Trust Fund for the People of the
Federated States of Micronesia

Fiscal Year 2011 Annual Report

March 23, 2012

I. Introduction

The Annual Report for the Trust Fund for the People of the Federated States of Micronesia (the Fund) is presented to provide the status of the Fund as of 30 September 2011, the performance during the fiscal year ending 30 September 2011, and a review of the Fund since its inception in April 2004. The Annual Report should be considered together with the audited financial statements for Fiscal Year 2011 (FY11).

The Annual Report's information is mainly sourced from the annual financial statements prepared by the Fund's bookkeeper and verified by the Fund's auditor, and quarterly investment reports prepared by the Fund's investment adviser, Mercer Investment Consulting, Inc. The analysis and presentation reflects the views of the Trust Fund Committee (the Committee).

The Annual Report was prepared by the Executive Administrator and approved by the Trust Fund Committee in March 2012. Any questions or comments pertaining to the report should be directed to the Executive Administrator, Anthony Costanzo, at apcostanzo@bgsi.net or at 703-683-3793.

FY11 Highlights

- The total Net Asset Value of the Fund increased 12% to $198.4 million in FY11 from $177.2 million in FY10. The increase was due mainly to increased contributions. The Fund experienced an investment loss of $339,386 primarily due to declining international equity markets.

- Overall, the Fund, after discounting for contributions, achieved zero growth gross of fees and a 0.4% loss net of fees. This compares to a -0.2% loss for the Total Trust Benchmark.[1]

- The poor performance of domestic and international equities was balanced by positive performance of the non-discretionary component of the portfolio (35% of all Fund assets), consisting of emerging market debt, convertible bonds, a real estate fund, a hedge fund, and private equity investments.

- A one-time contribution of $22.4 million was received from the United States for FY11. FY10 contributions amounted to $21.5 million.

- No transfer was made to the "C" account for FY11 since there was an investment loss. The "C" account remains at $20.2 million from FY10.

[1] The Total Trust Benchmark is comprised of 28% Russell 3000, 29% MCSI EAFE (net dividend), 10% Barclays Capital Aggregate, 8.5% JPMorgan Emerging Market Bond Index, 5% BofA Merrill Lynch All US Convertibles, 5% T-Bills +3%, 7.5% NCREIF NFI ODCE and 7% S&P 500 +3%.

- Investment expenses were substantially reduced by 31.3% to $645,382 in FY11 from $939,224 in FY10. The reduction is attributed to a new contract and fee structure with the newly contracted custodian and with the investment adviser in September 2010.

- Administrative expenses also decreased by 3.1% to $147,921 in FY11 from $152,679 in FY10. The decrease can be attributed to reduced legal, audit, and miscellaneous administrative fees.

- Since inception, the Fund has gained about 2.2% per annum net of fees.[2]

- The Trust Fund Committee has taken steps to attract additional subsequent contributors to the Fund.

[2] If the Fund manages an average 5% return annually from FY12 to FY23, the distribution from the estimated assets for FY24 should provide revenue equivalent to about 85% of the nominal amount of FY23 Compact of Free Association, as Amended, Section 211 grant assistance. If the Fund were to achieve an average 8% return annually, the Fund would probably provide FY24 revenue equivalent to nominal FY23 grant assistance without an inflation adjustment. There would also be a partial build-up of the C account.

II. Trust Fund Purpose, Organization and Commitments

A. Purpose

The Compact of Free Association, as Amended (the “Amended Compact”) -- as codified in the Compact of Free Association Amendments Act of 2003 (U.S. Public Law 108-188, December 17, 2003; “the Amended Compact Act”) -- under Title Two: Economic Relations, Section 216, provides for the establishment of a trust fund according to the Trust Fund Agreement negotiated between the Original Parties: the United States government (U.S. government) and the Federated States of Micronesia government (FSM government). The Compact’s Section 215 and 216 set forth the funding to be contributed by both governments to 2023. The Trust Fund Agreement provides the organizational structures, policies and procedures for most aspects of the Fund’s start-up and ongoing operations.

The Fund was incorporated as a non-profit corporation under the laws of the District of Columbia in August 2004. The Trust Fund Agreement is supported by a set of by-laws initially approved by the Committee on 24 March 2006. Resolutions are considered and approved periodically to improve the overall management and operations of the Fund, as determined by the Committee. The Fund’s main investment guidance is provided by the Investment Policy Statement, last updated and approved by the Committee in September 2010.

As stated in the Trust Fund Agreement, the purpose of the Fund is to:

> *“contribute to the economic advancement and long-term budgetary self-reliance of the Federated States of Micronesia by providing an annual source of revenue, after Fiscal Year 2023, for assistance in sectors described in Section 211 of the Compact, as amended, or other sectors as mutually agreed by the Original Parties, with priorities in education and health care.”*

The broad investment objective, as set forth in the Investment Policy Statement, is to:

> *“maximize investment returns, subject to constraints aimed at containing fluctuations in returns over shorter periods within acceptable limits. Over shorter periods, outperformance will be sought relative to the notional return on a benchmark portfolio designed to reflect the risk profile according to which the assets are invested at the time.”*

B. Organization

The Fund’s Committee has functions indicated by the Trust Fund Agreement to oversee the:

1. Operation, supervision, and management of the Fund;
2. Investment and distribution of resources of the Fund; and
3. Conclusion of agreements and arrangements with subsequent contributors and other organizations.

For FY11, the Committee consisted of 5 members. According to the Trust Fund Agreement, the U.S. government maintains a majority of voting members to include the Chairman. The FSM government appoints two voting members. A subsequent contributor may or may not be a voting member. Currently, the Fund does not have any subsequent contributors.

The FY11 Committee members were:

1. Nikolao Pula, Chairman, U.S.
2. Fabian Nimea, Member, FSM
3. Chris Marut, Member, U.S.
4. Joseph McDermott, Member, U.S.
5. Aren Palik, Member, FSM

An Executive Administrator supports the Committee. In April 2011, after a search, Anthony Costanzo was appointed as Executive Administrator for a one-year term, which is renewable.

During FY11, the Committee met quarterly to review investment performance and conduct Fund business on the following dates:

1. 9 November 2010 (Washington D.C. based teleconference)
2. 15 February2011 (San Francisco)
3. 16 May 2011 (Washington D.C. based teleconference)
4. 29 August 2011 (Honolulu)

Minutes have been recorded, approved and signed for each meeting.

A custodian and investment adviser support the Fund. State Street Bank has performed as custodian since September 2010. Mercer Investment Consulting, Inc., has served as the investment adviser since October 2005 with a new contract signed in September 2010.

C. Commitments

Contributions to the Fund by the U.S. government and FSM government are governed by the schedule in the amended Compact. The U.S. government is committed to contribute $16 million from FY04 to FY23 plus a cumulative $0.8 million addition annually beginning in FY07 plus a partial inflation adjustment as indicated in the amended Compact.[3] The FSM government was to provide $30 million prior to 30 September 2004.

For FY11, a total of $22,394,286 was contributed consisting of a scheduled contribution from the U.S. government

[3] As stated in the amended Compact, “the US government contribution shall be adjusted for each United States Fiscal Year by the percent that equals two-thirds of the percent change in the United States Gross Domestic Product Implicit price deflator, or 5 percent, whichever is less in any one year, using the beginning of Fiscal Year 2004 as the base.”

Figure 1 indicates total contributions to date and future contributions per the Trust Fund agreement.

Figure 1: Contributions to FY11 and Committed Future Contributions
($s millions)

Date	United States	FSM	Total
FY04	16.00		16.00
FY05	16.19	30.30	46.49
FY06	16.44		16.44
FY07	17.69		17.69
FY08	19.00		19.00
FY09	20.91		20.91
FY10	21.52		21.52
FY11	22.39		22.39
Actual Invested to Date	$150.14	$30.30	$180.44
FY12*	20.80		20.80
FY13	21.60		21.60
FY14	22.40		22.40
FY15	23.20		23.20
FY16	24.00		24.00
FY17	24.80		24.80
FY18	25.60		25.60
FY19	26.40		26.40
FY20	27.20		27.20
FY21	28.00		28.00
FY22	28.80		28.80
FY23	29.60		29.60
Total	$452.54	$30.30	$482.84

* US numbers as of FY12 do not include inflation adjustment. The adjustment will be calculated and added each fiscal year.

The Committee has discussed attracting subsequent contributors to the Fund so as to build up the Fund's corpus. Preliminary research was prepared for and considered by the Committee to help identify and target potential subsequent contributors.

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III. Administration and Approved Resolutions

A. Executive Administrator

The Fund contracts an Executive Administrator, who serves in support of the governance, administration and operations of the Committee.

The current Executive Administrator began providing services in April 2011 after the Committee conducted an advertised search for candidates. The former Executive Administrator served in the position from 2005. There was an interim period between April and May 2011 to help the Fund transition to the new Executive Administrator.

The key duties of the Executive Administrator are to maintain all official Committee documents and records; update the Chairman, Vice Chairman, and other members of the Committee on activities of the Fund; coordinate Fund service providers; provide administrative services regarding fund payments, decisions and deliberations; assist in audit preparation and draft annual report; and prepare periodic performance and other assessments to inform Committee members and staff.

Key accomplishments include the following:

- Updated bill payment process to make Fund payments.
- Updated collection of fee information from discretionary and non-discretionary money managers so accurate fee costs are available to the Committee and for accounting and audit purposes.
- Negotiated and gained Committee approval of new service agreements with the auditor and accountant. Conducted a search for legal counsel and Registered Agent.
- Organized and conducted and provided follow-up for the four quarterly review meetings.
- Prepared or coordinated the preparation and approval of 8 Committee resolutions.
- Actively liaised with the custodian, investment adviser, accountant and auditor to conduct Fund business and worked with the entities on improvements, as needed.
- Provided the Committee with issue research on such topics as: active versus passive investment management, issues regarding the delineation between the Fund's A and C accounts, the formula to calculate the C account possible contribution annually, public information sharing, and improving electronic decision making.
- Prepared research on potential subsequent contributor candidates and possible ways forward to attract subsequent contributors to the Fund.

B. Service Providers

The Fund maintains contracts with a set of service providers to help conduct Fund business. The following are the key service providers.

Custodian

State Street Bank serves as Fund custodian per a 3-year renewable contract between State Street Bank and the Committee dated 3 September 2010. State Street, as the custodian, provides all the services of the Trust Fund Agreement's Article 13 with the exception of the record keeping and reporting functions. Key services include:

- To collect and receive any and all money and other property of whatever kind or nature due or owing or belonging to the Fund;
- Follow written directions of the Committee with respect to retention, purchase, sale or encumbrance of trust property and the investment and reinvestment of principal and income;
- To disburse income or corpus only pursuant to the conditions set forth in the Trust Fund Agreement;
- Make all payment of liabilities and administrative expenses; and
- Effect all distributions pursuant to the instruction of the Committee.

State Street's fee is 3 basis points of Fund value assessed quarterly.

State Street maintains a web site portal for Committee members and key staff access for recordkeeping and reporting. State Street also provides planned accounting that helps to track each contributor's balance and the C account. Full planned accounting is to begin in FY12.

Investment Adviser and Money Manager

Mercer Investment Consulting, Inc. (Mercer) has served as the Fund's investment adviser since 2005. Mercer is currently engaged under a 3-year renewable contract between Mercer and the Committee signed in September 2010. Mercer performs the duties of investment adviser and money manager as specified in Article 14 of the Trust Fund Agreement. Key duties include:

- Advise and recommend to the Committee one or more money managers who will invest the assets of the Fund to produce a diversified portfolio.
- Provide the Committee with data relating to any prospective money manager, indicating performance and relevant comparisons with similar money managers to assist the Committee in evaluating the performance of the prospective money managers.
- Direct trades and manage liquidity, amongst other money manager-type functions.

Mercer's fee is 52 basis points of managed assets, assessed quarterly. In addition, Mercer applies a 9 basis points advisory fee on the non-discretionary assets.

Mercer has worked with the Committee to build a diversified portfolio based on managed assets, with oversight provided by Mercer, and the identification and monitoring of non discretionary assets consisting of investments in fixed income, real estate, private equity and hedge funds. Each of the non-discretionary assets has their own money managers. Their rates range from 0.70 to 1.50% of assets under their respective management.

Mercer has provided the Committee with monthly flash reports. The reports provide a snapshot of Fund performance by asset class and by individual asset, inclusive of values and comparisons to agreed upon benchmarks. Mercer also provides detailed quarterly performance reports prior to Committee quarterly meetings. The reports provide information on global, U.S.

and comparative fund investment performance and Fund status for the quarter, fiscal year and since inception. It also provides a forecast of potential future performance based on high, medium and low growth scenarios. Mercer representatives present the report at the quarterly meeting and respond to Committee member and staff questions. Mercer also reviewed the September 2010 Investment Policy Statement during the 29 August 2011 meeting and again in the first quarter of FY12 to recommend to the Committee any needed changes.

Accounting
The Committee has engaged Bookminders since 2008. Bookminders has prepared the Fund's financial records dating back to inception in 2004. A new 1-year service agreement was signed in June 2011 to provide monthly and end-of-year financial statements.

Auditor
ParenteBeard serves as the Fund's auditor and has conducted the annual audits dating back to FY04. The Committee engaged ParenteBeard in June 2011 to prepare the FY11 audit as well as the FY12 audit. ParenteBeard conducts the audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Legal Counsel
DLA Piper LLP serves as the Fund's legal counsel. The firm has provided legal advice since the Fund's inception as needed.

C. Approved Resolutions

The Committee approved 8 Resolutions. The following is the title and brief description of each resolution.

FSM Resolution 2011-1 *FSM Annual Report, Fiscal Year 2010*
Approval of the FY10 Annual Report

FSM Resolution 2011-2 *Contract Extension of Richard W. Miller on an Intermittent Basis*
Contract extension of the Executive Administrator's contract

FSM Resolution 2011-3 *Engagement Agreement with ParenteBeard LLC*
Engagement of ParenteBeard to conduct the FY11 and FY12 audits

FSM Resolution 2011-4 *Engagement Agreement with Bookminders for Accounting* Support Services
Engagement of Bookminders to provide accounting services on a quarterly basis for 1-year

FSM Resolution 2011-5 *Release of Information*
Per Resolution 2009-6, the release of certain information to the public requires Committee approval. Resolution 2011-5 provided the public release of certain asset allocation information and the timing of the decisions for changes in asset allocations. The release was based on a request from a public entity.

FSM Resolution 2011-6 Release of Information

Per Resolution 2009-6, the release of certain information to the public requires Committee approval. Resolution 2011-6 provided the public release of certain asset category values as of 30 June 2011. The release was based on a request from a public entity.

FSM Resolution 2011-7 Trust Fund A and C Account Income, Expenses and End-of-Year Calculations

The resolution clarified and set forth certain A and C account issues and indicated the end-of-year calculation to determine if and how much of a distribution should be made to the C account.

FSM Resolution 2011-8 Improving Electronic Decision Making

Allows Committee members to vote on decisions electronically via e-mail in a standard manner and format.

IV. FY11 Account Balances and Performance and Trends Since Inception

A. Trust Fund Asset Classes and Allocations

For FY11, the Fund has adhered to the asset allocations set forth in the September 2010 Investment Policy Statement. The portfolio consists of two components: managed assets and non-discretionary assets. The managed assets portfolio consists of U.S. equity (small, medium and large cap), non-U.S. equity, and fixed income. The non-discretionary component consists of fixed income (emerging market debt and convertible bonds), private real estate, a hedge fund and private equity. The asset classes are according to the following breakdown.

Figure 2: Asset Classes Per Investment Policy Statement and for FY10 and FY11
Source: Investment Policy Statement, 9/10; Mercer Quarterly Reports- 9/30/10 and 9/30/11

Asset Class	Strategic Target Allocation	Permitted Range	Allocation as of 9/30/10	Allocation as of 9/30/11
Managed Assets				
Domestic Equity	28.0%	23%-33%	27.3%	27.1%
U.S. Large Cap Equity	21.0%		20.5%	20.5%
U.S. Small/Med Cap Equity	7.0%		6.8%	6.7%
Non-U.S. Equity	29.0%	24%-34%	30.2%	27.4%
Fixed Income	10.0%	5%-15%	11.4%	10.1%
Total Managed Assets	*67.0%*		*68.9%*	*64.7%*
Non-Discretionary Assets				
Emerging Market Debt	8.5%	3.5%-13.5%	5.2%	4.8%
Convertible Bonds	5.0%	0%-10%	9.1%	8.1%
Private Equity	7.0%	2%-12%	8.3%	9.4%
Private Real Estate	7.5%	2.5%-12.5%	3.5%	8.6%
Hedge Funds	5.0%	0%-10%	5.0%	4.5%
Cash	0.0%	0%-3%	0.0%	0.0%
Total Non-Discretionary	*33.0%*		*31.1%*	*35.4%*
Total	***100%***		***100%***	***100%***

The asset classes have remained the same since FY10. The investment adviser has adjusted the asset classes within the permitted ranges indicated in the Investment Policy Statement based on market changes. These changes are mainly in response to U.S. and international market performance. The make-up of the Fund and the active management approach elected by the Committee allows the investment adviser to make such adjustments as needed.

The main adjustments through FY11 were a slight decrease (by 0.1%) in U.S. small/medium cap equity investments based on the declining performance of small cap stocks during the later part of the fiscal year and a more significant decrease in non-U.S. equity investments (-2.80) and fixed income (-1.30%). The reduction in both these asset classes was due to market performance, especially in the later part of the third quarter and throughout the fourth quarter. These percentage decreases in the managed assets component of the portfolio led to the managed assets having a reduced share of the overall fund- a change to 64.7% of total assets at the end of FY11 compared to 68.9% for FY10. With these adjustments, the managed asset investments were at or near their target allocations and within the permitted range of the Investment Policy Statement.

For the non-discretionary component of the portfolio, there was a significant increase in the private real estate asset by just over 5% along with a slight increase (1.1%) in private equity investments. Slight reductions occurred in the emerging market debt, convertible bonds and hedge fund holdings. The overall weight of non-discretionary assets increased to 35.4% of the portfolio from 31.1%. The movements to the non-discretionary assets was according to the investment strategy- since the managed asset equity component was underperforming, additions were made to the less equity market impacted non-discretionary assets. The movement of funds between these two components shows the flexibility of the portfolio and the ability to react in down markets.

Last, the portfolio’s private equity portion is beginning to show more sizable and more periodic returns as a result of the “J-Curve” effect. The Fund has continued to invest in these private equity funds and, as the money managers invest additional funds periodically, returns are starting to materialize which will hopefully increase as the investments start showing returns over the medium and longer term, as with a “J-Curve.”

The Committee has attempted to keep the cash account at minimal levels to meet monthly expenditures so that all funds are fully invested.

From a historic perspective, the asset allocation has changed periodically since inception. A change was made from the original asset allocation in November 2009. At that time, additional funds were added to the convertible bond fund, hedge fund, and emerging market debt and equity funds and changes were made between the small to the medium cap funds in the domestic equity asset class. The investment adviser recommended the changes.

In March 2010, in the domestic equity asset class, the shares of the SSgA Russell 3000 Index Fund (valued at $34.5 million) were sold and a total of $36 million was invested in the SSgA Russell 1000 Index Fund. Additional purchases were also made for the convertible bond fund, hedge fund, and emerging markets equity and debt funds. Funds were used from the cash account to make these additional purchases.

The individual assets have changed as the investment adviser has adjusted the assets per their review of the portfolio in September 2010. During FY11 changes were made in the managed asset component of the portfolio while the non-discretionary assets remained the same as in FY10. The Fund remains actively invested.

The individual asset change is illustrated in Figure 3.

Figure 3: Asset Change FY10 to FY11

Asset Class	Assets Held as of 9/30/10	Assets Held as of 9/30/11
Managed Assets		
Domestic Equity		
U.S. Large Cap Equity	SSgA Russell 3000 Index	SSgA S&P 500 Index Fund
U.S. Small/Med Cap Equity	Atlanta Capital Management	MIM Small/Mid Cap Growth Equity Fund MIM Small/Mid Cap Value Equity Fund
Non-U.S. Equity	Grantham, Mayo, Van Otterloo Int'l Opportunity Fund Newton Capital Mgm't Int'l Equity Fund Aberdeen Emerging Markets Fund Fidelity Investments (Int'l Small Cap Fund)	MIM Non-U.S. Core Equity Fund
Fixed Income	Aberdeen Fund Management	MIM Core Opportunistic Fixed Income Fund
Non-Discretionary Funds		
Emerging Market Debt	Ashmore Investment Management	Ashmore Investment Management
Convertible Bonds	Shenkman Capital Management	Shenkman Capital Management
Private Equity	HarbourVest Partners- VIII Venture Fund; VIII Buyout Fund; VIII Mezzanine & Distressed Debt Fund; Private Equity V Portfolio Advisors Private Equity Fund I	HarbourVest Partners- VIII Venture Fund; VIII Buyout Fund; VIII Mezzanine & Distressed Debt Fund; Private Equity V Portfolio Advisors Private Equity Fund I
Private Real Estate	Prudential Real Estate Investors	Prudential Real Estate Investors
Hedge Funds	Blackstone Alternative Asset Mgm't	Blackstone Alternative Asset Mgm't

Fund performance measurement is conducted according to a set of performance standards established in the Investment Policy Statement. Individual benchmarks are identified in the Statement, and the investment adviser also measures performance according to its Total Trust Benchmark and Foundation and other medians. Fund performance is measured preliminarily in the monthly Flash Reports and in more detail in the quarterly performance reports.

The following are the key benchmarks.

Figure 4: Performance Standard Benchmarks

Asset Class	Benchmarks
Overall	Total Trust Benchmark[4] Foundations Median
Domestic Equity	Russell 3000 Index Mercer Institutional U.S. Equity Combined Median
U.S. Large Cap Equity	Russell 1000 Index S&P 500 Index (total return) Mercer Institutional U.S. Equity Large Cap Core Median
U.S. Small/Med Cap Equity	Russell 2500 Growth Index Mercer Institutional U.S. Equity SMID Growth Median Mercer Institutional U.S. Equity SMID Value Median
Non-U.S. Equity	MSCI EAFE Index Mercer Institutional World ex U.S. EAFE Equity Median
Fixed Income	Barclays U.S. Aggregate Bond Index Mercer Institutional U.S. Fixed Core Opportunistic Median Custom Fixed Income Benchmark[5] Mercer Institutional U.S. Fixed Combined Median
Emerging Market Debt	JP Morgan Emerging Market Bond Index Mercer Institutional U.S. Convertible Composites Median
Convertible Bonds	BofA Merrill Lynch All U.S. Convertibles Index Mercer Institutional Emerging Market Debt Median
Private Equity	S&P 500 +3%
Private Real Estate	NCREIF Open End Diversified Core Equity Fund Index Mercer Institutional U.S. Real Estate Open End Median
Hedge Funds	T-Bills +3% Mercer Institutional Funds of Hedge Funds (Net) Median

[4] The Total Trust Benchmark is comprised of 42% Russell 3000 Index, 43% MSCI EAFE Index, 15% Barclays U.S. Aggregate Bond Index.
[5] The Custom Fixed Income Benchmark is comprised of 40% BofA Merrill Lynch All U.S. Convertibles Index and 60% JP Morgan Emerging Market Bond Index.

During FY11, the portfolio was reviewed each quarter during Committee meetings. A more complete review was provided by the investment adviser at the end of the third quarter (29 August 2011 Committee meeting) and at the end of the fourth quarter (13 December 2011 Committee meeting).

B. Summary of FY11 Performance and Trends Since Inception

The Fund ended FY11 with a net asset value of $198,460,034. The amount is a 12% gain from FY10. The gain is solely attributable to the contribution from the U.S. government. The U.S. contribution increased to $22,394,286 from the FY10 amount as scheduled with an additional $800,000 plus the cumulative inflation adjustment.

Figure 5: Trust Fund Assets FY10 and FY11, Percent Change
Source: Audited Financial Statements September 30, 2010 and 2009 and September 30, 2011 and 2010

	FY10	FY11	% Difference
Net Assets (Beginning of FY)	**$138,075,219**	**$177,198,362**	28.3%
Contributions			
U.S.	21,518,180	22,394,286	4.1%
FSM	0	0	0.0%
Total Contribution Income	21,518,180	22,394,286	4.1%
Investment Earnings and Unrealized Gains	18,696,866	-339,386	-101.8%
Less Investment Fees	939,224	645,382	-31.3%
Net Investment Income	17,757,642	-984,768	-105.5%
Misc Other Receipt	0	-75	
Total Income	39,275,822	21,409,593	-45.4%
Less Administrative Expenses	152,679	147,921	-3.1%
Change in Net Assets	39,123,143	21,261,672	-45.7%
Net Assets (End of Fiscal Year)	**$177,198,362**	**$198,460,034**	**12.0%**

The Fund experienced an investment loss in FY11 of $339,387. As shown in Figure 6, while increased interest and dividend earnings occurred in FY11 compared to FY10, there was a reduction of realized investment gains and a significant unrealized investment loss when compared to FY10. The losses occurred given the poor performance of U.S. and international equity markets, especially the downturn experienced in the last quarter of the fiscal year. The diversification of the portfolio helped to reduce losses. The non-discretionary assets (35.4% of the portfolio at year end)- private equity, real estate hedged, emerging market debt and convertible bonds- provided some positive balance away from the poorly performing U.S.

domestic and international equity assets (54.5% of the portfolio at year end). The fixed income portion of the managed assets portfolio also performed positively for FY11 (10.5% of the portfolio at year end).

Figure 6: Investment Income FY10 and FY11
Source: Audited Financial Statements September 30, 2010 and 2009 and September 30, 2011 and 2010

	FY10	FY11
Interest	230,382	314,982
Accretion	0	72,123
Dividends	2,765,679	3,619,882
Realized Gain (loss) on Investments	1,709,435	1,245,548
Unrealized Gain (loss) on Investments	13,991,207	-5,592,957
Currency Value Change	163	1035
Total	**$18,696,866**	**$(339,387)**

Overall, the Fund had a rate of return of -0.57% compared to a gain of 10.46% in FY10. The FY11 loss prevented any transfer to the C account, further described in Section C, below.

From a historical perspective, since inception, the Fund continues to increase, overall, given the annual contribution amounts plus positive market performance in most years.

The Fund, while established in FY04, was not fully invested until late FY06. Income for FY04 was non-existent. Income in FY05 consisted of interest earned. FY06 was the first year the Fund had unrealized investment gains. For FY07, the Fund earned interest, dividends, realized gains and unrealized gains since this was the first full year the Fund's investment policy was applied.

The only years investment losses occurred were in FY08 and FY11. For FY08 the loss was significant, -$23,270,263, which was more than the contribution amount resulting in a loss of value to the Fund. The loss was due to the U.S. and international market decline and economic crisis experienced that year, impacting managed equity assets as well as the non-discretionary assets. For FY11, the loss was much smaller (-$339,387). The loss was due to the poor performance of the U.S. and international equity markets. The non-discretionary assets as well as the fixed income holdings helped to minimize the losses.

Figure 7: Total Contributions, Income, Expenses and Net Assets Since Inception
Source: Annual Audited Financial Statements since FY04
$s millions

	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11
Net Assets (Beginning of Fiscal Year)	**$0.00**	**$46.26**	**$64.23**	**$86.46**	**$122.84**	**$117.52**	**$138.07**	**$177.20**
Contributions								
U.S.	16.00	16.19	16.44	17.69	19.00	20.91	21.52	22.39
FSM	30.26	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Total	46.26	16.19	16.44	17.69	19.00	20.91	21.52	22.39
Net Investment Income								
Earnings	0.00	1.79	5.94	19.41	-23.27	0.83	18.70	-0.34
Fees and Expenses	0.00	0.01	0.14	0.73	1.05	1.18	1.09	0.79
Total	0.00	1.78	5.80	18.69	-24.32	-0.35	17.60	-1.13
Net Assets (End of Fiscal Year)	**$46.26**	**$64.23**	**$86.46**	**$122.84**	**$117.52**	**$138.07**	**$177.20**	**$198.46**

Total Fund expenses were considerably reduced in FY11 compared to FY10, as shown in Figure 8. Overall investment and administrative expenses were reduced by 27.3%. Expenses were only 0.40% of net assets, a significant decline from recent years.

Total investment expenses were reduced by 31.3% compared to FY10. While custodian fees increased, partially due to the payment of some FY10 expenses in FY11, investment adviser expenses were reduced by 49.2% and money manager costs were reduced by 28.9%. The decrease in the investment adviser fees is a result of the reduced fees charged resulting from a new contract agreement implemented in September 2010. The reduced money manager fees are partially a result of the minimal performance of the investments for the fiscal year

Total administrative expenses were reduced by 3.1% compared to FY10. Reductions were made in auditing, legal fees and miscellaneous administrative fees. Increases were for the Executive Administrator position, mainly resulting from the transition period between the two Administrators in April-May 2011, and for accounting services, mainly due to the need for accurate accounting of the diversified portfolio.

Historically, fees were non-existent during the Fund's initiation in FY04, but, as the Committee contracted service providers to meet Fund legal, administrative and investment obligations, expenses steadily increased to FY10. As a percent of net assets, expenses increased to a high point of 0.89% of net assets in FY08. Part of the high ratio for that fiscal year is due to costs incurred the previous year. The FY11 ratio is the lowest since FY07- the first full year the Fund was fully invested. The current ratio is expected for future years given existing service agreements and the diligence of the Committee to keep expenses at reasonable levels.

Figure 8: Investment and Administrative Expenses Since Inception and Differences Between FY10 and FY11

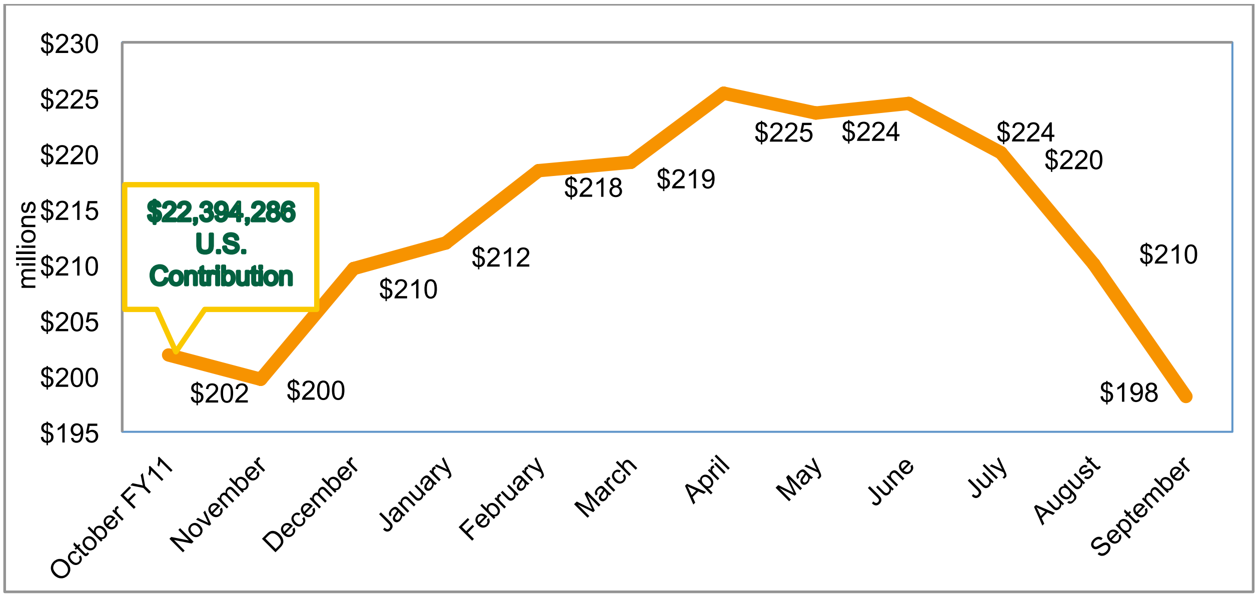
Source: Annual Audited Financial Statements since FY04

	FY05	FY06	FY07	FY08	FY09	FY10	FY11	Diff FY10-FY11
Investment Expenses	***$0***	***$132,039***	***$686,419***	***$955,763***	***$1,049,150***	***$939,224***	***$645,382***	***-31.3%***
Custodian	-	1,997	12,908	42,117	16,280	23,508	59,312	152.3%
Investment Adviser	-	125,385	142,402	126,800	187,754	319,704	162,496	-49.2%
Money Manager	-	4,657	531,109	786,846	845,116	596,012	423,574	-28.9%
% of Net Assets	*0.00%*	*0.15%*	*0.56%*	*0.81%*	*0.76%*	*0.53%*	*0.33%*	
Admin. Expenses	***$13,356***	***$9,458***	***$39,715***	***$93,851***	***$133,959***	***$152,679***	***$147,921***	***-3.1%***
Exec. Administrator	-	-	-	70,650	85,650	91,850	96,816	5.4%
Audit Fees	-	-	33,906	15,260	39,740	45,062	42,446	-5.8%
Accounting Fees	-	-	-	3,449	5,868	6,295	6,794	7.9%
Legal Fees	13,356	9,458	5,809	4,457	245	4,344	1,258	-71.0%
Miscellaneous Fees	-	-	-	35	2,456	5,128	607	-88.2%
% of Net Assets	*0.0002*	*0.0001*	*0.0003*	*0.0008*	*0.0010*	*0.0009*	*0.0007*	
Total $ Expenses	***$13,356***	***$141,497***	***$726,134***	***$1,049,614***	***$1,183,109***	***$1,091,903***	***$793,303***	***-27.3%***
Total % of Net Assets	*0.02%*	*0.16%*	*0.59%*	*0.89%*	*0.86%*	*0.62%*	*0.40%*	

Per Figure 9, overall for FY11, weak U.S. domestic and international equity market performance during the June-September period resulted in Fund net assets at about the same point at the end of the fiscal year when compared to the beginning of the fiscal year. The weak performance during the June-September period eroded gains made during most of the fiscal year despite the U.S. contribution injection in October 2010. The performance of the Fund followed general U.S. and international equity market performance for the fiscal year with gains occurring until almost to the end of the third quarter (ending in June) and steady declines afterwards to September.

As previously mentioned, the investment adviser did adjust the asset mix slightly throughout the year in response. Domestic equity holdings were slightly reduced- mainly in small/medium cap equity holding and non U.S. equity holdings. Investments in some of the non-discretionary assets increased, mainly due to capital commitments, for the private real estate asset and the private equity assets. The moves helped to reduce losses at the end of the FY11.

Figure 9: FY11 Monthly Net Asset Values
Source: Net Asset Values from Mercer Monthly Flash Reports, $s millions; contributions from State Street records



In terms of performance measurement, overall, the Fund had zero growth in FY11 in terms of gross returns and had 0.4% loss net of fees. The gross return is better than the Total Trust Benchmark (-0.2%) while the loss net of fees is slightly less than the benchmark. The Fund underperformed the Foundations Benchmark (1.2% gain). Fund performance measures are provided in Figure 10.

For the managed assets component of the portfolio (64.6% of the Fund), U.S. domestic equity investments showed a -0.2% return which is less than the 0.5% gain in the benchmark. International equity assets, as described above, performed poorly, losing 11.2%, more than the benchmark loss of -9.4%.

The non-discretionary component of the portfolio (35.4% of the Fund) helped to balance out the losses of the U.S. domestic and international equity assets. This component showed an 11.9% gain for FY11. The fixed income investments (convertible bond and emerging market debt assets) gained 2.1%, outperforming the benchmark that had no gain. The real estate asset had a significant gain of 23.3%, outperforming its benchmark of 18.3%. The hedge fund asset also had a gain of 2.6% but did not outperform the benchmark of 3.1%. The private equity investments substantially outperformed the benchmark increasing by 19.1% compared to the benchmark's 4.1% gain.

Overall, the Fund's two components- managed assets and non-discretionary assets, performed differently for FY11 with the managed assets resulting in losses and the non-discretionary assets resulting in gains. As indicated by the Fund's investment policy, the intent of the non-discretionary assets is to provide stability and some growth to the portfolio during downturns in the equity markets. This 'balancing' within the portfolio occurred in FY11. And, while capital is still being allocated to the private equity investments in the non-discretionary component, this component should continue to grow as a proportion of the overall Fund. The returns from these investments can lead to increased returns over time per the previously described J-curve effect.

Figure 10: FY11 Market Value and Percent Allocation by Asset Category and Annual Performance Compared to Benchmarks Since Inception

Source: Mercer Quarterly Report *The Trust Fund for the People of the Federated States of Micronesia, Investment Performance Period Ending September 30, 2011*

NA= Not Available

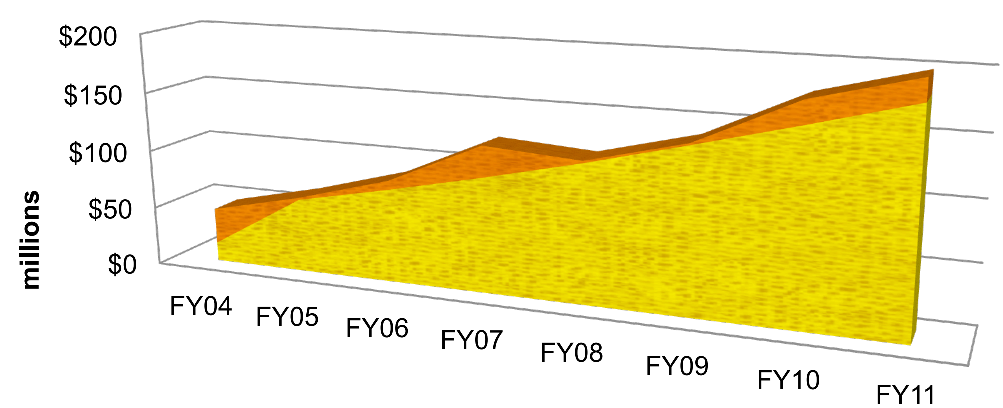
	Market Value 9/30/11	Percent Allocation	FY07	FY08	FY09	FY10	FY11	Since Inception
Total Fund- Gross	***$198,172,572***	***100%***	***17.7%***	***-15.9%***	***-1.2%***	***12.0%***	***0.0%***	***2.7%***
Total Fund -Net Fees			17.4%	-16.6%	-2.1%	11.1%	-0.4%	2.2%
Total Trust Benchmark			19.2%	-19.9%	1.4%	10.1%	-0.2%	2.4%
Foundations Median			16.3%	-14.6%	-1.1%	10.0%	1.2%	5.0%
Total Managed Assets	128,032,773	64.6%						
U.S. Domestic Equity	*$53,782,199*	*27.1%*	*16.6%*	*-21.5%*	*-4.6%*	*11.5%*	*-0.2%*	*0.4%*
Russell 3000 Index			16.5%	-21.5%	-6.4%	11.0%	0.5%	0.0%
International Equity	*$54,282,340*	*27.4%*	*25.5%*	*-26.3%*	*10.6%*	*12.8%*	*-11.2%*	*0.6%*
MSCI EAFE Index			24.9%	-30.5%	3.2%	3.3%	-9.4%	-2.8%
Mercer Inst'l World ex U.S. EAFE Equity Median			NA	-29.3%	3.9%	6.8%	-8.9%	NA
Fixed Income	*$19,968,223*	*10.1%*	*NA*	*NA*	*NA*	*NA*	*NA*	*2.9%*
Barclays Capital Aggregate			5.1%	3.7%	10.6%	8.2%	5.3%	4.9%
Mercer Inst'l U.S. Fixed Core Opportunistic Median			NA	-.7%	13.8%	11.5%	5.1%	NA
Total Non Discretionary Assets	$70,139,799	35.4%	17.7%	-15.9%	-1.2%	12.0%	11.9%	4.3%
Fixed Income	*$25,695,727*	*13.0%*	*NA*	*-1.7%*	*6.2%*	*14.3%*	*2.1%*	*5.2%*
Custom Fixed Income Benchmark			NA	-11.5%	17.2%	15.7%	0.0%	4.5%
Mercer Inst'l U.S. Fixed Combined Median			NA	1.3	12.2	9.5	4.3	NA
Real Estate	*$16,980,075*	*8.6%*	*NA*	*NA*	*-42.2*	*8.0*	*23.3*	*-7.0*
NCREIF NFIC ODCE			18.2	3.2	-35.2	7.0	18.3	-5.6
Mercer Inst'l U.S. Real Estate Open End Median			NA	3.7	-42.3	6.7	17.7	-3.9

	Market Value 9/30/11	Percent Allocation	FY07	FY08	FY09	FY10	FY11	Since Inception
Hedge Fund	*$8,928,978*	*4.5%*	*NA*	*NA*	*NA*	*NA*	*2.6*	*4.3*
T-Bills +3			7.9	5.1	3.2	3.1	3.1	3.1
Mercer Inst'l Funds of Hedge Funds (Net) Median			NA	NA	0.7	4.3	-0.8	0.9
Private Equity	*$18,533,986*	*9.4%*	*0.0*	*12.6*	*-25.3*	*15.9*	*19.1*	*3.0*
S&P 500 +3%			19.4	-19.0	-3.9	13.2	4.1	1.8
Cash	$1,034	0.0%						2.7

From a historical perspective, the Fund has had an overall gain since inception of 2.7% per annum gross of fees and 2.2% per annum net of fees. For the same time period, the Total Trust Benchmark had a 2.4% annualized gain and the Foundations Median had a 5% annualized gain. Most asset categories have exceeded their benchmarks since inception. The exceptions are: 1) the managed asset component's fixed income asset that has had a 2.9% annualized gain compared to the annualized benchmark gain of 4.9%; and 2) the real estate asset which, though performing well in the last two fiscal years, had a significant loss in FY08 (-42.2%). The rebound in the real estate asset, by 8% in FY10 and 23.3% in FY11, is due to improved real estate purchasing opportunities resulting from the 2008 real estate crisis and income from these holding along with sales.

Figure 11: Total Cumulative Contribution (Cost Basis) and Net Asset Value Annual Gain, FY04-FY11

Source: Audited Financial Statements FY04-FY11



	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11
Net Gain	$30,258,383	$1,780,410	$7,576,241	$26,262,901	$1,943,326	$1,591,297	$19,196,260	$18,063,645
Cumulative Contribution	$16,000,000	$62,446,383	$78,888,077	$96,576,682	$115,572,362	$136,483,922	$158,002,102	$180,396,388

As of FY11 a total of $180,396,388 was contributed to the Fund. The U.S. government contributed 83.2% and the FSM government 16.8%. Figure 11 shows the growth of the Fund with a steady incline of contributions and the periodic gains and losses of the investment income. Overall, given the amount of contributions, as of the end of FY11, the Fund has gained a total of $18,063,645 from those contributions.

C. The C Account

Article 16 of the Trust Fund Agreement requires that any annual income of the Fund over 6% shall be transferred to the C account. The C account funds can be used after FY23 to supplement annual distributions from the Fund if so desired by the Committee.

The C account is maintained as a sub account for accounting purposes. It is not invested separately but as part of the overall corpus. The end-of-year financial statements provide a calculation to determine if the Fund achieved the 6% annual income threshold and, if so, the amount to be transferred to the C account. Also, the breakdown of the A and C accounts is reported annually by contributor as show in Figure 12.

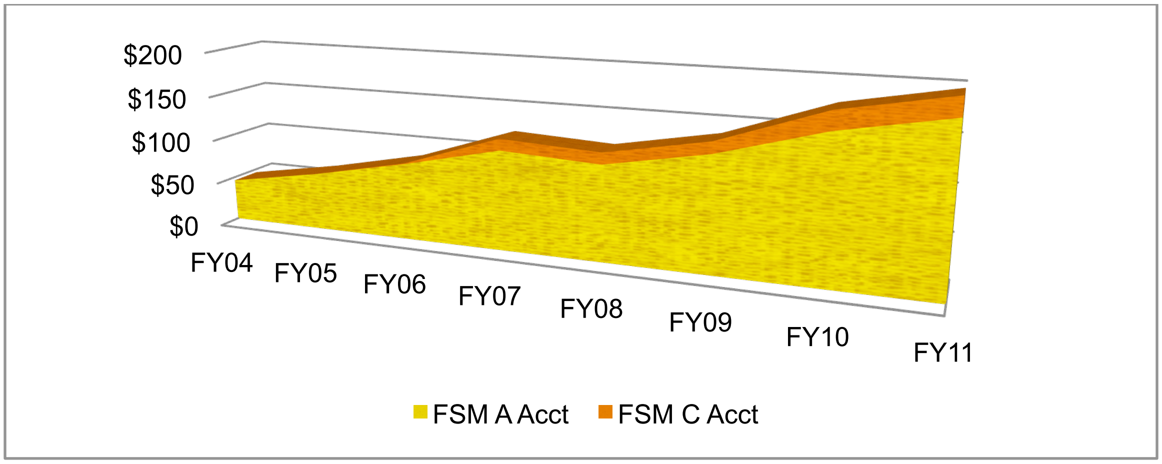
The amount in the C account remained the same as in FY10 since the fund had a loss for FY11 and did not achieve more than 6% annual income.

Figure 12: A and C Account Net Asset Balances, FY06-FY11
Source: Audited Financial Statements FY04-FY11

	FY06	FY07	FY08	FY09	FY10	FY11
Total Assets	**$86,464,317**	**$122,839,583**	**$117,515,688**	**$138,075,219**	**$177,198,362**	**$198,460,033**
A Account	*$85,645,391*	*$110,126,326*	*$104,802,431*	*$125,361,962*	*$156,981,440*	*$178,243,111*
U.S.	52,597,064	74,902,144	76,325,412	96,967,855	126,458,760	147,930,868
FSM	33,048,327	35,224,182	28,477,019	28,394,107	30,522,680	30,312,243
C Account	*$818,926*	*$12,713,257*	*$12,713,257*	*$12,713,257*	*$20,216,922*	*$20,216,922*
U.S.	502,911	8,587,013	8,587,013	8,587,013	13,655,271	13,655,271
FSM	316,015	4,126,244	4,126,244	4,126,244	6,561,651	6,561,651

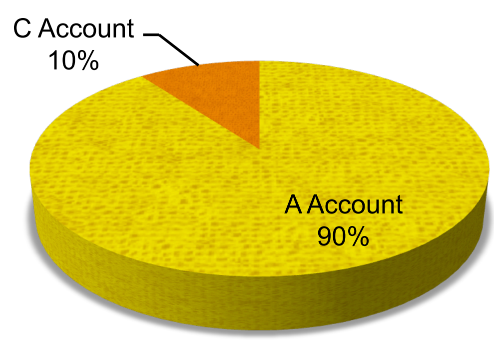
Historically, the C account has gained income in positive growth years to include FY06, FY07 and FY10. Per the Trust Fund Agreement, the C account is allowed to contain up to three times the amount of FY23 sector grant assistance plus an inflation adjustment. The current amount in the C account is about 25% of amended Compact sector grant assistance forecast for FY23. And, while the total Fund will continue to increase based on contributions and at least expected moderate income growth, the C account's growth is not assured since only annual income of the Fund in excess of 6% shall be transferred to the C account.

Figure 13: A and C Account Trends, FY04-FY11
Source: Audited Financial Statements FY04-FY11
($s millions)



As of FY11, the C account is 10% of the total Fund. This amount is slightly below the FY10 amount of 11%. While the value amount stayed the same for FY10 and FY11, given the increase in the net asset value of the entire Fund, the C account has become a reduced portion of the overall Fund.

Figure 14: FY11 A and C Account Breakdown
Source: FY11 Audited Financial Statements



V. Trust Fund Effectiveness and Recommendations Moving Forward

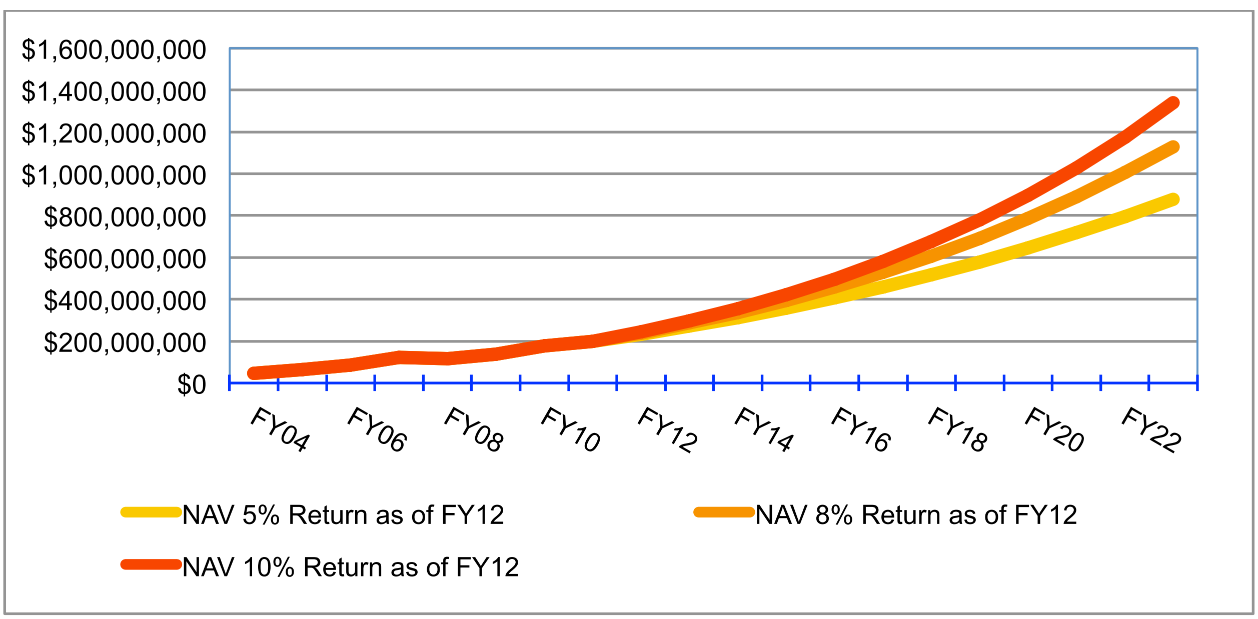
A. Effectiveness to Achieve Purpose

As stated previously, in the Trust Fund Agreement between the U.S. and FSM governments, the purpose of the Fund is to, *"contribute to the economic advancement and long-term budgetary self-reliance of the Federated States of Micronesia by providing an annual source of revenue, after Fiscal Year 2023, for assistance in sectors described in Section 211 of the Compact, as amended, or other sectors as mutually agreed by the Original Parties, with priorities in education and health care."*

The Trust Fund Agreement further states that the Committee should prepare an annual report that includes the "effectiveness of the Fund to accomplish that purpose" as well as provide "recommendations regarding improving the effectiveness of the Fund to accomplish that purpose." The following section is an effort to indicate effectiveness as well as provide recommendations, some summarized from previous sections, to improve effectiveness.

As stated above, since inception, the Fund has grown a total of 2.2% per annum net of fees. The low overall growth rate can be attributed to the fact that the funds were not fully invested until FY06 and investment performance has been weak given U.S. and global equity market performance since 2008.

Figure 14: Actual and Estimated Net Value Asset (NAV) Trends, FY04-FY23
Source: For FY04-FY12 numbers, Audited Financial Statements FY04-FY11, For FY12-23 estimates based on estimated contributions and indicated growth rates



An analysis by Mercer, the investment adviser, estimates that if the Fund manages an average 5% return annually from FY12 to FY23, the distribution from the estimated assets should provide FY24 revenue equivalent to approximately 85% of the nominal FY23 grant level without a partial inflation adjustment.

If the Fund were to achieve an average 8% return annually, the Fund would probably provide FY24 revenue equivalent to nominal FY23 grant assistance without an inflation adjustment. There would also be a build-up of the C account but probably not to the maximum level permitted under the Trust Fund Agreement. Per Figure 10, the Fund has only achieved 8% or more return in two years-FY07 and FY10.

If the Fund were to achieve an average 10% return annually, the Fund would probably provide FY24 revenue equivalent to partially inflation adjusted FY23 grant assistance. However, this would not allow for future inflation adjustments beyond the FY23 amount. There would also be a build-up of the C account but not to the maximum level permitted under the Trust Fund Agreement. However, achieving such annual average growth is not expected.

B. Recommendations Moving Forward

The Fund has made progress during FY11 in terms of keeping the growth trend on an upward incline while minimizing losses, reducing administrative and investment expenditure, and strengthening overall Fund management and administration. The Fund's investment mix and diversification has allowed it to better weather U.S. and international market and economic conditions, as shown in FY11 Fund performance. It has taken since late FY06 to build-up to this point and the Fund has a strong base on which to build future gains.

The Committee has taken steps to identify subsequent contributors to the Fund. The steps taken to date include research to identify potential contributors. The next step would be for the U.S. and FSM governments to initiate discussions or negotiations connected with efforts to seek contributions to the Fund from other sources.

The Fund's performance, as previously mentioned, has mainly been based on U.S. and international equity performance though the non-discretionary component has and hopefully will continue to help in all market conditions, but especially in down markets which was the intent of including such investments. The investment adviser has remained within the investment allocation classes and percent ranges as indicated by the Investment Policy Statement. The Committee should continue to monitor the portfolio's performance to determine, based on the investment adviser's advice, if any such changes to the Statement should take place.

Lastly, the Committee has significantly reduced administrative and investment expenditure in FY11. The Committee should remain prudent in ensuring expenses are appropriate relative to the services provided. To maintain the expenditure ratio at the current level while assets will increase will become more challenging in FY12 and future years.