Trust Fund for the People of the
Federated States of Micronesia

Fiscal Year 2012 Annual Report

March 6, 2013

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 2012, the performance during the fiscal year ending 30 September 2012, 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 2012 (FY12).

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 6 March 2013. 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.

FY12 Highlights

- The total net asset value of the Fund increased 30% to $257.3 million in FY12 from $198.5 million in FY11. The increase was due to a net investment gain of $35.3 million and a U.S. government contribution of $23.6 million.

- Overall, the Fund had a dollar weighted rate of return of 14.78% The rate is the Fund's second best return since inception in 2004. On a performance basis, not discounting for fees and expenses, the Trust Fund gained 16.9% compared to a benchmark of 19.0%.[1]

- Since inception the Fund has grown an average of 3.8% per annum (net of fees) a significant improvement over FY11's average of 2.2%. The growth rate is slightly below the Total Trust Benchmark of 4.3%.[2]

- The net annual investment gain was primarily due to strong performance in U.S. and international equity markets that positively impacted the Trust Fund's managed assets (69.9% of total assets) and supported by solid performance of the Trust Fund's fixed

[1] As of 5/1/12, the Total Trust Benchmark is comprised of 27% Russell 3000, 28% MSCI ACWIxUS, 10% Barclays Capital Aggregate, 8.5% JPMorgan Emerging Market Bond Index, 5% BofA Merrill Lynch All U.S. Convertibles, 5% T-Bills+3%, 7.5% NCREIF NFI ODCE, 9% S&P 500+3%.

[2] If the Fund was to average 5% growth annually to FY23, the distribution from estimated assets for FY24 should provide a distribution equivalent to approximately 85% of the nominal FY23 Compact of Free Association, as Amended, Section 211 grant level. If the Fund averages 8% growth annually, the Fund should provide FY24 revenue equivalent to the nominal FY23 Amended Compact grant level without an inflation adjustment and provide a partial build-up of the C account.

income and diverse non-discretionary assets (30.1% of total assets). The weight toward equities positively impacted the portfolio's returns and performance.

- Given the positive returns, an allocation of $20.9 million was made to the "C" account for FY12 bringing the total of that account to $41.2 million.[3]

- Investment expenses increased by 14.3% to $737,949 for FY12 from $645,382 in FY11. The increase was mainly due to the increased value of funds managed by the Investment Advisor, Money Managers and Custodian, and slight fee increases. Overall, investment expenses were 0.29% of total net assets, less than the FY11 percentage of 0.33%. The percentage is the lowest since FY06.

- Administrative expenses increased by 6.1% to $156,960 for FY12 from $147,921 in FY11. Increases were for the Executive Administrator's fee and miscellaneous expenses. Reductions occurred for legal, audit and accounting fees. Overall, administrative expenses were 0.06% of total net assets, less than the FY11 percentage of 0.07%. The percentage is the lowest since FY07.

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

[3] The C account contains any annual income on the Fund over 6%. The C account shall contain no more than three times the estimated equivalent of the FY23 annual grant assistance, including the estimated inflation adjustment provided in the Amended Compact of Free Association (Section 218). After FY23, the C account may be drawn on, to the extent it has sufficient funds, to address any shortfall if Fund income from the previous year falls below the previous year's distribution adjusted for inflation. Transfers were made to the C account in FY06, FY07 and FY10- the years with over 6% annual income.

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 with subsequent amendments.

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 Fund resources; and

3. Conclusion of agreements and arrangements with subsequent contributors and other organizations.

For FY12, 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. One FSM member is from the government and the other is from the private sector, as indicated by FSM law. A subsequent contributor may or may not be a voting member. Currently, the Fund does not have any subsequent contributors.

The FY12 Committee members were:

1. Nikolao Pula, Chairman (Department of the Interior), U.S.
2. Rose Nakanaga, Member (Department of Finance), FSM
3. Chris Marut, Member (Department of State), U.S.
4. Craig Allen, Member (Department of Commerce), U.S.
5. Aren Palik, Member (Private Sector), FSM

Rose Nakanaga replaced Fabian Nimea during the second quarter of the fiscal year as an FSM member. Craig Allen replaced Joseph McDermott as a U.S. member also during the second quarter.

An Executive Administrator supports the Committee.

During FY12, the Committee met quarterly to review investment performance and conduct Fund business on the following dates:

1. 13 November 2011 (Washington D.C. based teleconference)
2. 6 March 2012(Washington D.C.-based teleconference)
3. 16 May 2012 (Washington D.C. based teleconference)
4. 20 August 2012 (Honolulu)

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

Prior to the 20 August 2012 meeting, and for the first time, a seminar was held to educate the Committee members and support staff on several aspects of fund management and investment vehicles. The seminar included presentations by the Investment Advisor, Custodian and the Executive Administrator.

A Custodian and Investment Adviser support the Fund. State Street Bank and Trust Company 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, which correlates to the amount of the reductions in direct grant assistance, plus a partial inflation adjustment as indicated in the amended Compact.[4] The FSM government was to provide $30 million prior to 30 September 2004.

For FY12, a total of $23,587,200 was contributed consisting of a scheduled contribution from the U.S. government

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

Figure 1: Contributions to FY12 and Committed Future Contributions
($s millions)

Date	United States	FSM	Total
FY04	0.00	0.00	0.00
FY05	32.19	30.30	62.49
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
FY12	23.59		23.59
Invested to Date	*173.73*	*30.30*	*204.03*
FY13	24.99		24.99
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	**458.72**	**30.30**	**489.02**

* U.S. numbers as of FY14 do not include the inflation adjustment. The adjustment will be calculated and added each fiscal year. The U.S. FY13 contribution was received in October 2012 but is not included in the Annual Report analysis since it is an FY13 contribution.

[4] 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."

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. The Executive Administrator contract was extended to April 2013 with the approval of Resolution FSM 2012-3 Executive Administrator Contract Extension.

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 prepare the annual report; and prepare periodic performance and other assessments to inform Committee members and staff.

Key FY12 activities include the following:

- 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.
- Maintained service agreements with investment advisor, custodian, accountant, auditor, legal counsel and others. Negotiated service agreements or adjustments with Custodian, legal counsel and bookkeeper.
- Organized, conducted and provided follow-up for the four quarterly review meetings including meeting agenda, support documents and meeting minute preparation.
- Prepared or coordinated the preparation and approval of 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.
- Coordinated updating the Investment Policy Statement and implementing the asset allocation revisions.
- Prepared research on potential subsequent contributor candidates and possible ways forward to attract subsequent contributors to the Fund.
- Coordinated with both U.S. and FSM government members and staff in support of the above.

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 and Trust Company (State Street) serves as Fund Custodian per a contract between State Street 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. In July 2012 State Street indicated an additional flat fee- a Supplemental Custody and Accounting Fee- to be added to the quarterly assessment. The additional fee resulted from increased regulatory, recordkeeping and technology upgrading costs. The Committee negotiated a fee lower than that initially proposed.

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 was implemented in FY12 and is now provided monthly.[5]

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 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.

[5] Planned accounting is a breakdown of the fund by contributor (U.S. and FSM governments) and by the A and C account. The breakdown allows the allocation of contributions, investment gains and losses, and expenses to each contributor and helps to calculate the proportions of each contributor of the A and C accounts.

Mercer's management asset fee was adjusted twice in FY12. First, per Resolution FSM 2012-7 Asset Allocation for Emerging Market Investment, the fee increased to 54 basis points from 52 basis points with the addition of an emerging market fund to the portfolio. Second, per Resolution FSM 2012-9 Asset Allocation Revision, the fee will increase to 58 points in FY13 given the asset allocation mix and the eventual addition of a hedge fund and private equity fund under the managed assets portion of the portfolio. Both funds are "fund of funds" type managed assets.

In addition, Mercer applies a 9 basis points advisory fee on the non-discretionary assets. This fee was not adjusted in FY12.

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 about global, U.S. and comparative fund investment performance and Fund status for the quarter, fiscal year and since inception. Mercer 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, and its updates, during the 16 May 2012 Committee meeting and again during the 20 August 2012 meeting 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. The service agreement with Bookminders was extended by one year to June 2013. Bookminders produces monthly financial statements and the annual financial statements. The auditor reviews the annual 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. Both the FY11 and FY12 audits were prepared in a timely manner and completed by the deadline (end of March for each fiscal year).

Legal Counsel

DLA Piper LLP served as the Fund's legal counsel up to mid-February 2012. The firm had provided legal advice since the Fund's inception, as needed. After a search, the Committee selected Vorys, Sater, Seymour and Pease LLP as legal counsel. The service agreement was executed in February, 2012. As part of the agreement, Vorys also provides a Registered Agent for the Fund, as required by the District of Columbia for registered non-profit organizations.

C. Approved Resolutions

The Committee approved 10 Resolutions. The following is the title and brief description of each resolution.

FSM Resolution 2012-1 Cash Raising Authority
Allows the Executive Administrator to raise cash with the Investment Advisor to meet Fund expenses.

FSM Resolution 2012-2 Legal Counsel Appointment and Registered Agent Designation
Appointed Vorys, Sater, Seymour and Pease LLP as the Fund's legal counsel and as Registered Agent.

FSM Resolution 2012-3 Executive Administrator Contract Extension
Extended the Executive Administrator's contract one year to April 2013.

FSM Resolution 2012-4 Asset Allocation Amendment to the Investment Policy
Considering the expected growth of the private equity asset category, the domestic equity asset category (U.S. large cap allocation) Strategic Target Allocation was reduced 1% to 20% of total Fund assets; the non-U.S. equity Strategic Target Allocation was reduced by 1% to 28%; and the private equity Strategic Target Allocation was increased 2% to 9%.

FSM Resolution 2012-5 Additional Subsequent Contributors
Indicated the ability of the Original Parties of the Trust Fund Agreement to seek contributions to the Fund from other sources. And, resolved that the Executive Administrator is authorized to work with the Original Parties and potential contributors in support of seeking contributions to the Fund from other sources.

FSM Resolution 2012-6 Annual Report Approval
Approved the FY11 Annual Report and approved the transmission of the Annual Report and Audited Financial Statements to the respective governments and to the public.

FSM Resolution 2012-7 Emerging Market Allocation
Added an emerging market fund to the non-U.S. equity category of the managed assets portion of the portfolio with a Strategic Target Allocation of 5% of assets. The managed asset fee was increased to 54 basis points from 52 basis points.

FSM Resolution 2012-8 Engagement Agreement with Bookminders and Accounting Support Services
Approved a service proposal with Bookminders for accounting services to June 2013.

FSM Resolution 2012-9 Asset Allocation Revision
The resolution adjusted asset allocations mainly by reducing the managed asset category to 59% of the portfolio from 65% and increasing the non-discretionary asset category to 41% from

35%. And, new hedge fund and private equity “fund of funds” would be added to the managed assets category. The managed asset fee will increase to 58 basis points from 54 basis points in FY13 when the new funds are added. The non-discretionary management fee remained the same.

FSM Resolution 2012-10 Release of Information
Authorization to release information to a public source regarding the Fund’s A and C account calculations.

IV. FY12 Account Balances and Performance and Trends Since Inception

A. Trust Fund Asset Classes and Allocations

FY12 was a period of transition for the Fund's portfolio to help to further diversify the fund and improve upon its growth prospects. 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 (global and emerging market), 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 two key changes for the fiscal year were agreed to in Resolution FSM 2012-7 Asset Allocation for Emerging Market Investment in May 2012 and Resolution FSM 2012-9 Asset Allocation Revision in August 2012. The April resolution provided for an investment in an emerging market fund with a Strategic Target Allocation of 5% of total Fund assets. The allocations between the managed assets and non-discretionary assets were also adjusted whereas the managed asset portion decreased to 65% of the portfolio from 67% and the non-discretionary asset portion increased to 35% fro 33%. The August 2012 resolution provided for increasing the percentage of non-discretionary asset holdings to 41% and decreased managed assets to 59%. The resolution also included a hedge fund and private equity 'fund of funds' to be added to the managed asset portion of the portfolio.

The asset class changes are according to the breakdown provided in Figure 2, below. The table shows that the fiscal year ended with an increased percentage in the managed asset portion of the portfolio and a decreased portion in the non-discretionary assets. The reason for these end-of-year allocations was that in the first quarter of FY13 additional funds were contributed to two non-discretionary assets: the emerging market debt asset and the hedge fund. Thus the build-up of funds in the managed asset category helped to fund the additions to these two non-discretionary assets during the first quarter of FY13. Thus, there were overweights in the more liquid managed asset categories to include U.S. domestic equities, non-U.S. equities, and fixed income.

In addition, the Investment Adviser had adjusted the asset class allocations throughout the year within the permitted ranges indicated in the Investment Policy Statement based on market changes. These changes were 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. Given the performance of the different assets throughout the year and the more positive performance of U.S. public equities, more of a weight was given to these assets to help the Fund achieve a greater rate of return. These changes were especially applicable given the positive performance of the public equity markets, and thus the Fund, in the second and fourth quarters of the fiscal year.

Figure 2: Asset Classes Per Investment Policy Statement and for FY11 and FY12
Source: Investment Policy Statement, 9/10 with April and August 2012 updates; Mercer Quarterly Reports- 9/30/11and 9/30/12

Asset Class	Strategic Target Allocation & Permitted Range 9/30/11	Strategic Target Allocation & Permitted Range 9/30/12	Allocation as of 9/30/11	Allocation as of 9/30/12	Actual % Change
Managed Assets					
Domestic Equity	28% 23%-33%	25.5% 20.5-30.5	27.1%	29.9%	2.8%
U.S. Large Cap Equity	21.0%	18%	20.5%	22.3%	1.8%
U.S. Small/Med Cap Equity	7.0%	7.5%	6.7%	7.6%	0.9%
Non-U.S. Equity	29% 24%-34%	25.5% 20.5%-30.5%	27.4%	29.9%	2.5%
Fixed Income	10% 5%-15%	2.5% 0%-5%	10.1%	10.2%	0.1%
Hedge Fund (Fund of Hedge Funds)		5.5 3%-8%	0.0%	0.0%	0.0%
Total Managed Assets	*67.0%*	*59%*	*64.7%*	*70.0%*	5.3%
Non-Discretionary Assets					
Emerging Market Debt	8.5% 3.5%-13.5%	10% 5%-15%	4.8%	7.2%	2.4%
Convertible Bonds	5% 0%-10%	6.5% 4%-9%	8.1%	4.2%	-3.9%
Private Equity	7% 2%-12%	9.5% 4.4%-14.5%	9.4%	7.6%	-1.8%
Private Real Estate	7.5% 2.5%-12.5%	10% 5%-15%	8.6%	7.3%	-1.3%
Hedge Fund	5% 0%-3%	5% 2.5%-7.5%	4.5%	3.7%	-0.8%
Cash	0% 0%-3%	0% 0%-3%	0.0%	0.0%	0.0%
Total Non-Discretionary	*33.0%*	*41%*	*35.4%*	*30.0%*	-5.4%
Total	***100%***	***100%***	***100%***	***100%***	

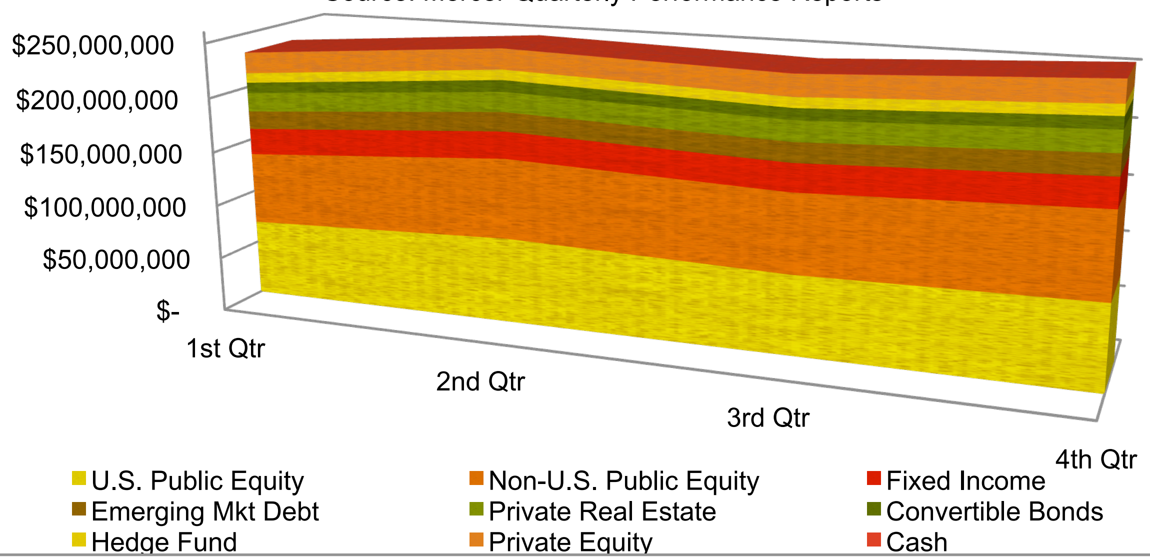
The portfolio's private equity portion is beginning to show more sizable and more periodic returns as a result of the "J-Curve" effect. The Fund has continued to invest in these private equity funds and, as the money managers invest additional funds periodically, returns are starting to materialize which 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 assets and asset allocations were changed by changing the large cap fund investment and making additional purchase in convertible bond, hedge, and emerging markets equity and debt funds. Funds were used from the cash account to make these additional purchases.

Figure 3: FY12 Asset Class Change

Source: Mercer Quarterly Performance Reports



The individual asset change is illustrated in Figure 4. As indicated above, the only new asset addition in FY12 was the emerging market fund (MIM Emerging Market Equity Fund).

Figure 4: Asset Change FY11 to FY12

Asset Class	Assets Held as of 9/30/11	Assets Held as of 9/30/12
Managed Assets		
Domestic Equity		
U.S. Large Cap Equity	SSgA S&P 500 Index Fund	SSgA S&P 500 Index Fund
U.S. Small/Med Cap Equity	MIM Small/Mid Cap Growth Equity Fund MIM Small/Mid Cap Value Equity Fund	MIM Small/Mid Cap Growth Equity Fund MIM Small/Mid Cap Value Equity Fund
Non-U.S. Equity	MIM Non-U.S. Core Equity Fund	MIM Non-U.S. Core Equity Fund MIM Emerging Markets Equity
Fixed Income	MIM Core Opportunistic Fixed Income Fund	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. The benchmarks are revised from FY11 given the previously described investment allocation adjustments. The benchmarks provided in Figure 5 are as of 5/1/12. With the asset allocation adjustment in August 2012, the benchmarks were to be adjusted once the new allocation was in place. These adjustments were put in place from October-February FY13.

Figure 5: Performance Standard Benchmarks

Asset Class	Benchmarks
Overall	Total Trust Benchmark[6] Foundations Median
Total Managed Assets Benchmark	Custom Bench Mark (adjusted 5/1/12): Russell 3000 (42%), MSCI ACWIxUS (43%), Barclays Capital Aggregate (15%)
Domestic Equity	Russell 3000 Index
U.S. Large Cap Equity	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 Russell 2500 Value Index Mercer Institutional U.S. Equity SMID Value Median
Non-U.S. Equity	MSCI ACWIxUS Index (changed as of 5/1/12) MSCI EAFE Mercer Institutional World ex U.S. EAFE Equity Median MSCI Emerging Markets (added as of 5/1/12) Mercer Institutional Emerging Markets Equity Median (added as of 5/1/12)
Fixed Income	Barclays U.S. Aggregate Bond Index Mercer Institutional U.S. Fixed Core Opportunistic Median
Emerging Market Debt	JP Morgan Emerging Market Bond Index Mercer Institutional Emerging Market Debt Median
Convertible Bonds	BofA Merrill Lynch All U.S. Convertibles Index Mercer Institutional U.S. Convertible Composites 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

The portfolio was reviewed each quarter during Committee meetings. The Investment Advisor also provided a longer-term review of the portfolio during the May and August 2012 meetings. A

[6] The Total Trust Benchmark was adjusted on 5/1/12 and is comprised of 27% Russell 3000, 28% MSCI ACWIxUS, 10% Barclays Capital Aggregate, 8.5% JPMorgan Emerging Market Bond Index, 5% BofA Merrill Lynch All U.S. Convertibles, 5% T-Bills+3%, 7.5% NCREIF NFI ODCE, 9% S&P 500+3%.

more complete annual review for FY11 was provided during the December 2011 quarterly meeting.

B. Summary of FY12 Performance and Trends Since Inception

The Fund ended FY12 with a net asset value of $257,346,109. The amount is a 30% gain from FY11, as shown in Figure 6. The gain is attributable to two factors: continued and increasing U.S. contributions and positive portfolio performance periodically throughout the fiscal year.

The U.S. contribution increased to $23,587,200 based on the FY11 amount plus the $800,000 annual increment and the annual inflation adjustment. No other contributions were provided to the Trust Fund.

Figure 6: Trust Fund Assets FY10- FY11, Percent Change
Source: Audited Financial Statements September 30, 2010 and 2009, September 30, 2011 and 2010, September 30, 2012 and 2011

	FY10	FY11	FY12	% Difference
Net Assets (Beginning of Fiscal Year)	**$138,075,219**	**$177,198,362**	**198,460,034**	**12.0%**
Contributions				
U.S.	21,518,180	22,394,286	23,587,200	5.3%
FSM	-	-	-	0.0%
Total Contribution Income	21,518,180	22,394,286	23,587,200	5.3%
Investment Earnings & Unrealized Gains	18,696,866	-339,386	36,187,893	10762.8%
Less Investment Fees	939,224	645,382	737,949	14.3%
Net Investment Income	17,757,642	-984,768	35,449,944	-105.5%
Misc Other Receipt	0	-75	-5,891	
Total Income	39,275,822	21,409,593	59,043,035	175.8%
Less Administrative Expenses	152,679	147,921	156,960	6.1%
Change in Net Assets	39,123,143	21,261,672	58,886,075	177.0%
Net Assets (End of Fiscal Year)	**$177,198,362**	**$198,460,034**	**$257,346,109**	**29.7%**

The Fund experienced a significant investment gain in FY12 of $36.1 million. As shown in Figure 7, almost all income categories showed increases from FY10 and FY11. Most notable were gains in dividends and unrealized gains. The gains are due to several factors with the most important being the positive performance of U.S. public equity capital markets and, to a lesser extent, performance of non-U.S. public equity markets. Also, FY12 showed the first full year of the Fund benefitting from its diverse portfolio of managed and non-discretionary assets. The performance of the managed assets (70% of the portfolio at year's end), mainly the public equity and fixed income investments, was the main driver behind the gains. And, the non-discretionary assets (30% of the portfolio at year's end), including the alternative investments, performed positively including increasing gains from private equity investments and rebounding of the real estate asset.

Figure 7: Investment Income FY10- FY12
Source: Audited Financial Statements September 30, 2010 and 2009,
September 30, 2011 and 2010, September 30, 2012 and 2011

	FY10	FY11	FY12
Interest	230,382	314,982	316,049
Accretion	-	72,123	47,761
Dividends	2,765,679	3,619,882	6,314,942
Realized Gain (loss) on Investments	1,709,435	1,245,548	744,530
Unrealized Gain (loss) on Investments	13,991,207	(5,592,957)	28,769,885
Currency Value Change	163	1,035	(5,275)
Total	**$18,696,866**	**$(339,387)**	**$36,187,892**

Overall, the Fund had a dollar weighted rate of return of 14.8%. The annual return was the second best since Fund inception in FY04. The return rate compares to a negative rate of return of -0.57% in FY11 and positive 10.46% in FY10. The FY12 gain allowed a significant transfer to the C account, further described in Section C, below.

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, -$23.2 million, 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 counter public equity market movements and minimize the losses in FY11.

Figure 8: Total Contributions, Income, Expenses and Net Assets Since Inception
Source: Annual Audited Financial Statements since FY04
$s millions

	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY112
Net Assets (Beginning of Fiscal Year)	**$0.00**	**$64.23**	**$86.46**	**$122.84**	**$117.52**	**$138.07**	**$177.20**	**$198.46**
Contributions								
U.S.	32.19	16.44	17.69	19.00	20.91	21.52	22.39	23.59
FSM	30.26	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Total	62.45	16.44	17.69	19.00	20.91	21.52	22.39	23.59
Net Investment Income								
Earnings	1.79	5.94	19.41	-23.27	0.83	18.70	-0.34	36.19
Fees and Expenses	0.01	0.14	0.73	1.05	1.18	1.09	0.79	0.89
Total	1.78	5.80	18.69	-24.32	-0.35	17.60	-1.13	35.29
Net Assets (End of Fiscal Year)	**$64.23**	**$86.46**	**$122.84**	**$117.52**	**$138.07**	**$177.20**	**$198.46**	**$257.34**

Total Fund expenses increased in FY12 compared to FY11 but remained less than in the FY08-FY10 period. Overall investment and administrative expenses increased 12.8%, as shown in Figure 9, but were only 0.35% of total fund net assets for the fiscal year- the lowest percentage since FY06- the first year the Fund was at least partially invested.

Total investment expenses increased 15.9%. These expenses are mainly based on the amount of assets held by the Fund. Since the value of the Fund substantially increased so did the custodial, advisory, and money management fees. The Custodian's fee increased 13.5% mainly due to the Fund's increased value. Also, the Custodian added an additional fee at fiscal year's end based on increased costs due to meeting regulatory and reporting requirements, and technology upgrades. The Investment Adviser's fee increased 10.6% again mainly due to the increase in the value of the assets managed. Also, the managed asset fee structure was adjusted upward in May to 54 basis points from 52 basis points when the emerging market fund was added to the portfolio. Money Manager fees increased 15.9%. The increase is due to the increased value of assets managed as well as performance fees earned by several managers. Overall, investment expenses were 0.29% of total net assets. The percentage is the lowest since FY06.

Total administrative expenses increased 6.1% compared to FY11. Increases were for the Executive Administrator fee and miscellaneous expenses. Decreases were for accounting, audit and legal fees. Overall, administrative expenses made up a small portion of the Fund, amounting to 0.06% of total net assets. The percentage is the lowest since FY07.

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 percentage for that fiscal year is due to costs incurred the previous year. As previously mentioned, the FY12 percentage is the lowest since FY06. The current percentage of total net assets is expected to remain about the same for future years given existing service agreements and the diligence of the Committee to keep expenses at reasonable levels.

Figure 9: Investment and Administrative Expenses Since Inception and Differences Between FY11 and FY12

Source: Annual Audited Financial Statements since FY04

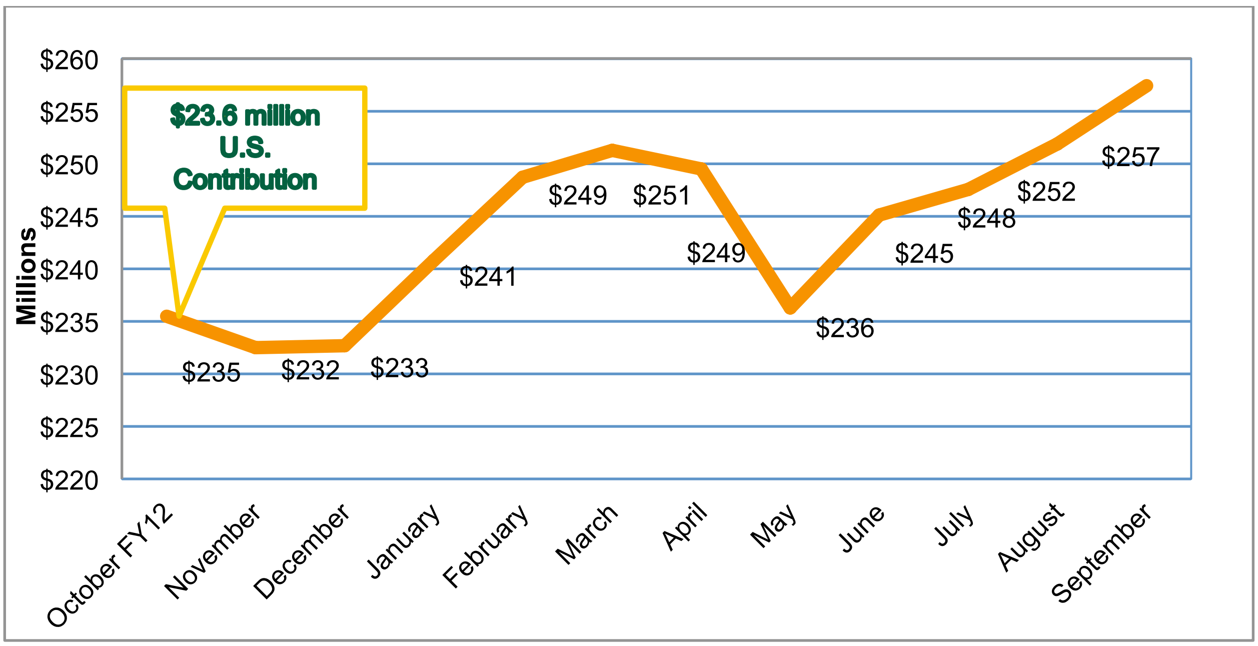
	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	Diff FY11-FY12
Investment Expense	**$0**	**$132,039**	**$686,419**	**$955,763**	**$1,049,150**	**$939,224**	**$645,382**	**$737,949**	14.3%
Custodian	-	1,997	12,908	42,117	16,280	23,508	59,312	67,313	13.5%
Investment Adviser	-	125,385	142,402	126,800	187,754	319,704	162,496	179,738	10.6%
Money Manager	-	4,657	531,109	786,846	845,116	596,012	423,574	490,898	15.9%
% of Net Assets	*0.00%*	*0.15%*	*0.56%*	*0.81%*	*0.76%*	*0.53%*	*0.33%*	*0.29%*	
Admin. Expense	**$13,356**	**$9,458**	**$39,715**	**$93,851**	**$133,959**	**$152,679**	**$147,921**	**$156,960**	6.1%
Exec. Administrator	-	-	-	70,650	85,650	91,850	96,816	102,760	6.1%
Audit Fees	-	-	33,906	15,260	39,740	45,062	42,446	39,900	-6.0%
Accounting Fees	-	-	-	3,449	5,868	6,295	6,794	6,639	-2.3%
Legal Fees	13,356	9,458	5,809	4,457	245	4,344	1,258	780	-38.0%
Miscellaneous Fees	-	-	-	35	2,456	5,128	607	6,881	1033.6%
% of Net Assets	*0.02%*	*0.01%*	*0.03%*	*0.08%*	*0.10%*	*0.09%*	*0.07%*	*0.06%*	
Total Expenses	**$13,356**	**$141,497**	**$726,134**	**$1,049,614**	**$1,183,109**	**$1,091,903**	**$793,303**	**$894,909**	12.8%
Total % of Net Assets	*0.02%*	*0.16%*	*0.59%*	*0.89%*	*0.86%*	*0.62%*	*0.40%*	*0.35%*	

Per Figure 10, overall for FY12, the portfolio experienced two periods of growth in the second and fourth quarters and two periods of declines in the first and third quarters. The performance mainly follows that of the strong U.S. public equity markets during the positive quarters and, to a lesser extent, some positive performance in the non-U.S. public equity markets. However, uncertainty and economic and financial weakness remained given U.S. and European economic and pubic finance conditions and a slowdown in various emerging economies. Despite these uncertainties and weaknesses, the portfolio was also buttressed by positive gains in its fixed income and non-discretionary asset holdings that help the portfolio in market downturns. Overall, with the positive public equity market performance periodically through the year and the solid returns of the fixed income and alternative assets, the Fund ended the year on an upswing but with still the same economic and finance uncertainties and weaknesses looming for FY13.

As previously mentioned, the Investment Adviser did adjust the asset mix slightly throughout the year in response to market conditions and for setting aside funds for additional investments in several Fund assets. Thus, the U.S. public equity and non-U.S. public equity and fixed income values increased mainly due to market performance but also due to increased weights place on them by the Investment Advisor for these more liquid assets so that the emerging market fund investment could be made in May 2012 and additional investment could be made in the first quarter of FY13 to the emerging market debt asset and the hedge fund.

Figure 10: FY12 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 significant growth gross of fees of 16.9% and 16.1% net of fees. The percentages are slightly below the Total Trust Benchmark (defined above) of 19% and above the Foundations Median of 14.5%. Fund performance measures are provided in Figure 11.

Overall, each of the managed asset categories (69.9% of Fund value) either equaled or outperformed their benchmarks. The total managed asset component had a 19.1% gain overall. U.S. domestic equity investments had a 29.9% return that is almost equal to the benchmark's 30.2% return. International equity assets performed below U.S. equity assets with a 14.4% return but performed positively compared with the benchmark's 13.2% return. Fixed income had a more modest 8.7% return outperforming its benchmark of 5.2%.

The non-discretionary component of the portfolio (30.1% of Fund value) helped to support the managed asset gains. This component showed a 10.1% gain for FY12. The fixed income investments (convertible bond and emerging market debt assets) gained 14%, underperforming its benchmark of 19.1%. The real estate asset had another significant gain following strong growth in FY11 (23.3% gain). The asset gained 10.4% in FY12, slightly below its benchmark that had an 11.6% gain. The hedge fund gained 6.7% that is more than double the benchmark's 3.1% performance. The private equity assets gained 7.1%, below its benchmark gain of 34%.

The performance of the private equity investments warrants more explanation since the Fund has invested in these assets since FY07 and there is a gradual build-up period until gains are evident. As previously mentioned, the Fund has contributed capital to these Funds periodically and is just now beginning to see returns as a result of the "J-curve" effect. As of the end of the fiscal year, the Fund has paid in capital of $19.1 million for this category of a total $24 million commitment. Since the inception of these investments, the distributions received amount to $4.9 million or a 4.31% net rate of return. Also, as part of the August 2012 asset allocation revision a private equity 'fund of funds' will be added to the portfolio in FY13.

Overall, the Fund's two components both performed strongly in FY12, the first full year in which the Fund has benefited so positively from its diverse yet balanced investment mix. In comparison to FY11, in which a slightly negative overall return was experienced, the managed assets and non-discretionary assets performed differently 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 public equity markets. This 'balancing' within the portfolio occurred in FY11. In FY12, both components of the portfolio were performing with the managed assets benefiting the portfolio in the up markets and the fixed income and non-discretionary assets providing support in slow or negative growth periods.

Figure 11: FY12 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, 2012*

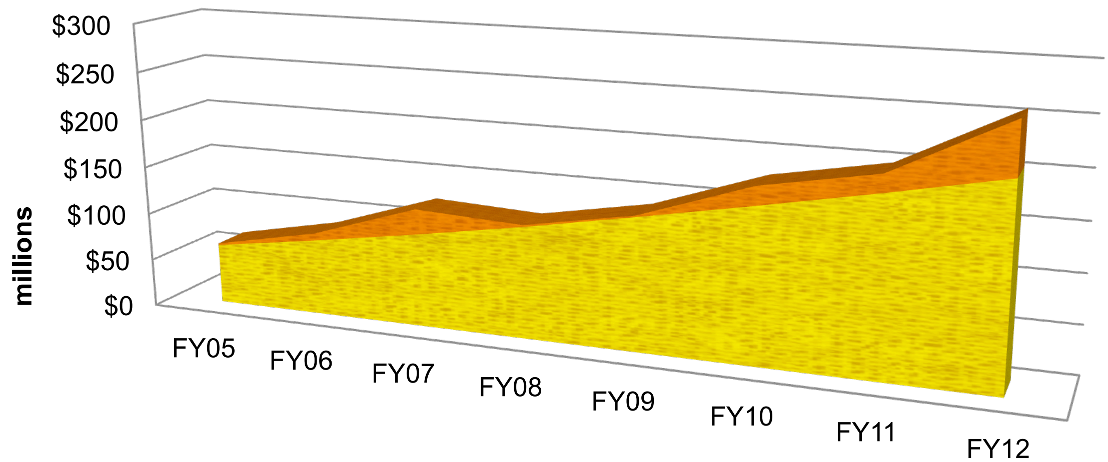
Notes: NA= Not Available; %'s based on performance net of fees; Total Non-U.S. Equity Benchmark was changed to MSCI ACWIxUS Index in May 2012

	Market Value 9/30/11	% All-ocated.	FY07	FY08	FY09	FY10	FY11	FY12	Since Inception
Total Fund- Gross	***$257,409,932***	***100.0%***	***17.7%***	***-15.9%***	***-1.2%***	***12.0%***	***0.0%***	***16.9%***	***4.3%***
Total Fund -Net Fees			*17.4%*	*-16.6%*	*-2.1%*	*11.1%*	*-0.7%*	*16.1%*	*3.8%*
Total Trust Benchmark			19.2%	-20.0%	1.4%	10.1%	-0.2%	19.0%	4.3%
Foundations Median			16.3%	-14.6%	-1.1%	10.0%	1.2%	14.5%	6.1%
Total Managed Assets	**$180,052,646**	**69.9%**						**19.1%**	**5.6%**
U.S. Domestic Public Equity	*$76,964,677*	*29.9%*	*16.6%*	*-21.5%*	*-4.6%*	*11.2%*	*-0.2%*	*29.9%*	*12.7%*
Russell 3000 Index			16.5%	-21.5%	-6.4%	11.0%	0.5%	30.2%	12.8%
Non-U.S. Public Equity	*$76,935,708*	*29.9%*	*25.5%*	*-26.9%*	*9.7%*	*11.9%*	*-11.3%*	*14.4%*	*2.2%*
Total Non-U.S. Equity Benchmark*			24.9%	-30.5%	3.2%	3.3%	-9.4%	13.2%	-0.4%

	Market Value 9/30/11	% All-ocated.	FY07	FY08	FY09	FY10	FY11	FY12	Since Inception
Mercer Inst'l World ex U.S. EAFE Equity Median			NA	-29.3%	3.9%	6.8%	-8.9%	17.3%	NA
Fixed Income	*$26,152,261*	*10.2%*	*NA*	*NA*	*NA*	*NA*	*NA*	*8.7%*	*6.0%*
Barclays Capital Aggregate			5.1%	3.7%	10.6%	8.2%	5.3%	5.2%	5.2%
Mercer Inst'l U.S. Fixed Core Opportunistic Median			NA	-0.7%	13.8%	11.5%	5.1%	9.0%	NA
Total Non Discretionary Assets	**$77,357,286**	**30.1%**	**17.7%**	**-16.6%**	**-2.1%**	**11.1%**	**10.7%**	**10.1%**	**4.5%**
Fixed Income	*$29,381,869*	*11.4%*	*NA*	*-2.3%*	*5.4%*	*13.4%*	*0.9%*	*14.0%*	*6.1%*
Custom Fixed Income Benchmark			NA	-11.5%	17.2%	15.7%	0.0%	19.1%	7.0%
Mercer Inst'l U.S. Fixed Combined Median			NA	1.3%	12.2%	9.5%	4.2%	7.1%	NA
Real Estate	*$18,688,290*	*7.3%*	*NA*	*NA*	*-42.6%*	*7.2%*	*22.3%*	*10.4%*	*-3.9%*
NCREIF NFIC ODCE			18.2%	3.2%	-35.2%	7.0%	18.3%	11.6%	-2.0%
Mercer Inst'l U.S. Real Estate Open End Median			NA	3.7%	-42.3%	6.7%	18.1%	11.7%	-2.1%
Hedge Fund	*$9,523,579*	*3.7%*	*NA*	*NA*	*NA*	*NA*	*1.4%*	*6.7%*	*4.3%*
T-Bills +3			7.9%	5.2%	3.2%	3.1%	3.1%	3.1%	3.1%
Mercer Inst'l Funds of Hedge Funds (Net) Median			NA	NA	0.7%	4.3%	-0.7%	4.6%	2.2%
Private Equity	*$19,648,918*	*7.6%*	*0.0%*	*12.6%*	*-25.9%*	*14.8%*	*18.1%*	*7.1%*	*3.2%*
S&P 500 +3%			1940%	-19.6%	-4.1%	13.4%	4.2%	34.0%	6.6%
Cash	$114,361	0.0%							NA

From a historical perspective, the Fund has had an overall gain since inception of 4.3% per annum gross of fees and 3.8% net of fees. The gross gain equals the Total Trust Benchmark gain but is below the Foundations Median of 6.1%. The gains in FY12 almost double the FY11 overall gain since inception of 2.7% per annum gross of fees and 2.2% per annum net of fees. Most asset categories have exceeded their benchmarks since inception. The exceptions are: 1) the non-discretionary component's fixed income assets that has had a 6.1% annualized gain compared to the annualized benchmark gain of 7%; 2) the real estate asset which, though performing well in the last three fiscal years, had a significant loss in FY08 (-42.2%). Though the real estate asset has rebounded by 8% in FY10, 23.3% in FY11 and 10.4% in FY12, the annualized growth is at -3.9%, below the benchmark of -2%. And, 3) the private equity class has an annualized gain of 3.2% that is below its benchmark of 6.6%.

Figure 12: Total Cumulative Contribution (Cost Basis) and Net Asset Value Annual Gain, FY04-FY12
Source: Audited Financial Statements FY04-FY12



	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
Net Gain	$1,780,410	$7,576,241	$26,262,901	$1,943,326	$1,591,297	$19,196,260	$18,063,645	$53,362,520
Cumulative Contribution	$62,446,383	$78,888,077	$96,576,682	$115,572,362	$136,483,922	$158,002,102	$180,396,388	$203,983,588

As of FY12 a total of $203,983,588 was contributed to the Fund. The U.S. government contributed 85.2% of funds and the FSM government 14.8%. Figure 12 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 FY12, the Fund has gained a total of $53,362,520 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 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 13.

Given the strong performance and significant investment gains in FY12, the 6% threshold was surpassed with a 14.78 dollar weighted rate of return and the amount of $20,966,806 was transferred to the C account. The total amount in the C account increased to $41,183,728.

The Fund's proportions amongst the contributors have changed for FY12. As mentioned previously, planned accounting was introduced by the Custodian in FY12 and further applied by the bookkeeper for monthly and annual reporting. The planned accounting allows the allocation of income and expenses to and from the contributors' proportions. In FY12, the adjustment between contributor proportions was made according to Resolution FSM 2011-7 Trust Fund A and C Account Income, Expenses and End-of-year Calculations. This resolution clarifies the C account annual calculation formula and indicates that the A account proportions should be applied to the C account as well to show proportional contributor values. The proportions are to be adjusted annually according to contributions and earnings/losses of the contributor's proportions.

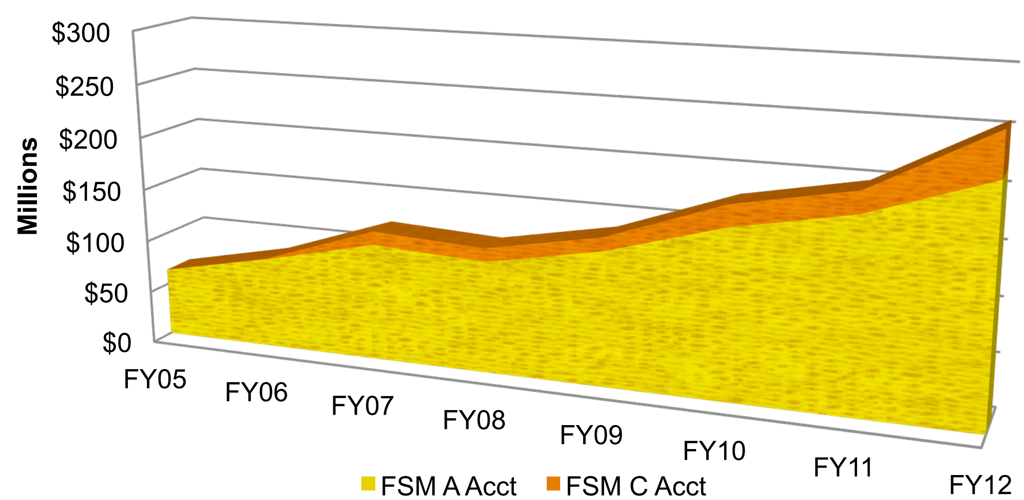
The reason for the significant proportional change in FY12 is that the proportions amongst contributors had not changed since FY07. The FSM had a significant overweight in its C account proportions even though the U.S. was making annual contributions and its contributions were making the bulk of the earnings (or losses). As seen in Figure 13, the FSM's A account share slightly increased in FY12 compared to the U.S. amount. For the C account, the FSM had a loss of value in FY12 even though there was a significant contribution to the C account in FY12. The reason is that the proportions between the A and C account were corrected per the resolution, and reflected proper proportions based on contributions. The proportions will be adjusted annually in the future based on the resolution's formula and guidelines.

Figure 13: A and C Account Net Asset Balances, FY06-FY12
Source: Audited Financial Statements FY04-FY11

	FY06	FY07	FY08	FY09	FY10	FY11	FY12
Total Assets	**$86,464,317**	**$122,839,583**	**$117,515,688**	**$138,075,219**	**$177,198,362**	**$198,460,033**	**$257,346,108**
A Account	*$85,645,391*	*$110,126,326*	*$104,802,431*	*$125,361,962*	*$156,981,440*	*$178,243,111*	*$216,162,380*
U.S.	52,597,064	74,902,144	76,325,412	96,967,855	126,458,760	147,930,868	183,186,779
FSM	33,048,327	35,224,182	28,477,019	28,394,107	30,522,680	30,312,243	32,975,601
C Account	*$818,926*	*$12,713,257*	*$12,713,257*	*$12,713,257*	*$20,216,922*	*$20,216,922*	*$41,183,728*
U.S.	502,911	8,587,013	8,587,013	8,587,013	13,655,271	13,655,271	34,901,145
FSM	316,015	4,126,244	4,126,244	4,126,244	6,561,651	6,561,651	6,282,583

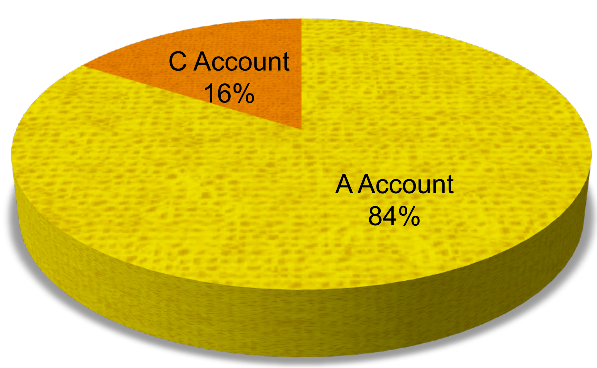
Historically, the C account has gained income in positive growth years to include FY06, FY07, FY10 and FY12. Per the Trust Fund Agreement, the C account is allowed to contain up to three times the amount of FY23 sector grant assistance plus an inflation adjustment. The current amount in the C account is about 50% 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 14: A and C Account Trends, FY04-FY12
Source: Audited Annual Financial Statements FY04-FY12
($s millions)



As of FY12, the C account has grown to 16% of the total Fund. The amount is above the 10% proportion of FY11.

Figure 15: FY12 A and C Account Breakdown
Source: FY12 Audited Annual Financial Statements



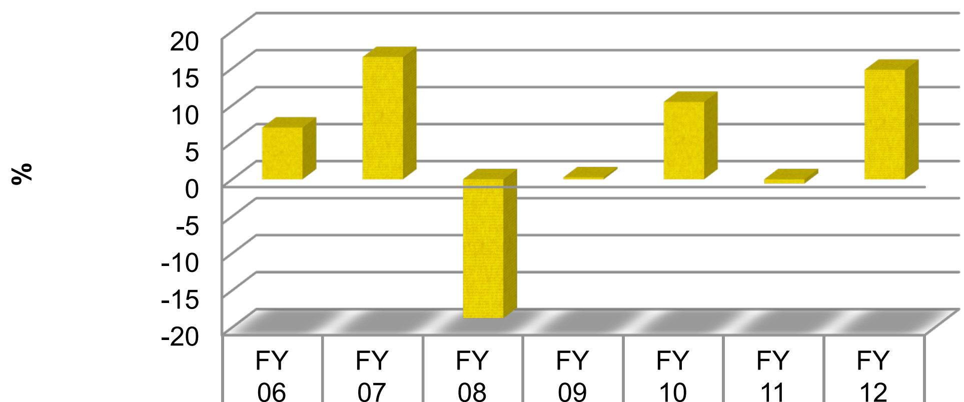
V. Trust Fund Effectiveness and Recommendations Moving Forward

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.

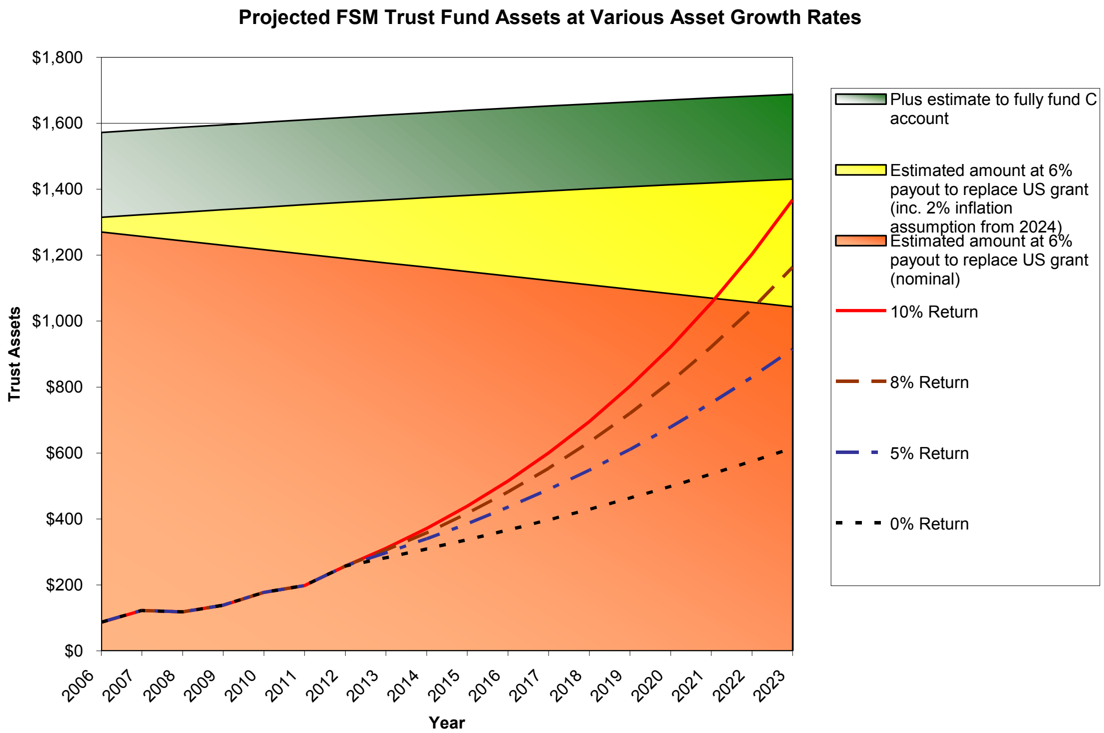
Figure 16: Dollar Weighted Return on Investment
Source: Audited Financial Statements



	FY 06	FY 07	FY 08	FY 09	FY 10	FY 11	FY 12
Dollare Weighted Investment Return	6.99	16.51	-18.75	0.26	10.46	-0.57	14.78

The Fund's dollar weighted rate of return on investment, after discounting for contributions, fees and expenses, was 14.78% for the year compared to a rate of -0.57% for fiscal year 2011 and 10.46% in fiscal year 2010. The fiscal year 2012 return is the second largest percentage annual investment gain experienced since Fund inception in 2004. In terms of performance measurement (not discounting for fees and expenses), the Fund gained 16.9%. This gain compares to a 19% gain for the Total Trust Benchmark and a 14.5% gain for the Foundations Median.

Figure 17: Projected Growth Trends, FY04-FY23
Source: Mercer Investment Consulting



An analysis by the Investment Adviser estimates that, assuming a 6% payout from the Fund, if the Fund manages an average 5% return annually from FY12 to FY23, the distribution from the estimated assets would probably provide FY24 revenue equivalent to approximately 85% of the nominal FY23 Compact of Free Association, as Amended, Section 211 sector grant level without a partial inflation adjustment. As of FY12, the average annual rate of return is 4.3% (gross of fees) and 3.8% (net of fees).

If the Fund were to achieve an average 8% return annually, the Fund would probably provide FY24 revenue equivalent to nominal FY23 sector grant assistance without an inflation adjustment. There would also be a build-up of the C account but not to the maximum level permitted under the Trust Fund Agreement. The Fund has only achieved 8% or more returns in three fiscal years: 2007, 2010 and 2012.

If the Fund were to achieve an average 10% return annually, the Fund would probably provide FY24 revenue equivalent to partially inflation adjusted FY23 sector grant assistance. However, this would not allow for future inflation adjustments beyond the fiscal year 2023 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.

Achieving an 8% annual growth rate is possible but not certain given the potential for market volatility to FY23. In addition to potential earnings on investment, analysis shows that additional contributions beyond those currently scheduled would improve the possibility to achieve such a rate.

B. Recommendations Moving Forward

The Fund has made significant progress in terms of recovering from the poor performance in FY11 as well as recovering some value lost in FY08 and weak performance in FY09. The growth is despite economic, capital and financial market uncertainties and instabilities that were prevalent throughout the fiscal year and will continue into FY13. The portfolio was further strengthened to provide more diversity as well as attempt to improve investment returns, within an acceptable risk level, on a more consistent basis.

Per Resolution FSM 2012-5 Additional Subsequent Contributors, the Committee has taken steps to identify other subsequent contributors to the Fund. The steps taken to date include research to identify potential contributors, applying to foundations and other sources of funding, and some inquiries with other potential bilateral donors. The U.S. and FSM governments may wish to consider, in cooperation or separately, initiating discussions or negotiations connected with efforts to seek contributions to the Fund from other sources.

The Fund’s positive performance, as previously mentioned, was mainly based on U.S. and international public equity performance. The Investment Adviser remained within the investment allocation classes and percent ranges as indicated by the Investment Policy Statement. As well, the non-discretionary assets consisting of alternative investments helped to provide stability to the portfolio and also invest in more medium and long term assets. 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.

Last, the Committee has reduced investment and administrative expenses in FY12 as a proportion of the overall Fund. 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 FY13 and future years.