

TEXAS MUNICIPAL RETIREMENT SYSTEM

INVESTMENT PROGRAM 2014 Year-End Wrap Up

Guiding Principles:

The overall objective of TMRS' investment program is to ensure that members, retirees and beneficiaries are provided the benefits they have been promised by their employers at a reasonable and predictable cost to the employers. Assets will be invested with a total return posture given appropriate consideration for portfolio volatility (risk) and liquidity. Total return includes dividends, interest and realized and unrealized capital appreciation.

General Objectives:

Investments are made with the degree of judgment and care, under the circumstances, that persons of prudence, discretion, and intelligence exercise in the management of their own affairs, considering the probable income from the securities and probable safety of their capital and in consideration of the purposes, terms, distribution requirements and other circumstances of the trust. Investment and management decisions respecting individual assets will be evaluated not in isolation but in the context of the investment portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust.

Total Portfolio Return Objectives:

- Achieve a total rate of return over rolling 5-year periods meeting or exceeding the Actuarial Return Assumption (currently 7%)
- Exceed an appropriate benchmark reflective of asset class participation over rolling five-year periods (i.e. actual allocation index during the implementation period and policy index once fully implemented).

Governance:

The **TMRS Board of Trustees** is responsible for the administration of the System and its investment program. The Board appoints the investment consultants, investment managers, Executive Director, General Counsel, Internal Auditor, Custodian Bank, Securities Lending Agent, and Consulting Actuary.

The **Executive Director** is appointed by the Board of Trustees to manage and administer the System and its assets, and **the Chief Investment Officer** directs the TMRS investment program consistent with the Board's Investment Policy Statement and applicable state and federal laws.

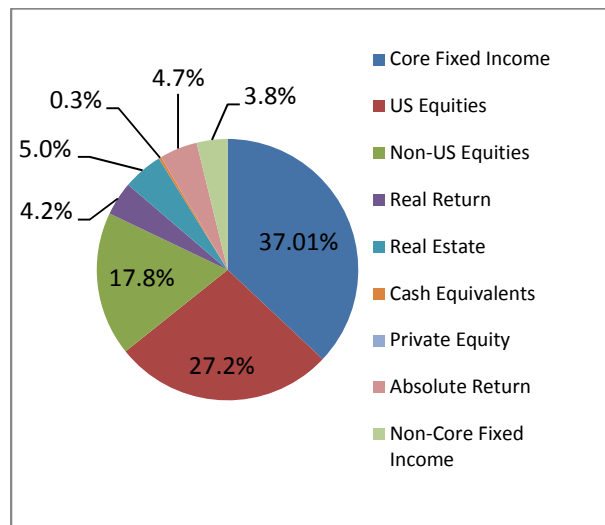
The Board of Trustees retains a **general investment consultant** primarily to advise the Board on all investment-related matters, conduct asset allocation studies, and evaluate performance relative to objectives; further, the consultant serves as a resource to staff in implementation matters.

Additionally, the Board retains a **real estate consultant**, an **absolute return consultant** and a **real return consultant** to assist in the management of these respective allocations.

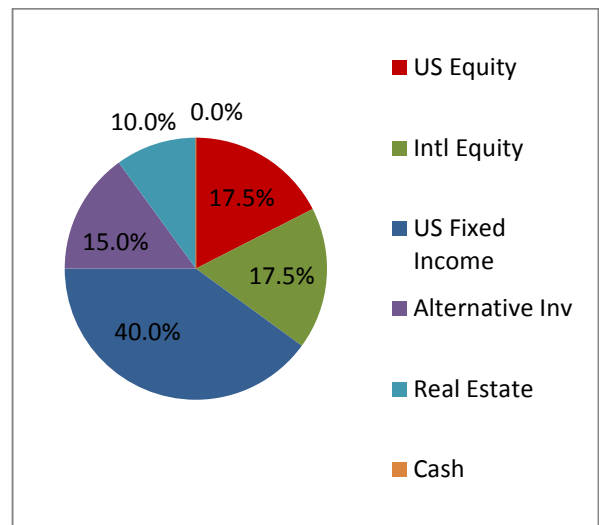
Asset Allocation:

Until 2009, the TMRS investment objective was income-focused, consistent with the plan design that statutorily relied on income returns. As such, the investment portfolio was primarily focused on high quality, long term fixed income securities. With passage of HB360 in 2009, TMRS adopted a fully diversified asset allocation strategy. **Diversification is being implemented through a deliberate multi-year process and so performance is reflective of this.**

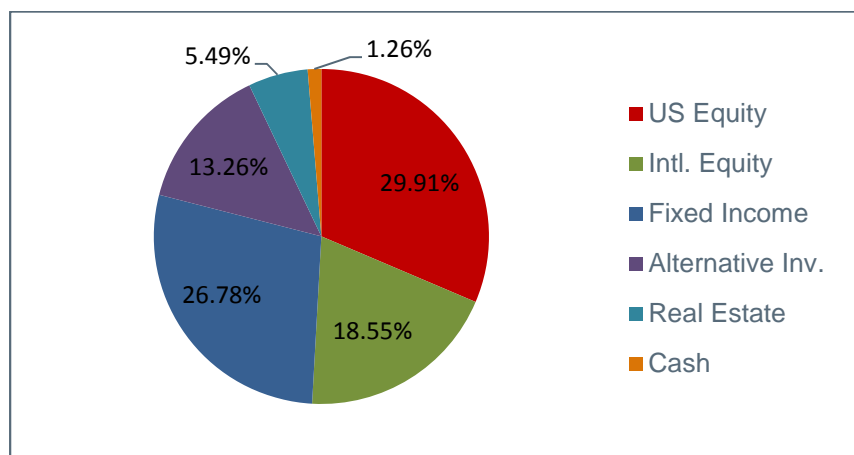
The asset allocation strategy is expected to meet the long-term total return objective of 7%, consistent with the actuarial interest rate assumption for the plan. This allows for a more conservative investment allocation, reflected in a lower equity allocation than the median plan sponsor in a peer universe of large public pension plans. The graphs below reflect the TMRS asset allocation as of year-end 12-31-2014, as compared to the TMRS target asset allocation and the median plan’s allocation.



TMRS Actual Allocation 12-31-14



TMRS Target Allocation



Median Plan Sponsor - RVK Public Plan Survey
All Public Plans > \$1B (12-31-14)

Note: The TMRS Alternative Investments category targeted at 15% consists of 5% each Real Return, Absolute Return, and Private Equity. Within this category, only the Real Return and Absolute Return have been implemented to date. Staff is expected to present a consultant selection recommendation to the Board for Private Equity at the May 2015 meeting. It is anticipated that the first targeted investment in Private Equity will occur by Q1 2016.

Implementation Strategies:

The TMRS Board of Trustees has determined that in order to implement the diversified portfolio strategy in a reasonable and prudent timeframe, portfolios will be managed externally. As such, investment staff is responsible for and collaborates with the consultant on strategy selection, manager selection, and risk management including compliance and due diligence monitoring of the managers and assets.

Initial implementation was focused on lower cost, passive strategies. As implementation continues, active strategies are being researched and employed to better ensure meeting the performance objectives.

Current Portfolio Structure and Strategies:

ASSET CLASS	STRATEGY	BENCHMARK
Domestic Equities	Passive Broad Market Index	Russell 3000 Index
	Passive Fundamental Index	Russell US Fundamental Index
	Passive Minimum Volatility	MSCI US Min Vol Index
	US Traditional All Cap	Russell 3000 Index
	US Opportunistic All Cap	Russell Mid Cap Value Index
	US Mid Cap Opportunistic	Russell Mid Cap Index
	US Mid Cap Core	Russell Mid Cap Index
International Equities	Passive Broad Market Index	All Country World (ACW) ex US Investable Market Index (IMI)
	Passive Fundamental Index	Russell Fundamental Global Ex US Index
	Passive Minimum Volatility	MSCI World Ex US Min Vol Index
	Non-US Opportunistic Relative Value	MSCI ACWI ex US Index
	Non-US Opportunistic Core	MSCI ACWI ex US Index
	Non-US Emerging Markets	MSCI Emerging Markets (EM) Index
Core Fixed Income	US Core (Enhanced Index)	Barclays US Agg Bond Index
	Active Core Plus	Barclays US Agg Bond Index
Non-Core Fixed Income	Bank Loan/CLO Debt	Credit Suisse Leveraged Loan Index
	RMBS/CMBS	33% Barclays US Agg Corp Index and 67% Barclays US Corp High Yield Index
Real Estate	Core, Value-Add, Opportunistic	NCREIF-ODCE
Real Return	Active Global Linkers	Barclays World Govt Inflation Linked Bond Index
Absolute Return	Customized Fund of One	HFRI Diversified Fund of Funds Composite Index
Private Equity	N/A	S&P 500 +5%
Cash Equivalents	N/A	30 Day T-Bill

Performance Results as of 12/31/2014*

	2014	2013	2012	2011	2010	2009
TMRS Total Portfolio Market Value (billions)	23.6	22.4	20.4	18.5	17.9	16.3

As of 12-31-14	1 year	3 years	5 years	7 years	10 years
TMRS Total Fund	5.85%	8.46%	7.31%	6.44%	6.41%
Actual Allocation Benchmark**	5.63%	8.24%	7.20%	6.34%	5.90%

Year	2014	2013	2012	2011	2010	2009
TMRS Total Fund	5.85%	9.65%	9.93%	2.36%	8.97%	10.20%
Actual Allocation Benchmark**	5.63%	9.68%	9.47%	2.21%	9.08%	4.06%

*Net of management fees

**Actual Allocation Benchmark return reflects the stage of diversification; 2009 benchmark reflects change in fixed income strategy from Barclays Long Govt/Credit to the Barclays Aggregate in mid-2009 Performance Composites versus Objectives*