DALLAS
POLICE & FIRE
PENSION SYSTEM

INVESTMENT POLICY

Adopted December 11, 1986
As Amended through December 11, 1997

Dallas Police and Fire Pension System

Investment Policy

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A. PURPOSE

The investment policy of the Dallas Police and Fire Pension System ("the System") will provide the framework for the management of the System's assets. It has been designed to allow for sufficient flexibility in the management process to capture investment opportunities as they may occur, yet provide reasonable parameters to ensure prudence and care in the execution of the investment program.

The investment policy of the System has been developed from a comprehensive study and evaluation of many alternatives. The primary objective of this policy is to implement a plan of action which will result in the highest probability of maximum investment return from the System's assets available for investment within prudent levels of risk.

The cornerstone of this policy rests upon the proposition that there is a direct correlation between risk and return for any investment alternative. While such a proposition is reasonable in logic, it is also probable based on empirical investigations.*

It is essential that the value added by the System's investment management be appropriate not only to meet inflationary effects but also to provide additional returns above inflation to meet the investment goals of the System. Meeting the System's investment goals finances an optimal package of retirement benefits for Dallas police officers and firefighters and maximizes the utilization of the members' contributions and the tax dollars of the citizens of Dallas.

In order to achieve maximum returns the policy of the Dallas Police & Fire Pension System Board of Trustees ("the Board") is to diversify between various investment types as deemed suitable.

* Stocks, Bonds, Bills, and Inflation: Year by Year Historical Returns (1926-1995). Roger C. Ibbotson and Rex A. Siquefield.

B. GENERAL INVESTMENT GOALS

The general investment goals are broad in nature to encompass the purpose of the System and its investments. They articulate the philosophy by which the Board will manage the System's assets within the applicable regulatory constraints.

1. The overall goal of the System is to provide benefits, as anticipated under the pension plan, to its participants and their beneficiaries through a carefully planned and executed investment program.

2. The System seeks to produce the highest return on investment which is consistent with levels of liquidity and investment risk that are prudent and reasonable, given prevailing capital market conditions. While the importance of the preservation of capital is recognized, the theory of capital market pricing which maintains that varying degrees of investment risk should be rewarded with compensating returns is also recognized. Consequently, prudent risk taking is justifiable.

3. The pension investment program shall at all times comply with existing and future applicable state and federal regulations.

C. GENERAL POLICIES

1. The Board, and any investment manager, in investing the System's assets shall discharge its duties solely in the interests of members and beneficiaries, by among other duties, acting with the care, skill, prudence, and diligence under the prevailing circumstances that a prudent person acting in a like capacity and familiar with matters of the type would use in the conduct of an enterprise of a like character and like aims.

2. The investment policy shall be based on a financial plan that will consider the current and expected condition of the System, the expected long term capital market outlook and the System's risk tolerance. The financial plan shall measure the potential impact on pension costs of alternative asset allocation policies based on various levels of diversification in terms of risk and return and the existing and projected liability structure of the pension plan.

3. Based on the financial plan it will be the responsibility of the Board, the System's fiduciary, to determine the specific allocation of the investments among the various asset classes. The Board will periodically undertake strategic asset allocation studies. Such studies address the appropriateness of asset classes to be considered for permanent commitments, define the targeted or normal commitments to each asset class to achieve the desired level of diversification and return, and assign the range in which the commitments are permitted to fluctuate.

4. The asset allocation plan shall be predicated on the following factors:
    a) the historical performance of capital markets adjusted for the perception of the future short and long term capital market performance;
    b) the correlation of returns among the relevant asset classes;
    c) the perception of future economic conditions, including inflation and interest rate assumptions;
    d) the projected liability stream of benefits and the costs of funding to both covered employees and employers;
    e) the relationship between the current and projected assets of the plan and the projected actuarial liability stream.

5. The asset allocation shall be sufficiently diversified to maintain risk at a reasonable level as determined by the Board without imprudently sacrificing return. The Board shall review the asset allocation plan against capital market planning assumptions to ensure the adopted asset mix will achieve the long term goals of the System.

6. In accordance with the asset allocation plan the Board will select external investment managers with demonstrated experience and expertise whose investment styles collectively will implement the planned asset allocation to form the System's investment structure. Each investment manager shall be a registered advisor under the Investment Advisers Act of 1940 (or appropriately exempt from registration.) Additionally, each investment manager will acknowledge their fiduciary status and other conformity with applicable state and federal laws. The Board will set guidelines for these managers and regularly review their investment performance on a total return basis against stated objectives.

7. The Board will utilize the service of a master custodian bank that will be responsible for holding the System's assets, settling purchases and sales of securities, identifying and collecting income which becomes due and payable on assets held, and providing a management information and accounting system.

8. The Board may retain independent professional investment consultants to assist in the development and implementation of the investment policy, to monitor, oversee, report on and make recommendations with respect to the activity of current and if appropriate prospective investment managers.

9. A formal review of the System's investment structure will be conducted periodically by the Board. The purpose of this investment structure review shall be to ensure that policy guidelines as determined in the most recent asset allocation plan continue to be met. The source of information for these reviews shall come from System staff, outside consultants, and investment mangers, as they may be retained.

10. It is the responsibility of the Board to administer the investments of the System at the lowest possible cost, being careful to avoid sacrificing quality. These costs include, but are not limited to, management and custodial fees, consulting fees, transaction costs and other administrative costs chargeable to the System.

11. The Board will reallocate assets on an on-going basis to balance the overall asset allocation against target when deviations occur because of capital market fluctuations. All transactions undertaken on behalf of the System shall be for the sole benefit of the beneficiaries.

12. The Board considers the active voting of proxies an integral part of the investment process. Proxy voting may be delegated to the discretion of investment managers retained by the Board. The managers shall be required to establish a proxy voting policy and maintain records of proxy votes, and shall make these records available quarterly to the Board or its designee. The Board may at its discretion establish an overall policy of voting proxies in which case the managers' proxy voting policy shall not conflict with that of the Board's. The Board recognizes that in certain emerging markets, investment managers may, balancing the costs and benefits, not exercise proxy voting.

13. No investment or action pursuant to an investment may be taken unless expressly permitted by this Policy, unless separately reviewed and approved by the Board.

14. The Board may amend this Investment Policy after discussion at two meetings by the Board, either the quarterly financial meeting or the regular monthly meeting. The two meetings must be a minimum of 21 calendar days apart.

D. STRATEGIC ASSET ALLOCATION POLICY

The Board has adopted the following asset allocation policy, which has three primary asset groups; Equity, Fixed Income and Real Estate.

EQUITY

Domestic Equity: 34.0% of the fund is to be allocated to domestic equity-oriented marketable securities and selected private market opportunities to provide the System with the potential to earn high rates of return, recognizing that equity investments also generate commensurate risk levels. Private market opportunities will be approved on a case-by-case basis.

International Equity: 24.0% of assets are to be allocated to the equity securities of companies domiciled outside of the U.S. which are traded on non-U.S. stock exchanges and are not denominated in U.S. dollars. This portfolio should provide counter-cyclical performance to U.S. equities thereby enhancing the overall rate of return through diversification.

This allocation to international equity may include emerging market equity. Emerging markets are generally smaller and the public securities of such markets tend to offer the potential for somewhat higher long-term returns than those of more developed markets.

FIXED INCOME

Global High Quality Fixed Income: 6.0% of assets are to be allocated to an actively managed publicly-traded bond portfolio invested within a global, primarily investment grade fixed income universe. This portfolio will be diversified among countries, market sectors, maturities, coupons, and quality ratings and is expected to provide returns above a market index by capturing yield opportunities around the world, and represents the core fixed income segment.

Domestic High Yield Fixed Income: 6.0% of the System's assets are to be publicly-traded, below investment grade fixed income securities. These high yield investments typically will be characterized by high rates of return along with higher degrees of risk than high quality fixed income.

Global Opportunistic Fixed Income: 15.0% of the assets are to be allocated to an actively managed portfolio invested opportunistically in a variety of high yielding, generally below investment grade fixed income securities. This segment is to capture newly developed fixed income investments such as insurance claim receivables as well as existing fixed income securities like convertibles, emerging market debt, local emerging market currency, private placements, distressed debt, commercial mortgage-backed securities, around the world. The expectation is that this segment will earn equity-like returns through fixed income investments, thus diversifying the equity segment of the System's portfolio.

REAL ESTATE

Real Estate: 15.0% of the fund is to be allocated to a real estate portfolio that is diversified by property type and geographic location. The objective of the real estate portfolio is to provide immediate protection against unexpected inflation, dampen overall asset volatility and provide diversification from traditional capital market exposure.

There is no specific allocation to cash; the investment structure is forecast to produce sufficient cash flow to provide required liquidity without a specific allocation to cash. It is recognized that up to 5% in residual cash can result from normal trading activity.

SUMMARY OF ASSET ALLOCATION TARGETS AND RANGES

	Target	Minimum	Maximum
EQUITY			
Domestic Equity	34.0%	29.0%	39.0%
International Equity	24.0%	20.0%	28.0%
TOTAL EQUITY	58.0%		
FIXED INCOME			
Global High Quality	6.0%	4.0%	8.0%
Domestic High Yield	6.0%	4.0%	8.0%
Global Opportunistic	15.0%	13.0%	17.0%
TOTAL FIXED INCOME	27.0%		
REAL ESTATE	15.0%	13.0%	17.0%
TOTAL PORTFOLIO	100.0%		

E. TACTICAL ASSET ALLOCATION POLICY

An asset allocation review shall be conducted at least quarterly. This comparison shall be developed from the month end asset valuation obtained generally on line from the System's custodian. If this comparison reveals that an account is at the upper or lower boundary of the designated range, the Board shall direct the Administrator to effect a reallocation of assets by month end to achieve target.

F. PERFORMANCE OBJECTIVES

Long term objectives have been established against which the performance of the investment policy is to be measured. Because capital markets fluctuate and given the duration of the liability stream, the viability of the asset allocation is to be judged over a period of a full market cycle. The performance objectives are:

1. To avoid actuarial loss;

   Match or exceed inflation as measured by an appropriate Consumer Price Index, to ensure that real asset growth maintains pace with real pay growth and cost of living adjustments, primary determinants of benefits and, therefore, pension costs.

   Match the actuarial interest rate assumption of 8.75% to avoid an actuarial loss which would increase future years' contributions.

2. To measure the value added by active management the total fund performance should exceed a Board approved policy index that is calculated by weighting the appropriate indices according to asset allocation.

3. Meet a target of the expected return of the asset allocation policy: 9.86%.

G. GENERAL INVESTMENT MANAGER GUIDELINES

The investment management for the System is to be provided by external investment managers. The guidelines for the managers are provided below:

1. Each manager shall operate under a set of guidelines specific to the strategic role its portfolio is to fulfill in the overall investment structure.

2. A manager under contract to the Board must advise the Board in writing within 24 hours if at any time there is:

   a. a significant change in investment philosophy;
   b. a loss of one or more key management personnel;
   c. a new portfolio manager on the System's account;
   d. a change in ownership structure of its firm;

e. any occurrence which might potentially impact the management, professionalism, integrity, or financial position of the investment management firm; or
f. a change in any other matter requiring notice in the contract between the investment manager and the System.

3. Sector and security selection, portfolio quality and timing of purchase and sales are delegated to the investment manager.

4. The following transactions are prohibited: purchase of non-negotiable securities, short sales, selling on margin, puts, calls, straddles, options (other than covered options), or "letter" (restricted) stock.

5. Transactions that involve a broker acting as a "principal", where such broker is also the investment manager who is making the transaction are prohibited.

6. Transactions shall be executed at the lowest possible cost, taking into consideration prevailing market considerations and services and research provided by the executing broker.

The individual managers will be judged according to benchmarks which reflect the objectives and characteristics of the strategic role their portfolio is to fulfill.

H. GLOSSARY

Actuarial Interest Rate	The actuaries assumed rate of investment return used to discount future benefits and amortize the unfunded liability.
Actuarial Liability	The excess of the present value of all benefits payable under the plan over the present value of future normal costs.

Beta	A measure of U.S. stock market volatility. The market (S&P 500 Index) has a beta of 1.00.
Call Option	A contract that gives the owner the right, not obligation, to purchase an asset at a specified price at any time until the option expires.
Correlation	Correlation is a measure of the degree to which returns of asset classes move together.
Diversification	The spreading of investment funds among classes of securities and localities in order to distribute the risk.
Dividend Yield	The annual dividend (earnings distribution) of a stock divided by the stock's current price.
Duration	A measure of the average time to receipt of all bond cash flows. It is used as a measure of the sensitivity of the portfolio to changes in interest rates.
Liquidity	The capacity of the market place to accommodate a given supply of and / or demand for a security without unreasonable price changes resulting.
Market Capitalization	The price per share of stock multiplied by the number of shares of stock issued and outstanding.
Market Cycle	The length of time for a market to move from peak to trough to peak, on average three to five years.

Naked Short Sells	Securities position that is not hedged from market risk - for example, the position of someone who writes a call or put option without having the corresponding long position or short position on the underlying security.
Price/Earnings Ratio	A measure of a stock value relative to the earnings it represents calculated by dividing the stock price by the annual earnings per share.
Put Option	A security that gives the owner the right to sell a particular stock at a certain price within a designated period of time.
Strategic Asset Allocation	The long range asset allocation of a plan designed to obtain a reasonable long term total return consistent with the degree of risk assumed while emphasizing the preservation of long term capital.
Tactical Asset Allocation	The procedural and implementation aspects of the strategic asset allocation to include periodic review and on-going adjustment to achieve goals of the plan.