The Birmingham Fund

Quarterly Review of Performance & Account Activity

September 2008

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II. Summary of the Policy and Ordinance
III. Quarterly Market Recap and Economic Outlook
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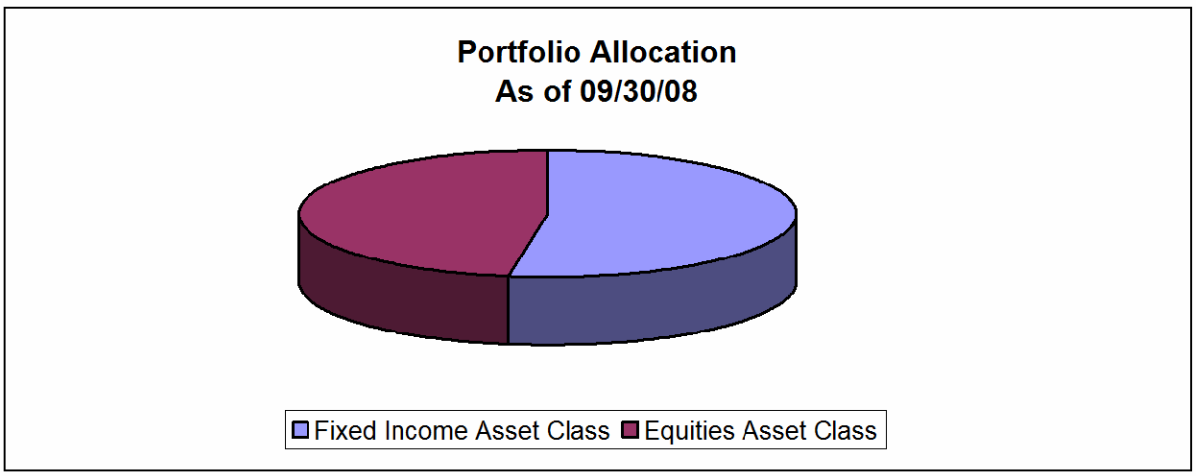
I. Executive Summary

This report details the investment policy, guidelines, portfolio analysis, and returns for the Birmingham Fund. This is a comprehensive, internally generated report, compiled in satisfaction of the policies reporting requirements. The summarized positions and returns for the Birmingham Fund investment portfolio is as follows:

Portfolio Summary:

	Book Value 30-Sep-08	Market Value 30-Sep-08
Fixed Income Asset Class	$ 42,484,837.25	$ 42,907,651.79
Equities Asset Class	32,655,060.65	38,845,700.28
Total Value of Assets	$ 75,139,897.90	$ 81,753,352.07



Actual Returns vs. Benchmarks

	Qtr.	Ytd.	1Yr.	3 Yr.	5 Yr.
Fixed Income Portfolio Return	-0.32%	1.83%	4.67%	4.82%	3.40%
Lehman 1-5 Benchmark Return	-0.31%	1.48%	4.05%	4.49%	3.25%
Equities/Stock Portfolio Return	-5.76%	-10.69%	-12.77%	2.61%	6.52%
S&P 500 Benchmark Return	-8.37%	-19.29%	-21.98%	0.54%	5.15%

II. Summary of Birmingham Fund Creation and Policy

Pursuant to Alabama State Law, in 1994, the City of Birmingham (herein referred to as the "City") authorized the creation of a Trust Fund to be designated as the Original Birmingham Fund. The original trust fund was established to hold in escrow, various investments and income derived from those investments acquired with certain proceeds received by the City from the sale of certain assets and properties previously owned by the Industrial Water Board of the City of Birmingham.

In November 1998, the City through a general election ballot proposition won voter approval to amend (The Trust Fund Amendment) the Original Birmingham Fund and correspondingly establish a new trust fund designated as the "Birmingham Fund" for which assets held in the Original Birmingham Fund were to be transferred.

The City set forth, in Ordinance 99-67, appropriate guidelines for the appropriation of monies to be withdrawn from the Birmingham Fund and the investment of all monies transferred into the Birmingham Fund.

Overview of Appropriation Policy & Guidelines

The adopted City Ordinance established two primary categories of appropriation activity, Regular and Extraordinary, that may occur within the Birmingham Fund.

Regular Appropriations & Disbursements: The Director of Finance may disburse monies for any lawful purpose for which monies may be spent, pursuant to appropriations made in ordinances adopted by the Council in accordance with its normal procedures, the general requirements of applicable law and subject to the Annual Limit requirement of the adopted City Ordinance.

For each fiscal year end of the City, the Annual Limit or maximum amount of money that shall be disbursed cannot exceed five (5 %) percent of the five year average market value of the Birmingham Fund calculated at the end of each fiscal year end.

The Director of Finance is authorized to disburse monies to pay the costs and expenses incurred with respect to the administration, custody, and investment of Birmingham Fund assets.

Extraordinary Appropriations: In addition to the Regular appropriations and disbursements, the Council may from time to time, appropriate monies from the Birmingham Fund for any lawful purpose to address extraordinary circumstances or opportunities confronted by the City. Monies may be appropriated and disbursed from the Birmingham Fund if and only if the following conditions have been satisfied:

- The Council, by affirmative vote of at least five members of Council, shall have adopted an ordinance authorizing expenditure;

- The proposed ordinance specifies the amount of money for a particular purpose;

- The proposed ordinance shall include findings that the making of the authorized expenditure would clearly be in the best interest of the City and its residents; and,

- The authorized disbursement would address any extraordinary circumstance that was not foreseen or anticipated at the time of the establishment of the Birmingham Fund.

- The proposed Ordinance shall have been approved by the Mayor.

Overview of Investment Policy Statement

In accordance with Alabama Law and the requirements of the Trust Fund Amendment the City adopted an Investment Policy Statement that provides for the following:

- The mode and manner for investing the assets of the City;

- Establishes benchmarks and criteria for measuring investment performance and compliance with the Investment Policy Statement; and,

- Specifies a requirement for the preparation and publication of periodic reports on investment performance and investment policy compliance.

Review of Investment Policy Guidelines

The purpose of the Investment Policy Statement, as adopted, is to set forth the investment objectives and policies applicable to the portfolio of assets maintained in the Birmingham Fund. A review of the policy guidelines is presented below.

Statement of Objectives

The City proposes to manage the Fund as a long-term source of income and as a reserve for extraordinary events. The City expects to disburse no more than 5 % of the Fund's assets per year and expects investment returns in excess of 5 % per year to maintain the value of the Fund when taking into consideration inflation.

Asset Allocation & Performance Benchmark

The policy has established the following investment classes and related investment allocations based on the fair market value of the assets.

Investment Class	Types of Investments	Adopted Policy Allocation (FMV)	Performance Benchmark
Fixed Income	Intermediate Term Bonds, Government and Investment Grade Corporate Securities	≥ 50%	Lehman Brothers 1-5 Investment Grade Index
Stocks (Equities)	Broadly Diversified Portfolio of Publicly Traded Stocks	≤ 50%	S&P 500 Index

Rebalancing & Liquidity Procedures

From time to time, market conditions may cause the Fund's investments in various asset classes to vary from the established allocation. To remain consistent with the asset allocation guidelines, each asset class in which the Fund invests shall be reviewed on a quarterly basis by the City and rebalanced if necessary to maintain compliance with the adopted policy.

To the extent cash is required for disbursements from the Fund pursuant to permitted appropriations, investment assets will be sold in such a manner as will maintain the adopted asset allocation.

Selection of Investments

The Mayor of the City and the Director of Finance are authorized to select all investments in the Birmingham Fund within the following policy constraints:

- All investments must be readily marketable;
- All investments to be placed in mutual funds will be determined by the Director of Finance in accordance with the Policy's "Criteria and Benchmarks for Mutual Funds" as detailed in this review.
- All investments to be placed in diversified portfolios of securities with investment managers shall be selected by the Mayor of the City.

Criteria and Benchmarks for Selection of Mutual Funds and Managed Funds

Investment Class	Investment Management	Management Criteria
Fixed Income	Mutual Fund	No load Low Expense Fund must have assets ≥ \$2 billion in funds under common management
Fixed Income	Investment Manager	Average Maturity ≤ 3 Yrs Average Duration ≤ 2.5 Yrs
Stocks	Mutual Fund	No load Low Expense Fund must have assets ≥ \$2 billion in funds under common management
Stocks	Investment Manager	Broadly Diversified

Reporting

The Director of Finance shall deliver to the Mayor and Council at least semi-annually within 45 days after the end of each semi-annual period the following reports:

- Portfolio performance results over the last quarter, one (1) year, three (3) years and five (5) years as applicable;
- Performance results of each fund or manager for the same periods;
- Performance results in relation to the benchmark established pursuant to the Investment Policy and approved by the Director of Finance for the same periods;
- Performance shall be on a time-weighted basis;
- End of period status regarding asset allocation and compliance with the adopted policy;
- Portfolio turnover;
- Compliance with the Investment Policy; and,
- At least annually, an analysis of all fees and expenses relating to Fund assets;

III. Quarterly Market Recap & Economic Outlook: (See following pages)

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www.Hoisington.com

Quarterly Review and Outlook

Third Quarter 2008

Risk Free Treasurys

The past fiscal year has decimated equity portfolios, as typified by the S&P Stock Index which declined by 23% through September. In the fixed income arena credit problems have caused lower quality yields to rise, restraining the Lehman Bond Index return to 3.4%. Only risk free Treasury securities provided healthy returns, with the longest dated maturities realizing 13%. At the end of Q3, 2007, a 4.8% yield on a 30 year bond appeared quite low in the light of exploding commodity prices, which eventually lifted the annual gain in the Consumer Price Index to 5.6%. However, these rising commodity prices were masking a rapidly deteriorating economic scene that included the disappearance of venerable financial institutions, as well as the loss of 1.4 million jobs from its peak (household survey). Industrial production has dropped 2.0%, while real business sales and real income less transfers dropped 2.4% and .8%, respectively, from their cyclical highs. Decades of living beyond our means, poor government oversight, and excessive speculation have culminated in a financial disaster of epic proportions. For investors caught in such an economic hurricane, the question is whether long dated Treasuries, now yielding about 4.25%, will serve as an equally profitable investment over the next twelve months. We believe they will.

The present financial chaos is only the outer band of the economic hurricane yet to arrive. The economic fallout that follows a period of excessive debt increases and subsequent restriction of credit availability will carry over to the real side of the economy in the form of lower production, sales, jobs and profits. The winds of this economic downturn began long ago, and will not be meaningfully altered by federal or monetary authorities. Time will eventually cause this storm to pass, and prosperity will return, but two or three years of economic difficulties are unprecedented in modern times. One positive is that many small banks and financial institutions managed their balance sheets far more conservatively than the larger ones, and are thus in a position to contribute to economic recovery. Here are the most critical problems.

- First, the economy is nine or more months into recession and the Leading Economic Index (LEI), a premiere guide to economic activity, is declining at an increasing rate. In view of the LEI's nine month visibility, the recession will persist into late next year (Chart 1). The Coincident Economic Index (CEI) peaked in October 2007 and has declined 0.8% since then (also Chart 1). Comprised of employment, industrial production, real business sales and real personal income less transfer payments, its components are used by the NBER, the official arbiter of the U.S. business cycle, to date expansions and contractions. Sales and income both peaked in October of last year, while

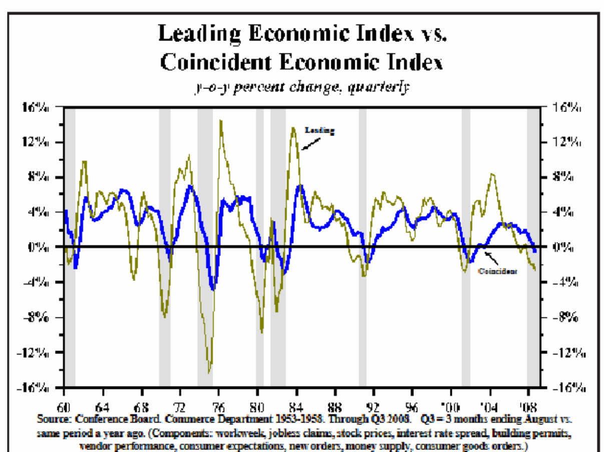

Chart 1

employment peaked in December and production peaked in January of this year. This indicates the economy has been in recession since the first quarter of 2008.

- Second, major foreign economies are in as much trouble as the U.S., resulting in a world that is on the verge of a synchronized downturn. Real domestic demand in the fifteen large countries outside the U.S. rose just .9% in the latest four quarters, down sharply from the peak of 2.8% registered in early 2007. The OECD's World Leading Economic Index has slumped 3.3% in the past twelve months. Declines of this magnitude have always been associated with global recessions (Chart 2). Global conditions will continue to deteriorate as imports to the U.S., -1.1% for the twelve months ending July, continue to fall, sending our recessionary impulses to the rest of the world. At some point the foreign downturn will feed back to and reinforce the U.S. recession.

- Third, monetary policy has been extremely active in pursuing expansionary activities through a series of innovative actions designed to liquify markets or inject liquidity into the system, yet it has not gained traction. Unfortunately, unique financial circumstances indicate that the Fed's response will, for a time, be unsuccessful in spurring economic growth. For example, M2 has expanded sharply in recent weeks, but this increase has been unable to stimulate borrowing and lending because velocity, or the turnover of money into the real sector, is estimated to have declined even more sharply. Velocity is outside the Fed's control, and is determined by the rate of change in financial innovation. To say financial creativity has ceased would be an understatement; thus, it is logical to assume that velocity will continue to plummet.

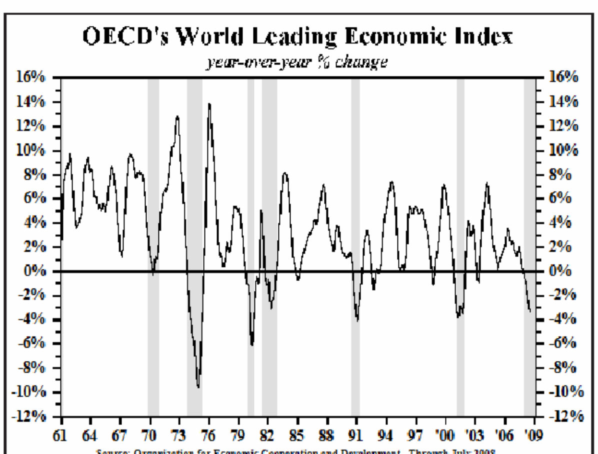

Chart 2

Recent massive increases in bank reserves, which under certain circumstances could lead to inflationary growth, have lost their power as the increase reflects a "seizing up" of the financial markets rather than the start of a new borrowing and lending process. In the two week reserve maintenance period of late September, total reserves jumped by an all-time record of $62.4 billion, but excess reserves leaped an even greater $66.5 billion. Thus, the banks refused to re-lend funds obtained over the discount window and froze all the reserves placed in the system. Banks went to the Fed's discount window to fund their existing positions and made no further use of these borrowed reserves because the counterparty risk is perceived as too great. In the late September reserve period, loans from the discount window rose a staggering $97.6 billion, of which only $36.4 billion was offset by the Fed's open market operations. A necessary, but insufficient, condition for a return to financial market normalcy would be a willingness on the part of the banks to make loans with these massive levels of excess reserves they are currently holding.

- Fourth, in real terms, wealth of the household sector declined an estimated $4.5 trillion from the second quarter of 2007 to the third quarter of this year. The loss in stock market wealth has exceeded the fall in housing sector wealth. In the third quarter alone, the losses in stock market values actually exceeded those on homes by a ratio of about 2.4 to 1. Ultimately, the damage to housing wealth should be far worse since a massive overhang of unsold homes remains on the market, suggesting that the bottom of house prices remains in the distant future. In the latest month a twice normal 10.4 month supply of existing homes was on the market, while there were 2.4 million units of unsold new homes, also twice the average since 1971. In addition, the U.S. mortgage foreclosure inventory was a record 2.8%. In spite of substantial reductions in new housing starts, the industry has been unable to cut production as fast as demand has fallen. By 2010, the real wealth loss of the household sector, from homes and stock, could exceed $7 trillion, thereby posing a major restraint on consumer spending for both domestic and imported goods.

- Fifth, fiscal policy is often considered to be a powerful tool because it supposedly worked in the great depression. That assessment is incorrect. The dismal conditions of the 1930s only improved materially after Europe and Asia went to war, thus benefiting the U.S., initially a non-combatant selling to both sides of the conflict. The massive Treasury bailout could actually make conditions worse than doing nothing, and in any event will be ineffectual. Recall that the tax rebate/stimulus package earlier in the year was supposed to be a panacea, yet failed to spur economic activity, and merely left the government with greater indebtedness. The Washington/Wall Street pundits predict similar success for the bailout, yet it will also fail and another ill-conceived package will likely be enacted. Part of the reason for their ineffectiveness is that the government is robbing the private sector of sorely needed resources via its massive issuance of debt to fund these programs.

Failing Fiscal Policy

As the federal budget deficit ballooned from the third quarter of 2007 to the second quarter of this year, the increase in total nonfederal debt dropped to $200 billion, down from $600 billion (Chart 3). Issuing more federal debt will further reduce funds available to the nonfederal borrowers, slowing the process of reducing the cost of private sector debt and the subsequent healing of the economy's bloated balance sheet.

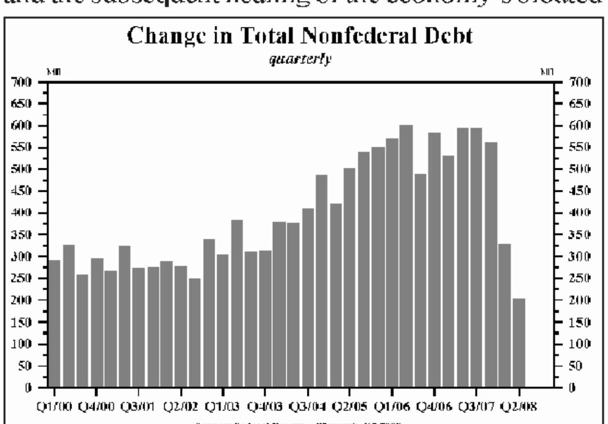

Chart 3

If spending were directed at actually creating jobs through necessary projects such as nuclear power plants, highways, bridges or other production or energy enhancing items, fiscal spending might have a chance of stimulating economic activity. Spending projects that increase domestic energy production have higher multipliers because, not only is the work done with U.S. labor and capital, but also the higher domestic production displaces imported oil, leaving more funds for domestic uses. Issuing more federal debt can also be beneficial to economic growth if marginal tax rates, a la Kennedy in 1962 or Reagan in 1981, are cut significantly, but such a prospect appears highly unlikely.

Unfortunately, highly visible fiscal actions such as tax rebates or Wall Street bailouts raise household expectations that the government is on the job working to solve problems. When those actions do not work, hopes will be dashed and consumer confidence could fall even more sharply, putting the economy at greater risk than if hopes were not raised in the first place.

Another constraint on government fiscal and monetary action, however, is the massive scope of the sums owed by the U.S. economy. To bring financial liabilities into alignment with income will require several years of quasi or outright recessionary conditions, as the private sector allocates more of its income to saving and less to spending. Such a shift would be a dramatic reversal of the prevailing pattern of the past 30+ years since the personal saving rate dropped from the 14.6% high reached in 1975 to 1% in the latest month. This needed repair of an over-leveraged balance sheet also applies to the corporate sector.

In the second quarter, corporate debt surged to a record 49% of GDP, dramatically above the post 1952 average of 34.9% (Chart 4). The unprecedented business sector indebtedness suggests that firms will be forced to curtail employment, capital spending, and other discretionary expenditures in order to service this debt in a cyclically challenged economic environment where sales slow.

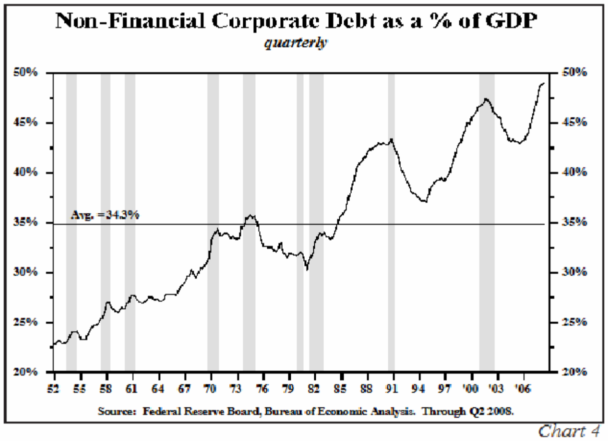

Chart 4

Historically, economists have evaluated the economy's overall leverage in terms of nonfinancial debt. The theory for this is that the financial sector takes on debt in order to make loans for the nonfinancial sector; thus, to include financial debt would result in double counting. The logic of that approach is not valid in the current situation. The leverage in the financial system, including the financial intermediaries and government sponsored entities like Fannie and Freddie, is clearly excessive and the source of much distress in the economy. When viewed on this more comprehensive basis, total leverage of the U.S. economy surged to an all time peak for the past 92 years that records have been kept. Total U.S. debt in the second quarter jumped to 357% of GDP, up from an average of 195% from 1916 to the present. In less than five years, the total debt to GDP ratio jumped more than 50% (Chart 5.)

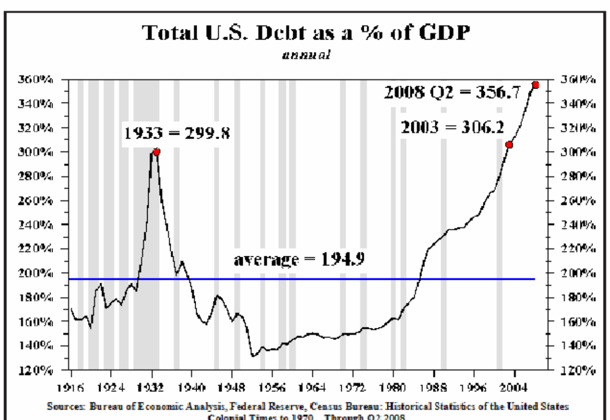

Chart 5

As the chart indicates, 300% was the 1933 high of the total debt to GDP ratio. The current peak, however, was reached due to a surge in debt, while the 1933 peak reflected a dramatic fall of nominal GDP, the denominator of the ratio. The new record level of debt in the second quarter reflected the worsening situation among corporations, both financial and nonfinancial. Clearly the magnitude of the debt problem is unprecedented and years, not months or quarters, will be required to bring debt into some reasonable relationship with economic activity. As long as this situation persists, the U.S. faces a difficult economic environment. This is due to the fact that over the past four decades every additional dollar of debt created 86 cents worth of GDP, and with debt shrinking, GDP will struggle to generate positive growth.

In spite of numerous monetary and fiscal policy actions taken well before the bailout, recessionary forces have intensified and the leading indicators indicate that this process is worsening. The Treasury bailout bill's miracle cure will be equally disappointing. With aggregate demand continuing to falter, the risk of deflation is far greater than the risk of inflation. Since commodity prices and rents are now falling, negative readings on the monthly inflation gauges may occur before this year ends. In the 1990s, Japan's budget deficit reached 14% of GDP. Because deflation prevailed, short, intermediate, and long-term Japanese government bond yields fell to extremely low levels. This experience reminds us of the overwhelming relevance of the Fisher equation, which explains exactly what determines the long, risk-free bond yield. In this equation, the Treasury bond yield is equal to the real rate plus expected inflation. Much empirical research has indicated that the dominant independent variable of this equation over time is expected inflation. With inflation moving lower, possibly considerably lower, long Treasury bond yields will follow, creating significant gains for investors who are able to look beyond the present low coupons and extreme volatility in today's markets.

Van R. Hoisington
Lacy H. Hunt, Ph.D.

IV. Summary Portfolio Characteristics

Fund Designation and Policy:

Trust Fund:	Birmingham Fund
Date of Creation:	November 1998
Fund Objectives:	Long-term source of income and reserve for extraordinary events of the City.
Investment Target Return:	≥ 5%
Asset Class Target Allocation:	≥ 50% in Fixed Income ≤ 50% in Stocks and Equities

Fund Management & Administration:

City Cash & Investment Manager:	Aaron Saxton, Finance Department
Designated Investment Manager:	Regions Bank
Custodian/Safekeeping:	State Street Bank

	Book Value	
Fixed Income Asset Class (06EV)	**30-Jun-08**	**30-Sep-08**
Treasury Bonds	10,858,899.74	10,907,024.74
Corporate Bonds	11,067,931.68	10,545,241.68
Other Government Securities	19,324,004.21	19,635,179.26
Money Market Funds	1,174,574.03	1,397,391.57
Total Fixed Income Asset Class	**42,425,409.66**	**42,484,837.25**
Equities Asset Class (06AE)		
Corporate Stocks	30,105,872.69	30,105,872.69
Corporate Bonds	215,599.76	-
Money Market Funds	2,143,002.59	2,549,187.96
Total Equities Asset Class	**32,464,475.04**	**32,655,060.65**
Total Book Value of Assets	**74,889,884.70**	**75,139,897.90**

	Qtr.	Ytd.	1Yr.	3 Yr.	5 Yr.
Fixed Income Portfolio Return	-0.32%	1.83%	4.67%	4.82%	3.40%
Lehman 1-5 Benchmark Return	-0.31%	1.48%	4.05%	4.49%	3.25%
Equities/Stock Portfolio Return	-5.76%	-10.69%	-12.77%	2.61%	6.52%
S&P 500 Benchmark Return	-8.37%	-19.29%	-21.98%	0.54%	5.15%

Policy Compliance:

Asset Allocation Requirement:	Yes
Fixed Income Duration Requirement	Yes
Expected Portfolio Return:	Yes

V. Comparison of Market to Book Value of Fund Assets

Market Value		
Fixed Income Asset Class (06EV)	**30-Jun-08**	**30-Sep-08**
Treasury Bonds	10,939,550.95	11,044,892.78
Corporate Bonds	11,034,782.50	10,386,764.95
Other Government Securities	19,801,003.78	20,078,602.49
Money Market Funds	1,174,574.03	1,397,391.57
Total Fixed Income Asset Class	**42,949,911.26**	**42,907,651.79**
Equities Asset Class (06AE)		
Corporate Stocks	38,869,023.70	36,296,512.32
Corporate Bonds	212,202.99	0.00
Money Market Funds	2,143,002.59	2,549,187.96
Total Equities Asset Class	**41,224,229.28**	**38,845,700.28**
Total Market Value of Assets	**84,174,140.54**	**81,753,352.07**

BookValue		
Fixed Income Asset Class (06EV)	**30-Jun-08**	**30-Sep-08**
Treasury Bonds	10,858,899.74	10,907,024.74
Corporate Bonds	11,067,931.68	10,545,241.68
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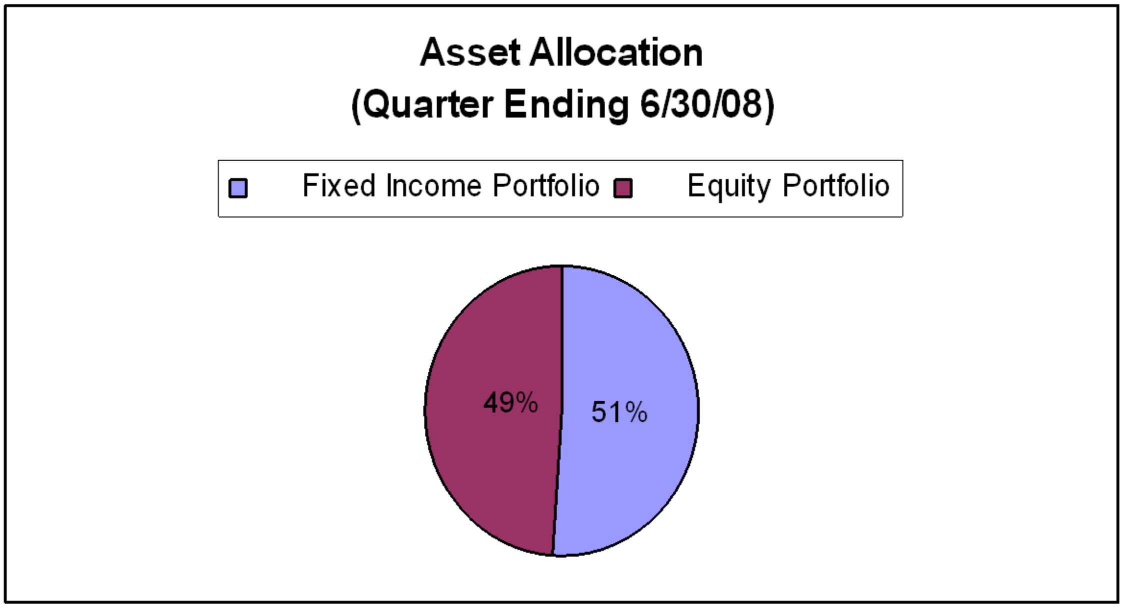
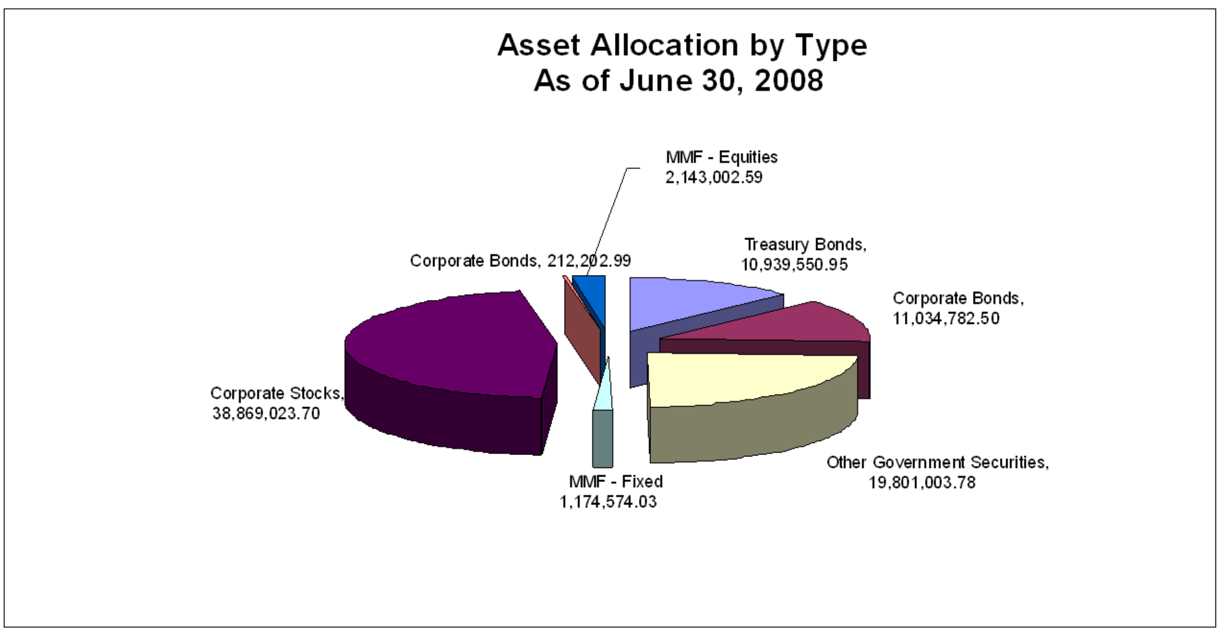
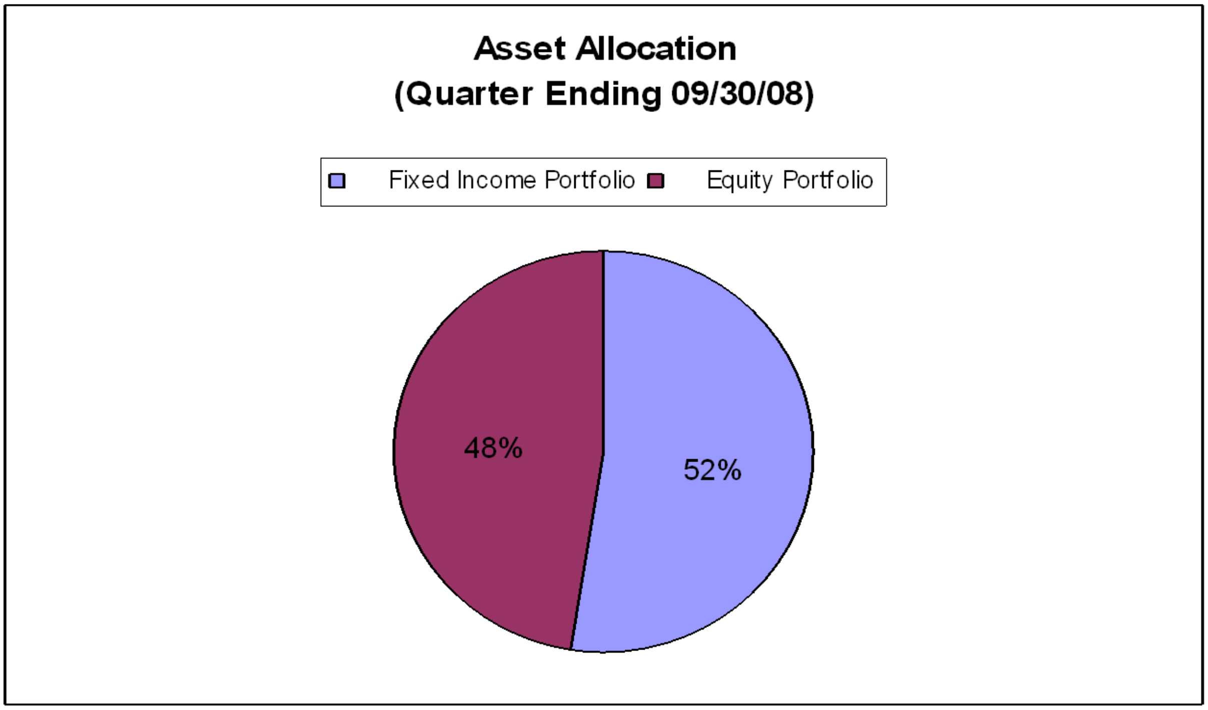
Total Equities Asset Class	**32,464,475.04**	**32,655,060.65**
Total Book Value of Assets	**74,889,884.70**	**75,139,897.90**

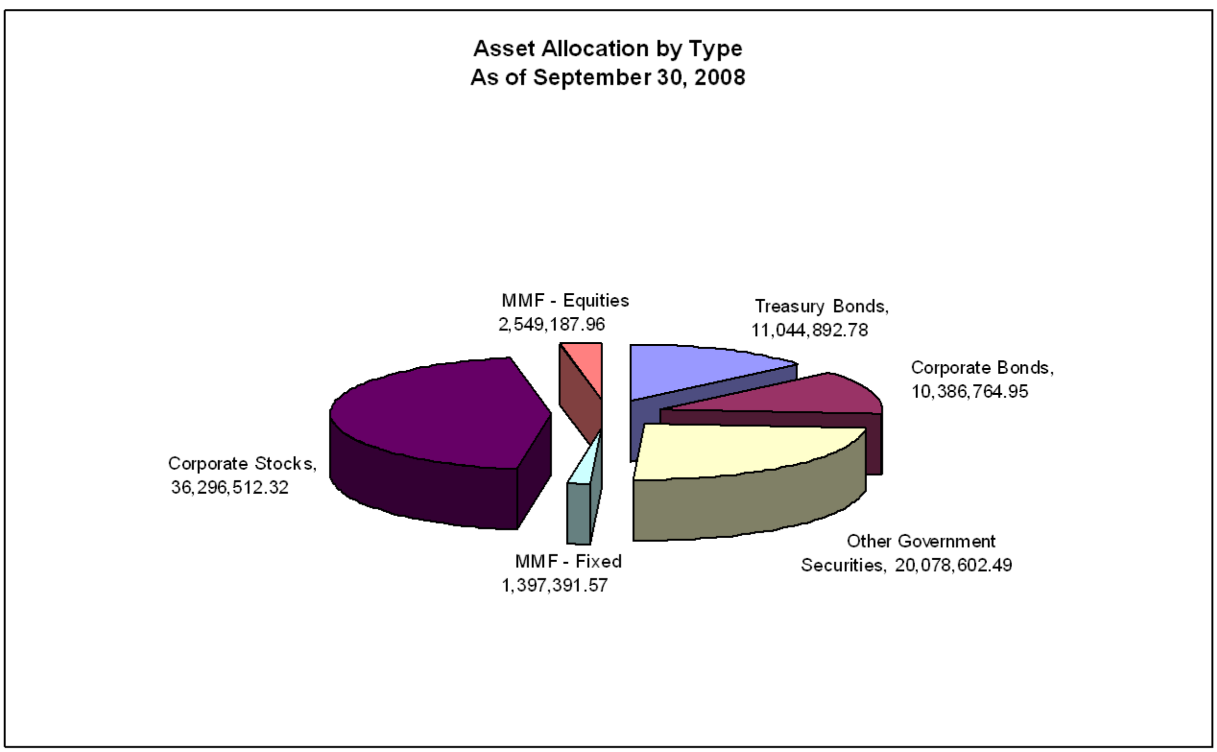
Quarterly Portfolio Analysis

	Quarter **30-Jun-08**	Quarter **30-Sep-08**
Market Value in Excess of Book Value	9,284,255.84	6,613,454.17
Market Value/Book Value	1.12	1.09
FMV Asset Allocation		
Fixed Income Portfolio	51.03%	52.48%
Equity Portfolio	48.97%	47.52%
FMV Performance Returns (Quarterly)		
Fixed Income Portfolio	-0.53%	-0.32%
Lehman 1-5 Benchmark	-1.35%	-0.31%
Average Coupon	4.52%	4.64%
Current Yield	4.45%	4.57%
YTM/C	3.57%	3.59%
Average Life	2.30	2.15
Effective Duration	2.02	1.95
Equity Portfolio	0.31%	-5.76%
S&P 500 Index Benchmark	-2.73%	-8.37%

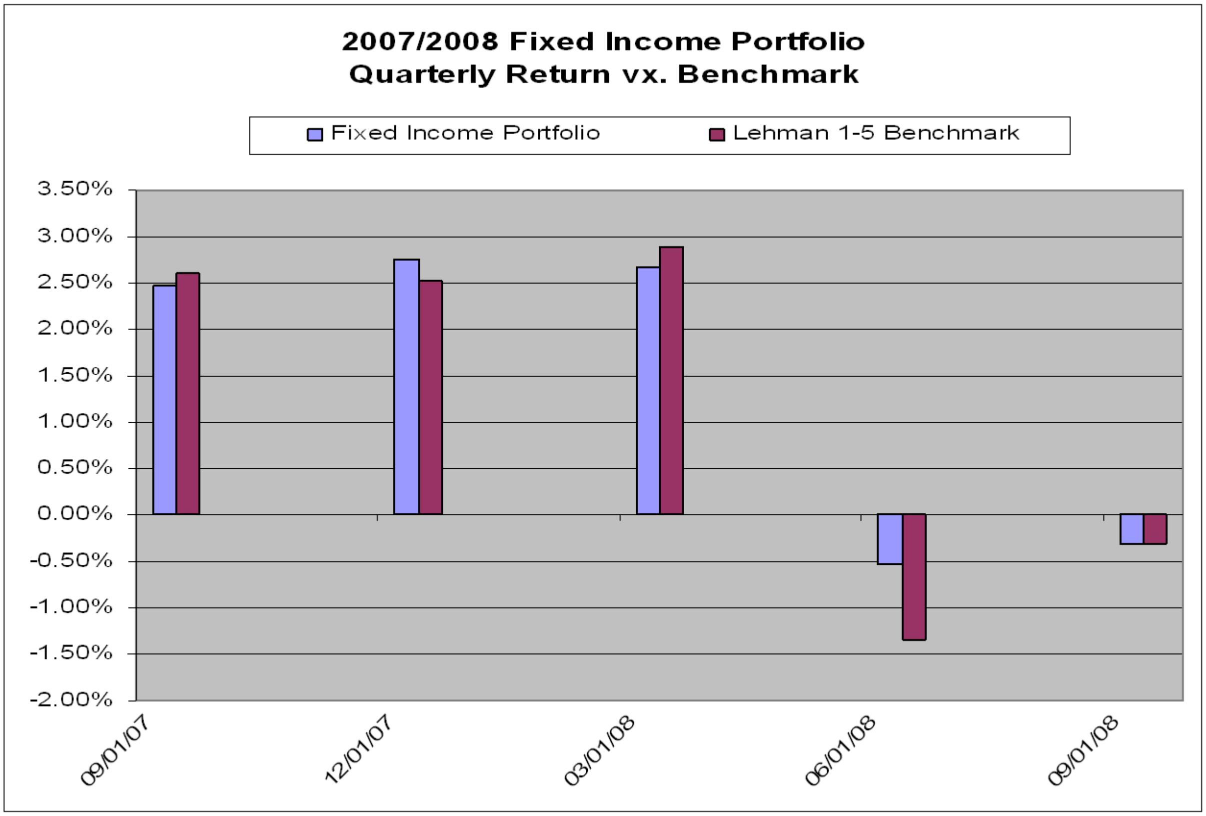

Asset Allocation
(Quarter Ending 6/30/08)
Fixed Income Portfolio
Equity Portfolio
49%
51%

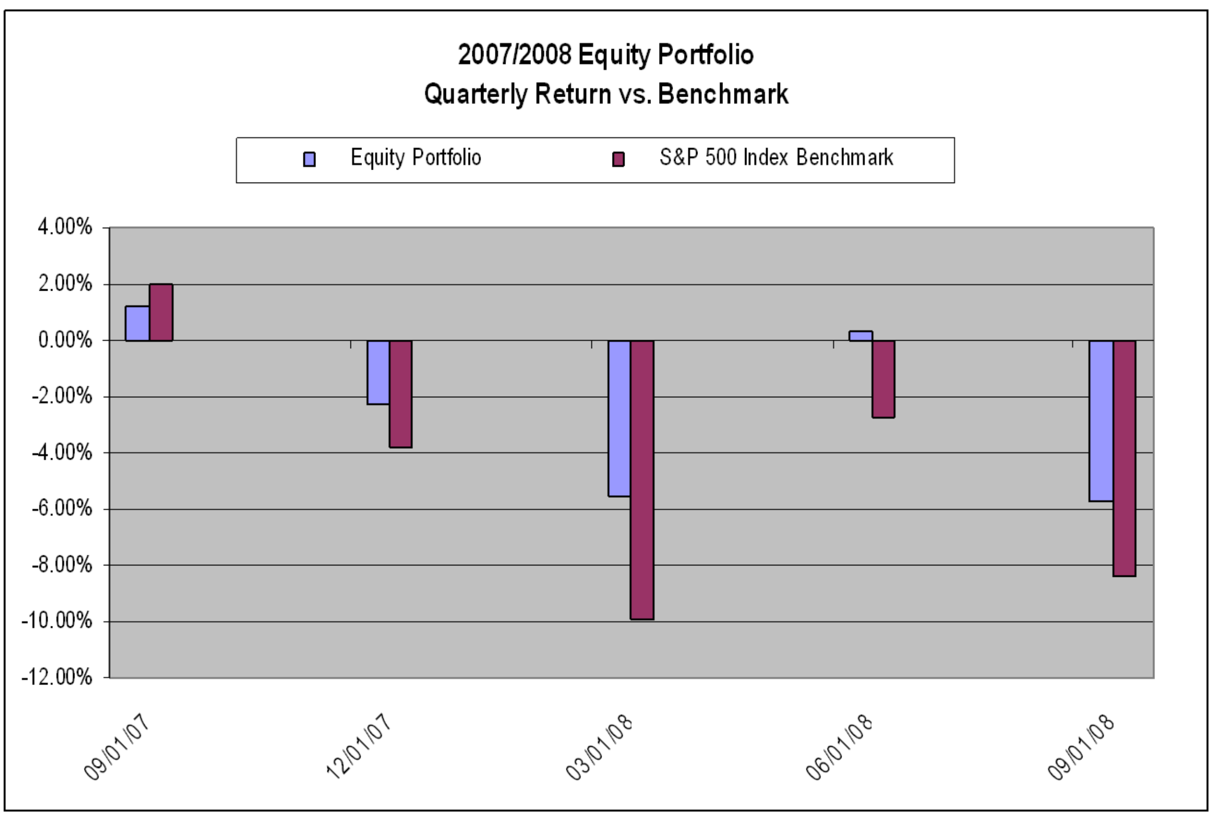

Asset Allocation by Type
As of June 30, 2008
MMF - Equities
2,143,002.59
Treasury Bonds,
10,939,550.95
Corporate Bonds, 212,202.99
Corporate Bonds,
11,034,782.50
Corporate Stocks,
38,869,023.70
Other Government Securities,
19,801,003.78
MMF - Fixed
1,174,574.03


Asset Allocation
(Quarter Ending 09/30/08)
Fixed Income Portfolio
Equity Portfolio
48%
52%


Asset Allocation by Type
As of September 30, 2008
MMF - Equities
2,549,187.96
Treasury Bonds,
11,044,892.78
Corporate Bonds,
10,386,764.95
Corporate Stocks,
36,296,512.32
Other Government
Securities, 20,078,602.49
MMF - Fixed
1,397,391.57

Portfolio Analysis Continued





VI. BOOK VALUE ACCOUNT RECONCILIATION

	Book Value	
Fixed Income Asset Class (06EV)	**30-Jun-08**	**30-Sep-08**
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Money Market Funds	2,143,002.59	2,549,187.96
Total Equities Asset Class	**32,464,475.04**	**32,655,060.65**
Total Book Value of Assets	**74,889,884.70**	**75,139,897.90**

Account Reconciliation

	Qtr Ended 06/30/08	**Qtr Ended 09/30/08**
Beginning Cash Balances		
STIFF - Money Market Fund	4,789,704.08	2,821,001.76
Compass Money Market Fund	136,417.08	285,689.31
	4,926,121.16	3,106,691.07
Receipts		
Interest/Dividends	559,528.19	804,312.76
Interest Purchased	(6,515.61)	(45,850.86)
Securities Lending	163,425.63	-
Total Receipts	716,438.21	758,461.90
Purchases(Disbursments)		
Corporate Bonds	-	-
Treasuries	-	(2,071,250.00)
Government Agencies	(3,786,469.26)	(3,450,190.64)
Equities	(496,574.86)	-
Project Disbursements	(14,670.61)	-
Total Purchases(Disbursements)	(4,297,714.73)	(5,521,440.64)
Sales		
Corporate Bonds	1,490,105.00	738,289.76
Treasuries		2,023,125.00
Government Agencies	254,966.65	3,139,015.59
Equities	-	496,574.86
Total Sales	1,745,071.65	6,397,005.21
Gains from Investment Sales	16,774.78	1,913.64
Losses from Investment Sales	-	(509,013.38)
Net Gain(Loss)	16,774.78	(507,099.74)
Ending Cash Balance	3,106,691.07	4,233,617.80
Change in Cash Position	(1,819,430.09)	1,126,926.73

APPENDICES – Account 06EV (Fixed Income Asset Class)

APPENDICES – Account 06AE (Equities Asset Class)