

City of Pontiac General Employees' Retirement System

Management's Discussion and Analysis

Using this Annual Report

This annual report consists of three parts: (1) management's discussion and analysis (this section), (2) the basic financial statements, and (3) required supplemental information. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data. The statements are followed by a section of required supplemental information that further explains and supports the information in the financial statements.

Condensed Financial Information

The table below compares key financial information in a condensed format between the current year and the prior year:

	Fiscal Year Ended December 31	
	2005	2004
Total assets	\$ 489,069,164	\$ 476,831,091
Total liabilities:		
Amounts due broker under securities lending agreement	52,857,655	46,743,999
Other liabilities	754,175	657,582
Total liabilities	<u>53,611,830</u>	<u>47,401,581</u>
Assets held in trust for pension benefits	<u>\$ 435,457,334</u>	<u>\$ 429,429,510</u>
Net investment gain	\$ 23,113,895	\$ 33,722,655
Net securities lending income	100,187	79,396
Contributions:		
Employee - Reinstated members	20,291	9,709
Employer	16,926	13,613
Retiree pension and annuity benefits	<u>16,562,544</u>	<u>14,546,774</u>
Benefits paid in excess of contributions	16,525,327	14,523,452
General and administrative expenses	<u>660,931</u>	<u>226,698</u>
Net increase in net assets held in trust	<u>\$ 6,027,824</u>	<u>\$ 19,051,901</u>

City of Pontiac General Employees' Retirement System

Management's Discussion and Analysis (Continued)

Overall Fund Structure and Objectives

The City of Pontiac General Employees' Retirement System (the "System") exists to pay benefits to its members and retirees. Active members earn service credit that entitles them to receive benefits in the future. Benefits currently being paid are significantly greater than contributions currently being received. The excess of benefits over contributions must be funded through investment income. The public capital markets represent the primary source of investments.

Asset Allocation

The System has established asset allocation policies, which are expected to deliver sufficient investment income over a very long period of time to satisfy the obligations to pay the benefits promised to the members of the System. The following is a summary of the adopted asset allocation as of December 31, 2005:

Domestic equities	40%
International equities	10%
Domestic fixed income	36%
Global fixed income	8%
Real estate	5%
Cash	1%

Investment Results

While returns were down from the prior year, both the domestic equity and domestic bond markets posted positive returns during the past year. In 2005, U.S. equities were again helped by strong profits, as well as by the expectation that the federal reserve would raise rates only one or two more times during the first quarter of 2006 and may even begin to lower rates by the end of 2006. U.S. bonds were helped by benign inflation reports and continued foreign investment in domestic bonds. The domestic equity market, as measured by the S&P 500 Index, returned 4.9 percent for the year. The fixed income market, as measured by the Lehman Aggregate Index, returned 2.0 percent for the year. The international equity market, as measured by the MCSI EAFE (non-U.S.) Index returned 13.5 percent for the year. The total fund returned 5.44 percent for the year.

The System's total fund return must always be considered in a longer-term context. The asset allocation of each fund is built upon the foundation that the obligations of the System to pay the benefits promised to members and retirees are very long-term obligations. Accordingly, the board of trustees must make investment decisions that it believes will be the most beneficial to the System over many years, not just one or two years.