

Fresno County Employees' Retirement Association

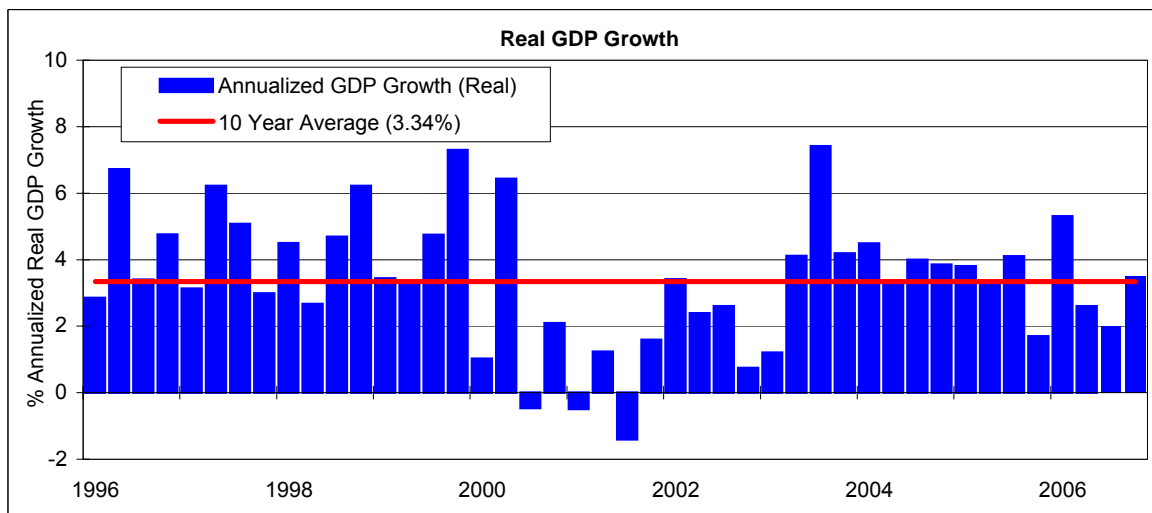
Investment Performance Review

Period Ending: December 31, 2006

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Economic Growth

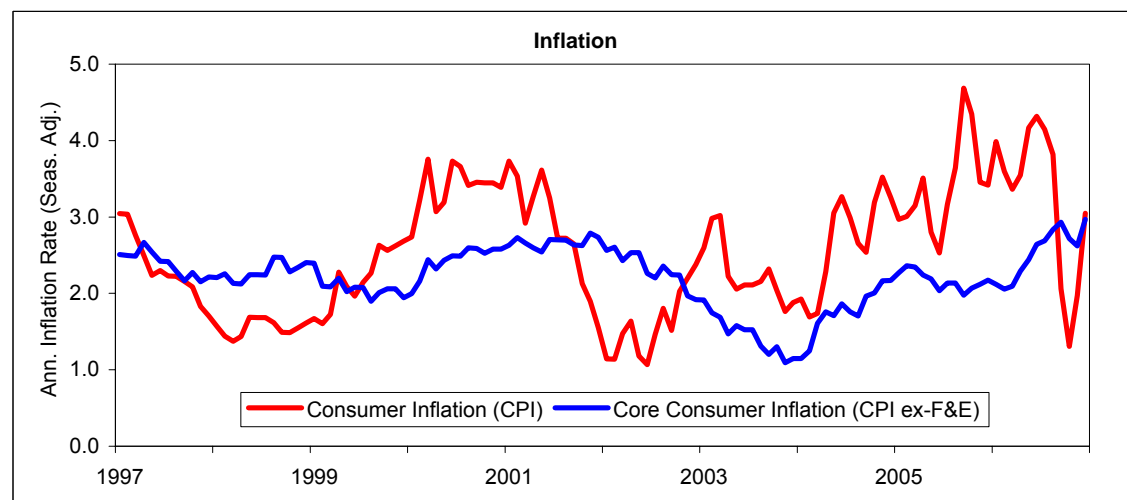


Source: Bureau of Economic Analysis. Green indicates preliminary estimate.

- The third quarter's real gross domestic product grew by 2.0% based on final estimates by the Bureau of Economic Analysis (BEA). The final figure was lower than the preliminary estimate of 2.2% and much lower than the 2.6% growth during the second quarter.
- The deceleration in real GDP was due to a number of factors including increases in imports and a decrease in spending at the state and local government level.
- The US economy bounced back during the fourth quarter with a preliminary real GDP estimate of 3.5% from the BEA. A *Wall Street Journal* survey of economists currently forecast GDP growth of 2.3% during the first half of 2007.

Inflation

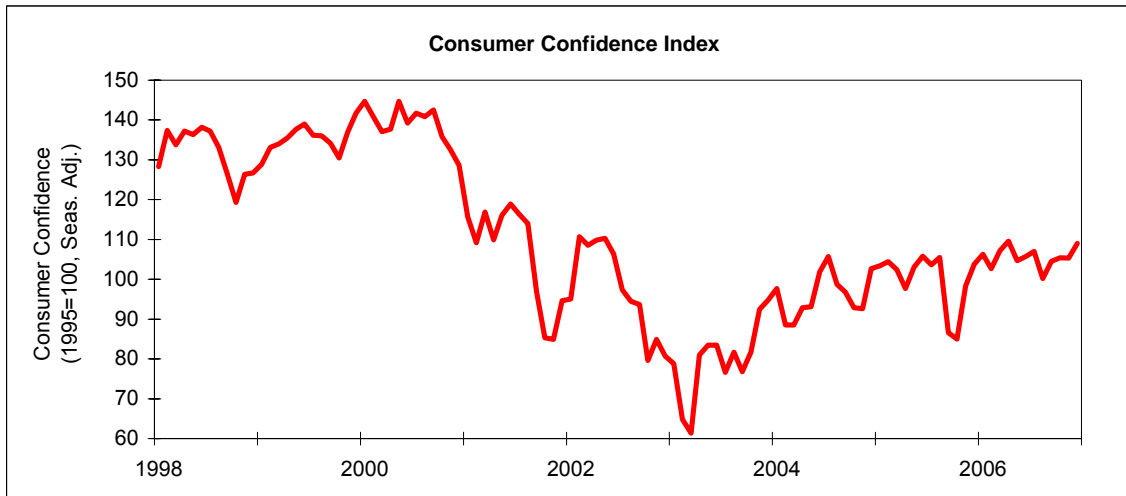
- The Consumer Price Index increased 0.2% on a seasonally adjusted annual rate (SAAR) during the fourth quarter. This compares to SAAR's of 4.3%, 5.1% and 0.8% during the first three quarters of 2006.
- Core CPI, which excludes food and energy, advanced 2.6% during the fourth quarter, in large part due to higher shelter (e.g. rent) costs.
- For the year, CPI rose 2.5%, down from an increase of 3.4% in 2005 and in line with the 2.4% average over the past ten years. Energy costs were particularly volatile during the year, advancing 22.8% during the first half of 2006 and subsequently falling 13.4% during the second half.



Source: Bureau of Labor Statistics; Federal Reserve Bank of St. Louis

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Consumer Confidence

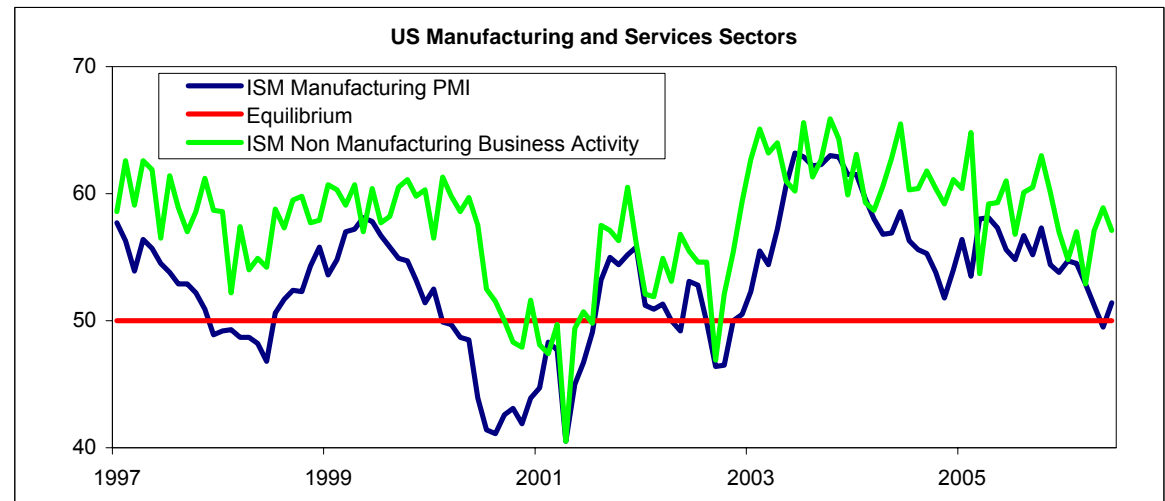


Source: The Conference Board

- Consumer confidence improved during December after remaining virtually unchanged during the previous month. Consumers cited an improvement in their "present day conditions" including their assessment of the job market.
- Consumers also gave an upbeat assessment of their outlook for the next six months. Readings for consumer's opinions on improved business conditions and job availability were both improved from November's outlook.
- Conversely, the proportion of consumers who expect their incomes to rise actually declined since November.

Business Activity

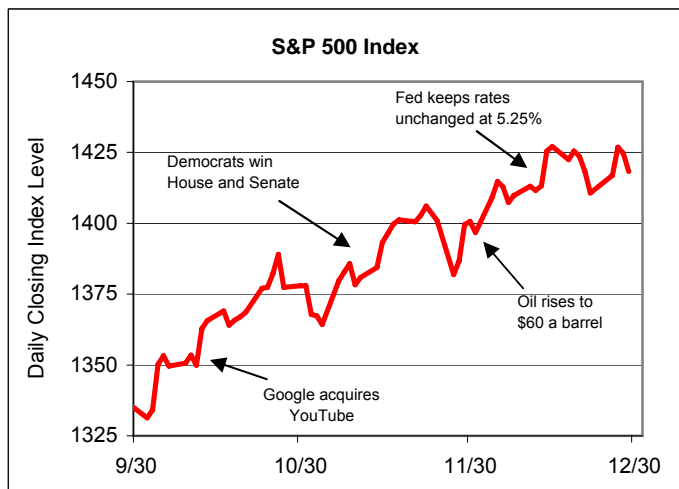
- The Institute for Supply Management, a trade group, reported that its Purchasing Manager's Index (PMI), which measures the economic health of the manufacturing sector, fell below 50 in November for the first time since 2002 (50 and above signals expansion). However, the index bounced back in December to 51.4 on the heels of increased production and declining inventories.
- The ISM non-manufacturing index, which represents the services industry, continued strong growth with a December level of 57.1. This marked the 45th consecutive month of expansion in the services sector.



Source: Institute for Supply Management

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US Stock Market Highlights



Source: Yahoo! Finance

Sector Performance

	<u>Quarter</u>	<u>One Yr</u>
Consumer Disc.	10.4	18.6
Consumer Staples	3.5	14.4
Energy	11.3	24.6
Financials	7.1	19.4
Health Care	1.3	7.3
Industrials	5.8	12.8
Info. Technology	6.1	8.5
Materials	10.9	17.3
Telecom. Services	7.6	33.8
Utilities	9.2	21.2

- The S&P 500 Index finished the year strong, returning 6.7% during the fourth quarter and completing 2006 with a total return of 15.8%, its strongest annual performance since 2003.
- Telecommunications services was the strongest sector during 2006 with a return of 33.8%. The sector's performance was aided by the year's largest acquisition: AT&T's \$72.7 buyout of BellSouth Corporation.
- Technology and health care were the only sectors to experience single-digit performance over 2006. Tech was weighted down by poor performance by bellwethers Dell, Intel and eBay.

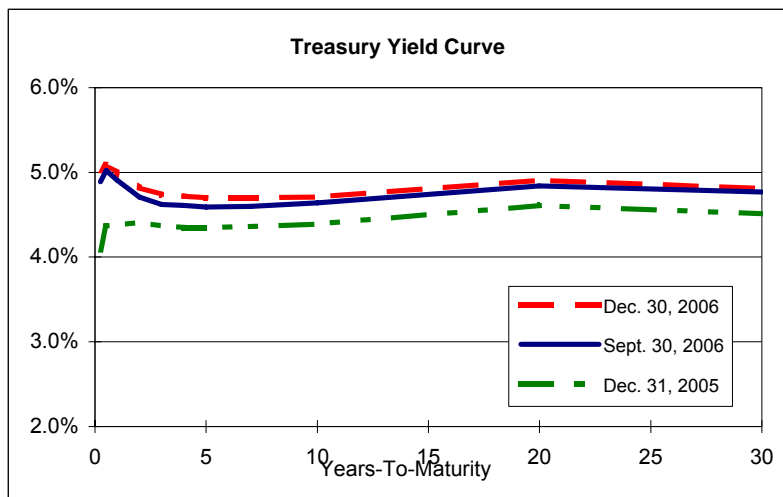
Equity Market Performance

- Small caps outperformed large caps for the fourth quarter and calendar year. 2006 marks the seventh time in the past ten years that small caps outperformed large caps as measured by the S&P 500 and Russell 2000 indices.
- Mega-cap performance was also strong during 2006 as the Dow Jones Industrial Average and Russell Top 200 indices returned 19.0% and 15.5% respectively.
- Value trumped growth in both the large cap and small cap spaces. For the year, value outperformed growth by a staggering 13% within large caps, its largest margin since 2001.

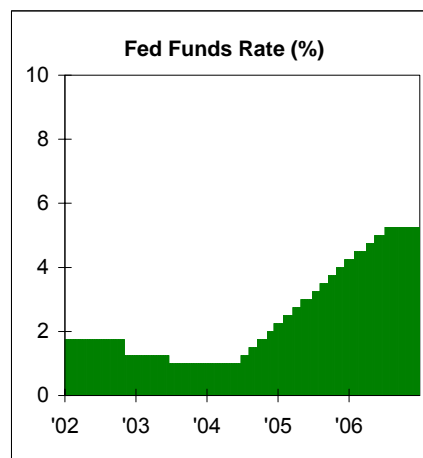
	<u>Quarter</u>	<u>YTD</u>	<u>One Yr</u>	<u>Three Yrs</u>	<u>Five Yrs</u>	<u>Ten Yrs</u>
<u>Core Index Performance:</u>						
Standard & Poor's 500	6.7	15.8	15.8	10.4	6.2	8.4
S&P 500 Equal Weighted	7.1	15.9	15.9	13.6	11.1	11.6
Dow Jones Industrial Average	7.4	19.0	19.0	8.4	6.8	8.9
Russell Top 200	6.7	15.5	15.5	9.1	4.7	7.6
Russell 1000	7.0	15.5	15.5	11.0	6.8	8.6
Russell 2000	8.9	18.4	18.4	13.6	11.4	9.4
Russell 3000	7.1	15.7	15.7	11.2	7.2	8.6
Russell Mid Cap	7.7	15.3	15.3	16.0	12.9	12.1
<u>Style Index Performance:</u>						
Russell 1000 Growth	5.9	9.1	9.1	6.9	2.7	5.4
Russell 1000 Value	8.0	22.2	22.2	15.1	10.9	11.0
Russell 2000 Growth	8.8	13.4	13.4	10.5	6.9	4.9
Russell 2000 Value	9.0	23.5	23.5	16.5	15.4	13.3

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Interest Rate Environment



Source: State Street Corp.



Source: Federal Reserve

- The Federal Reserve held rates steady at 5.25% over the quarter's two FOMC meetings but reiterated its concern about inflationary pressures on the economy.
- The yield on 10-Year Treasuries finished 2006 at 4.7%, an increase of about 30 basis points since the start of the year. The yield curve remained inverted with the two-year Treasury yielding 10 basis points higher than ten-year Treasuries.
- Economists surveyed by the *Wall Street Journal* expect the Fed to cut rates to 4.75% by the end of 2007.

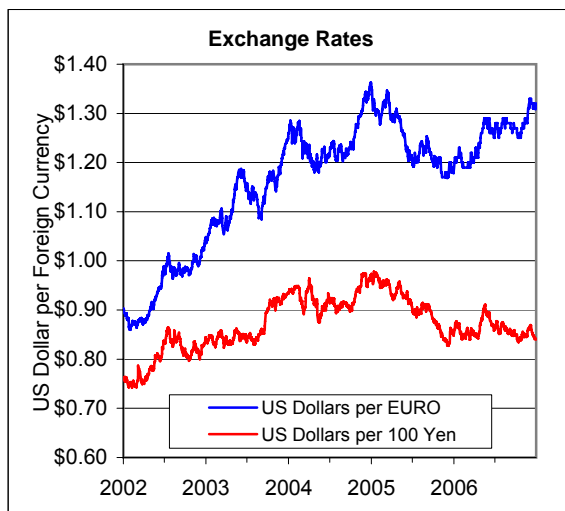
Bond Markets

- Bond markets had a modest quarter with the Lehman Aggregate returning 1.2%. TIPS had a negative quarter due to a narrowing of breakeven spreads.
- High yield bonds had another strong quarter, returning 4.2% during the period. The sector was the only domestic bond segment to post double digit returns during 2006 after returning 11.9%. Within high yield, lower quality issues outperformed higher quality.
- Emerging market bonds had another strong year with a return of 10.5%. Over the past five years, this segment has produced an annualized return of 15.3%.

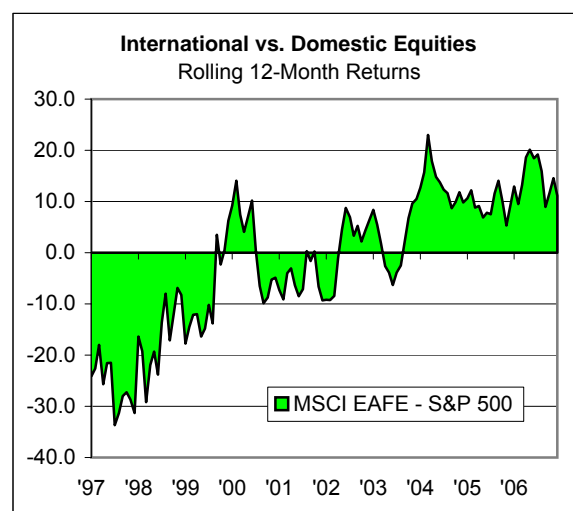
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	<u>Quarter</u>	<u>YTD</u>	<u>One Yr</u>	<u>Three Yrs</u>	<u>Five Yrs</u>	<u>Ten Yrs</u>
<u>Index Performance:</u>						
LB Aggregate	1.2	4.3	4.3	3.7	5.1	6.2
LB US TIPS	(1.3)	0.4	0.4	3.9	7.2	n/a
90 Day US Treasury Bills	1.3	4.8	4.8	3.1	2.4	3.8
<u>Maturity Evaluation:</u>						
LB 1-3 Yr Treasury	0.9	3.9	3.9	2.2	2.8	n/a
LB Intermediate Treasury	0.8	3.5	3.5	2.4	3.7	5.3
LB Long Treasury	0.5	1.8	1.8	5.3	6.9	7.7
<u>Issuer Performance:</u>						
LB Intermediate Agency	1.1	4.5	4.5	3.1	4.3	5.7
LB U.S. Credit	1.3	4.3	4.3	3.8	5.9	6.6
LB Mortgage	1.6	5.2	5.2	4.2	4.9	6.2
LB High Yield	4.2	11.9	11.9	8.5	10.2	6.6
JPM Emerg. Mkts Bond Index	4.1	10.5	10.5	11.4	15.3	11.0
Non-US Gov't Bond (Hedged)	0.6	3.1	3.1	4.6	4.6	6.4

International Market Environment



Source: Federal Reserve Bank, Daily Press



Source: Ibbotson

- International equities finished the year strong with the MSCI EAFE returning 10.4% during the quarter and nearly 27% for 2006. International markets have outperformed the US market on a rolling annual basis since 2003, which marks the longest stretch of international outperformance since 1988.
- The U.S. dollar weakened against most major currencies during the year, partly due to the Fed's decision to hold rates steady. The euro gained approximately 11.5% while the yen fell 1.4% against the dollar. The Chinese yuan has steadily appreciated relative to the dollar, rising 3% in 2006.

International Equity Market Performance

- International value outperformed growth over the fourth quarter by 200 basis points. For the year, value trumped growth by nearly 8%.
- International small caps also outperformed large caps during the fourth quarter but underperformed for the year due to weakness during the first half of 2006. Reginal performance varied from weak performance in Japan to standout returns in Latin America.
- Emerging market equities surged 17.6% during the fourth quarter and finished 2006 with a 32.6% return. Performance was particularly strong in the "BRIC" countries of Brazil, Russia, India and China, which gained 56% during the year.

	<u>Quarter</u>	<u>YTD</u>	<u>One Yr</u>	<u>Three Yrs</u>	<u>Five Yrs</u>	<u>Ten Yrs</u>
<u>Broad Index Performance:</u>						
MSCI EAFE	10.4	26.9	26.9	20.4	15.4	8.1
MSCI World	8.5	20.7	20.7	15.2	10.5	8.1
MSCI EAFE ex. Japan	12.7	34.2	34.2	21.9	16.0	10.3
MSCI Emerging Markets	17.6	32.6	32.6	31.0	27.0	n/a
MSCI EAFE Small Cap	11.7	19.7	19.7	25.8	24.5	n/a
<u>Style Index Performance:</u>						
MSCI EAFE Growth	9.4	22.7	22.7	17.5	12.6	5.4
MSCI EAFE Value	11.4	31.1	31.1	23.3	18.2	10.6
<u>Regional Index Performance:</u>						
MSCI Europe ex-UK	12.2	36.4	36.4	23.0	16.4	11.9
MSCI United Kingdom	10.3	30.7	30.7	18.8	n/a	n/a
MSCI Japan	5.0	6.3	6.3	15.7	n/a	n/a
MSCI Asia	15.2	33.2	33.2	25.1	n/a	n/a
MSCI Latin America	22.1	43.5	43.5	44.4	32.3	16.4

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Portfolio Diversification

Asset Class Rankings Over the Past Twenty Years

Fourth Quarter 2006

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Best	69.9	24.9	29.5	35.9	8.9	51.2	29.1	32.9	8.1	38.3	23.1	35.2	38.7	43.1	22.8	14.0	10.3	48.5	22.3	18.9	26.9
	20.0	8.0	28.6	25.2	7.9	41.7	13.8	23.8	6.4	37.2	21.6	31.8	20.3	33.2	12.3	8.4	6.7	46.0	20.7	14.0	23.5
	15.9	5.9	23.2	20.2	2.6	41.2	8.0	18.1	4.2	31.0	21.4	30.5	16.2	27.3	11.6	7.3	1.8	38.6	16.5	7.1	22.2
	15.4	5.3	20.4	18.8	2.3	24.6	7.8	13.4	2.7	25.8	14.1	18.6	15.6	13.0	7.0	4.1	-8.6	30.0	14.3	7.1	16.1
	15.3	4.6	11.7	14.5	-0.3	21.7	7.4	11.5	-0.8	24.6	11.3	13.9	13.6	11.4	6.0	-2.7	-11.4	29.7	13.1	5.3	13.4
	8.3	2.7	11.3	12.4	-8.1	16.0	5.0	9.8	-1.5	18.5	10.3	12.9	8.7	7.3	1.9	-5.6	-15.5	21.6	11.1	4.7	12.8
	7.4	0.5	9.6	10.8	-17.4	12.5	3.6	3.1	-2.0	11.6	6.4	9.7	5.1	4.7	-14.0	-9.2	-15.7	9.0	6.3	4.1	9.1
	6.2	-7.1	7.9	8.6	-21.8	5.8	-4.3	2.9	-2.4	7.5	5.3	5.2	1.2	-0.8	-22.4	-20.4	-27.9	4.1	4.3	3.1	4.8
	Worst	3.6	-10.5	6.8	7.8	-23.2	-5.6	-11.9	1.4	-2.9	5.8	3.6	2.1	-6.5	-1.5	-22.4	-21.2	-30.3	1.2	1.2	2.4


 Large Cap Growth US Stocks (Russell 1000 Growth Index)

 International Stocks (MSCI EAFE Index)


 Large Cap Value US Stocks (Russell 1000 Value Index)

 Domestic Fixed Income (LB Aggregate Bond Index)

 Small Cap Growth US Stocks (Russell 2000 Growth Index)

 Real Estate (NCREIF Property Index)

 Small Cap Value US Stocks (Russell 2000 Value Index)

 Cash (SB 3-Mo Treasury)

 ICC Universe Median (Total Funds)

Data: Ibbotson Associates, 2005; Institutional Consultants Cooperative.
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