

Kentucky Teachers' Retirement System

2015



Investment  
Section

**REPORT ON INVESTMENT ACTIVITY**

This report is prepared by the Investment staff of the  
Kentucky Teachers' Retirement System.

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Chief Investment Officer

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**Mr. Gary L. Harbin, CPA**  
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**Mr. Tom Siderewicz, CFA**  
Chief Investment Officer



December 1, 2015

**To the members of the Board of Trustees and participants of the Teachers' Retirement System of Kentucky:**

The KTRS investment program produced a total return of 5.1% in the twelve-month period ended June 30, 2015. This return exceeded that of the policy benchmark by 1.7 percentage points and ranked in the top 6% of returns in a peer group universe of 78 public pensions with over \$1 billion in assets. This strong relative performance was driven by favorable investment manager returns relative to their given benchmarks for both internally and externally managed portfolios. Favorable asset allocation strategy and implementation, in addition to the strong manager performance, propelled KTRS to near the top of its peer universe rankings.

Over the past fiscal year, the global economy was characterized by ongoing central bank easing as it became clear that China's economy was experiencing a slowdown and the Eurozone continued to struggle with slow growth and high unemployment. Here in the U.S., the economy showed relatively steady progress as inflation-adjusted gross domestic product grew by 2.7% and the unemployment rate fell from 6.1% to 5.3%.

Equities, which represented 62.8% of the system's assets as of June 30, 2015, returned 5.7%. Domestic equities returned 9.0% versus 7.3% for the S&P 1500 Index. International equities returned -1.9% versus -4.9% for the MSCI All Country (ex-U.S.) Index. Fixed income, which composed 17.4% of assets, returned 2.1% versus 1.7% for the Barclays Government/Credit Index.

The system's other asset classes, including real estate, private equity, and alternative credit strategies, provided solid returns over the fiscal year. Collectively, these strategies represented 17.2% of total assets as of June 30.

Over the trailing five-year period, KTRS' investment returns rank in the top 9% of the pension fund universe cited earlier. We believe the consistently strong relative returns achieved over the past several years have been the result of the successful implementation of a sound investment philosophy and a high degree of professionalism.

The retirement annuity trust fund's returns were calculated by the Segal Rogers Casey performance reporting system using a time-weighted rate of return calculation based upon market values.

We would like to thank the Board of Trustees, Investment Committee, and Investment Staff for their confidence. We appreciate the opportunity to assist the retirement system in meeting its investment goals.

Respectfully,

Patrick J. Kelly, CFA, CAIA  
Partner

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## RETIREMENT ANNUITY TRUST FUND

### INVESTMENT POLICY SUMMARY

The KTRS Board of Trustees has a statutory obligation to invest the members' assets in a manner consistent with the fiduciary standards set forth in the "prudent person rule." Consistent with these fiduciary standards, the board has recognized certain principles that guide investment-related decisions. First, the board will preserve the long-term corpus of the fund. Second, the board will seek to maximize total investment return within prudent risk parameters. Third, the board will act in the exclusive interest of the members and beneficiaries of the System. This broad summary is a reference point for management of retirement assets and outlines the investment philosophy and practice of KTRS.

### INVESTMENT OBJECTIVES

KTRS invests the members' funds in several diverse classes of assets, including equities, bonds and real estate. This diversification helps us earn the highest possible long-term rate of return within appropriate risk levels. In turn this enables us to pay guaranteed benefits to members and their beneficiaries at the lowest possible cost to participating employers and the taxpayers that fund them. Generally, the retirement system's liabilities will not be paid for as many as 30-40 years. Therefore, as a long-term investor, KTRS holdings can withstand some short-term volatility. The retirement annuity trust fund's long-term investment objective is to achieve an annualized rate of return of 7.5%.

### RISK CONTROLS

The KTRS investment program faces various risks; however, the primary risk to KTRS is that the assets will not support liabilities over long periods of time. In order to control this risk and any other risks, the board has taken the following steps on an ongoing basis:

- Actuarial valuations are performed each year to evaluate the funding objectives of the retirement system. In addition, every ten years an external audit of the actuary is conducted to ensure that the assumptions made and calculation methods used are resulting in properly computed liabilities of the System.
- Asset/liability studies are conducted approximately every five years. These studies ensure that the portfolio design is structured to meet the liabilities of the retirement system.
- The KTRS Investment Committee adopts, and regularly reviews, detailed investment strategies for implementation of the investment policy.

### ASSET ALLOCATION

Operating within relevant regulatory limitations, the retirement system's investment consultant, on an annual basis, presents to the Investment Committee for approval target percentages and ranges for the retirement system's various asset classes. Annually approved asset allocation parameters serve to balance the retirement system's liquidity requirements, volatility tolerance, and return requirements to meet both short-term and long-term obligations. The retirement system's assets are diversified across a variety of asset classes, investment management styles, and individual securities in order to reduce volatility and enhance the potential of the investment portfolio to achieve the retirement system's long-term goals.

Asset allocation decisions for pension plans are highly dependent on the unique characteristics of a particular plan. Factors such as liability requirements, the level of funding, and statutory investment restrictions are important considerations within the context of the asset allocation decision making process. Consequently, asset allocations may differ markedly between various pension plans due to their unique circumstances.

The information below shows the retirement system's asset allocation by fair value as of June 30, 2015, and June 30, 2014, as well as the target and strategic range for each asset class for fiscal year 2015.

Retirement Annuity Trust

|                        | <u>June 30,2015*</u>     | %            | <u>June 30,2014**</u>    | %            |
|------------------------|--------------------------|--------------|--------------------------|--------------|
| Cash Equivalents***    | \$ 477,398,294           | 2.6          | \$ 420,338,047           | 2.3          |
| Fixed Income           | 3,103,821,351            | 17.4         | 3,594,965,963            | 19.9         |
| Domestic Equities      | 7,798,497,485            | 43.6         | 7,982,520,773            | 44.3         |
| International Equities | 3,439,336,257            | 19.2         | 3,411,422,169            | 18.9         |
| Real Estate            | 825,335,346              | 4.6          | 733,045,846              | 4.1          |
| Private Equity         | 636,890,428              | 3.6          | 457,408,593              | 2.6          |
| Timberland             | 207,797,668              | 1.1          | 186,481,696              | 1.0          |
| Additional Categories  | 1,404,919,549            | 7.9          | 1,248,651,062            | 6.9          |
| <b>TOTALS</b>          | <b>\$ 17,893,996,378</b> | <b>100.0</b> | <b>\$ 18,034,834,149</b> | <b>100.0</b> |

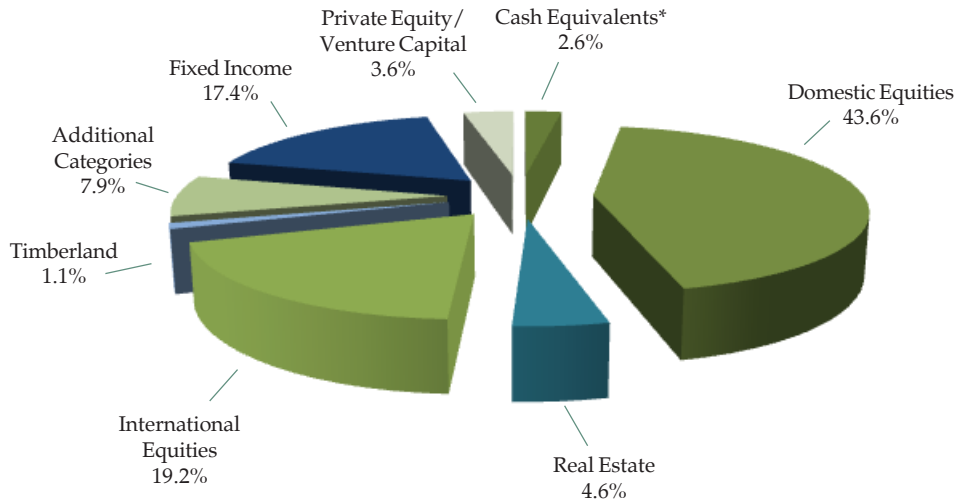
\* Includes Life Insurance Trust values of \$87,963,949, Tax Shelter Annuity value of \$363,978, and 401(h) value of \$29,150,708.

\*\* Includes Life Insurance Trust values of \$89,250,576, Tax Shelter Annuity value of \$377,268, and 401(h) value of \$41,237,374.

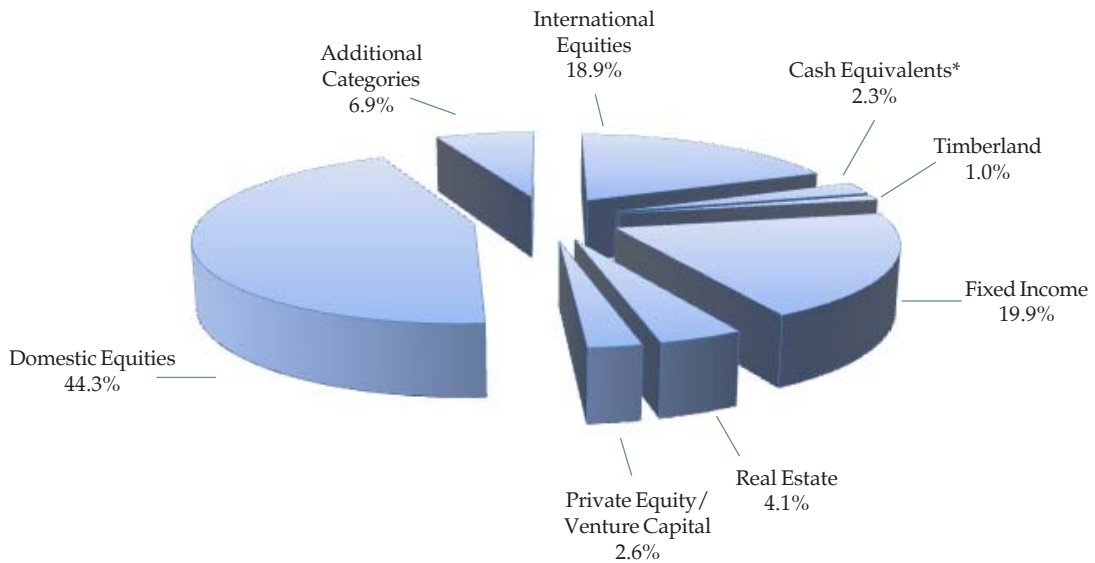
\*\*\* Reflects only cash balances not allocated to other asset classes. Uninvested cash balances allocated to various asset classes are represented in the respective asset classes.

Distribution of Investments  
Retirement Annuity Trust\*\*  
Fair Values

June 30, 2015



June 30, 2014



\* Reflects only cash balances not allocated to other asset classes. Uninvested cash balances allocated to various asset classes are represented in the respective asset classes.

\*\* Includes Life Insurance Trust values.

Strategic Weightings by Asset Class

| Asset Class              | Regulatory Limits (Mkt Value) | Strategic Range (Mkt) | Target (Mkt)  | 6/30/2015 (Mkt)** |
|--------------------------|-------------------------------|-----------------------|---------------|-------------------|
| Cash                     |                               | 1 - 3%                | 2.0%          | 2.6%              |
| Fixed Income             |                               | 14 - 20               | 17.0          | 17.4              |
| Government/Agency/Other  | Unlimited                     |                       |               | 9.5               |
| Corporate                | 35%                           |                       |               | 7.9               |
| Equity                   | 65%                           | 58 - 65               | 62.0          | 62.8              |
| Domestic Large Cap       |                               | 34 - 42               | 38.0          | 37.3              |
| Domestic Mid Cap         |                               | 1 - 5                 | 3.0           | 3.9               |
| Domestic Small Cap       |                               | 1 - 3                 | 2.0           | 2.4               |
| International***         | 30%                           | 16 - 22               | 19.0          | 19.2              |
| Real Estate              | 10%                           | 3 - 7                 | 5.0           | 4.6               |
| Alternative Investments* | 10%                           | 2 - 8                 | 5.0           | 4.7               |
| Additional Categories    | 15%                           | 6 - 12                | 9.0           | 7.9               |
| <b>TOTAL</b>             |                               |                       | <b>100.0%</b> | <b>100.0%</b>     |

\* Includes private equity, venture capital, timberland, and infrastructure investments.

\*\* Starting with 7/2008, Cash is only the unallocated cash balance. Manager cash balances will be included with the asset type of the managers investments.

\*\*\* As of 6/30/15, 19.2% of Total International Equities was invested in Emerging Markets.

PORTFOLIO RETURNS

For the fiscal year, the retirement annuity trust fund's portfolio generated a total return of 5.1%, exceeding the policy benchmark return of 3.4%. Domestic equities returned 9.0% versus 7.3% for the Standard & Poor's 1500 Index, while international equities returned -1.9% versus -4.9% for the MSCI All Country World (Ex-US) Index. Fixed income investments outperformed, returning 2.1% versus 1.7% for the Barclays Government/Credit Index. Less traditional asset classes such as real estate, private equity, timberland, and alternative credit are beginning to contribute meaningfully to total return as those programs are expanded.

The table below details historical performance for the retirement annuity trust fund and its component asset classes for the period ended June 30, 2015. The retirement annuity trust fund's returns were generated by the Segal Rogers Casey performance reporting system using a time-weighted rate of return calculation based upon market values.

## INVESTMENT SECTION

### Portfolio Returns continued ...

|   | <u>1 Yr<sup>(2)</sup></u> | <u>3 Yr<sup>(2)</sup></u> | <u>5 Yr<sup>(2)</sup></u> | <u>10 Yr<sup>(2)</sup></u> | <u>20 Yr<sup>(2)</sup></u> |
|---|---------------------------|---------------------------|---------------------------|----------------------------|----------------------------|
| <b>Total Fund</b>   |                           |                           |                           |                            |                            |
| KTRS  | 5.1                       | 12.3                      | 12.0                      | 7.0                        | 7.6                        |
| Policy Index <sup>(1)</sup>                               | 3.4                       | 11.1                      | 11.3                      | -                          | -                          |
| <b>Equities</b>   |                           |                           |                           |                            |                            |
| Domestic Equities   | 9.0                       | 19.1                      | 18.1                      | 8.4                        | 9.5                        |
| S & P Blended Index <sup>(3)</sup>                        | 7.3                       | 17.5                      | 17.4                      | 8.1                        | 9.0                        |
| International Equities <sup>(4)</sup>                     | -1.9                      | 11.4                      | 9.8                       | -                          | -                          |
| MSCI AC World (Ex US)                                     | -4.9                      | 9.9                       | 8.2                       | -                          | -                          |
| Total Equities  | 5.7                       | 16.8                      | 15.9                      | 7.5                        | 9.0                        |
| <b>Fixed Income</b>                                       |                           |                           |                           |                            |                            |
| Total Fixed Income  | 2.1                       | 2.5                       | 4.4                       | 5.3                        | 6.1                        |
| Barclays Govt/Credit Index                                | 1.7                       | 1.8                       | 3.5                       | 4.4                        | 5.7                        |
| <b>Real Estate</b>  |                           |                           |                           |                            |                            |
| Non-Core Real Estate                                      | 23.0                      | 24.8                      | -                         | -                          | -                          |
| NCREIF Index  | 13.0                      | 11.6                      | -                         | -                          | -                          |
| Core Real Estate  | 14.2                      | 12.5                      | 14.5                      | -                          | -                          |
| NCREIF ODCE   | 14.4                      | 13.1                      | 14.4                      | -                          | -                          |
| Triple Net Lease Real Estate                              | 7.9                       | 7.6                       | 7.6                       | 8.4                        | 8.9                        |
| CPI plus 2%   | 2.2                       | 3.3                       | 3.9                       | 4.1                        | 4.3                        |
| <b>Alternative Investments</b>                            |                           |                           |                           |                            |                            |
| Private Equity <sup>(5)</sup>                             | 11.7                      | 12.9                      | 12.8                      | -                          | -                          |
| Timberland  | 15.6                      | 7.2                       | 6.3                       | -                          | -                          |
| NCREIF Timberland Index                                   | 10.0                      | 9.8                       | 6.1                       | -                          | -                          |
| <b>Cash</b>   |                           |                           |                           |                            |                            |
| Cash (Unallocated)  | 0.1                       | 0.1                       | 0.1                       | 1.8                        | 2.9                        |
| 90 Day Treasury Bill                                      | 0.0                       | 0.1                       | 0.1                       | 1.4                        | 2.5                        |
| <b>Additional Categories</b>                              |                           |                           |                           |                            |                            |
| <b>High Yield</b>   |                           |                           |                           |                            |                            |
| High Yield Bond Fund                                      | 0.6                       | 6.7                       | 8.6                       | -                          | -                          |
| B of A Merrill Lynch<br>High Yield Master II              | -0.6                      | 6.8                       | 8.4                       | -                          | -                          |
| <b>Alternative Credit</b>                                 |                           |                           |                           |                            |                            |
| KTRS Credit Fund  | -1.0                      | 11.3                      | -                         | -                          | -                          |
| Special Situations Fund                                   | 2.2                       | 9.4                       | -                         | -                          | -                          |
| Oaktree Opportunities Fund                                | -1.0                      | -                         | -                         | -                          | -                          |
| AG Select Partners Adv Fund                               | -3.3                      | -                         | -                         | -                          | -                          |
| B of A Merrill Lynch<br>High Yield Master II              | -0.6                      | 6.8                       | -                         | -                          | -                          |
| Shenkman Capital Mgmt                                     | 1.5                       | -                         | -                         | -                          | -                          |
| Highbridge Pr Str III                                     | 11.1                      | -                         | -                         | -                          | -                          |
| Golub Pearls 11   | 6.2                       | -                         | -                         | -                          | -                          |
| Oaktree Eur Dislocation Fund                              | 7.5                       | -                         | -                         | -                          | -                          |
| Marathon Eur Cr Opp Fund                                  | 5.4                       | -                         | -                         | -                          | -                          |
| S & P LSTA Leverage Loan Index                            | 1.8                       | -                         | -                         | -                          | -                          |
| Babson Capital Eur Loan Fund                              | -                         | -                         | -                         | -                          | -                          |
| CS Institutional WELLI, USD Hedged                        | -                         | -                         | -                         | -                          | -                          |
| <b>Non-US Dollar Fixed Income</b>                         |                           |                           |                           |                            |                            |
| Rogge Global Intl Fixed Income                            | -10.9                     | -                         | -                         | -                          | -                          |
| Barclays Global Aggregate ex<br>USD 25% EUR 25% JPY Index | -10.7                     | -                         | -                         | -                          | -                          |

Footnotes on page 65



- (1) Prior to July 1, 2008, KTRS did not benchmark overall fund performance. Effective July 1, 2008, the Board of Trustees approved a Policy Index which represents the returns of appropriate benchmarks for the various asset classes weighted by the mid-point of the strategic range for the current fiscal year.
- (2) Annualized
- (3) Total Domestic Equity is benchmarked to a S&P Blended Index. Total domestic equity was benchmarked to the S&P 500 through the fiscal year ending 6/30/2007. As of 7/1 2007, domestic equity is benchmarked to the S&P 1500 Index since the System's domestic stock mix is most comparable to this index.
- (4) As of 06/30/15 19.2% of Total International Equities were invested in emerging markets.
- (5) For a period of five years private equity investments will be benchmarked against their own returns. The primary reason for this is that these investments have a minimum investment horizon of ten years and there is no market benchmark that would be expected to track these types of assets in their early years. Beginning five years after the first capital call, investments in this class shall be benchmarked versus the S & P 500 plus 3%, which is the System's long-term expected return for this asset class.

**SCHEDULE OF INVESTMENT RETURNS - RETIREMENT ANNUITY TRUST**

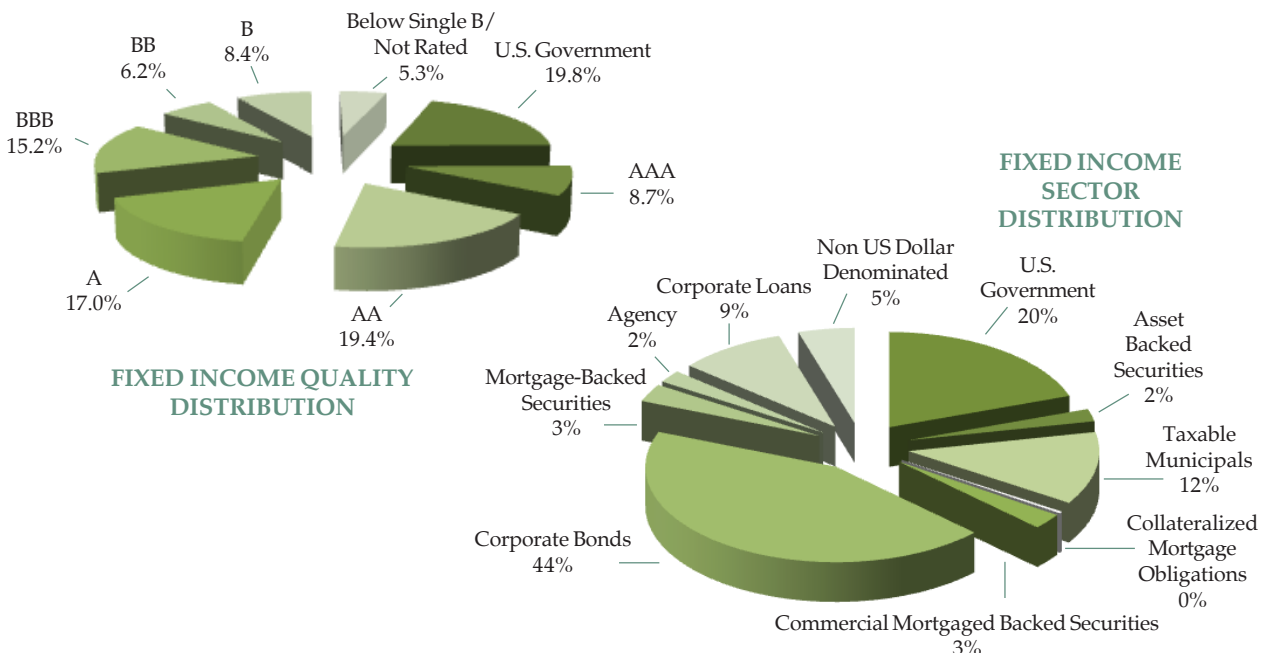
|      |   |        |
|------|---|--------|
| 2015 | Annual Rate of Return Net of Investment Expense | 4.96%  |
| 2014 | Annual Rate of Return Net of Investment Expense | 17.95% |

**FIXED INCOME INVESTMENTS**

As of June 30, 2015, the retirement annuity trust fund had approximately \$3.1 billion, 17.4% of total assets, in the fixed income category of investments. The retirement annuity trust fund's fixed income investments maintained the average investment grade rating required by administrative regulation as of June 30, 2015.

In addition, the retirement annuity trust fund had \$1.4 Billion, 7.9% of total assets, in other debt related investments under a regulatory provision which allows for up to 15% of assets in "additional categories of investments" approved by the Board of Trustees. Investments under this authorization included a high yield bond portfolio, an international fixed income portfolio, and two syndicated bank loan portfolios. Also under this provision are several alternative credit portfolios including a multi - strategy opportunistic credit portfolio as well as distressed debt and specialty lending funds.

The credit quality distribution for the retirement annuity trust fund is illustrated below. This chart includes the fixed income category of investments as well as the high yield bond, international fixed income, and the syndicated bank loan portfolios included in "additional categories of investments". Also illustrated below is the distribution of fixed income assets by sector, again including the high yield bond, international fixed income, and the syndicated bank loan portfolios held under "additional categories of investments".



### FIXED INCOME MARKET OVERVIEW

The retirement annuity trust fund's investment grade fixed income portfolios returned 2.1% for the fiscal year ending June 2015. This compares favorably to the trust fund's fixed income benchmark, the Barclays U.S. Government / Credit Index, which returned 1.7%. The outperformance was driven by the system's overweighting in corporate bonds which provided higher coupon interest than government bonds of similar duration.

As has been the case in recent years, fixed income markets were heavily influenced by the development of global Central Bank monetary policy, but additional factors seemed to have a significant weighing on the level of interest rates as the year progressed. Yields on long term U.S. Treasuries ended fiscal year 2015 modestly lower while yields on short term U.S. Treasuries rose over the same time period. This "flattening" of the interest rate term structure is consistent with market expectations of tighter monetary policy from the Federal Reserve, which was in the process of winding down its third asset purchase program, known as Quantitative Easing (QE), as the fiscal year began.

Beginning in February 2014, this latest round of QE was completed in October 2014, and market participants began to speculate about the timing of the first increase in the Federal Funds rate. Initially, investors were anticipating the rate increases to begin in the second quarter of calendar year 2015. At the same time, the Bank of Japan announced it was expanding its QE program and investors were expecting a similar announcement from the European Central Bank. The divergence in monetary policy among the major Central Banks, tighter U.S. policy contrasting with easier policy in Japan and Europe, caused a major rally in the U.S. Dollar. The U.S. Dollar index, which measures average exchange rates between the U.S. Dollar and other major currencies, rose from 79.78 on June 30, 2014 to a peak of 100.39 in mid-March 2015.

The strength in the U.S. Dollar had implications for other financial markets. The CRB commodity index fell from a high of 313.27 at the end of June, 2014 to 206.81 in mid-March, 2015. The drop was led by industrial and energy markets including crude oil. The price per barrel of West Texas Intermediate crude oil fell from \$106.09 to \$42.05 over the same time period. Long term U.S. Treasuries benefited greatly as foreign investors purchased Treasuries to participate in U.S. Dollar strength and U.S. investors lengthened the duration of their portfolios to take advantage of falling commodity price inflation. Yields on 30 year U.S. Treasuries fell from 3.47% at the beginning of the fiscal year to a record low of 2.22% at the end of January 2015. Corporate bonds also performed well during the first half of the fiscal year as corporate yields followed Treasury yields lower. The yield on the Barclays Investment Grade Long Corporate Index, which began the fiscal year at 4.57%, fell to 4.03% at the end of January.

Inflation, which had already been running below the Federal Reserve's stated target of 2%, began to decline in November of 2014, and also dropped significantly in December 2014 and January 2015. In response, the Federal Reserve issued a "dovish" statement following the January 2015 Federal Open Market Committee meeting stating that "inflation is anticipated to decline further in the near term". The statement caused market participants to reassess the timing of interest rate increases. Investors pushed out their expectation of the starting point for rate increases to the fourth quarter of calendar year 2015, later than previously expected. The more dovish view on rates truncated the rally in the U.S. Dollar and reversed some of the market action that had taken place over the first eight months of the fiscal year. The U.S. Dollar index fell to 93.13 before closing the fiscal year at 95.48. Oil rebounded to a near term high of \$61.43 and closed the fiscal year at \$59.47. Yields on both long term U.S. Treasuries and long term corporate bonds rose 90 basis points to finish the fiscal year at 3.12% and 4.93% respectively.

With U.S. Treasury rates and risk premiums on corporate bonds both near the low end of their historical range, investment grade fixed income is an asset class with moderately unfavorable risk / reward characteristics and below average upside potential. The retirement system continues to adjust the structure of its fixed income portfolio to control risk and maintain required liquidity. Specifically, the retirement system continues to increase exposure to nontraditional debt-related investments, reduce exposure to investment grade fixed income, and limit interest rate risk.

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## EQUITY INVESTMENTS

As of June 30, 2015 the retirement annuity trust fund's public equity investments had a market value of \$11.24 billion, representing 62.8% of total assets. Positive equity returns over the fiscal year prompted several rebalancing sales to reduce equity exposure back to target levels and to raise cash to fund pension benefits. The retirement annuity trust fund divides its public equity into two broad categories: domestic and international.

The domestic portfolio had a market value of \$7.80 billion as of June 30, representing 43.6% of total assets. This is a \$180 million decrease from last year due to the rebalancing sales. The benchmark for the domestic portfolio is the S&P 1500. The S&P 1500 is made up of three well known component indices based upon market capitalization: the S&P 500 large cap, S&P 400 mid cap, and the S&P 600 small cap. The retirement annuity trust fund's domestic equity holdings are comprised of eleven portfolios. Three of the portfolios are internal passively managed index portfolios benchmarked to the S&P 500, 400, and 600. The other eight portfolios are managed externally by four different asset managers, with each portfolio representing a specific strategy and measured against an appropriate benchmark. The collective array of portfolios provides diversification by capitalization, manager, style, and strategy.

The market value of the international equity holdings as of June 30, 2015 was \$3.44 billion, representing 19.2% of total assets, up from 18.9% a year earlier. The benchmark for international equities is the Morgan Stanley Capital International All Country World Index ex US (MSCI ACWI ex US), which represents the markets of 22 developed countries and 23 emerging market countries. Five external asset managers manage the retirement annuity trust fund's international equities, one of which is a passively managed international index fund. The retirement annuity trust fund plans to continue incremental increases in the international equity exposure during the coming fiscal year.

## EQUITY MARKET OVERVIEW

Public Equities maintained steady gains throughout fiscal year 2015. The upward trend was fairly consistent starting in October after a volatile first quarter. This steady rise saw just a few hiccups, with the most pronounced setbacks coming in mid-December and January. Returns of domestic stocks as measured by the S&P 1500 and Russell 2000 were 7.31% and 6.49%, respectively. Within the S&P 1500, small (S&P 600) and mid-cap (S&P 400) stocks were up 6.70% and 6.38%, while the large-cap S&P 500 was up 7.42%. The performance of International stocks was a drag on overall equity returns. The Morgan Stanley Capital International (MSCI) All Country World (ex-U.S.) Index returned -4.9%. The MSCI Emerging Markets Index was down -4.8%, with both indices showing volatile returns across international markets.

The domestic markets advanced overall throughout the fiscal year, due largely to easy monetary policies around the world driving asset prices higher. The first half of the year saw three major pullbacks, however. The beginning of August 2014 proved choppy because of geopolitical risks, such as Russia's military presence in Eastern Ukraine, and the US conducting airstrikes in Iraq against ISIS militants. After stocks rallied back, they once again stumbled from mid-September through the fiscal year low point on October 15, 2014. Domestically, this was attributed to the Ebola breakout and concerns over deflation. Globally, there were democracy protests in Hong Kong and major economic slowdowns in Europe and China. As volatile global markets increased investor demand for safe haven assets, the 10-year Treasury yield dropped to 2.06%, down from 2.6%. Again, however, US equities rallied on the back of stronger than expected GDP growth, and a surprise announcement from the Bank of Japan to increase the pace of its purchases of Japanese government bonds. The first half of the fiscal year saw a huge increase in market volatility. This, coupled with an accelerated decline in oil prices, triggered the third market setback in early to mid-December. Crude oil prices fell roughly 50% from July through December going from approximately \$106 to \$53 per barrel. The first half ended on a high note, thanks to China's central bank signaling further stimulus and easing lending requirements for home buying to boost their housing market.

The second half of the fiscal year continued the overall upward trend domestically, but started slow as January produced volatile and negative returns. Oil prices continued its downward spiral, dragging commodities and the energy sector down with it. Global GDP growth became a concern to investors as China and Europe both posted low numbers. Starting in February, markets rallied for most of the second half of the fiscal year. The US economy continued to add jobs at a high pace as inflation remained low and steady below the Fed's 2% target. The European Central Bank launched its quantitative easing program providing another boost to the market. Unfortunately, the last week of the fiscal year saw a 3% selloff in equities losing most of the gains from the previous five months. This was spurred by the revival of the Greek debt crisis and turmoil in China's markets.

Internationally, markets lagged the US as non-US equities produced negative returns for the fiscal year. The main drivers of this were the economic slowdowns in Europe and China. As the US dollar strengthened, international

## INVESTMENT SECTION

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investors fled Europe and Asia to invest in US markets. The Chinese economy grew at its slowest pace in six years as energy prices plummeted. At the end of the fiscal year China was exposed for restricting stock sales for market participants creating further turmoil in their stock market. Crude oil prices plunged to a fiscal year low of \$42.05 per barrel in March sending a ripple effect throughout the global economy, hitting the Chinese and emerging markets the hardest. European markets were negatively affected by the Russian occupancy in the Ukraine and once again by Greece's debt crisis. Japan's quantitative easing was a rallying point for many Japanese and International stocks, but was not enough to bring the International indices into positive territory.

In summary, we experienced a positive equity market for the fiscal year. Domestic large caps were the drivers, but mid and small caps also enjoyed solid gains on the year. International and emerging markets were a drag on equity performance this year. Domestic and International monetary policies provided the tailwinds for equities, while growing geopolitical tension and a dramatic economic slowdown in China proved to be headwinds. In the coming fiscal year FOMC Chair Janet Yellen is expected to announce the first Fed Funds Rate hike in over nine years, however, the Federal Reserve is still expected to keep rates low in the near future.

### REAL ESTATE

The retirement annuity trust fund's real estate investments had a market value of \$825.3 million as of June 30, 2015, representing 4.6% of total assets. The retirement annuity trust fund's investments in real estate are intended to provide attractive long-term returns, generate reliable cash flow, and provide diversification, thereby reducing the volatility of the overall investment portfolio.

The retirement annuity trust fund's real estate exposure is currently provided through nine portfolios. The retirement annuity trust fund maintains an internally managed portfolio of directly owned properties under long-term lease agreements with high credit quality tenants. The retirement annuity trust fund is also invested in a commingled real estate fund (PRISA Fund), which is managed by Prudential Real Estate Investors. This fund is a core real estate equity fund which invests primarily in existing income-producing properties with strong cash flows and the potential for capital appreciation. The fund is diversified across several property types including office, retail, industrial, apartment, self-storage and hotel.

Additionally, the retirement annuity trust fund is invested in seven real estate limited partnerships: Carlyle Realty Partners VI, Blackstone Real Estate Partners VII, Rockwood Capital Real Estate Fund IX, TA Realty Associates Fund X, AG Net Lease Realty Fund III, Carlyle Realty Partners VII, and Landmark Real Estate Partners VII. Going forward, investment staff will continue to opportunistically add to the annuity trust fund's real estate investments.

### REAL ESTATE OVERVIEW

The commercial real estate market continued to attract substantial amounts of new capital during the fiscal year. According to Green Street Advisors, private real estate funds, publicly traded REITs and other entities raised approximately \$440 billion of funds for investment in the U.S. property market in 2014. Over the coming year investor demand for commercial real estate should remain strong as the asset class is expected to generate attractive yields relative to other types of investments while also providing upside price appreciation due to strong supply/demand fundamentals. Depending on the sector, average rents nationwide should grow by 2% to 4% annually over the next two years.

According to Real Capital Analytics, nearly \$424 billion in commercial and multi-family property transactions occurred in 2014. This was an 18% increase over the \$362 billion in deals that were closed in the prior year. The largest volume of deals occurred in the office building and apartment sectors, while the industrial property sector had the least amount of activity. With the large inflow of capital into the market property values have been driven higher due to the increased competition for assets. The greatest run-up in prices has been in the market for core properties located in top-tier cities. This has led to investors focusing more on non-core assets located in secondary markets that offer higher total return potential.

#### Real Estate Investments \$825.3 Million Fair Value As of June 30, 2015

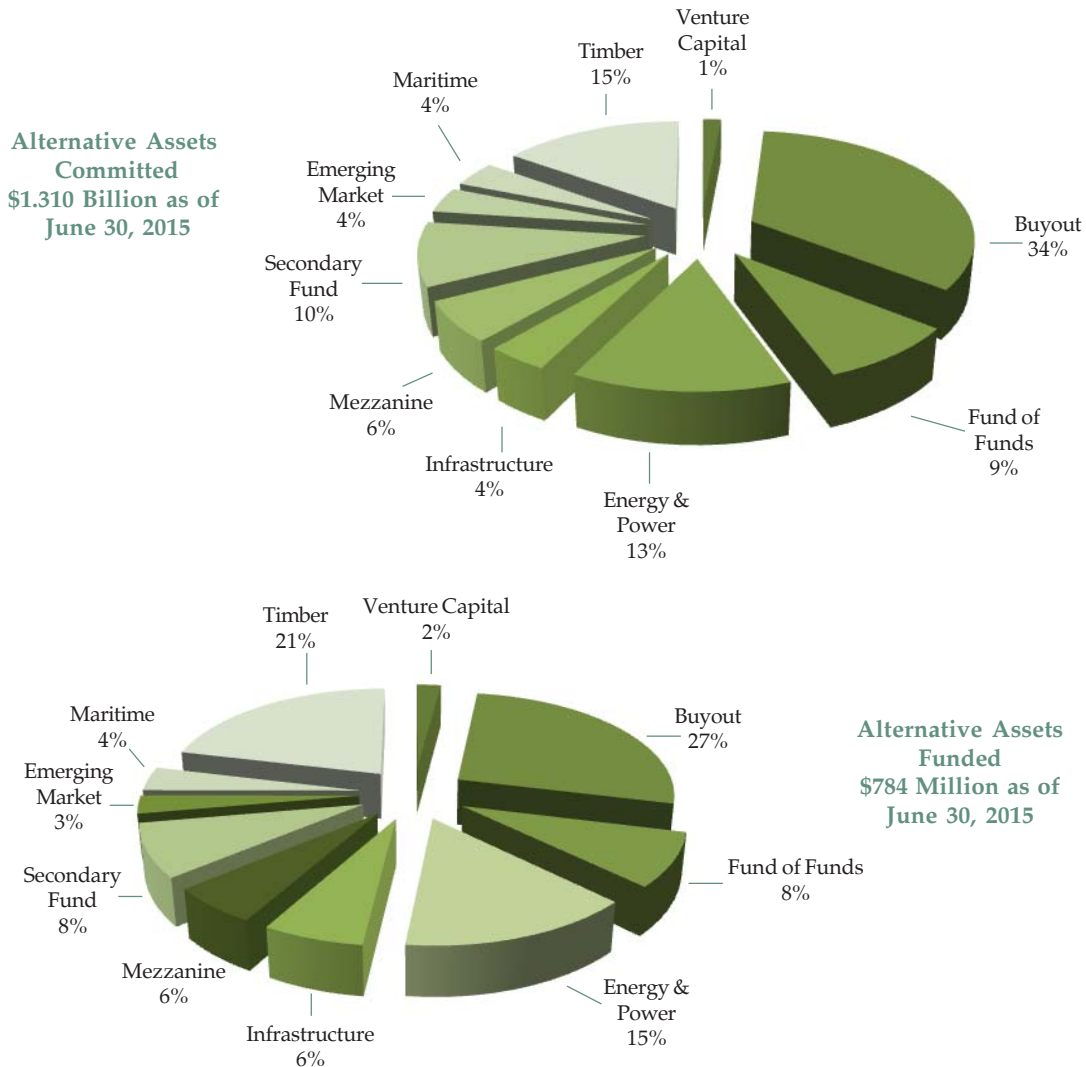


On the debt side of the market, lending activity remained robust across all sectors of commercial real estate. Data provided by the Mortgage Bankers Association show that an estimated \$387 billion in new commercial and multi-family loans were originated in 2014, up from \$359 billion in 2013. Loan originations are expected to grow to over \$400 billion in 2015. Additionally, an estimated \$1 trillion of existing commercial real estate loans are expected to come due over the next three years.

The environment for commercial real estate should remain favorable over the next year as the U.S. economy continues to slowly recover from the Great Recession of 2008-2009. Interest rates remain low, consumer and business confidence is growing, and the employment picture continues to improve. Upward pressure on commercial real estate prices should continue to increase as investors remain drawn to the relative value of the asset class. Furthermore, the steady income and inflation-hedging attributes which have traditionally made real estate an integral part of a diversified investment portfolio remain intact.

**ALTERNATIVE ASSETS**

As of June 30, 2015, the retirement annuity trust fund had committed \$1.310 billion to alternative investments and had funded \$784 million of those commitments. The percentage of the retirement annuity trust fund's portfolio invested in alternative assets was 4.7%. The retirement annuity trust fund's current alternative asset portfolio consists of private equity investments and timberland.



### PRIVATE EQUITY

The retirement annuity trust fund has exposure to venture, buyout, infrastructure, energy, mezzanine and several other private equity sectors via participation in limited partnerships as well as investments in funds of funds. The retirement annuity trust fund is in the early stages of its private equity investment program, which it intends to grow with a disciplined plan of commitments over the next several years. The retirement annuity trust fund looks to diversify its private equity portfolio by manager, country, strategy, and vintage year. Vintage year diversification is achieved by building out the portfolio with disciplined levels of commitments over time. A commitment to any given partnership shall not exceed 20% of the partnership's total commitments.

The Board and staff understand that private equity (along with many other forms of alternative assets) are illiquid and have a long-term holding period. When added to a portfolio with other publicly traded assets, this asset class can help to diversify and reduce risk for the retirement annuity trust fund's overall portfolio while enhancing returns. Private equity returns for the first several years of a partnership's life are routinely negative due to the J-curve effect. Positive returns are typically realized only several years into a partnership's existence, during the harvesting period.

### PRIVATE EQUITY MARKET OVERVIEW

The private equity markets continued to be positively affected by the strong public equity markets in the first half of the fiscal year. Consequently, older vintage funds were able to shed many of their portfolio companies either through a sale or an IPO. This return of capital has encouraged investors, especially institutional investors, to continue to increase their allocation to alternative investments, including private equity. However, the pull back in the public equity markets and the increased volatility in the second half of the fiscal year have caused the private equity markets to see a slowdown in portfolio company exits during this time.

The bifurcation in the private equity market continues with the top tier funds raising capital much easier than less desirable funds. This should, over the long term, provide a shakeup in this space as the weaker firms are forced to exit. The past fiscal year has also seen a large amount of buyout funds returning to the marketplace with mixed results. We continue to see more opportunity in the middle market space and in other niche areas such as infrastructure and distressed credit. Additionally, the stress in the European markets should continue to present investment opportunities in the private equity space over the next fiscal year.

### TIMBERLAND

In addition to private equity, the retirement annuity trust fund has invested in timberland in the alternative asset class. As of June 30, 2015 the retirement annuity trust fund owns approximately 73,000 acres of timberland outright, has a 7.15% interest in a commingled fund that holds approximately 98,000 acres of timberland and is a member of a joint venture that purchased an interest in approximately 124,000 acres of timberland located across seven southern states. Timberland is, by nature, a long term investment as our anticipated time horizon in this asset category is generally a minimum of ten to fifteen years. Timberland provides valuable diversification, current income, and a hedge against inflation. Due to the low correlation of returns with other asset classes, timberland investments should lower the overall volatility of the retirement annuity trust fund's portfolio. Timberland should earn real returns comparable to traditional equity investments with volatility between equities and fixed income over the long-term.

The retirement annuity trust fund diversifies its timberland investments by geography, species of trees, and maturity of timber stands. Investment returns from timberland are primarily driven from net cash flow generated from the sale of trees (referred to as stumpage sales) and capital appreciation from the biological growth of the trees. Both of these return factors depend to some degree upon the direction of forest commodity prices (paper goods and lumber products). There can also be gains from the timely sale of timberland from the conversion of timberland into higher and better uses, such as vacation property sales.

### TIMBERLAND MARKET OVERVIEW

The U.S. continued to see improvement in the housing markets during the fiscal year. In the short term, published forecasts expect housing starts to reach 1.22 million in 2015, a level that has typically stimulated the southern timber market. Long term, demand for sawtimber is bright as forecasters call for sustained increases through 2017. Additionally, while sawtimber exports from the West Coast have been down, southern pine lumber exports were up over 20 percent in 2014. Interestingly, there has been a flurry of Canadian purchases of southern sawmills. With the current high levels of standing southern pine inventory, this additional usage will begin to bring supply back into line with demand.

Currently, however, markets have been impacted by seasonal conditions. 2015 has seen dry weather across the U.S. South, with the exception of the extreme East Coast, resulting in a tightening of the region's timber markets. In-woods operability has been good, and as a result, logging production and regional mill inventories have remained steady. While timber pricing was attractive based on historical levels, spot-market opportunities typically prompted by wet weather events were largely absent. Late spring, rainfall increased significantly, triggering some attractive selling opportunities. However, this situation was short-lived.

Similar market conditions persist in the U.S. North, with frozen ground conditions supporting high levels of logging production earlier in the year. After ending 2014 in somewhat of a panic mode, especially with regard to pulpwood markets, northern buyers have reversed their backsliding inventories, and timber markets have calmed.

**RETIREMENT ANNUITY TRUST  
PORTFOLIOS  
FAIR VALUES \*  
June 30, 2015**

**Internally Managed**

|  |                      |
|--|----------------------|
| <b>Cash Equivalents</b>                |                      |
| Cash Collections Fund (Unallocated)    | \$ 477,398,294       |
| <b>Fixed Income</b>                    |                      |
| Intermediate Bond Fund                 | 832,814,130          |
| Broad Market Bond Fund                 | 546,362,748          |
| Long Term Bond Fund                    | 521,705,174          |
| Internal Bond Fund                     | 193,485,080          |
| Life Insurance Trust                   | 87,963,949           |
| Tax Shelter Fund                       | 363,978              |
| <b>Equity</b>                          |                      |
| S & P 500 Stock Index Fund (Large Cap) | 2,524,072,862        |
| S & P 400 Stock Index Fund (Mid Cap)   | 383,171,980          |
| S & P 600 Stock Index Fund (Small Cap) | 256,604,671          |
| <b>Real Estate</b>                     |                      |
| Internally Managed Fund                | 383,002,196          |
| <b>Subtotal</b>                        | <b>6,206,945,062</b> |

**Externally Managed**

|  |               |
|--|---------------|
| <b>Fixed Income</b>                    |               |
| Galliard Capital Management            | 480,842,149   |
| Ft. Washington Broad Market            | 440,284,143   |
| <b>Domestic Equity</b>                 |               |
| Todd Asset Management (Large Cap Core) | 1,297,404,384 |
| UBS (Large Cap Value)                  | 987,826,452   |
| GE Asset Management (Large Cap Growth) | 713,727,335   |
| Wellington (Large Cap Core)            | 622,741,774   |
| Todd Asset Management Opportunity Fund | 328,809,349   |
| Wellington (Mid Cap Core)              | 308,007,220   |
| UBS (130/30)                           | 202,012,960   |
| Wellington (Small Cap Core)            | 174,118,498   |
| <b>International Equity</b>            |               |
| Baillie Gifford EAFE Alpha             | 849,903,142   |
| Todd Asset Management International    | 796,815,219   |
| UBS All Country World ex US            | 691,720,452   |
| Baring All Country World ex US         | 537,126,346   |
| BlackRock All Country World ex US IMI  | 470,711,520   |
| Todd Asset Management                  | 93,059,578    |
| International Intrinsic Value          |               |
| <b>Real Estate</b>                     |               |
| Prudential PRISA Fund                  | 254,856,900   |
| The Realty Associates Fund X           | 51,967,460    |
| Blackstone Partners VII, LP            | 49,484,809    |
| Carlyle Realty Partners VI, LP         | 34,494,026    |
| Rockwood Capital Real Estate Fund IX   | 28,063,167    |
| AG Net Lease Realty Fund III, LP       | 14,655,153    |
| Carlyle Realty Partners VII, LP        | 4,703,439     |
| Landmark Real Estate Partners, VII     | 4,108,196     |

**Externally Managed continued...**

|   |                          |
|---|--------------------------|
| <b>Alternative Investments</b>                |                          |
| Molpus Woodlands Group                        | 120,007,522              |
| Lake Superior Timberlands LLC                 |                          |
| IFM Global Infrastructure LP                  | 101,512,225              |
| Molpus Seven States LLC                       | 58,887,805               |
| Alinda Infrastructure Fund II                 | 54,492,129               |
| KKR & Co European Fund III                    | 50,737,741               |
| NGP Natural Resources X, LP                   | 38,493,411               |
| Hellman & Friedman Fund VII                   | 33,773,848               |
| Ft. Washington Fund VI                        | 33,055,512               |
| Hancock Bluegrass LLC - Oregon                | 28,902,342               |
| Riverstone/Carlyle E & P Fund IV              | 28,529,319               |
| J. P. Morgan Maritime Fund                    | 27,087,169               |
| Actis Global Fund IV                          | 25,329,873               |
| Chrysalis Venture Fund III                    | 19,476,691               |
| Riverstone E & P Fund V                       | 18,778,403               |
| KKR & Co Fund 2006                            | 18,397,645               |
| Stepstone Pioneer Capital Fund III, LP        | 18,094,401               |
| Oaktree European Principal Fund III           | 18,061,782               |
| Lexington Capital Partners Fund VII           | 17,533,892               |
| Landmark Equity Partners Fund XIV, LP         | 17,208,362               |
| APAX VIII, LP                                 | 15,037,735               |
| Audax Private Equity Fund IV, LP              | 14,947,109               |
| Ft. Washington Fund V                         | 13,479,197               |
| Audax Mezzanine Fund III                      | 13,245,014               |
| Oaktree Mezzanine Fund III                    | 11,908,903               |
| Carlyle Global Financial Services Partners II | 10,203,721               |
| Carlyle Europe Partners IV, LP                | 7,487,702                |
| Landmark Equity Partners Fund XV, LP          | 6,629,762                |
| Oaktree Mezzanine Fund IV                     | 5,753,759                |
| Ft. Washington Fund VIII                      | 4,569,146                |
| Lexington Capital Partners Fund VIII          | 3,940,531                |
| KKR & Co European Fund IV                     | 3,401,749                |
| NGP Natural Resources XI, LP                  | 2,077,283                |
| Public Pension Capital LLC                    | 1,756,764                |
| Gavea Investments Fund V, LP                  | 1,333,912                |
| CapitalSouth Partners Fund III                | 555,737                  |
| <b>Additional Categories</b>                  |                          |
| Fort Washington High Yield Bond Fund          | 299,669,960              |
| Marathon KTRS/Credit Fund LP                  | 272,347,137              |
| Shenkman Capital Management                   | 262,966,624              |
| Golub Capital Pearls 11, LLC                  | 125,730,280              |
| Babson Capital European Loan Fund             | 102,840,000              |
| Rogge Global International Fixed Income       | 89,500,325               |
| Avenue Special Situations Fund VI             | 74,228,248               |
| Marathon European Credit Opp Fund II          | 67,927,915               |
| Oaktree Opportunities IX, LP                  | 48,086,629               |
| Highbridge Principal Strategies III           | 44,742,440               |
| Oaktree European Dislocation Fund, LP         | 12,826,868               |
| AG Select Partners Advantage Fund             | 4,053,123                |
| <b>Subtotal</b>                               | <b>\$ 11,687,051,316</b> |
| <b>TOTAL ASSETS</b>                           | <b>\$ 17,893,996,378</b> |

\* Detailed information concerning the market values of all KTRS investments is available upon request.



**Investment Summary**  
**Fair Value – Retirement Annuity Trust\***  
**June 30, 2015**

| Type of Investment    | Fair Value 07/01/14      | Acquisitions             | Appreciation (Depreciation) | Sales Redemptions, Maturities & Paydowns | Fair Value 06/30/15      |
|-----------------------|--------------------------|--------------------------|-----------------------------|--|--------------------------|
| Cash Equivalents      | \$ 829,364,814           | \$ 3,935,054,978         | \$ -                        | \$ 4,120,767,700                         | \$ 643,652,091           |
| Fixed Income          | 3,329,133,881            | 2,101,712,586            | (41,430,930)                | 2,358,557,363                            | 3,030,858,174            |
| Real Estate           | 733,045,846              | 101,760,928              | 35,722,669                  | 45,194,097                               | 825,335,346              |
| Alternative           | 643,890,289              | 298,205,608              | 53,827,202                  | 151,235,005                              | 844,688,096              |
| Equities              | 11,266,188,790           | 3,250,052,524            | 443,499,691                 | 3,796,175,725                            | 11,163,565,280           |
| Additional Categories | 1,233,210,529            | 551,974,640              | (63,558,077)                | 335,729,700                              | 1,385,897,391            |
| <b>TOTAL</b>          | <b>\$ 18,034,834,149</b> | <b>\$ 10,238,761,264</b> | <b>\$ 428,060,555</b>       | <b>\$ 10,807,659,590</b>                 | <b>\$ 17,893,996,378</b> |

\* Includes Life Insurance Trust Values of \$87,963,949, Tax Shelter Annuity value of \$363,978, and 401(h) value of \$29,150,708.

**Contracted Investment Management Expenses**  
**Fiscal Year 2014-15**  
*(in thousands)*

| Investment Counselor Fees                    | Assets Under Management | Expense          | Basis Points <sup>(1)</sup> |
|--|-------------------------|------------------|-----------------------------|
| Equity Manager(s)                            | \$ 8,073,984            | \$ 15,597        | 19.3                        |
| Fixed Income Manager(s)                      | 921,126                 | 403              | 4.4                         |
| Real Estate                                  | 442,333                 | 5,863            | 132.5                       |
| Additional Categories                        | 1,404,920               | 8,043            | 57.2                        |
| Alternative Investments <sup>(2)</sup>       | \$844,688               | 11,479           | 135.9                       |
| <b>TOTAL</b>                                 | <b>\$ 11,687,051</b>    | <b>\$ 41,385</b> | <b>35.4</b>                 |
| <b>Administrative and Operation Expenses</b> |                         |                  |                             |
| Custodian Fees <sup>(3)</sup>                | \$ 17,894,548           | \$ 336           | 0.2                         |
| Consultant Fees                              |                         | 448              | 0.3                         |
| Legal & Research                             |                         | 84               | 0.0                         |
| Other Administrative and Operational         |                         | 2,474            | 1.5                         |
| <b>TOTAL</b>                                 | <b>\$ 17,894,548</b>    | <b>\$ 3,342</b>  | <b>2.0</b>                  |
| <b>GRAND TOTAL</b>                           |                         | <b>\$ 44,727</b> | <b>25.1</b>                 |

(1) - One basis point is one hundredth of one percent or the equivalent of .0001.

(2) - Private equity fees are either withheld from the Fund operations or paid by direct disbursement, depending on contract terms.

(3) - Includes J. Losey Scholarship Fund.

## INVESTMENT SECTION

### Schedule of Contracted and Administrative Investment Expenses Retirement Annuity Trust June 30, 2015

#### INVESTMENT COUNSELOR FEES

##### EQUITY MANAGERS

|                               |                      |
|-------------------------------|----------------------|
| Baillie Gifford               | \$ 3,083,458         |
| Baring Asset Management, Inc. | 2,463,293            |
| GE Asset Management           | 800,000              |
| Todd Asset Management LLC     | 1,377,639            |
| UBS Global Asset Management   | 4,529,001            |
| Wellington Management Company | 3,107,897            |
| Blackrock                     | 235,529              |
| <b>Total Equity Managers</b>  | <b>\$ 15,596,817</b> |

##### FIXED INCOME MANAGERS

|   |                   |
|---|-------------------|
| Fort Washington Investment Broad Market | 157,680           |
| Galliard Capital Mangement              | 245,252           |
| <b>Total Fixed Income Managers</b>      | <b>\$ 402,932</b> |

##### REAL ESTATE

|  |                     |
|--|---------------------|
| Prudential PRISA                           | 1,713,599           |
| Angelo Gordon Net Lease Fund III           | 312,555             |
| Blackstone Partners Fund VII, L.P.         | 704,405             |
| Carlyle Realty Partners Fund VI, L.P.      | 510,996             |
| Carlyle Realty Partners Fund VII, L.P.     | 700,000             |
| Landmark Real Estate Fund VII              | 620,879             |
| Rockwood Capital Real Estate Fund IX, L.P. | 685,026             |
| TA Realty Associates Fund X, L.P.          | 615,176             |
| <b>Total Real Estate Managers</b>          | <b>\$ 5,862,636</b> |

##### ADDITIONAL CATEGORIES

|   |                     |
|---|---------------------|
| Angelo Gordon Select Partners Advantage Fund    | 36,533              |
| Avenue Capital Special Situations Fund VI, L.P. | 438,216             |
| Babson European Capital                         | 258,264             |
| Fort Washington Investments High Yield          | 608,313             |
| Golub Capital - Pearls 11, LLC                  | 835,529             |
| Highbridge Principle Strategies Fund III, L.P.  | 560,862             |
| Marathon Credit Fund                            | 2,575,817           |
| Marathon European Credit Fund II                | 481,696             |
| Oaktree European Dislocation Fund, L.P.         | 144,331             |
| Oaktree Opportunities Fund IX, L.P.             | 800,000             |
| Rogge Global International Fund                 | 234,376             |
| Shenkman Capital                                | 1,069,394           |
| <b>Total Additional Category Managers</b>       | <b>\$ 8,043,331</b> |

##### ALTERNATIVE INVESTMENTS

|  |         |
|--|---------|
| Actis Global Fund IV, L.P.                     | 999,000 |
| Alinda Infrastructure Fund II, L.P.            | 638,983 |
| APAX Fund VIII, L.P.                           | 485,726 |
| Audax Mezzanine Fund III, L.P.                 | 303,581 |
| Audax Private Equity Fund IV, L.P.             | 0       |
| Capital South Fund III, L.P.                   | 0       |
| Carlyle Europe Parners IV, L.P.                | 35,154  |
| Carlyle Global Finacial Services Fund II, L.P. | 624,148 |
| Chrysalis Fund III, L.P.                       | 387,162 |
| Fort Washington Fund V, L.P.                   | 87,243  |
| Fort Washington Fund VI, L.P.                  | 222,300 |
| Fort Washington Fund VIII, L.P.                | 89,700  |
| Gavea V  | 300,000 |
| Hancock Bluegrass LLC Oregon                   | 234,111 |
| Hellman and Friedman Fund VII, L.P.            | 733,843 |
| IFM Global                                     | 147,480 |
| JP Morgan Maritime Fund , L.P.                 | 561,617 |
| KKR Fund 2006, L.P.                            | 33,555  |

##### ALTERNATIVE INVESTMENTS continued ...

|   |                      |
|---|----------------------|
| KKR European Fund III, L.P.                       | (216,530)            |
| KKR European Fund IV, L.P.                        | 137,271              |
| Landmark Equity Partners Fund XIV, L.P.           | 299,845              |
| Landmark Equity Partners Fund XV, L.P.            | 300,000              |
| Lexington Capital Partners Fund VII, L.P.         | 225,680              |
| Lexington Capital Partners Fund VIII, L.P.        | 522,719              |
| Molpus Lake Superior Michigan                     | 859,775              |
| Molpus Lake Superior Hiwassee                     | 64,734               |
| Molpus Seven States                               | 577,811              |
| NGP Natural Resources Fund X, L.P.                | 817,555              |
| NGP Natural Resources Fund XI, L.P.               | 8,090                |
| Oaktree European Principal Fund III, L.P.         | 343,776              |
| Oaktree Mezzanine Fund III, L.P.                  | 265,402              |
| Oaktree Mezzanine Fund IV, L.P.                   | 31,635               |
| Stepstone Partners Fund III, L.P.                 | 150,512              |
| Public Pension Capital                            | 857,363              |
| Riverstone/Carlyle Energy and Power Fund IV, L.P. | 127,654              |
| Riverstone Energy and Power Fund V, L.P.          | 221,925              |
| <b>Total Alternative Managers</b>                 | <b>\$ 11,478,820</b> |

#### ADMINISTRATIVE & OPERATIONAL EXPENSES

##### CUSTODIAN

|                             |                   |
|-----------------------------|-------------------|
| The Bank of New York Mellon | 335,800           |
| <b>Total Custodian Fees</b> | <b>\$ 335,800</b> |

##### CONSULTANT

|                              |                   |
|------------------------------|-------------------|
| Aon Hewitt                   | 358,850           |
| Bevis Longstreth             | 55,262            |
| George Philip                | 34,134            |
| <b>Total Consultant Fees</b> | <b>\$ 448,246</b> |

##### LEGAL & RESEARCH

|                                   |                  |
|-----------------------------------|------------------|
| Ice Miller                        | 84,131           |
| <b>Total Legal &amp; Research</b> | <b>\$ 84,131</b> |

##### OTHER

|  |                     |
|--|---------------------|
| Other Administrative and Operational (includes Personnel, Subscription services, etc...) | \$ 2,639,773        |
| <b>Total Other Expenses</b>  | <b>\$ 2,639,773</b> |

**TOTAL INVESTMENT EXPENSES** **\$ 44,892,486**

**Ten Largest Stock Holdings Ranked <sup>(1) (2)</sup>  
by Fair Value  
June 30, 2015**

| Rank | Description                 | Fair Value  | Percentage of Equities |
|------|-----------------------------|-------------|------------------------|
| 1    | Apple Inc                   | 221,037,732 | 2.627                  |
| 2    | JP Morgan Chase             | 107,408,273 | 1.276                  |
| 3    | Gilead Sciences             | 99,455,596  | 1.182                  |
| 4    | Allergan PLC                | 90,878,077  | 1.080                  |
| 5    | UnitedHealth Group          | 89,772,968  | 1.067                  |
| 6    | Amazon.com Inc              | 78,309,402  | 0.930                  |
| 7    | Home Depot Inc              | 72,689,133  | 0.864                  |
| 8    | Disney Walt Co (Holding Co) | 71,443,878  | 0.849                  |
| 9    | Pepsico Inc                 | 66,287,174  | 0.787                  |
| 10   | Wells Fargo & Co            | 64,633,314  | 0.768                  |

**Top Ten Fixed Income Holdings <sup>(2)</sup>  
by Fair Value  
June 30, 2015**

| Rank | Description        | Maturity   | Coupon | Par Value  | Fair Value | Percent of Fixed Income |
|------|--------------------|------------|--------|------------|------------|-------------------------|
| 1    | U S Treasury       | 11/15/2017 | 0.880  | 65,370,000 | 65,492,896 | 2.161                   |
| 2    | U S Treasury       | 10/15/2016 | 0.630  | 50,000,000 | 50,133,000 | 1.654                   |
| 3    | U S Treasury       | 2/15/2025  | 2.000  | 48,000,000 | 46,634,880 | 1.539                   |
| 4    | U S Treasury       | 6/30/2019  | 1.630  | 45,000,000 | 45,425,250 | 1.499                   |
| 5    | U S Treasury Bonds | 8/15/2023  | 6.250  | 31,900,000 | 41,636,837 | 1.374                   |
| 6    | U S Treasury       | 4/30/2018  | 0.630  | 41,290,000 | 40,919,216 | 1.350                   |
| 7    | U S Treasury       | 5/15/2024  | 2.500  | 31,000,000 | 31,530,410 | 1.040                   |
| 8    | U S Treasury Bonds | 8/15/2029  | 6.130  | 22,000,000 | 31,130,000 | 1.027                   |
| 9    | U S Treasury       | 11/30/2019 | 1.500  | 30,000,000 | 30,004,800 | 0.990                   |
| 10   | U S Treasury       | 7/31/2019  | 1.630  | 28,800,000 | 29,045,376 | 0.958                   |

(1) Includes only actively managed separate accounts.

(2) Detailed information concerning these values along with book values and cost of all KTRS investments is available upon request.

Transaction Commissions Fiscal Year 2014-2015

| COMPANIES                       | SHARES<br>TRADED | COMMISSIONS  | COMMISSION<br>PER SHARE | % OF<br>TOTAL |
|---------------------------------|------------------|--------------|-------------------------|---------------|
| Abel Noser                      | 4,995,835.00     | \$ 46,642.85 | \$ 0.009                | 2.23 %        |
| Academy Securities, Inc.        | 20,240.00        | 708.42       | 0.035                   | 0.03          |
| Allen & Co                      | 33,300.00        | 1,577.80     | 0.047                   | 0.08          |
| Avondale Partners, LLC          | 4,845.00         | 3,844.28     | 0.793                   | 0.18          |
| B. Riley & Co. LLC              | 30,541.00        | 1,147.95     | 0.038                   | 0.05          |
| Barclays                        | 607,962.00       | 21,300.03    | 0.035                   | 1.02          |
| Bass / Baypoint Trading         | 13,030.00        | 458.39       | 0.035                   | 0.02          |
| BB & T Capital Markets          | 25,868.00        | 905.39       | 0.035                   | 0.04          |
| Blair, William & Co             | 68,570.00        | 8,346.04     | 0.122                   | 0.40          |
| BMO Capital Markets             | 94,179.00        | 3,553.20     | 0.038                   | 0.17          |
| BNP Paribas Securities Bond     | 1,650.00         | 57.75        | 0.035                   | 0.00          |
| BNY Brokerage                   | 13,441.00        | 592.47       | 0.044                   | 0.03          |
| Brean Murray, Carret & Co., LLC | 34,186.00        | 1,196.53     | 0.035                   | 0.06          |
| BTIG                            | 173,886.00       | 6,394.34     | 0.037                   | 0.31          |
| Burke & Quick Partners LLC      | 1,082.00         | 37.87        | 0.035                   | 0.00          |
| Canaccord Genuity, Inc.         | 142,255.00       | 5,721.25     | 0.040                   | 0.27          |
| Cantor Fitzgerald & Co          | 26,362.00        | 1,021.80     | 0.039                   | 0.05          |
| CIBC Worldmarket                | 41,572.00        | 10,495.06    | 0.252                   | 0.50          |
| Citigroup Global                | 284,133.00       | 7,434.24     | 0.026                   | 0.36          |
| ConvergEx - Algos               | 36,637,262.00    | 186,809.75   | 0.005                   | 8.94          |
| ConvergEx - FS                  | 2,007,580.00     | 21,876.80    | 0.011                   | 1.05          |
| ConvergEx ADR Conversions       | 4,957,873.00     | 109,878.32   | 0.022                   | 5.26          |
| Cornerstone                     | 775,490.00       | 22,149.70    | 0.029                   | 1.06          |
| Cowen & Co                      | 149,511.00       | 8,789.61     | 0.059                   | 0.42          |
| Credit Agricole Securities      | 175,298.00       | 6,148.69     | 0.035                   | 0.29          |
| Credit Research & Trading LLC   | 11,320.00        | 396.21       | 0.035                   | 0.02          |
| Credit Suisse Sec. LLC          | 2,430,284.00     | 70,061.33    | 0.029                   | 3.35          |
| Cuttone & Co Inc                | 5,225.00         | 182.88       | 0.035                   | 0.01          |
| Deutsche Bank                   | 432,388.00       | 12,438.50    | 0.029                   | 0.60          |
| Drexel Hamilton LLC             | 25,464.00        | 891.30       | 0.035                   | 0.04          |
| Evercore Group LLC              | 3,560.00         | 92.60        | 0.026                   | 0.00          |
| Fidelity Capital Markets        | 2,670.00         | 93.45        | 0.035                   | 0.00          |
| First Kentucky Securities Corp  | 382,880.00       | 11,486.40    | 0.030                   | 0.55          |
| Freidman Billings               | 59,216.00        | 14,469.64    | 0.244                   | 0.69          |
| Goldman Sachs                   | 1,824,240.00     | 80,420.44    | 0.044                   | 3.85          |
| Instinet                        | 137,248.00       | 1,623.83     | 0.012                   | 0.08          |
| Investment Tech Grp Transition  | 20,324,639.00    | 195,971.40   | 0.010                   | 9.38          |
| Investment Technology Grp       | 19,095,084.00    | 208,528.36   | 0.011                   | 9.98          |
| ISI Group                       | 2,063,441.00     | 59,263.09    | 0.029                   | 2.84          |
| J.J.B. Hilliard, W.L. Lyons     | 1,788,002.00     | 53,640.06    | 0.030                   | 2.57          |
| Janney Montgomery Scott Inc     | 92,839.00        | 3,232.38     | 0.035                   | 0.15          |
| Jefferies & Co.                 | 309,307.00       | 7,217.68     | 0.023                   | 0.35          |
| Jones & Associates              | 45,083.00        | 1,658.22     | 0.037                   | 0.08          |
| JP Morgan & Chase               | 421,370.00       | 12,362.03    | 0.029                   | 0.59          |
| Keefe Bruyette & Woods          | 80,204.00        | 3,212.42     | 0.040                   | 0.15          |
| Keybank Capital                 | 46,225.00        | 1,608.74     | 0.035                   | 0.08          |
| King, CL, & Associates, Inc.    | 17,800.00        | 558.99       | 0.031                   | 0.03          |
| Knight Equity Markets           | 101,641.00       | 3,221.78     | 0.032                   | 0.15          |
| Leerink Swann & Co.             | 21,404.00        | 800.46       | 0.037                   | 0.04          |
| Lexington Investment Co.        | 169,670.00       | 5,090.10     | 0.030                   | 0.24          |
| Liquidnet Inc - Transition      | 18,294,256.00    | 137,207.21   | 0.008                   | 6.57          |
| Liquidnet Inc                   | 12,624,819.00    | 124,086.29   | 0.010                   | 5.94          |
| Loop Capital Markets, LLC       | 8,685.00         | 86.85        | 0.010                   | 0.00          |
| MacQuarie Securities Inc        | 54,230.00        | 2,044.04     | 0.038                   | 0.10          |
| Merrill Lynch ADR Conversions   | 678,382.00       | 20,351.46    | 0.030                   | 0.97          |
| Merrill Lynch                   | 3,077,006.00     | 89,877.50    | 0.029                   | 4.30          |
| Merrill Lynch, Pierce, Fenner   | 13,573.00        | 475.07       | 0.035                   | 0.02          |

Transaction Commissions continued . . .

| COMPANIES                               | SHARES<br>TRADED      | COMMISSIONS            | COMMISSION<br>PER SHARE | % OF<br>TOTAL |
|---|-----------------------|------------------------|-------------------------|---------------|
| Mizuho Securities, USA                  | 11,837.00             | 414.31                 | 0.035                   | 0.02          |
| MKM Partners                            | 29,530.00             | 1,049.02               | 0.036                   | 0.05          |
| Morgan Stanley Smith Barney-Huntington  | 920,400.00            | 26,971.50              | 0.029                   | 1.29          |
| Morgan Stanley Smith Barney-Louisville  | 1,381,800.00          | 41,454.00              | 0.030                   | 1.98          |
| Morgan Stanley Smith Barney-Northern KY | 1,386,485.00          | 41,594.55              | 0.030                   | 1.99          |
| Morgan Stanley                          | 452,102.00            | 23,148.91              | 0.051                   | 1.11          |
| Pacific Crest Securities                | 9,030.00              | 316.05                 | 0.035                   | 0.02          |
| Pershing LLC                            | 227,133.00            | 7,875.21               | 0.035                   | 0.38          |
| Piper Jaffray                           | 113,828.00            | 4,353.22               | 0.038                   | 0.21          |
| Pulse Trading                           | 105,920.00            | 1,059.20               | 0.010                   | 0.05          |
| R W Baird                               | 238,998.00            | 8,218.70               | 0.034                   | 0.39          |
| Raymond James & Assoc                   | 3,106,220.00          | 94,096.02              | 0.030                   | 4.50          |
| RBC Capital Markets                     | 147,813.00            | 9,112.27               | 0.062                   | 0.44          |
| Rosenblatt Securities LLC               | 1,865.00              | 65.28                  | 0.035                   | 0.00          |
| Ross Sinclair & Assoc                   | 164,930.00            | 4,947.90               | 0.030                   | 0.24          |
| Royal Bank of Scotland RBS              | 2,511.00              | 113.00                 | 0.045                   | 0.01          |
| Sandler O'Neill                         | 23,200.00             | 14,407.20              | 0.621                   | 0.69          |
| Sanford C Bernstein                     | 482,035.00            | 18,760.00              | 0.039                   | 0.90          |
| Scotia Capital, USA                     | 60,359.00             | 2,112.59               | 0.035                   | 0.10          |
| Sidoti & Company LLC                    | 4,780.00              | 167.30                 | 0.035                   | 0.01          |
| Simmons & Co                            | 6,160.00              | 215.60                 | 0.035                   | 0.01          |
| State Street Global                     | 1,500.00              | 60.50                  | 0.040                   | 0.00          |
| Stephens Inc.                           | 126,150.00            | 14,062.31              | 0.111                   | 0.67          |
| Sterne, Agee & Leach                    | 1,525.00              | 53.38                  | 0.035                   | 0.00          |
| Stifel, Nicolaus & Co                   | 1,350,647.00          | 40,964.09              | 0.030                   | 1.96          |
| Stifel, Nicolaus & Co-Louisville        | 192,910.00            | 5,787.30               | 0.030                   | 0.28          |
| Suntrust Robinson                       | 77,151.00             | 8,968.92               | 0.116                   | 0.43          |
| Susquehanna Brokerage                   | 4,320.00              | 151.20                 | 0.035                   | 0.01          |
| Telsey Advisory Group LLC               | 72,032.00             | 2,521.18               | 0.035                   | 0.12          |
| UBS/Paine Webber Securities             | 328,071.00            | 9,109.65               | 0.028                   | 0.44          |
| UBS/Paine Webber-Louisville             | 862,960.00            | 25,888.80              | 0.030                   | 1.24          |
| Wedbush Morgan Securities               | 1,350.00              | 47.25                  | 0.035                   | 0.00          |
| Weeden & Co                             | 2,187,579.00          | 66,686.97              | 0.030                   | 3.19          |
| Wells Fargo Securities, LLC             | 249,896.00            | 13,845.94              | 0.055                   | 0.66          |
| Wunderlich Securities Inc               | 16,200.00             | 567.02                 | 0.035                   | 0.03          |
| Zacks & Company                         | 2,900.00              | 101.50                 | 0.035                   | 0.00          |
| <b>TOTAL</b>                            | <b>150,310,233.00</b> | <b>\$ 2,089,007.08</b> | <b>\$ 0.014</b>         | <b>100%</b>   |

The acquisition of initial public offerings (IPOs) represented a portion of small capitalization stock purchases. IPOs usually have a high commission rate; however, the security issuers and not the investors pay the commissions. In 2014-15, the retirement annuity trust fund bought small capitalization IPOs that generated \$192,743 in commissions. Although these commissions were not paid by the retirement system, they resulted from the retirement annuity trust fund's investment activities and are included in the total commissions of \$2,089,007. Typical stock transactions occur at lower commission rates than IPO transactions, frequently \$.03 per share or less. Investment companies usually provide investment research for brokerage clients.

### PROXY VOTING AND CORPORATE BEHAVIOR

The System regularly votes proxy statements associated with its equity ownership. The positions assumed by the System are intended to represent the financial interests of the membership. The Board of Trustees has adopted a policy that directs the staff not to subjugate the financial concerns of the System to social or political protests. At the same time, the System expects the companies in which it acquires stock to be solid corporate citizens that abide by federal, state, and local laws. The Board has adopted the following position on corporate behavior:

The Board's stated fiduciary duty is to obtain the highest return for the Fund commensurate with acceptable levels of risk. This implies that non-financial considerations cannot take precedence to pure risk/return considerations in the evaluation of investment decisions. However, action taken by the Fund as a shareowner can be instrumental in encouraging action as a responsible corporate citizen by the companies in which the Fund has invested.

The Board expects the managements of the companies whose equity securities are held in the Fund's portfolio to conduct themselves with propriety and with a view toward social considerations. A level of performance above minimum adherence to the law is generally expected. If any improper practices come into being, the Board expects corporate management to move decisively to eliminate them and effect adequate controls to prevent recurrence.

On the other hand, the Board does not intend to supplant the duties which are the responsibility of federal or state regulatory agencies, such as the Equal Employment Opportunity Commission, the Environmental Protection Agency, the Occupational Safety and Health Agency, the Nuclear Regulatory Commission, the Securities and Exchange Commission, and others which are covered by the laws of the United States Government or the State of Kentucky.

Should satisfaction of the Board's criteria by any company not be adequate, the Board will consider what action to take, which may include, but not be limited to, correspondence with the company, meetings with company officials, sponsoring of shareholder resolutions or, as a last resort, liquidation of the System's holdings in the company, if the sale is consistent with sound investment policy.

### SECURITY LENDING

The System operates a security lending program in which it temporarily lends securities to qualified agents in exchange for a net fee and high quality collateral. U.S. Government and agency securities and select stocks and bonds are the types of securities loaned. The System's custodian, The Bank of New York Mellon, acts as lending agent in exchanging securities for collateral. The collateral, at the time of the loan, has a value of not less than 102% of the market value of the lent securities plus any accrued, unpaid distributions. The collateral consists of cash, marketable U.S. Government securities, and selected marketable U.S. Government agency securities approved by the System.

Cash collateral is invested in short term obligations fully guaranteed by the United States Government or select Government agencies and Government Repurchase Agreements with qualified agents. The System cannot pledge or sell collateral securities unless the borrower defaults. The lending agent also indemnifies the System from any financial loss associated with a borrower's default and collateral inadequacy. The weighted average maturity of cash collateral investments is typically two days. The System has no credit risk exposure to borrowers, since the amounts the System owes borrowers exceeds the amounts the borrowers owe the System.

Security lending programs can entail considerable interest rate risk and credit risk. The System has structured its program to minimize these two main categories of risk. The interest rate risk is managed, as mentioned above, by limiting the term of cash collateral investments to several days. The credit risk is controlled by investing cash collateral in securities with qualities similar to the creditworthiness of lent securities.

### KENTUCKY INVESTMENTS

The retirement system is always cognizant of its significant role in the Commonwealth's economy. Over \$1.7 billion in benefits are distributed to members and annuitants living in Kentucky annually. Approximately \$300 million of the retirement annuity trust fund's investments directly impact the Commonwealth. These investments include: commercial real estate; bonds issued by public agencies of the Commonwealth and those of local municipalities; pools of single-family mortgages in Kentucky; financing for multi-family housing, and; investments in companies which have an impact on the Commonwealth's economy but receive earnings from global operations. Fiduciary duty requires that investments be made solely for the benefit of the retirement system's members and annuitants. Investments which benefit the Commonwealth's economy are made only when fully consistent with this fiduciary duty.

PROFESSIONAL SERVICE PROVIDERS

**Investment Consultant**

Aon Hewitt

**Investment Custodian**

The Bank of New York Mellon

**Fixed Income Managers**

Galliard Capital Management  
Ft. Washington Investment Advisors

**Domestic Equity Managers**

Todd Asset Management LLC  
UBS Global Asset Management  
Wellington Management Company  
GE Asset Management

**International Equity Managers**

Todd Asset Management LLC  
UBS Global Asset Management  
Baring Asset Management, Inc.  
Baillie Gifford  
BlackRock Institutional Trust Company

**Real Estate Managers**

Prudential Real Estate Investors  
Carlyle Realty Partners  
Blackstone Real Estate Partners  
Rockwood Capital Real Estate  
TA Associates Realty  
Angelo Gordon & Co.  
Landmark Real Estate Partners

**Alternative Investment Managers**

Molpus Woodlands Group  
Hancock Natural Resources Group  
Kohlberg Kravis Roberts & Co.  
Chrysalis Ventures  
Ft. Washington Private Equity Investors  
Alinda Capital Partners, LLC  
Riverstone Holdings, LLC  
CapitalSouth Partners  
Landmark Partners  
Lexington Partners  
Oaktree Capital Management  
Stepstone Pioneer Capital  
Audax Group  
J.P. Morgan Asset Management  
Hellman & Friedman Capital Partners  
Natural Gas Partners  
Apax Partners  
Actis LLP  
Carlyle Global Partners  
Public Pension Capital  
IFM Investors  
Gavea Investimentos

**Additional Categories Investment Managers**

Avenue Capital Group  
Marathon Asset Management  
Ft. Washington Investment Advisors  
Oaktree Capital Management  
Shenkman Capital Management, Inc  
Rogge Global Partners  
Highbridge Principal Strategies, LLC  
Angelo Gordon & Co.  
Golub Capital  
Babson Capital Management

**Attorney**

Ice Miller LLP

### HEALTH INSURANCE TRUST FUND

#### INVESTMENT POLICY SUMMARY

The statute that created the health insurance trust fund on July 1, 2010, KRS 161.677, obliges the Board to "manage the assets of the fund in the same general manner in which it administers the retirement funds, except that the asset allocation may differ and separate accounting and financial reporting shall be maintained for the trust fund." KRS 161.430, which governs the investment of funds for the retirement funds, requires that members' assets be managed in a manner consistent with fiduciary standards set forth in the "prudent person rule." Subject to this statute, administrative regulation 102 KAR 1:178 establishes investment policies for the health insurance trust fund. This regulation requires the Board and Investment Committee to prudently diversify assets and to consider the fund's "liquidity and its capability of meeting both short and long-term obligations" in setting asset allocation policy.

Due to an imbalance of required distributions over contributions early in the fund's existence, liquidity needs have dominated investment policy. This will evolve as contribution rate increases provided in statute improve cash flow in future years. As near-term liquidity needs recede in importance, the focus will increasingly be on establishing an investment policy which achieves the required rate of return and matches the health insurance liability.

#### INVESTMENT OBJECTIVES

The definitive objective of the health insurance trust fund is to provide for beneficiaries' health insurance benefit obligations, both short and long-term. In support of this objective, investment policy will be designed, on an ongoing basis, to: (1) meet all liquidity needs, (2) achieve the actuarially assumed 8.0% rate of return over the long-term, and (3) do so within appropriate risk levels.

#### RISK CONTROLS

Any investment program faces various risks; as with the retirement funds, the primary risk is that the assets will not support liabilities over the long-term. Risk control measures for the health insurance trust fund mirror those of the retirement annuity trust fund, but are customized to reflect the fund's unique liability. Primary risk control measures include the following steps:

- Actuarial valuations are performed each year to evaluate the funding objectives of the health insurance trust fund. Every ten years an external audit of the actuary is conducted to ensure that the assumptions made and calculation methods used are resulting in properly computed liabilities of the fund.
- Asset/liability studies are conducted approximately every five years. These studies ensure that the portfolio design is structured to meet the liabilities of the fund.
- In accordance with administrative regulation 102 KAR 1:178, which governs investment policies for the fund, the KTRS Investment Committee adopts and regularly reviews an asset allocation policy designed to meet the fund's needs.



ASSET ALLOCATION

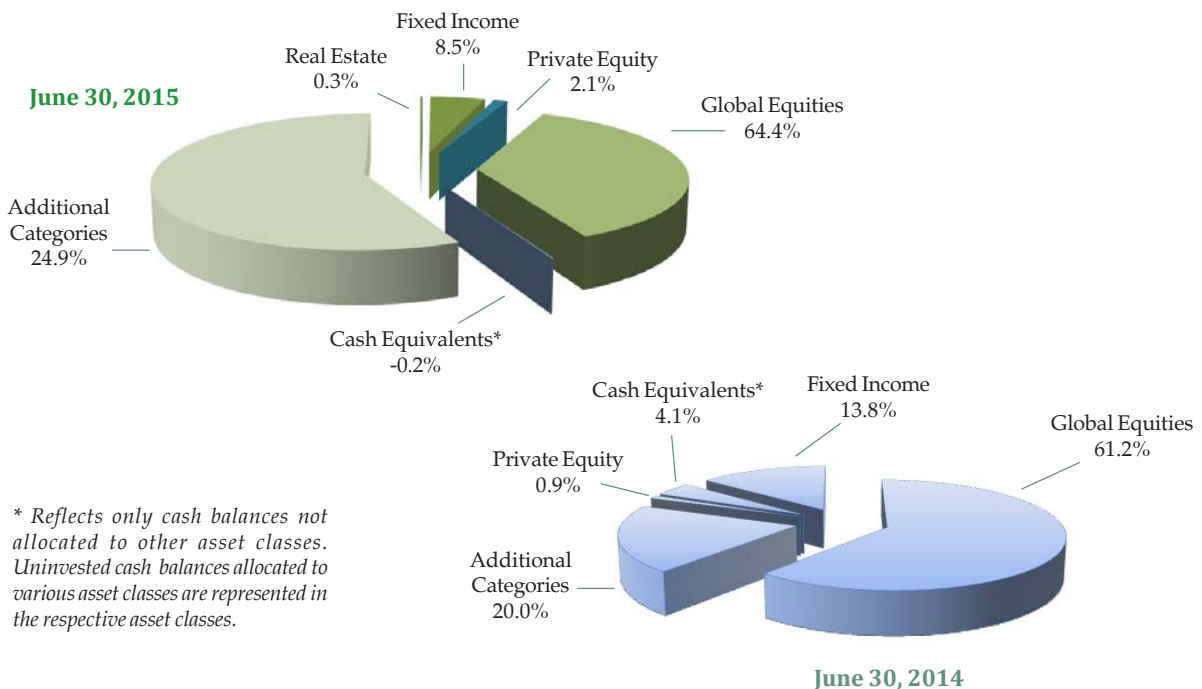
As of June 30, 2015, the health insurance trust fund had approximately \$552.9 million in total assets. This included \$47 million in short-term high quality bonds for liquidity purposes. This trust fund also had \$65.1 million in high yield bonds, \$355.7 million in a global stock index fund, \$11.3 million in private equity investments, \$28.8 million in bank loan investments, and \$43.7 million in an alternative credit funds, and \$1.2 million in real estate funds.

Asset allocation will be adjusted annually by the Investment Committee to reflect changing liquidity needs and actuarial funding status. Due to upcoming contribution rate increases enacted in statute, liquidity needs are expected to decline in coming years while funding status improves. The information below shows the health insurance trust fund's asset allocation by fair value as of June 30, 2015 and June 30, 2014.

| Health Insurance Trust |                              |                     |                              |                     |
|------------------------|------------------------------|---------------------|------------------------------|---------------------|
|                        | June 30,2015                 | %                   | June 30,2014                 | %                   |
| Cash Equivalents*      | \$ -1,034,005                | -0.2                | \$ 20,149,704                | 4.1                 |
| Fixed Income           | 47,019,105                   | 8.5                 | 67,647,915                   | 13.8                |
| Global Equities        | 355,702,555                  | 64.4                | 300,857,011                  | 61.2                |
| Real Estate            | 1,762,328                    | 0.3                 | -                            | 0.0                 |
| Additional Categories  | 137,798,860                  | 24.9                | 99,027,356                   | 20.0                |
| Private Equity         | 11,698,357                   | 2.1                 | 4,251,239                    | 0.9                 |
| <b>TOTALS</b>          | <b><u>\$ 552,947,200</u></b> | <b><u>100.0</u></b> | <b><u>\$ 491,933,225</u></b> | <b><u>100.0</u></b> |

\* Reflects only cash balances not allocated to other asset classes. Uninvested cash balances allocated to various asset classes are represented in the respective asset classes.

Distribution of Investments Health Insurance Trust Fair Values



HEALTH INSURANCE TRUST

PORTFOLIO RETURNS

For the fiscal year, the health insurance trust fund's portfolio returned 1.48%. The fund's global equities returned 1.36% versus .81% for the MSCI All country World IMI Index. A short-term bond fund held for liquidity purposes returned 0.96%. A high yield bond fund returned .55% versus -.55% for its benchmark.

Due to a necessary focus on liquidity needs early in the fund's existence and rapidly evolving asset allocation as its funding mechanism is implemented, no policy benchmark has yet been established. Returns were generated by the Segal Rogers Casey performance reporting system using a time-weighted rate of return calculation based upon market values.

|  | <u>1 Yr<sup>(1)</sup></u> | <u>3 Yr<sup>(1)</sup></u> | <u>5 Yr<sup>(1)</sup></u> | <u>10 Yr<sup>(1)</sup></u> | <u>20 Yr<sup>(1)</sup></u> |
|--|---------------------------|---------------------------|---------------------------|----------------------------|----------------------------|
| <b>Total Fund</b>                            |                           |                           |                           |                            |                            |
| KTRS Health Insurance Trust                  | 1.5                       | 8.9                       | -                         | -                          | -                          |
| <b>Equities</b>                              |                           |                           |                           |                            |                            |
| Global Equities                              | 1.4                       | 13.9                      | -                         | -                          | -                          |
| MSCIAC World IMI                             | 0.8                       | 13.3                      | -                         | -                          | -                          |
| <b>Fixed Income</b>                          |                           |                           |                           |                            |                            |
| Internal Bond Fund                           | 1.0                       | 0.6                       | -                         | -                          | -                          |
| 90 Day Treasury Bill                         | 0.0                       | 0.1                       | -                         | -                          | -                          |
| <b>Alternative Investments</b>               |                           |                           |                           |                            |                            |
| Private Equity <sup>(2)</sup>                | 13.6                      | 23.3                      | -                         | -                          | -                          |
| <b>Additional Categories</b>                 |                           |                           |                           |                            |                            |
| <b>High Yield</b>                            |                           |                           |                           |                            |                            |
| High Yield Bond Fund                         | 0.6                       | 6.7                       | -                         | -                          | -                          |
| KTRS Credit Fund                             | -2.3                      | -                         | -                         | -                          | -                          |
| B of A Merrill Lynch<br>High Yield Master II | -0.6                      | 6.8                       |                           |                            |                            |
| <b>Alternative Credit</b>                    |                           |                           |                           |                            |                            |
| Shenkman Capital Management                  | 2.4                       | -                         | -                         | -                          | -                          |
| Highbridge Principal Strategies              | 11.0                      | -                         | -                         | -                          | -                          |
| Marathon European Credit Opportunities       | 5.3                       | -                         | -                         | -                          | -                          |
| S & P LSTA Leverage Loan Index               | 1.8                       | -                         |                           |                            |                            |
| <b>Real Estate</b>                           |                           |                           |                           |                            |                            |
| Non-Core Real Estate                         | -32.4                     | -                         | -                         | -                          | -                          |
| NCREIF Index                                 | 13.0                      | -                         |                           |                            |                            |
| <b>Cash</b>                                  |                           |                           |                           |                            |                            |
| Cash(Unallocated)                            | 0.1                       | 0.1                       |                           |                            |                            |
| 90 Day Treasury Bill                         | 0.0                       | 0.1                       |                           |                            |                            |

(1) Annualized.

(2) For a period of five years private equity investments will be benchmarked against their own returns. The primary reason for this is that these investments have a minimum investment horizon of ten years and there is no market benchmark that would be expected to track these types of assets in their early years. Beginning five years after the first capital call, investments in this class shall be benchmarked versus the S & P 500 plus 3%, which is the System's long-term expected return for this asset class.

SCHEDULE OF INVESTMENT RETURNS - HEALTH INSURANCE TRUST

|      |   |        |
|------|---|--------|
| 2015 | Annual Rate of Return Net of Investment Expense | 1.38%  |
| 2014 | Annual Rate of Return Net of Investment Expense | 15.38% |

**HEALTH INSURANCE TRUST**  
**PORTFOLIOS**  
**FAIR VALUES \***  
**June 30, 2015**

**Internally Managed**

|                                     |                      |
|-------------------------------------|----------------------|
| <b>Cash Equivalents</b>             |                      |
| Cash Collections Fund (Unallocated) | \$ (1,034,005)       |
| <b>Fixed Income</b>                 |                      |
| Internal Bond Fund                  | 47,019,105           |
| <b>Subtotal</b>                     | <b>\$ 45,985,100</b> |

**Externally Managed**

|                                      |                       |
|--------------------------------------|-----------------------|
| <b>Global Equities</b>               |                       |
| BlackRock Fund B                     | 355,702,555           |
| <b>Alternative Investments</b>       |                       |
| Ft. Washington Fund VII              | 3,194,928             |
| Actis Global Fund IV                 | 2,532,587             |
| Carlyle Europe Fund IV               | 1,497,542             |
| Ft. Washington Fund VIII             | 1,305,470             |
| Landmark Equity XV                   | 1,104,964             |
| Ft. Washington PE Opp III            | 967,060               |
| KKR European Fund IV                 | 680,350               |
| NGP Natural Resources XI             | 415,456               |
| <b>Additional Categories</b>         |                       |
| Fort Washington High Yield Bond Fund | 65,150,105            |
| Marathon/KTRS Credit Fund            | 34,819,185            |
| Shenkman Capital Management          | 28,826,798            |
| Marathon European Credit Opp Fund II | 4,528,528             |
| Highbridge Principal Strategies III  | 4,474,244             |
| <b>Real Estate</b>                   |                       |
| Carlyle Realty VII                   | 940,688               |
| Landmark Real Estate VII             | 821,640               |
| <b>Subtotal</b>                      | <b>\$ 506,962,100</b> |
| <b>TOTAL ASSETS</b>                  | <b>\$ 552,947,200</b> |

\* Detailed information concerning the market values of all KTRS investments is available upon request.

**Investment Summary**  
**Fair Value – Medical Insurance Trust**  
**June 30, 2015**

| Type of Investment    | Fair Value<br>06/30/14 | Acquisitions          | Appreciation<br>(Depreciation) | Sales<br>Redemptions,<br>Maturities &<br>Paydowns | Fair Value<br>06/30/15 |
|-----------------------|------------------------|-----------------------|--------------------------------|---|------------------------|
| Cash Equivalents      | \$ 71,133,632          | \$ 161,236,133        | \$ -                           | \$ 225,908,627                                    | \$ 6,461,138           |
| Fixed Income          | 21,234,589             | 47,584,313            | (278,412)                      | 25,794,026  | 42,746,464             |
| Real Estate           | -                      | 2,430,795             | 227,808                        | 896,275   | 1,762,328              |
| Equities              | 300,857,011            | 50,001,212            | 4,844,331                      | -   | 355,702,555            |
| Alternative           | 4,251,239              | 7,940,611             | 774,374                        | 1,267,867   | 11,698,357             |
| Additional Categories | 94,456,754             | 82,629,225            | (4,784,606)                    | 37,725,014  | 134,576,358            |
| <b>TOTAL</b>          | <b>\$ 491,933,225</b>  | <b>\$ 351,822,289</b> | <b>\$ 783,495</b>              | <b>\$ 291,591,809</b>                             | <b>\$ 552,947,200</b>  |

## INVESTMENT SECTION

### Health Insurance Trust Fund Contracted Investment Management Expenses Fiscal Year 2014-15 *(in thousands)*

| <u>Investment Counselor Fees</u>       | <u>Assets Under Management</u> | <u>Expense</u>  | <u>Basis Points <sup>(1)</sup></u> |
|--|--------------------------------|-----------------|------------------------------------|
| Equity Manager(s)                      | \$ 355,703                     | \$ 187          |                                    |
| Fixed Income Manager(s)                | -                              | -               |                                    |
| Real Estate <sup>(2)</sup>             | 1,762                          | 264             |                                    |
| Additional Categories                  | 137,799                        | 519             |                                    |
| Alternative Investments <sup>(3)</sup> | 11,698                         | 299             |                                    |
| <b>TOTAL</b>                           | <b>\$ 506,962</b>              | <b>\$ 1,269</b> | <b>25.0</b>                        |
| <b>Other Investment Services</b>       |                                |                 |                                    |
| Custodian Fees                         | 552,947                        | \$ 8            | 0.1                                |
| Consultant Fees                        |                                | -               | 0.0                                |
| Legal & Research                       |                                | -               | 0.0                                |
| Other Administrative and Operational   |                                | 53              | 1.0                                |
| <b>TOTAL</b>                           | <b>\$ 552,947</b>              | <b>\$ 61</b>    | <b>1.2</b>                         |
| <b>GRAND TOTAL</b>                     |                                | <b>\$ 1,330</b> | <b>24.1</b>                        |

1 - One basis point is one hundredth of one percent or the equivalent of .0001.

2 - Accrual of fees payable as of June 30, 2015.

3 - Private equity fees are either withheld from the Fund operations or paid by direct disbursement, depending on contract terms.

### Schedule of Contracted and Administrative Investment Expenses Health Insurance Trust Fund June 30, 2015

#### INVESTMENT COUNSELOR FEES

##### EQUITY MANAGERS

|                              |                   |
|------------------------------|-------------------|
| BlackRock                    | 187,274           |
| <b>Total Equity Managers</b> | <b>\$ 187,274</b> |

##### REAL ESTATE

|                          |                   |
|--------------------------|-------------------|
| Carlyle VII              | 140,000           |
| Landmark VII             | 124,176           |
| <b>Total Real Estate</b> | <b>\$ 264,176</b> |

##### ADDITIONAL CATEGORIES

|  |                   |
|--|-------------------|
| Highbridge Principal Strategies Fund III, L.P. | 56,088            |
| Fort Washington Investments High Yield         | 128,982           |
| Marathon Credit Fund                           | 189,343           |
| Marathon European Credit Fund II               | 32,113            |
| Shenkman Capital                               | 112,452           |
| <b>Total Additional Category Managers</b>      | <b>\$ 518,978</b> |

##### ALTERNATIVE INVESTMENTS

|  |                   |
|--|-------------------|
| Actis Global Fund IV, L.P.               | 100,000           |
| Fort Washington Private Equity III, L.P. | 43,125            |
| Fort Washington Fund VII, L.P.           | 37,500            |
| Fort Washington Fund VIII, L.P.          | 39,660            |
| KKR European IV, L.P.                    | 27,454            |
| Landmark Fund XV, L.P.                   | 50,000            |
| NGP Natural Resources XI, L.P.           | 1,618             |
| <b>Total Alternative Managers</b>        | <b>\$ 299,357</b> |

#### ADMINISTRATIVE AND OPERATIONAL EXPENSES

##### CUSTODIAN

|                             |                 |
|-----------------------------|-----------------|
| The Bank of New York Mellon | 8,263           |
| <b>Total Custodian</b>      | <b>\$ 8,263</b> |

##### LEGAL & RESEARCH

|                                   |             |
|-----------------------------------|-------------|
| Ice Miller                        | -           |
| <b>Total Legal &amp; Research</b> | <b>\$ -</b> |

##### OTHER

|  |                  |
|--|------------------|
| Other Administrative and Operational (includes Personnel, Subscription services, etc...) | 52,536           |
| <b>Total Other</b>   | <b>\$ 52,536</b> |

**TOTAL INVESTMENT EXPENSES** **\$ 1,330,584**

**HEALTH INSURANCE TRUST PROFESSIONAL SERVICE PROVIDERS**

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**Investment Consultant**

AON Hewitt

**Investment Custodian**

The Bank of New York Mellon

**Additional Categories Managers**

Ft. Washington Investment Advisors  
Shenkman Capital Management, Inc.  
Highbridge Principal Strategies, LLC  
Marathon Asset Management

**Global Equity Manager**

BlackRock Institutional Trust Company

**Alternative Investment Managers**

Ft. Washington Private Equity Investors  
Actis LLP  
Landmark Partners  
Kohlberg Kravis Roberts & Co.  
Natural Gas Partners  
Carlyle Global Partners

**Real Estate**

Carlyle Realty Partners  
Landmark Real Estate Partners

**Attorney**

Ice Miller LLP

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