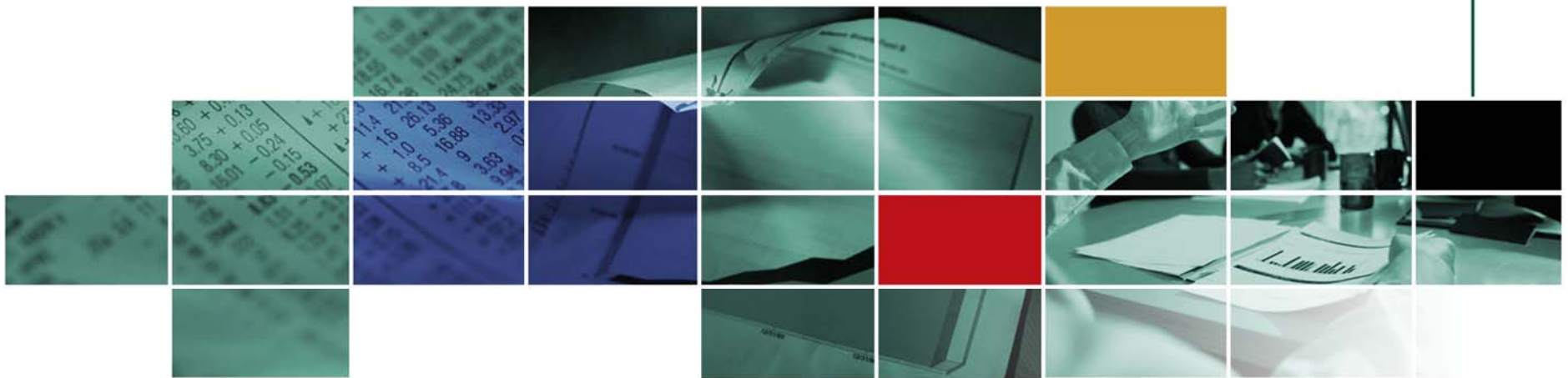


RVKuhns

▶▶▶ & ASSOCIATES, INC.

Investment Program Looking Ahead Texas Municipal Retirement System August 2009





Diversification and Risk

Background and introduction:

- ▶ TMRS was invested in 100% bonds due to plan design
 - ▶ Lacking diversification
 - ▶ Potentially insufficient return given long-term market dynamics
- ▶ There is another way
 - ▶ Broad diversification and a long-term perspective can lead to higher returns without undue risk
 - ▶ Legislation in 2009 will allow for diversification and management to total return objectives



Recent Portfolio Events

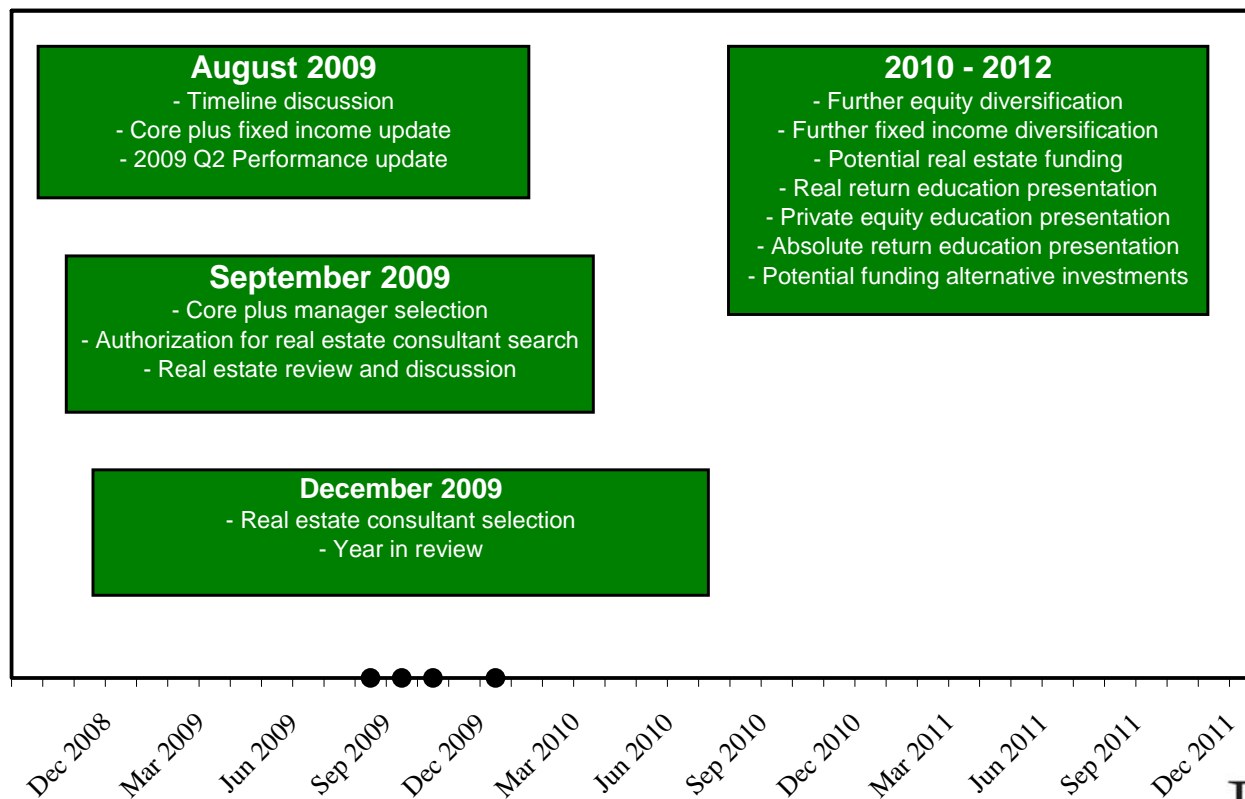
- ▶ Domestic Equity has been added to the portfolio
 - ▶ Passive (or indexed) exposure
 - ▶ Dollar cost averaging to minimize risk
 - ▶ 6% position as of 6/30/2009
- ▶ International Equity has been added to the portfolio
 - ▶ Passive (or indexed) exposure
 - ▶ Developed countries only to date
 - ▶ Dollar cost averaging to minimize risk
 - ▶ 6% position as of 6/30/2009
- ▶ Fixed income investments - interest rate risk has been reduced and portfolio has become more diversified
- ▶ 100% externally advised by best in class fiduciary



Investment Program Timeline

- ▶ An expected timeline follows
 - ▶ Will be dynamic and require updates as we move through time

TMRS Timeline





Fixed Income – Timeline

- ▶ **Fixed income diversification:**
 - ▶ Additional sub-asset classes within fixed income offer potential diversification benefits and enhanced returns to the fixed income allocation as well as the overall portfolio. The role of fixed income as a deflation hedge, anchor to safety, or need for income will be considered.
- ▶ Core plus fixed income manager search initiated: Jun 2009
- ▶ Manager interviews and selection: Sep 2009
- ▶ Non-US and Emerging Mkt fixed income considered: 2010
- ▶ Passive core fixed income allocation considered: 2011
- ▶ High Yield fixed income allocation considered: 2012



Current Fixed Income Diversification

- ▶ Fixed Income Structure:
 - ▶ Core plus manager search and selection is expected to be completed over the next couple of months
- ▶ Diversification into a core plus strategy is expected to provide:
 - ▶ Manager diversification
 - ▶ Diversification of fixed income asset class by including high yield and non-U.S. exposures
 - ▶ Higher expected returns through the expanded opportunity set, greater flexibility, and higher risk exposures
 - ▶ Suitable alignment with current resources and non-discretionary mandates
- ▶ Core plus strategy is targeted for 10% of the total portfolio to be implemented in a prudent and cost effective manner.



Core Plus Fixed Income Manager Search

- ▶ The core plus fixed income manager search is well under way
- ▶ TMRS Staff and R.V. Kuhns have so far:
 - ▶ Agreed on the minimum criteria for manager inclusion
 - ▶ Identified and invited 9 managers to participate based on minimum criteria
 - ▶ Reviewed proposer responses and additional data analysis
 - ▶ Conducted telephone interviews
 - ▶ Interviewed semi-finalists at TMRS offices
- ▶ Upcoming Steps:
 - ▶ RVK and Staff select finalists, and conduct manager site visits (early September)
 - ▶ Board interviews & potentially selects recommended manager(s) (September 25th)



Equity – Timeline

- ▶ **Equity diversification:**

- ▶ Continuation of additional allocation increase to US and international equity by approximately 1.5% per month.
- ▶ Further diversification within equity portfolio by introducing additional sub-asset classes.

- ▶ International small cap and emerging markets considered: 2010
- ▶ Structure and implementation recommendation: 2010
- ▶ Manager recommendations and selections: 2010



Real Estate – Timeline

- ▶ **Real estate:**

- ▶ Real estate provides an alternative source of income and is often used as a substitute for fixed income. The nature of direct ownership of core properties can range in expected returns and volatility.

- ▶ Real estate education and discussion: Sep. 2009
- ▶ Real estate consultant selection: Dec. 2009
- ▶ Potential implementation: 2010-2013



Alternative Investments – Timeline

- ▶ **Alternative investments:**

- ▶ Alternative investments, with low correlation to traditional asset classes, are typically utilized by investors to further increase returns and decrease portfolio volatility. Other risks besides volatility will be discussed.

- ▶ Real return educational presentation: 2010-2011
- ▶ Private equity educational presentation: 2010-2011
- ▶ Absolute return educational presentation: 2010-2011
- ▶ Potential manager recommendations and selections: 2011-2013



Summary

- ▶ **Continue progress toward optimal diversification in an incremental manner by approving final target and interim 2009 and 2010 targets**
 - ▶ Continue to increase and diversify equity allocation
 - ▶ 2009 increase current exposures
 - ▶ 2010 consider adding non-U.S. small cap and emerging markets exposures
 - ▶ Continue to diversify fixed income allocation
 - ▶ 2009 add core plus mandate (including exposure to high yield and non-U.S.)
 - ▶ 2010 continue to diversify fixed income
 - ▶ Introduce real estate allocation
 - ▶ 2009 seek real estate consultant
 - ▶ 2010 real estate manager searches
 - ▶ Introduce real return allocation
 - ▶ 2010 introduce TIPS or commodities