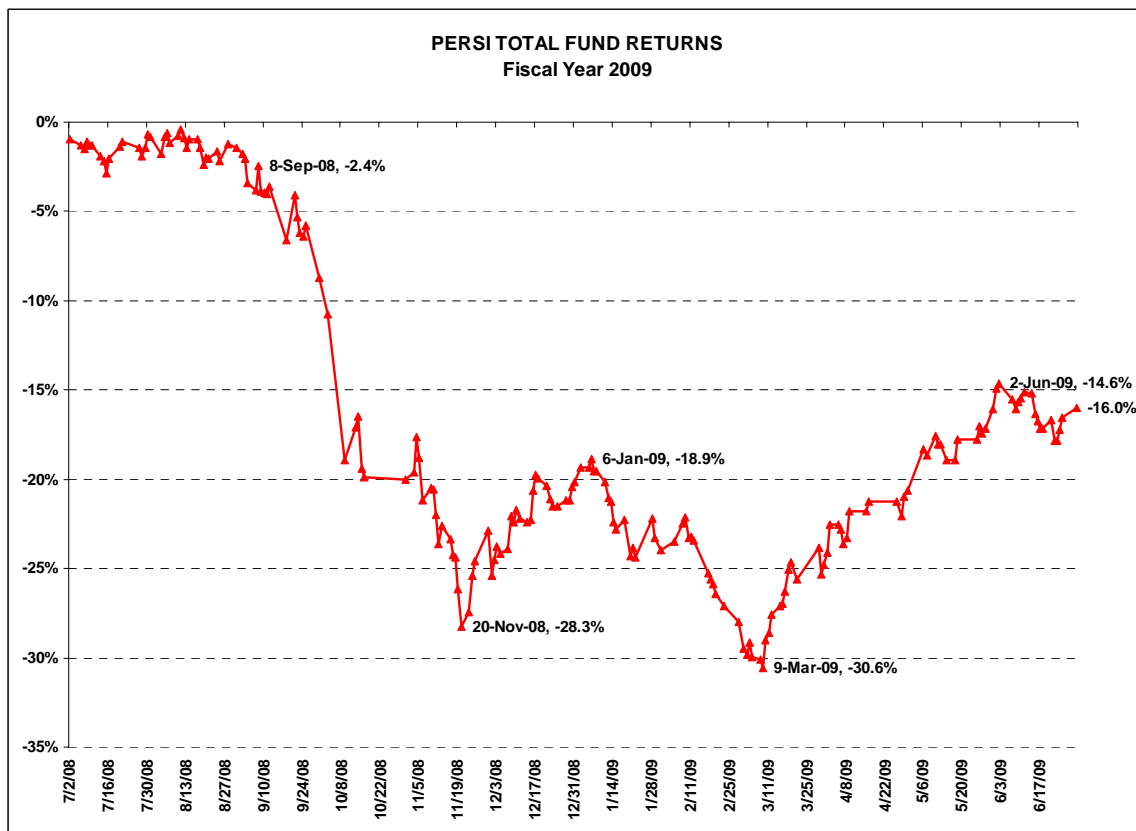


A HISTORY MAKING YEAR

It was a terrible year. As befits the worst economic, financial, and market crisis since the Great Depression, PERSI matched the lowest previous fiscal year return in our history (1974) with a return of -16.0%. The fund ended the year at \$9,075,049,353, representing an investment loss of \$1.75 billion.

It could have been even worse – and for most of the year it was. At one point during the year, PERSI was down over -30%, and was down to below \$7.6 billion. The year was characterized by stunning drops and similarly large and rapid recoveries.

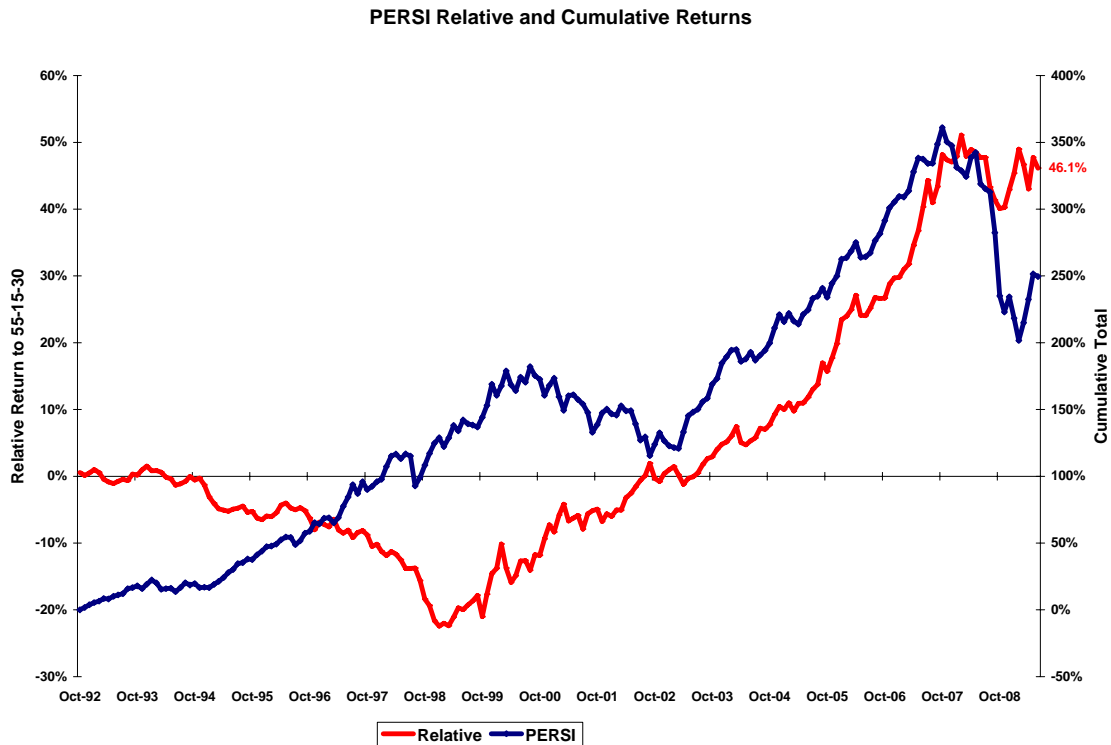


With the collapse of Lehman on September 11th, the world capital markets went into a nose dive the likes of which haven't been seen since 1929-1930. PERSI lost over 26% in the following two months, recovered almost 13% in the next month and a half, lost 14% in the next two months, then made 23% in the succeeding two and a half months. Overall, the returns for the year actually felt much worse than our ending point indicated.

On the other hand, it may have been PERSI’s best year, as well. Although from a purely return perspective we ended the year absolutely depressed, we were actually relatively happy, for three primary reasons: our returns relative to benchmarks (and peers) were excellent, the fund (given the markets) benefited from diversification both in rebalancing and in previous underperformers stepping up relatively to help our returns, and, in one of the most severe stress tests a portfolio could endure, the PERSI fund exhibited no liquidity or operational stresses or strains (unlike many of our peers in pension and endowment land).

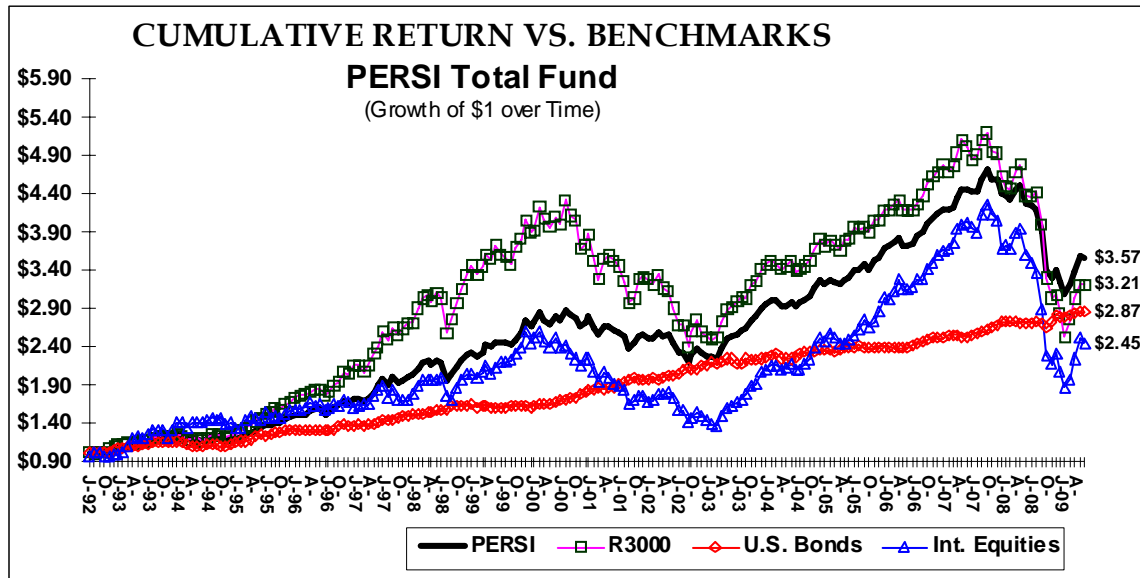
In fact, last year was the type of year where, in the long term, PERSI “makes its money”. As a long term investor that depends on market returns over extended periods of time, our basic goal is to lose less than the markets when markets collapse, and keep up with the markets when they rise. Over time, the cumulative impact of this activity has served PERSI well, and the performance of the portfolio over the past year may turn out to position us very well for the next decade.

PERSI ended up the year well ahead of its strategic benchmarks, and also well ahead of most of its peers. The overall fund outperformed the strategic benchmark (55% Russell 3000, 15% EAFE, 30% BC Aggregate) by over 2.0%, which brings the total outperformance for the PERSI fund over the past 17 years to over 46%:



PERSI’s cumulative returns have also been excellent when compared to the general capital markets. Since 1992, PERSI returns have exceeded every major capital market, and \$1 dollar invested with the PERSI fund would now be worth \$3.57, compared with

\$3.21 in US equities, \$2.87 in bonds, and \$2.45 in international equities. This outperformance has added over \$1.2 billion dollars to total fund value over the past 15 years.



Another silver lining was that during the most severe “stress test” that a portfolio could encounter, PERSI had few, and even then, only very minor problems. Our liquidity remained secure at all times, our insistence on independent, third party daily pricing for our securities kept us out of the toxic and illiquid assets that plagued many institutions, our avoidance of commingled funds – including avoiding the custodial STIF funds – kept us from any “rushing to the exits” of frozen accounts, and our non-participation in securities lending kept us out of the problems fostered on most of the industry in that arena. Our avoidance of hedge funds, portable alpha, and the new asset classes of commodities and similar strategies allowed us to be spectators, and not participants, when much of the industry ran into both performance and liquidity problems (and headline risk with incidents such as the Madoff Ponzi scheme and the Westridge and other frauds causing severe publicity problems for some public funds in addition to the lost money).

In other words, our emphasis on being “simple, transparent, and focused” not only turned out to be the best risk control, but also led to better returns than that experienced by many of our peers. But, “better” is a relative term, and whether one is doing better than others is of faint comfort when everyone is down -16% or more for a year.

The year saw some reversals of roles in contributions to PERSI’s performance, both absolutely and relatively. For the first time this millennium, PERSI’s US only equity contributed substantially to relative outperformance, losing -20.1% compared to the Russell 3000’s loss of -26.7%. The US equity outperformance was due to private real estate and US equity only active manager outperformance (led by Donald Smith and Tukman). Global equities for the first time in many years both underperformed their benchmark and underperformed the US public equity market, with returns of -30.2%

(compared to the MSCI World Index return of -29.2%). Bernstein Global was the primary driver of the relative underperformance. International equity outperformed EAFE by losing -26.9% compared to the index return of -31.1%. The comeback of emerging markets late in the fiscal year drove this result. And, fixed income had a great absolute year with returns of +3.9%, but a terrible relative year compared to the BC Aggregate return of 6.0%. Active manager underperformance (“led” by Western) and a very poor relative year for TIPS were the driving negative factors for this segment of the portfolio.

PERSI’s adherence to rebalancing in volatile times also was a major contributor to fiscal year relative returns. Rebalancing and diversification go hand in hand. There is no diversification benefit without rebalancing – otherwise the total return will simply be the weighted average of the long-term geometric returns. If you don’t rebalance to asset types, you will get no diversification benefit. If you can’t rebalance to an asset type, you cannot get diversification benefits.

Rebalancing benefits increase as volatility rises, and decreases in less volatile times. The benefit of rebalancing after a 10% movement is more than 10 times the benefit after a 1% movement, and the benefit from rebalancing after a 50% move is more than 5 times the benefit after a 10% move. The greatest benefit comes in times, like 2008-2009, when there are wild movements in portfolios.

PERSI rebalances after major market moves, and did so in late October and early November, and again in early March. And, our rebalancing favored moving money to emerging markets and REITS. Both the decision to rebalance and the favoring of these areas added over 1% to total portfolio returns (0.7% from rebalancing to equities, and over 0.3% from favoring emerging markets and REITs in the rebalance).

U.S. only equity had a very good relative year, outperforming the Russell 3000 by 6.6%. The general U.S. equity market had one of its worst fiscal years ever, with a loss by the index of 26.7%. In comparison, PERSI lost only -20.1%, and had a number of segments and managers that did much better (meaning lost a lot less) than the general markets. PERSI’s private real estate was down -7.7% for the year, with the Olympic/Cascade portion down -7.9%, and the Koll properties down -7.4%. The PRISA fund, our open-ended commingled fund, was down -27.3% for the year. Private equity slightly outperformed the public equity markets with a time-weighted loss of -24.1% for the year.

PERSI’s US only public equity managers had a stand-out year in relative returns. Donald Smith lost -10.6% for the year, 16.7% better than either the Russell 3000’s loss of -26.7% or the Russell 2000’s loss of -25.1%. Tukman, with losses of -14.9%, Peregrine, with a loss of -15.7%, and Mountain Pacific, with a loss of -18.1% all had standout relative performances. Only TCW Domestic, with a loss of -29.1%, and Adalente, with a loss of -49.5%, had below benchmark returns (REITs as an area lost more than -45% although with some recovery at the end of the year).

PERSI's global managers had a disappointing year, both against benchmark and compared to US equity markets. The MSCI World Index was down -29.2% for the year, underperforming US markets by over -2%, and PERSI's global managers collectively did even worse by losing -30.2%. Bernstein Global with a loss of -40.5% for the year had the worst of it. Baring's equity, with a loss of -24.3% and Zesiger, with a loss of -26.7% beat their benchmark, while Capital Guardian (-28.9%) and Brandes (-30.1%) had close to benchmark returns. Fortis, who was terminated during the year because of personnel losses, had generally benchmark performance.

International equity, thanks to a late and spectacular run by the emerging markets, had a very good relative year, losing -26.9% compared to the MSCI EAFE loss of -31.1%. The MSCI emerging markets index was down -28.0% for the year, with Genesis substantially outperforming that index with returns of -19.9%, and Bernstein Emerging Markets underperforming with returns of -29.5%. Mondrian (-27.2%) had a relatively good year compared to the markets.

Fixed income did its general work in a disastrous capital market by retaining its value and actually making +3.9% for the fiscal year – unfortunately it could have done better. The general investment grade fixed income market, represented by the re-named Barclay's Aggregate Index, made 6.0% for the year. With liquidity and credit issues at the center of the "Great Collapse", government bonds did well, and everything else had a very rough year. PERSI's underperformance was due to credit exposures by all three of our active bond managers: (Barings with 4.3% returns, Fidelity (now terminated for other than performance reasons) at 2.4%, and Western at 0.1%). The TIPS market also had a very poor year, with the index actually down -1.1% over the fiscal year. Both of PERSI's TIPS exposures did better than the index, with the buy and hold portfolio losing -0.1%, and the Western active TIPS portfolio losing -0.5%, but our exposure to the area still hurt overall relative returns.

The mortgage backed security market and the Idaho mortgage programs were the standout areas of the portfolio, and the best performing segment of the entire portfolio. The Idaho Commercial Mortgage program made 11.0% for the year, far better than the general mortgage index of 8.8%. Although default rates in that program are near 0%, the real driver of the outperformance is our convention of pricing these mortgages off of the Treasury yield curve, which was the standout segment of the fixed income market for the year. Our mortgage backed securities managers both had good years with returns near the benchmark (DBF at +8.4% and Clearwater at +8.1%).

All in all as bad a year as PERSI has ever experienced since its founding in 1965. Given the near collapse and severe devastation wrought over the past year by the Great Collapse and its consequences, however, it was one of PERSI's best relative years ever. A little moderation on both counts over the next few years would be welcome.