YOUR PENSION MATTERS

Pompano Beach Police & Firefighters' Retirement System

Fiscal Year 2006

Fourth Quarter Ended September 30, 2006

by: Lt. Paul O'Connell
Board Chairperson

"There are two times in a man's life when he should not speculate. When he can't afford it and when he can." Mark Twain

Thus, your Pension Board does **NOT** speculate. As stated in our prior newsletters, many of our investment decisions are guided by the Pension Board's adopted "investment guidelines" which act as the backbone of our investment philosophy (a newly revised copy of the guidelines can be viewed on our web site or obtained from our pension office). Remember, our investment strategy is a long term strategy (20 years and beyond) which seeks to invest for maximum returns with minimum risks. Currently, our guidelines call for an investment split of 65% equities and 35% bonds. Compare this with the Florida Retirement System (**FRS**) which has investment guidelines that prohibit investments of more than 20% in fixed income (bonds). That is a very aggressive position in contrast to our guidelines.

Before we review our equity investments (bonds were reviewed in our March 2006 newsletter), we would be remiss if we did not take time to recognize and thank retired Battalion Chief Bob Lynn for his 10 years of service on the Board of Trustees for the Pompano Beach Police & Fire Retirement System. We wish him the very best in his retirement from firefighting service for the City of Pompano Beach. We welcome onto the Pension Board Fire Inspector Peter McGinnis, who was elected by acclamation to replace Bob on the Pension Board. On a personal note, I too was elected to the Board by acclamation for another 3-year term and I thank all of you for your trust in me. In addition, I was re-appointed Chairperson for the Board and I thank my fellow Trustees for their confidence in me. Finally, Richard Avallone was selected as our Board Vice-Chairperson and I look forward to working with him and the entire Pension Board to face the many challenges in the year ahead of us.

Legal Update: As discussed in our 9/5/06 letter to you, Judge Eade ruled on the Board's Motion for Summary Judgment and simultaneously ruled on the City's Motion for Summary Judgment regarding 2 of the 4 issues in controversy (2003 & 2004 1% variable COLA and BSO's 8.6% employee contribution counted as pensionable wages). In a nutshell, the Judge "split the baby." He ruled in favor of the Board's Motion for Summary Judgment regarding the Board's past decisions to grant the 1% variable COLA for retired police officers, thus denying the City's Motion for Summary Judgment on the same issue. Judge Eade granted the City's Motion for Summary Judgment on BSO's 8.6% employee contribution being recognized as pensionable wages.

All parties met in a settlement meeting held on 10/3/06. The details of that meeting are confidential as the parties exchanged settlement proposals in an effort to find common ground. All parties will now review these proposals with their respective clients and return to the table on a date yet to be determined.

In the investment world, the 3 most important factors are diversify, diversify and diversify. Thus, over the past 10 years your Board of Trustees has worked very hard at spreading our investments over a broad range. For example, in 1997 we had three (3) money managers in the traditional investment world of US

based equities and bonds. We now have seven (7), four (4) of which are in equities.
Now it is time to look at our position in equities.

EQUITIES: In this newsletter we will discuss equities, an investment that can return more, but certainly can have more risk. For example, during the recent recession the equity market suffered double digit losses from 2000 – 2002 while the bond market had double digits gains.

Currently, we are invested in four segments or types of equities: large cap growth (**Sands Capital**), large cap value (**Lord Abbett**), an Index Fund (**Freedom Capital**) that attempts to switch back and forth from growth and value index equities based on market conditions and finally, international equities (**Invesco**). Growth implies exactly what you would expect; long term growth (both in earnings and revenue) of companies in which you invest.

Value-oriented fund manager: Our **Lord Abbett** money manager currently holds $37 million (or 22% of the Fund) and seeks out those stocks issued by companies that have fallen out of favor and that they consider bargain-priced relative to their potential underlying value. While these stocks have low valuations, they have historically demonstrated attractive performance. Of course, that often takes time and there is no guarantee it will ever come to pass. The objective for the value investor is to spot bargains the rest of the market has missed. That's possible thanks to market research, market inefficiencies and other factors such as cash flow, P/E ratio, past earnings, corporate management and product development. Clues may be found in any one or several of these items that would lead a **long term investor** to invest in a particular company because of its potential for excellent returns. During the quarter, Lord Abbett returned 6.96% and during the past year Abbett has out-performed its benchmark (Russell Value 1000) 14.88% v. 14.59%. Thus, the Board is pleased with Lord Abbett's performance and direction and will, with the help of our consultant, continue to monitor their performance.

Large cap growth fund manager: **Sands Capital,** currently at $35 million (or 21.4% of the Fund), looks for stocks with high potential for growth based on their respective products, demand for those products (both current and potential future demands), production efficiencies and management stability. This fund manager targets these companies from a "bottom up" approach which means that the following items are of extreme importance in deciding whether or not to invest in the company: potential market for their product(s), efficiency in product production and the management team in place to provide long term stability in the company. Of all investments, this is the most volatile, but, at the same time it holds the most potential for outstanding returns on investments. By its very nature, this is a "measured risk" in which potential return substantially outweighs the risk encountered. Sands Capital has demonstrated outstanding performance since the Board hired them in May 2003 averaging 12% return per year. Of course, the Board will continue to monitor their performance.

Large cap asset allocation manager: **Freedom Capital** provides an **Index Fund** based on market conditions which selects either a growth index or value index (whichever is in favor based on their market research). Freedom Capital is currently at $15 million (or 9% of the Fund. First, it is important to understand exactly what is "indexing". Indexing is simply matching your asset allocation to parallel particular market index. Freedom Capital swings back and forth between the Russell 1000 Value and Russell 1000 Growth, depending on which is in favor. Because this is an investment which parallels an Index, the Fund pays at a substantial discount for this investment team. Again, your Board monitors the money manger's performance through the Board's consultant.

International investment manager: Through **Invesco**, the Fund invests in large cap companies domiciled in foreign countries (investment is currently at $13.7 million or 8% of the Fund). Until very recently, your Pension Funds had zero exposure to the foreign market. We strongly believed that we were "missing the boat" by not being invested in this important segment of the investment universe which has the advantage of giving us more diversity in our equity holdings. By State Statute, we are limited to 10% exposure in foreign equities and we are currently at 8 % exposure. The Board invests only in those foreign companies that trade in ADRs (American Depository Receipts). What are ADRs? They are negotiable certificates issued by a depositary institution (usually a bank) which represent ownership of securities of non-US companies held outside the US on behalf of US investors. Importantly, ADRs are US securities traded on US exchanges and, as such, they are regulated by the SEC and are denominated in US dollars and trade in US dollars. These facts accomplish many things.

First, because the SEC oversees these companies and the trading of their shares, there is a certain "security" to this investment. Everyone plays by the same set of rules (US rules), not perfect, but certainly gives the investor the ability to sleep at night. Second, because ADRs trade in US dollars we have no exposure to dramatic swings in currency fluctuations. Last, and most important, the Fund's consultant provides us a fiduciary review of Invesco and its investments. In other words, the Fund's consultant has a duty to monitor the investments made, the performance of the Invesco investment team and provide the Board with a quarterly performance review. YTD for 2006 has shown a 15% return on investments. The Board of Trustees is very pleased with this performance and, with the assistance of our consultant, will continue to monitor Invesco.

A quick note on our performance over the past year as 9/30/06 marked the end of fiscal year 2005-06 - for the quarter ending 9/30/06, the Fund returned **3.94%** gross of fees. A good quarter in light of our asset allocation, however, some may think not in line with the rest of the market. For the entire year ending 9/30/06, the Fund returned 6.74%. Again, a solid return, but it is nothing to get excited about. Remember, asset allocation (diversification), more than anything else, determines how the Fund performs. Your Board of Trustees continues to modify the Fund's investments expanding into the international market and into the real estate market (the topic of our next newsletter) in an effort to secure better returns on our investments.

Do not be fooled by the "record highs" set for the **Dow** during October. Remember, the Dow consists of only 30 stocks and is not the most accurate gauge of the health of the broader market. For example, while the Dow hit a new high, the S&P 500 (which accounts for **75%** of the market's total value) is still 12.7% below its all-time high. The tech heavy **NASDAQ** is 55.6% below its all-time high. In fact, the total value of the stock market is still **$1.6 trillion LESS** that it was at its 2000 high. These are just numbers that may or may not give an accurate reflection of the overall economy. There are many, many factors involved. What is important to us is how we, as a Fund, do in our investments.

Here is some **important information** gleaned from the **<u>Pension Protection Act of 2006</u>** that affects all of us:

1. Starting in **2007**, our current and future retirees who buy health insurance or long term care insurance from their former employer will be able to deduct up to $3,000 of that expense from their taxable pension income. The pension office will be sending a full explanation of this benefit which should save each retiree between $750 and $1000 in federal taxes every year.

2. Starting immediately, withdrawals from DROP accounts for retirees age 50 and over are no longer subject to the 10% early withdrawal penalty. The age was dropped down from 55 years of age. The withdrawal will still be taxed as regular income tax rates. As before, tax free rollovers are available at any age.

In our next newsletter we will review our developing position in real estate, why we have chosen to delve into this alternative investment market, how we accomplished this and the prospects for the future.

Until then, stay safe and stay in touch!

BREAKDOWN OF RETURNS
Pompano Beach Police & Firefighters' Retirement System
As of September 30, 2006

LORD ABBETT/BOSTON *	**Your Returns**				
Large Cap. Value	**Gross**	**Net**	**Russ 1000 Value**	**Money Mgrs.**	**S&P 500**
Quarter	6.96	6.81	6.21	NA	5.67
1 year	14.88	14.23	14.59	NA	10.78
Since 10/31/2004	12.17	11.60	15.37	NA	11.16
Lord Abbett/Boston - 3 year	13.22	12.67	17.23	NA	12.29
Lord Abbett/Boston - Since 9/30/2002	16.39		18.98	NA	15.20
Lord Abbett/Boston - 5 year	6.90		10.72	NA	6.97
Lord Abbett/Boston - Since 6/30/1995	10.59		12.35	NA	10.13
SANDS CAPITAL					
Large Cap. Growth			**Russ 1000 Growth**	**Money Mgrs.**	
Quarter	0.83	0.68	3.93	NA	
1 year	(1.43)	(1.98)	6.04	NA	
3 year	10.15	9.52	8.36	NA	
Since 5/31/2003	12.00	11.40	9.19	NA	
FREEDOM CAPITAL *					
Large Cap. Asset Allocator			**S&P 500**		**Dynamic Index****
Quarter	4.09	3.98	5.66		3.93
1 year	5.55	5.21	10.78		4.59
3 year	7.71	7.38	12.29		7.56
Since 9/30/2002	12.24	11.90	15.20		12.33
Since 3/31/2002	2.79		5.30		2.79
INVESCO					
International			**MSCI EAFE Net**		
Quarter	4.93	4.93	3.93		
1 year	19.36	18.79	19.16		
Since 1/31/2004	17.90	17.26	17.61		
ALLEGIANCE CAPITAL					
Fixed Income			**LB Int. Aggregate**	**LB Aggregate**	**LB Int. Gov/Credit**
Quarter	3.40	3.34	3.41	3.81	3.19
1 year	3.57	3.31	3.84	3.67	3.54
3 year	3.10	2.85	3.15	3.38	2.56
Since 5/31/2003	2.78	2.54	2.89	2.93	2.27
STANDISH MELLON					
Fixed Income			**LB Aggregate**	**LB Int. Aggregate**	**LB Int. Gov/Credit**
Quarter	3.78	3.71	3.81	3.41	3.19
1 year	3.67	3.37	3.67	3.84	3.54
3 year	3.60	3.21	3.38	3.15	2.56
Since 9/30/2002	3.60		3.88	3.60	3.41
MUNDER CAPITAL					
Fixed Income			**LB Aggregate**	**LB Int. Aggregate**	**LB Int. Gov/Credit**
Quarter	3.61	3.55	3.81	3.41	3.19
1 year	3.96	3.84	3.67	3.84	3.54
3 year	3.64	3.42	3.38	3.15	2.56
Since 9/30/2002	3.91	3.65	3.88	3.60	3.41
INVESCO					
REIT			**NAREIT**		
Quarter	8.53	8.26	9.27		
INVESCO					
Private Real Estate			**LB Aggregate**		
Since 7/31/2006	1.32	1.32	2.42		
TOTAL FUND *					
			Total Fund Index		
Quarter	3.94	3.82	4.67		
1 year	6.74	6.28	8.85		
3 year	8.89	8.44	10.05		
Since 9/30/2002	11.09	10.63	12.00		
5 year	6.15				
Since 6/30/1995	7.90				

Total Fund Index comprised of 25% Russell 1000 Value/ 25% Russell 1000 Growth/ 15% Dynamic Index/ 23% LB Aggregate/ 12% LB Int. Aggregate for periods prior to January 31, 2004; 22.5% Russell 1000 Value/ 22.5% Russell 1000 Growth/ 12% Dynamic Index/ 8% MSCI EAFE Net/ 23% LB Aggregate/ 12% LB Int. Aggregate for periods from January 31, 2004 to April 30, 2006; and 22.5% Russell 1000 Value/ 22.5% Russell 1000 Growth/ 9.5% S&P 500/ 8% MSCI EAFE Net/ 25% LB Aggregate/ 10% LB Int. Aggregate/ 2.5% NAREIT for periods thereafter.

* Per the Board's request, all performance results (including but not limited to rates of return, risk, measures, unit values, and dollar values) prior to September 30, 2002, were provided by GRS Asset Consulting Group, who was the previous consultant. The performance data is believed to be accurate, but there is no assurance. Smith Barney Consulting Group has not calculated or independently verified the accuracy of the returns or market values and is not responsible or liable for any mistake or miscalculations. Effective September 30, 2002, all valuations and rates of return are calculated by Smith Barney Consulting Group.

** Dynamic Index represents blended performance of S&P 500 BARRA Value for periods prior to July 31, 2003, S&P 500 BARRA Growth for periods from July 31, 2003 to April 30, 2006, & Russell 1000 Growth for periods thereafter