

TEXAS MUNICIPAL RETIREMENT SYSTEM

INVESTMENT PROGRAM 2013 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 for total return with appropriate consideration for portfolio volatility (risk) and liquidity. Emphasis is on both capital appreciation as well as the production of income in order to satisfy the short-term and long-term funding needs of TMRS. 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 TMRS fund. Investment and management decisions respecting individual assets will be evaluated not in isolation but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the fund.

Total Portfolio Performance Objectives:

- Total Rate of Return, over rolling 5-year periods, consistent with the assumed long term rate of return on TMRS assets established by the actuary (currently 7%)
- Exceed an appropriate benchmark reflective of asset class participation over rolling five-year periods (i.e. Policy Index)

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.

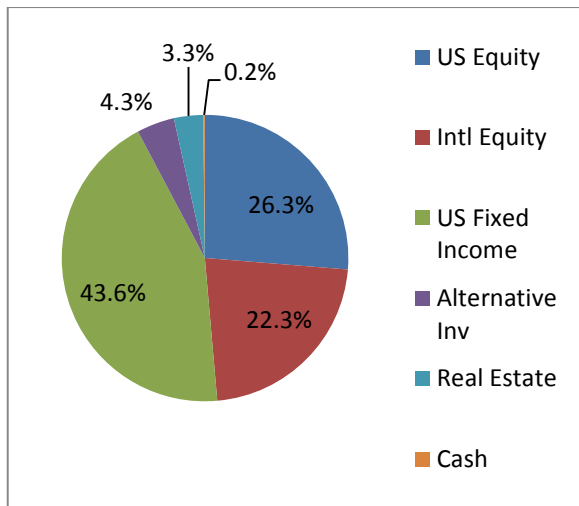
The Board of Trustees retains a **general investment consultant** primarily to advise the Board in investment-related matters, conduct asset allocation studies, and evaluate performance relative to objectives; further, the consultant serves as a resource to staff in implementation matters.

Additionally, the Board retains a **real estate consultant** to assist in the management of the real estate allocation.

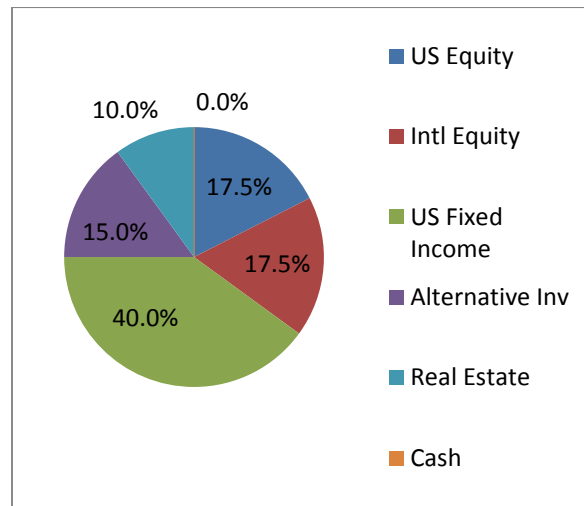
Asset Allocation:

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.**

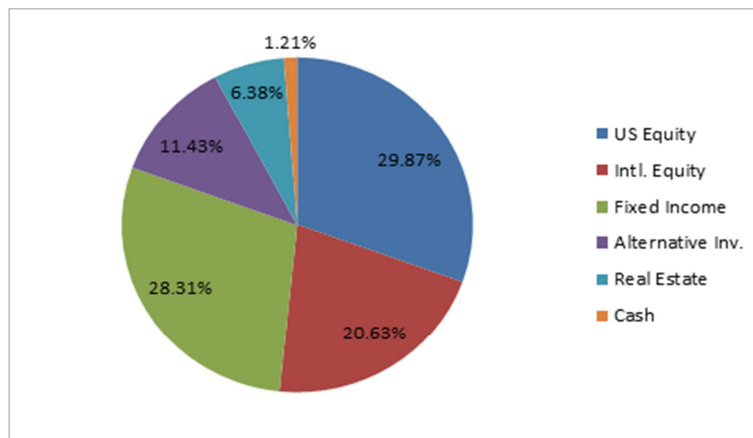
The asset allocation strategy is expected to meet the long-term total return objective of 7%, consistent with the actuarial interest rate assumption for the plan. This allows for a more conservative investment allocation, reflected in a lower equity allocation than the median plan sponsor in a peer universe of large public pension plans. The graphs below reflect the TMRS asset allocation as of year-end 12-31-2013, as compared to the TMRS target asset allocation and the median plan’s allocation.



TMRS Actual Allocation 12-31-13



TMRS Target Allocation



Median Plan Sponsor - RV Kuhns Public Plan Survey
All Public Plans > \$1B (12-31-13)

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 has been implemented to date. Staff will present a manager selection recommendation to the Board for Absolute Return at the February 2014 meeting; Absolute Return portfolio is anticipated to be fully funded by June 2014.

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 Minimum Volatility Index	MSCI USA Min Vol Index
	Passive Fundamental Index	Russell Fundamental Index US
International Equities	Passive Broad Market Index	ACW-Ex US IMI
	Passive Minimum Volatility Index	MSCI World Ex-US Min Vol Index
	Passive Fundamental Index	Russell Fundamental Global Ex-US Index
Fixed Income	US Core (Enhanced Index)	Barclays US Agg Bond Index
	Active Core Plus	Barclays US Agg Bond Index
Real Return	Active Global Linkers	Barclays World Govt Inflation Linked Bond Index
Real Estate	Core, Value-Add, Opportunistic	NCREIF-ODCE

Performance Results*

	2013	2012	2011	2010	2009	2008
TMRS Total Portfolio Market Value (billions)	22.4	20.4	18.5	17.9	16.3	14.6

As of 12-31-13	1 year	3 years	5 years	7 years	10 years
TMRS Total Fund	9.65%	7.26%	8.18%	6.72%	7.09%
Actual Allocation Benchmark**	9.68%	7.11%	6.88%	6.48%	6.19%

Year	2013	2012	2011	2010	2009	2008
TMRS Total Fund	9.65%	9.93%	2.36%	8.97%	10.20%	-1.31%
Actual Allocation Benchmark**	9.68%	9.47%	2.21%	9.08%	4.06%	4.41%

*Net of management fees

**Actual Allocation Benchmark return reflects the stage of diversification; 2008 and 2009 benchmarks reflect change in fixed income strategy from Barclays Long Govt/Credit to the Barclays Aggregate in mid-2009 Performance Composites versus Objectives:*

Domestic Equity Composite (Gross) returned 16.11% over the trailing three-year period ending December 31, 2013. Since inception (02/01/2008), the Domestic Equity managers have closely tracked their benchmarks.

International Equity Composite (Gross) returned 5.72 % over the trailing three-year period ending December 31, 2013. Since inception (02/01/2008), the Non-U.S. Equity managers have outperformed or closely tracked their benchmarks.

Fixed Income Composite (Net) returned 4.72% over the trailing five-year period ending December 31, 2013. Since inception (01/01/1989), the Fixed Income managers have outperformed or closely tracked the Barclays US Agg Bond Index.

Real Return Composite (Net) returned -4.22% for the year ending December 31, 2013, outperforming its benchmark return of -4.84%.

* R.V. Kuhns & Associates, Inc.

Performance objectives for passive strategies are “gross” of fees; active strategies are “net” of fees.