

September 20, 2007

## ***A Common Sense Approach to OPEB***

---



**Joseph D. Mason**  
Vice President  
804-780-2000  
jmason@investdavenport.com

**Cleighton L. Hilbert, Jr., CIMA®**  
Senior Vice President  
804-780-2096  
chilbert@investdavenport.com

One James Center  
901 East Cary Street  
Richmond, Virginia 23219  
804.780.2000

**DAVENPORT**  
& COMPANY  
*Building Wealth Together*

## The Challenge

- Establishing an OPEB Program Can Be Complex.
- Many Virginia Localities Lack Sufficient Experience & Assets to Implement Typical Pension-Style Investment Strategies.
- Professionally Managed Pool Programs like VRS may be available in the future, but are currently unproven and cannot be customized to meet specific client objectives.
- Localities Need A Safe and Proven Investment Approach that Allows their OPEB Program to Evolve.

# A Common Sense Approach to OPEB

---

## Davenport Partners:

- Davenport Has Joined With the Following Firms to Provide a Full Range of OPEB-Related Services:

HUNTON &  
WILLIAMS

- Full Capabilities in Employment, Labor & Tax Law
- Generic & Customized OPEB Trust Documents
- Widely Respected National Law Firm



- 32 Years Actuarial & Benefits Consulting Experience
- Basic OPEB Valuations & Multiple “What-If” Scenarios
- Extensive Mid-Atlantic OPEB Valuation Experience

- Use of these firms is optional and not required in the Davenport program. However, “economies-of-scale” pricing may be available for participating localities.

# Three Phases of Implementation

## Phase 1- Preliminary Work

- **No Assets Under Management**
- Initial Liability Measurement
- Assess Initial Affordability of Actuarially Determined Contributions
- Develop Initial Investment Policies and Procedures
- Assess Need and Form of Trust Document
- Develop Appropriate Funding Strategy

## Phase 2- Transition Phase

- **Asset Accumulation Phase**
- Determine Appropriate Asset Allocation Given Projected Cash Flows
- Davenport Analyzes and Recommends Funds and Managers to Meet Goals
- Initial Deposit of OPEB Contribution with Davenport Asset Management
- Monitor Policy Compliance and Investment Performance
- Modify Policies and Asset Allocation Based Upon Performance and Subsequent Actuarial Updates
- Provide Periodic Performance Reports and Meet Regularly to Review Program

## Phase 3- Plan Matures

- **Substantial Assets Under Management**
- Once Sufficient Assets Are Available, Consider Solicitation for Outside Investment Management Consultant
- Consultant Responsible for Engaging a Variety of Individual Asset Managers and Overseeing Their Work in Specialized Sectors of the Trust Portfolio
- Davenport Assists in Transition to New Program as Appropriate

## Four Critical Questions:

1. Do I Need Flexibility In Establishing My Trust?
2. How Readily Can I Enter or Exit The Investment Program?
3. How Do I Get Comfortable That The Risk Profile of The Investment Portfolio Is Suitable?
4. Since there are thousands of Mutual Funds, How Can I Be Sure I Am Getting Access to the Best Managers Available?
  1. Will They Outpace Their Sectors in Up and Down Markets?
  2. Are They Going to Consistently Generate A Competitive Return?

# ***Davenport Asset Management***

---

## ***Overview***

Professional Money Management Division

- 
- *Serving Clients Since 1984*    ➤ *\$3 Billion in Assets*    ➤ *Five Different Strategies*
- 

## Stock Strategies:

- Core Portfolio
- Value & Income Portfolio
- Mid Cap Portfolio

## Mutual Fund Strategy:

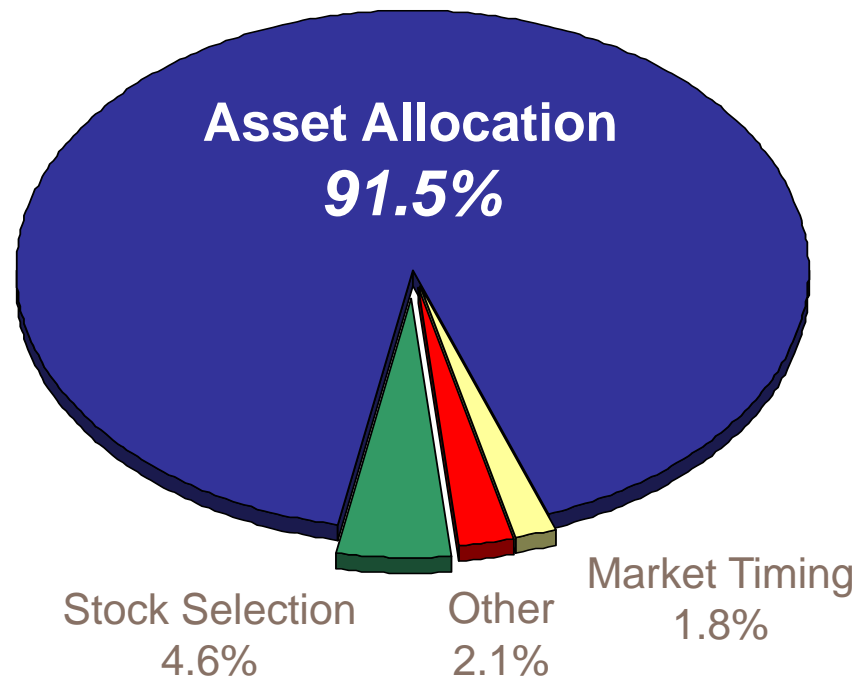
- FundAdvisor (4 Model Portfolios)

## Blended Strategy:

- Blended Allocation Portfolios
  - Core Allocation
  - Value & Income Allocation

## How Important is Asset Allocation?

### Determinants of Portfolio Risk

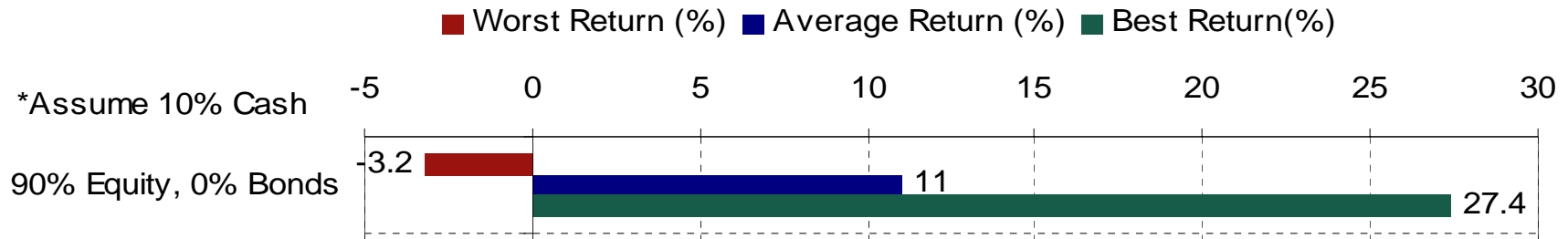


Source: Brinson, Singer and Beebower (1991). The information presented herein was compiled from sources believed to be reliable. It is intended for illustrative purposes only and is furnished without responsibility for completeness or accuracy.

# Asset Allocation

Across Stocks, Bonds & Cash

## Five Year Rolling Returns: January 1950 – June 30, 2007



Stocks: Standard & Poor's 500 Stock Index; Bonds: 5 Year Treasury Bonds; Cash: 90-Day Treasury Bills

Sources: Standard & Poor's Corporation; Ryan Labs, Inc.; Lehman Brothers; Copyright©2005 Crandall Pierce & Co.

The S&P 500 Index is comprised of 500 U.S. stocks and is an indicator of the performance of the overall U.S. stock market. An investor cannot invest in an index, and its returns are not indicative of the performance of any specific investment. The information presented herein was compiled from sources

believed to be reliable. It is intended for illustrative purposes only and is furnished without responsibility for completeness or accuracy. Past performance

does not guarantee future results.

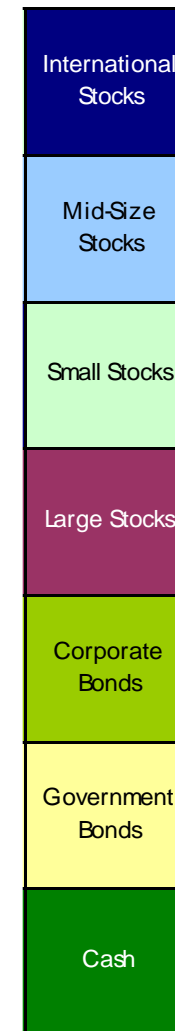
\*Returns as of June 30, 2007

Data: Rolling 5 year returns using monthly data

# Asset Allocation

Across Sub-Asset Classes

2004



Source: Zephyr StyleADVISOR (Data as of December 31, 2006). Past performance is no guarantee of future results. It is not possible to invest directly in an index. See Disclosures in the Appendix.

## Ibbotson Associates

*Ibbotson Associates is widely recognized as one of the foremost authorities on asset allocation and has been providing institutional advice and services since 1977.*

---

To “bridge the gap between modern financial theory and real world investment practice.”<sup>1</sup>

---

- Portfolio allocations range from conservative to aggressive
- Achieve targeted returns with minimal risk
- Long-term emphasis

---

1. Ibbotson Associates, Executive Summary, Page 1

# Asset Allocation

Establishing an Appropriate Asset Allocation

Expected Return: 12.0  
Expected Risk: 19.7

- **Maximum Growth**
- **Growth**
- **Conservative Growth**
- **Balanced**
- **Conservative Balanced**
- **Risk Averse**

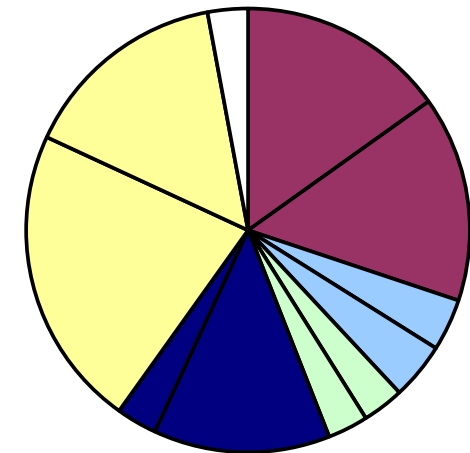
Expected Return: 5.7  
Expected Risk: 5.8

## Sample Balanced Model

*(For Discussion Only, Not a Recommendation)*

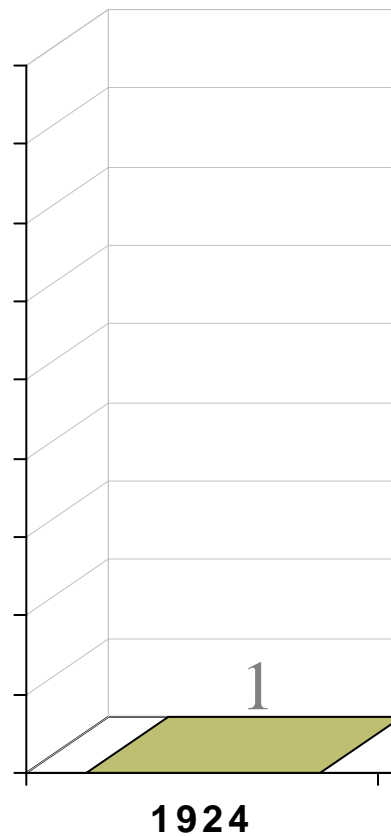
**Equity 60% Fixed Income 37% Cash 3%**

- 15% Large Cap Growth
- 15% Large Cap Value
- 4% Mid Cap Growth
- 4% Mid Cap Value
- 3% Small Cap Growth
- 3% Small Cap Value
- 13% International
- 3% Emerging Markets
- 22% Interm. Term Bonds
- 15% Short Term Bonds
- 3% Cash



Expected statistics are 20-year estimates based on the model allocations of sub-asset classes (Large Cap, Mid Cap, Small Cap, etc.). These expected statistics were calculated using proprietary processes of Ibbotson Associates. Portfolio Holdings are subject to change at any time.

## Number of Mutual Funds



Data as of 12/31/2006.  
Source: Investment Company Institute

## What We Look For in Managers

---

*We want disciplined managers that outperform by taking less risk*

---

### 1. The Numbers

*Consistency and long-term success*

### 2. The Portfolio and Style

*Diversified funds that deliver what they promise*

### 3. The People and Culture

*Experienced & passionate professionals whose convictions breed a culture of discipline.*

### 4. The Literature

*Clean operations and no hidden surprises.*

Rolling period analysis relative to peers and benchmarks

- Good Returns
- Holdings-Based Analysis
- Performance-Based Style Analysis
- Turnover and Expense Comparisons

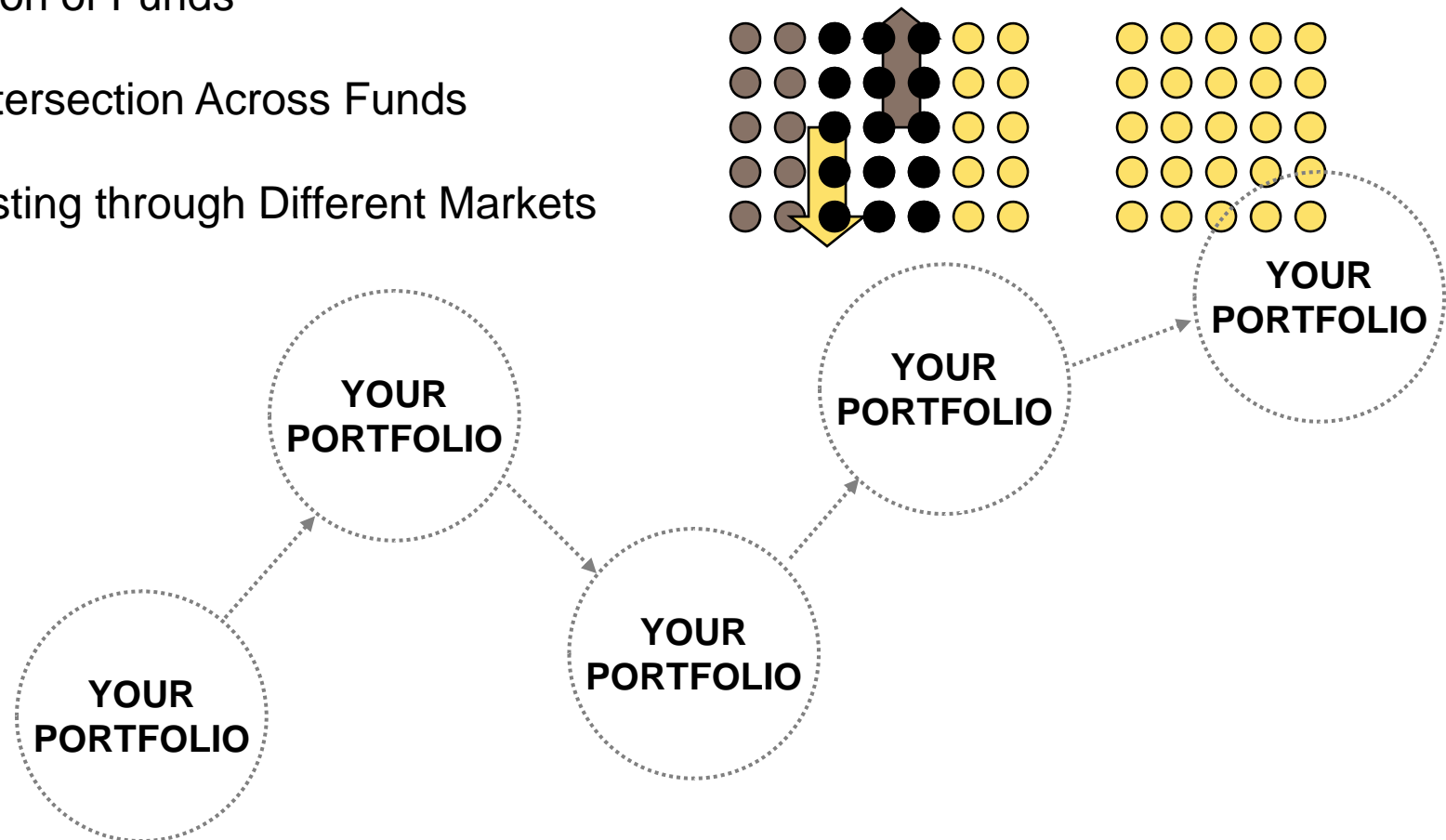
Due Diligence Interview

- Experienced Mgmt & Long Tenure
- Sound Philosophy & Strategy
- Effective Research Process
- Prospectus
- Statement of Additional Information
- Other Reports & Forms

Best-in-Category  
Managers

## Portfolio Construction

- Correlation of Funds
- Stock Intersection Across Funds
- Back Testing through Different Markets



## Monitoring & Rebalancing

### Manager Monitoring

---

- Performance & Risk
- Manager Change
- Strategy Change or Style Drift
- Regulatory Issues

### Rebalancing

---

- Performed Annually
- Buy Low and Sell High
- Realign your portfolio with long-term goals

- **Team Approach to Service**
- **Regular In-Person Reviews**
- **Customized Reporting**

- Monthly Statements
- Trade Confirmations
- Quarterly Performance Reporting
  - Asset Growth
  - Total Portfolio Performance
  - Underlying Manager Performance
  - Underlying Manager Violations of *Monitoring Criteria*
  - Target vs. Actual Asset Allocation Analysis
  - Holdings Summary
  - Trade Activity Summary

## What We Offer You:

**A Process:** by which we work together to determine your needs and requirements.

**A Solution:** in which you will gain access to some of the leading asset management firms throughout the country.

**A Commitment:** to discipline, integrity and the highest standards of personal attention.

To help you in your decision making process, we will be happy to compare our proven and documented track record with any other proposed portfolios you receive, at no cost to you.

# Glossary of Terms

---

This glossary is intended to provide readers with a general understanding of terms used to describe Davenport's proprietary screening and monitoring processes in Blended Allocation Portfolios marketing materials. This glossary is not intended to provide readers with mathematical or statistical details.

**Absolute Returns:** the nominal percentage return of a mutual fund.

**Average Credit Quality:** an average of each bond's credit rating, adjusted for its relative weighting in the portfolio.

**Average Maturity:** a weighted average of all the maturities of the bonds in a portfolio, computed by weighting each maturity date (the date the security comes due) by the market value of the security.

**Batting Average:** the percentage of periods that a mutual fund outperforms its benchmark.

**Capture Ratio:** measures how well a mutual fund was able to replicate or improve on positive benchmark returns, and how badly the mutual fund was affected by negative benchmark returns.

**Correlation (R-Squared):** the degree to which the returns of the mutual fund move with the returns of the benchmark. R-Squared is the square of correlation. It indicates the percentage of the mutual fund's movements that can be explained by the movements of the benchmark.

**Expense Ratio:** the percentage of fund assets paid for operating expenses and management fees, including 12b-1 fees, administrative fees, and all other asset based costs incurred by the fund, except brokerage costs.

**Market Up's and Down's:**

**Max Drawdown:** represents the manager's maximum loss during any sub-period of the entire time period.

**Max Run-up:** represents the manager's largest gain during any sub-period of the entire time period.

**Up Market Average Return:** represents the manager's average return when its benchmark is up.

**Down Market Average Return:** represents the manager's average return when its benchmark is down.

**Market Relative Gain to Loss Ratio:** represents the ratio of the Up Market Average Return to the down Market Average Return.

**Up Market Capture Ratio:** represents how well a manager was able to replicate or improve on phases of positive benchmark returns.

**Down Market Capture Ratio:** represents how badly a manager was affected by phases of negative benchmark returns.

**Omega:** represents the ratio of expected positive returns to expected negative returns.

**Pain Index:** represents the frequency, depth, and width of a manager's drawdown(s).

**Peer Group (Category):** a composite of similar mutual funds (based on factors such as capitalization, style, and/or geography).

**Peer Group Median:** the midpoint of a range of numbers arranged in order of value, the range is constructed using values from each member of the peer group.

**Peer Group Average:** the sum of all values of a given statistic for each member of a peer group divided by the number of members in that peer group.

**Performance (Returns) Based Style Analysis:** calculates a style benchmark for a mutual fund from a mutual fund's return series and the return series of a select set of indices, that style benchmark best tracked the returns of the mutual fund over the period analyzed.

# Glossary of Terms

**Quartile:** a range of numbers that are arranged in order of value can be divided into four sections of an equal number of observances such that each section represents 25% of the total number of observances, each section of 25% is known as a quartile.

**Risk:** can be defined and measured in many different ways. Davenport uses the following measures to evaluate risk for the Watch List Criteria:

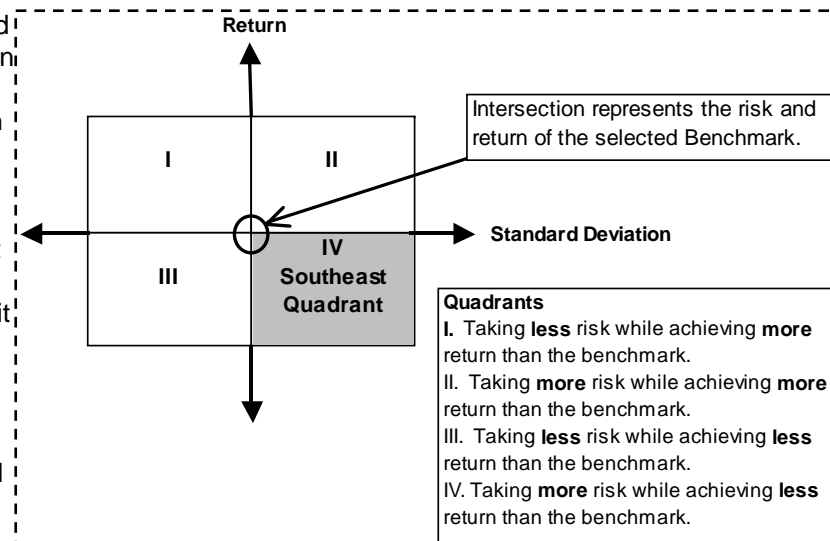
1. **Beta**—market risk or non-diversifiable risk. It can be thought of as the sensitivity of a mutual fund's returns to the returns of the market.
2. **Downside Deviation**—the variability of returns that are below a designated level (such as the risk-free rate or zero).
3. **Upside Deviation**—represents the standard deviation of a manager's positive returns
4. **Standard Deviation**—the variability of returns around the average return. Roughly two thirds of the funds returns fall within the average return plus or minus one standard deviation.
5. **Tracking Error**—active risk, standard deviation of returns in excess of the benchmark's returns

**Risk-Adjusted Returns:** returns that have been adjusted for the risk that the mutual fund has taken over the period being measured. Davenport uses the following measures when evaluating risk-adjusted returns for the Watch List Criteria:

1. **Alpha**—a measure of value added. It can be thought of as the mutual fund's return if the market returned nothing.
2. **Information Ratio**—a measure of excess return per unit of excess risk (as measured by Tracking Error)
3. **Sharpe Ratio**—a measure of reward (excess return over the risk-free rate) per unit of risk taken (as measured by Standard Deviation)
4. **Treynor Ratio**—a measure of reward (excess return over the risk-free rate) per unit of risk taken (as measured by Beta)

**Risk/Return Scatterplot:** a graph representing the risk (as measured by Standard Deviation) and return characteristics of a mutual fund over a given period of time. The depiction to the right is an example.

**Southeast Quadrant:** the area of the risk/return scatterplot that indicates that the mutual fund has taken higher risk and achieved a lower return than the benchmark over the period being measured.



**Style Drift:** the degree to which a mutual fund has drifted away from its stated style. For Watch List Criteria purposes, Davenport evaluates style drift using Performance Based Style Analysis.

**Turnover:** the lesser of purchases or sales (excluding all securities with maturities of less than one year) divided by the average monthly net assets.

## **Asset Allocation Category Definitions:**

**Corporate Bonds:** This group was evaluated using the Citigroup Corporate Bond 3-7 Year Index of intermediate-term corporate, high grade bonds rated BBB through AAA/AA. The bonds represented by this index involve risks, including default and loss of principal.

**Government Bonds:** This group was evaluated using the Citigroup Treasury/Agency 3-7 Year Index of intermediate-term government debt securities. The bonds represented by this index involve risks, including default and loss of principal.

**International Stocks:** Performance for this group was found through the Morgan Stanley Capital International Index focusing on Europe, Australia and the Far East, the index is commonly referred to as MSCI EAFE. This index is a widely recognized benchmark based on 21 developed international market indices. International stocks are subject to additional risk, including loss of principal, and varying accounting standards. International funds invest primarily in equity securities of issuers outside the United States. World stock funds are funds that invest primarily in equity securities of issuers located throughout the world, while maintaining a percentage of assets (normally 25% to 50%) in the United States. International investments are subject to additional risks such as currency fluctuations, political instability and the potential for illiquid markets.

**Large Stocks:** The ranking of this asset class is based on the performance of the S&P 500. This composite is a market capitalization weighted price index composed of 500 widely held common stocks listed on the New York Stock Exchange, American Stock Exchange and Over-The-Counter market. The value of the index varies with the aggregate value of the common equity of each of the 500 companies. The stocks represented by this index involve investment risks which may include the loss of principal invested.

**Mid-Size Stocks:** Davenport considers companies with market capitalizations between \$2 billion and \$10 billion to be "Mid-Size" or "Mid Cap" companies. Performance of Medium-size stocks, or mid-cap stocks, is evaluated using the Russell Midcap Index. The Russell Midcap Index includes 800 medium sized companies, is completely reconstituted annually and represents an unbiased barometer for the mid-cap segment. The stocks represented in this index may experience loss of principal and are subject to investment risk.

**Cash:** Performance of the Cash asset class is based on the Citigroup 3-Month Treasury Bill, which represents the 3-Month US Treasury Bill as a proxy for cash. Although money market funds seek to preserve the value of your investment at \$1.00 per share, it is possible to lose money.

**Small Stocks:** Performance for this asset class is based on the Russell 2000 Index. This index measures the performance of the 2000 smallest companies in the Russell 3000 Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index. The stocks represented by this index involve investment risks which may include the loss of principal.

## **Benchmark Definitions:**

**Russell 1000® Index** measures the performance of the 1,000 largest companies in the Russell 3000 Index, which represents approximately 92% of the total market capitalization of the Russell 3000 Index.

**Russell 2000® Index** measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index.

**Russell Midcap® Index** measures the performance of the 800 smallest companies in the Russell 1000 Index, which represent approximately 25% of the total market capitalization of the Russell 1000 Index.

**MSCI EAFE® Index (Europe, Australasia, Far East):** is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the US & Canada.

**MSCI Emerging Markets:** is a capitalization-weighted index of stocks from 26 emerging markets that only includes issues that may be traded by foreign investors. The reported returns reflect equities priced in US dollars and do not include the effects of reinvested dividends.

**Lehman Brothers Intermediate Government Index** is an unmanaged index based on publicly issued intermediate government debt securities. Average maturity of 4 years. This index represents asset types which are subject to risk, including loss of principal.

**Lehman Brothers Intermediate Government/Corporate Index** is an unmanaged index composed of debt securities with maturities from one to ten years issued or guaranteed by the U.S. Treasury, U.S. Government agencies, quasi-federal corporations and fixed rate dollar denominated SEC-registered corporate debt that are rated investment grade or higher by Moody's Investors Service and Standard and Poor's Corporation or Fitch Investor's Service, in that order.

**Citigroup 3-Month U.S. Domestic Treasury Bill Index:** is an unmanaged index designed to represent the average of U.S. Domestic T-bill rates for each of the prior three months, adjusted to a bond-equivalent basis.

The value of equity investments are more volatile than other securities. Corporate and U.S. government bond funds fluctuate in value and may be worth more or less when redeemed than their original investment. Investments in small- and mid-capitalization stocks generally involve greater risks than investments in the stocks of larger companies; hence, the prices of investing in small- and mid- capitalization stocks may be more variable that those of funds investing in larger companies. International funds invest primarily in equity securities of issuers outside the United States. World stock funds are funds that invest primarily in equity securities of issuers located throughout the world, while maintaining a percentage of assets (normally 25% to 50%) in the United States. International investments are subject to additional risks such as currency fluctuations, political instability and the potential for illiquid markets.

**Disclosures:**

Indices are unmanaged and cannot be invested in directly. Returns are calculated by using historical performance of market indices generally accepted to represent market segments as stated above. Past performance is no guarantee of future results. The information provided is for information purposes only and should not be considered an individual recommendation or personalized investment advice. Each investor needs to review his or her particular situation. Data contained here is obtained from what are considered reliable sources; however, its accuracy, completeness or reliability cannot be guaranteed.

# DAVENPORT & COMPANY LLC

---

**EST. 1863 • MEMBER: NYSE • SIPC**

**Joseph D. Mason**

Vice President

804-780-2000

[jmason@investdavenport.com](mailto:jmason@investdavenport.com)

**Cleighton L. Hilbert, Jr.**

Senior Vice President

804-780-2096

[chilbert@investdavenport.com](mailto:chilbert@investdavenport.com)

# Investment Policy Committee

## Davenport Equity Research

- 12 Analysts
- 160 Securities

## Correspondent Research

- Credit Suisse First Boston
- D.A. Davidson

## Portfolio Specialists

- Former Equity Analysts
- Explore IPC Ideas
- New Ideas & Themes

## Investment Policy Committee

- **7 Professionals**
- **52 Years:** Avg Age
- **28 Years:** Avg Experience
- **24 Years:** Avg Tenure
- **Daily Interaction**
- **Weekly Meetings**

## Davenport Manager Research

- 5 Member Team
- Thousands of Managers
- Best-in-Category:
  - Mutual Funds
  - Asset Managers

## Ibbotson Associates

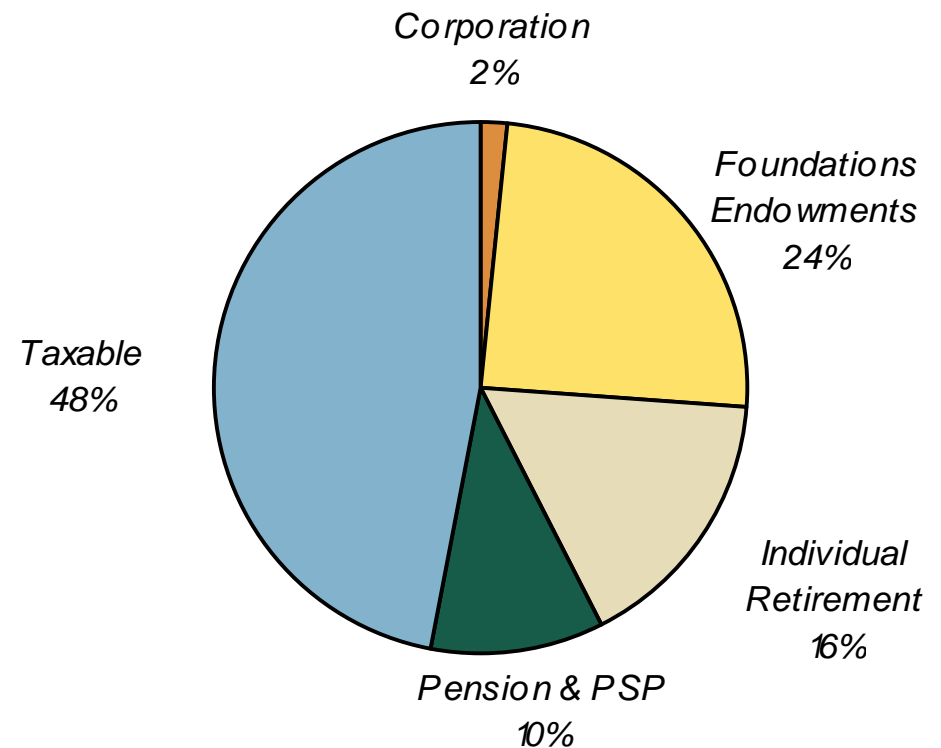
- Capital Mkt Assumptions
- Asset Allocation Advice

## Client Types

- Affluent Individuals
- Foundations and Endowments
- Pensions and Profit Sharing Plans
- Fine Arts and Museums
- Continuing Care Retirement Centers
- Historical Societies
- Law Enforcement Organizations
- Religious Groups
- Social Services

## Allocation by Client

(For The Core Portfolio)



We do not use performance based criteria to determine clients on this list. We attempted to select well known, institutional clients in or around Richmond, VA. It is not known whether the listed clients approve or disapprove of Davenport & Company LLC as an advisor or of our advisory services.