 2009" that track recovery in cyclical activity have shown year-to-date improvement (see page 9). In addition, unemployment rates have already started to decline in Mexico and Brazil, exports are up in Japan and Taiwan, and China's electricity production has risen 14% during the past eight months. Surveys of business conditions in the US and around the world are turning up, giving further hope that a broad-based recovery will soon take root globally (see chart, page 2).

How will we know when the US recession has ended and a recovery has begun? In our view, one of the early telltale signs will be a sharp decline in weekly jobless claims filed. At the end of each of the last five recessions, there was a large drop in jobless claims—a pattern that we believe is starting to unfold now (see chart, page 3). What's more, the way in which jobless claims decline from their recessionary peaks should offer some clues about the recovery's strength. In the milder U-shaped recoveries of the early 1990s and 2000s, claims stopped falling after a few months; in the stronger V-shaped recoveries of the 1970s and early 1980s, they continued to slide.

HOW RECESSIONS END. Recessions typically end when pent-up demand for goods and services meets enticing levels of affordability made possible by price reductions, promotional sales and attractive financing. It's also necessary to have a monetary policy environment that encourages growth and risk-taking while making it uneconomical to hoard cash. With the federal funds rate at zero, hoarding cash is not a winning tactic.

(continued on inside cover)

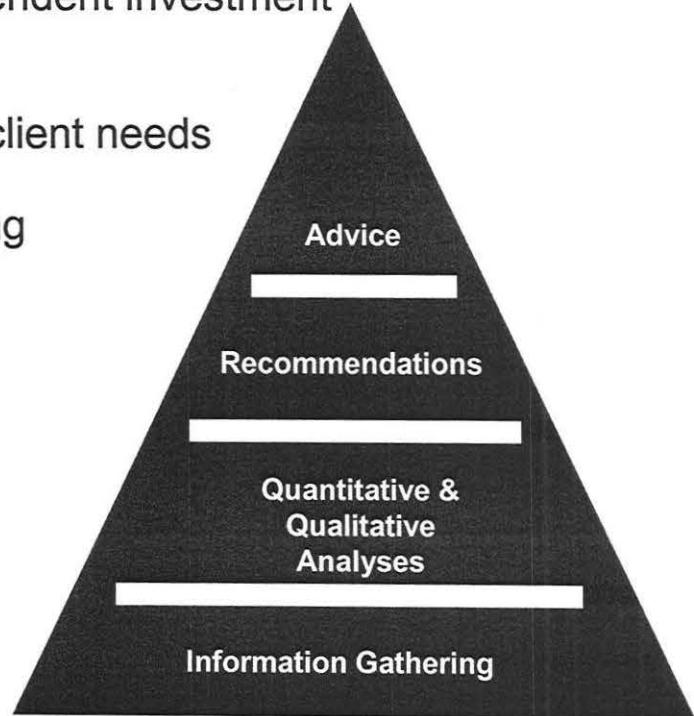
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# Graystone Consulting

## Investment Advisor Research

- » Identify superior traditional and alternative investment money managers through a rigorous quantitative and qualitative research process
- » Deliver access to a world-class platform of quality, independent investment firms
- » Identify appropriate investment opportunities for diverse client needs
- » Provide unbiased, independent research while maintaining strong relationships with investment managers
- » Educate colleagues and clients on investment manager trends, specific product characteristics and portfolio positioning of specific investment products
- » Analyze the risks: investment risk, business risk, management risk and event risk



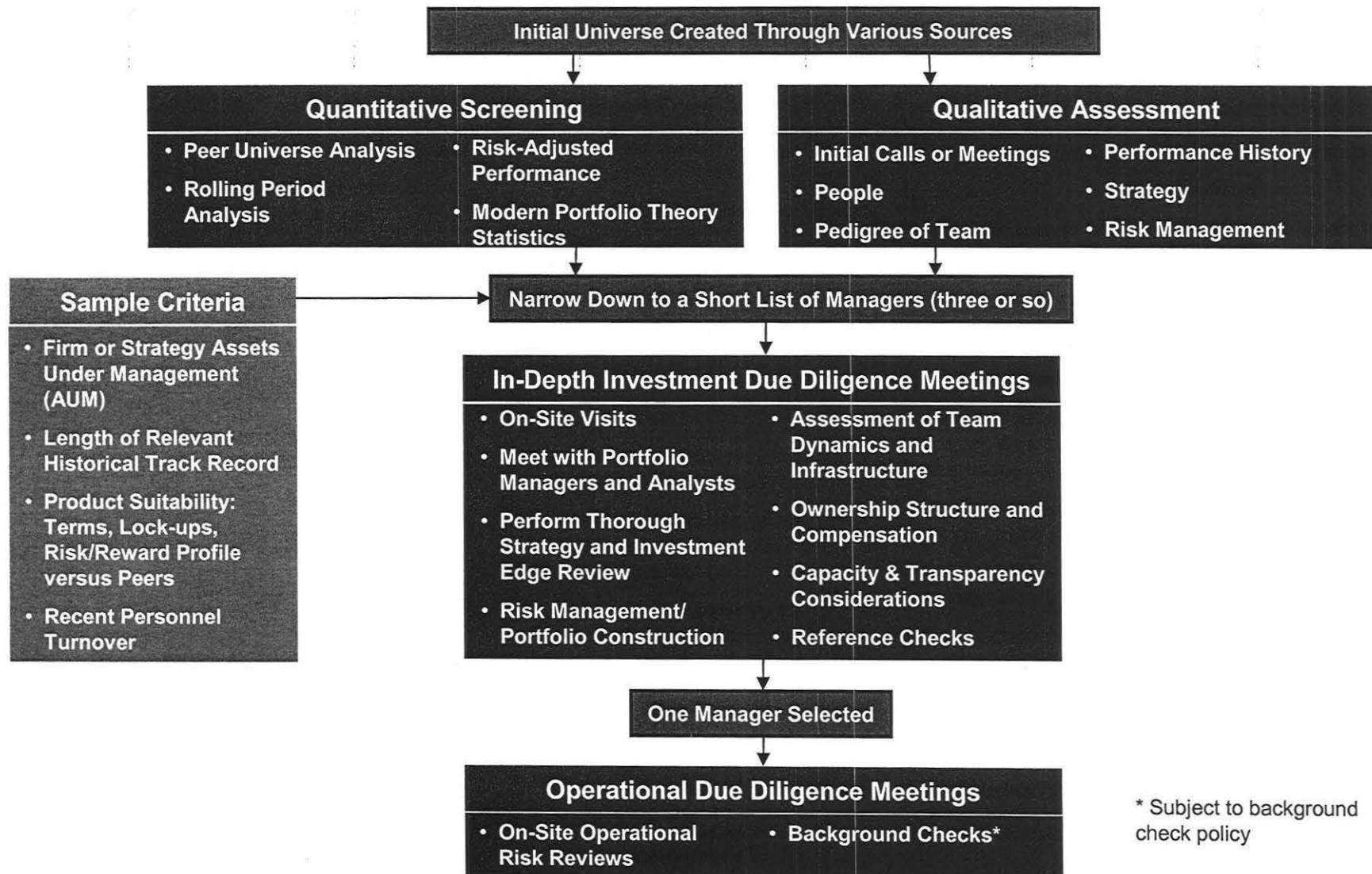


## Standards of Traditional Strategies Review Process

Quantitative Analysis	Qualitative Assessment
<p><b>KEY EVALUATION ASPECTS</b></p> <ul style="list-style-type: none"><li>▪ Narrows the universe of managers</li><li>▪ Evaluates managers in specific asset classes</li><li>▪ Applies measurable criteria:<ul style="list-style-type: none"><li>▪ Return / return characteristics</li><li>▪ Risk-Adjusted Performance</li><li>▪ Style consistency</li><li>▪ Portfolio turnover</li></ul></li></ul>	<p><b>PEOPLE AND ORGANIZATION</b></p> <ul style="list-style-type: none"><li>▪ History and stability of firm</li><li>▪ Background of key professionals</li><li>▪ Business evaluation</li><li>▪ Ownership structure</li><li>▪ Compensation/incentive to key professionals</li><li>▪ Personnel turnover</li></ul> <p><b>STRATEGY / PROCESS</b></p> <ul style="list-style-type: none"><li>▪ Sources of returns</li><li>▪ Risk controls</li><li>▪ Style analysis</li><li>▪ Attribution analysis</li><li>▪ Strategy implementation</li></ul> <p><b>QUALITY OF RESEARCH</b></p> <ul style="list-style-type: none"><li>▪ Proprietary systems and analytical tools</li><li>▪ Depth and breadth of research process</li><li>▪ Technology and business operations</li></ul>



# Due Diligence for Traditional and Alternatives Managers



\* Subject to background check policy



# Graystone Consulting

## Aggregated Performance Evaluation

- » Consolidate multiple custodians in a comprehensive, understandable format
- » Customized reports designed specifically for client's needs and reporting schedules
  - Executive Summary
  - Monthly Updates, etc
- » Returns for each account and aggregate to all accounts
- » Returns for each asset class
- » Peer group comparisons
- » Insights from our investment consulting experience
  - Alerts on emerging issues
  - Recommendations for corrective action
- » Reports provide analysis of portfolio results and causes
- » Comparison of managers vs. benchmarks
- » Detailed manager and portfolio performance attribution analysis



## Port of Houston Proposed Fees

### Defined Benefit Plan

Asset Based Fee	1 <sup>st</sup> \$100 Million in Assets Next \$100 Million in Assets	0.10% (10 basis points)* 0.09% ( 9 basis points)*
Total Fee on	\$93,200,000	\$93,200.00

#### This includes:

- Investment Policy Review
- Asset Allocation Analysis
- Manager Searches
- Manager Research (written reports)
- Portfolio Rebalancing
- Quarterly Performance Analysis
- Quarterly Performance Attribution
- Trustee Education
- All trading commissions
- Custody of Assets (Optional)
- Asset Liability Study

\*Unlike most other fee proposals, please note that this proposal includes any equity and fixed income trading costs if executions are done through the MSSB institutional trading desk. Equity trades are executed at no commission and bond trades with no mark ups or mark downs. This is done to eliminate any potential conflicts of interest. Included would be trades done as "step outs" at other firms that are brought back to our desk for settlement. According to "Plexus", average trading costs above and beyond advisory and investment management fees can average .10%-.13% annually. Managers have an obligation to obtain "best execution" and can trade wherever they can best accommodate the client. If some percentage of the trades were done on the institutional desk it would amount to substantial savings in execution costs for Regions Bank.



# Plexus Trading Cost Analysis

Consulting Group Capital Markets Funds: Aggregate

Second Quarter 2009

Total Cost Analysis									
Review Period	Decision Value	Total Cost	Total Cost Benchmark		Value Added (Versus Actual Cost Benchmark)	Turnover Ratio	Index Return	Traded Returns*	
			Actual	Adjusted				Before Costs	After Costs
		\$millions	bp	bp	\$'000	bp	%	bp	bp
2008/Q3	2,837.0	-72	-34	-43	-10,654	-38	20	-1,338	15
2008/Q4	2,196.0	-143	-49	-53	-20,541	-94	20	-2,357	218
2009/Q1	1,926.2	-135	-139	-178	792	4	21	-967	-66
2009/Q2	2,367.4	-59	-66	0	1,741	7	31	1,391	-30
Total	9,326.6	-98	-67	-84	-28,462	-31	88	-809	50
									-49

Components of Cost Analysis									
--- Execution Costs ---									
Review Period	Delay	Implicit Cost	Impact	Explicit Costs Commissions		Total Cost	Total Cost Benchmark	Benchmarks	
				bp	(¢)			bp	bp (¢)
2008/Q3	-48		-12	-11	(-1.5)	-72	-34	-18	-8 (-1.4)
2008/Q4	-101		-29	-13	(-1.5)	-143	-49	-21	-8 (-1.3)
2009/Q1	-66		-54	-15	(-1.2)	-135	-139	-77	-9 (-1.2)
2009/Q2	-15		-31	-13	(-0.9)	-59	-66	-41	-9 (-1.1)
Total	-56		-30	-13	(-1.2)	-98	-67	-37	-9 (-1.3)

Commission Rate Trend (%)

Period	Trend (%)
Annual	-1.24 (-1.3bp)
2008/Q3	-1.54 (-1.1bp)
2008/Q4	-1.54 (-1.3bp)
2009/Q1	-1.24 (-1.5bp)
2009/Q2	-0.94 (-1.3bp)

Brokerage Cost Efficiency Trend (bp)  
(Brokerage Cost vs. Brokerage Cost benchmark)

Period	Trend (bp)
Annual	-2.6
2008/Q3	-2.5
2008/Q4	-2.5
2009/Q1	-2.4
2009/Q2	-1.8

Commission Rate Ranking (One-Year - One Quarter Lag)

Quarter	Ranking (%)
2008/Q3	94
2008/Q4	94
2009/Q1	94
2009/Q2	98

Brokerage Cost Efficiency Ranking (One-Year - One Quarter Lag)

Quarter	Ranking (%)
2008/Q3	94
2008/Q4	94
2009/Q1	94
2009/Q2	98

Fund Rank 1-Year:  
53% (-1.4%)

Fund Rank 1-Year:  
40% (-8bp)

\* Represents change in value of stocks purchased or sold through the end of the quarter (Total represents the dollar weighted average of prior 4 quarters.)

Plexus Plan Sponsor Group, Inc.

A subsidiary of Investment Technology Group, Inc.



## Defined Benefit Plan Fee Schedule Analysis

Defined Benefit Plan	Hard Dollar Fee	Asset Based Fee (includes trading costs)
Consulting Fee		\$93,200 10 basis points
Trading Costs 13 basis points Assets \$93,200,000		\$0
25% of trades@ 0 Commission		POHA Saves \$30,290
50% of trades@ 0 Commission		POHA Saves \$60,580
100% of trades @ 0 Commission		POHA Saves \$121,160
Custody Fees	.03%.07%	0% (Optional)



# Graystone Consulting

## SUMMARY: WHY CHOOSE US?

We are relentless in our pursuit of performance and steadfast to the highest standards of ethical professional behavior.

- Client Centric:** Clients solutions based upon objective professional advice.
- Integrity:** We commit to the highest standards of ethical behavior. We only provide services to investors. We seek to AVOID CONFLICTS OF INTEREST. We do not sell investment research, charge investment managers for inclusion in any database, receive compensation from investment managers, nor provide services to investment managers. We do not accept soft dollars or directed brokerage on consulting arrangements.
- Collaboration:** We strive to be academically inquisitive thinkers and share our intellectual capital with our colleagues and our clients.
- Innovation:** Our goal is to provide state-of-the-art solutions and consulting practices by maintaining individual competence through training and education and by leveraging the resources of Citigroup and the Joint Venture with Morgan Stanley.
- Open Architecture:** We focus on “Best of Class” asset management firms when determining the appropriate portfolio construction solution for our clients.
- Transparency:** We strive for transparency with clients and colleagues. We use all-inclusive asset-based fees that cover all our consulting services.
- Education:** We pride our advisor services on education to our clients.

Thank You For Your Consideration



## Important Disclosures

To the extent the investments depicted herein represent international securities, you should be aware that there may be additional risks associated with international investing, including foreign economic, political, monetary and/or legal factors, changing currency exchange rates, foreign taxes, and differences in financial and accounting standards. These risks may be magnified in emerging markets. International investing may not be for everyone. Small capitalization companies may lack the financial resources, product diversification and competitive strengths of larger companies. In addition, the securities of small capitalization companies may not trade as readily as, and be subject to higher volatility than, those of larger, more established companies.

Bonds are subject to interest rate risk. When interest rates rise bond prices fall; generally the longer a bond's maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which allows the issuer to retain the right to redeem the debt, fully or partially, before the scheduled maturity date. Proceeds from sales prior to maturity may be more or less than originally invested due to changes in market conditions or changes in the credit quality of the issuer.

Investing in alternative investments is speculative, not suitable for all clients, and intended for experienced and sophisticated investors who are willing to bear the high economic risks of the investment, which can include:

- loss of all or a substantial portion of the investment due to leveraging, short-selling or other speculative investment practices;
- lack of liquidity in that there may be no secondary market for the fund and none expected to develop;
- volatility of returns;
- restrictions on transferring interests in the fund;
- potential lack of diversification and resulting higher risk due to concentration of trading authority with a single advisor;
- absence of information regarding valuations and pricing;
- delays in tax reporting;
- less regulation and higher fees than mutual funds; and
- advisor risk.

Although the statements of fact and data in this report have been obtained from, and are based upon, sources that the Firm believes to be reliable, we do not guarantee their accuracy, and any such information may be incomplete or condensed. All opinions included in this report constitute the Firm's judgment as of the date of this report and are subject to change without notice. This report is for informational purposes only and is not intended as an offer or solicitation with respect to the purchase or sale of any security. Past performance is not a guarantee of future results.

Actual returns would be reduced by expenses that may include management fees and costs of transactions. Expected return and risk (standard deviation) calculations are based on historical data for periods indicated.

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