CIO INVESTMENT REPORT
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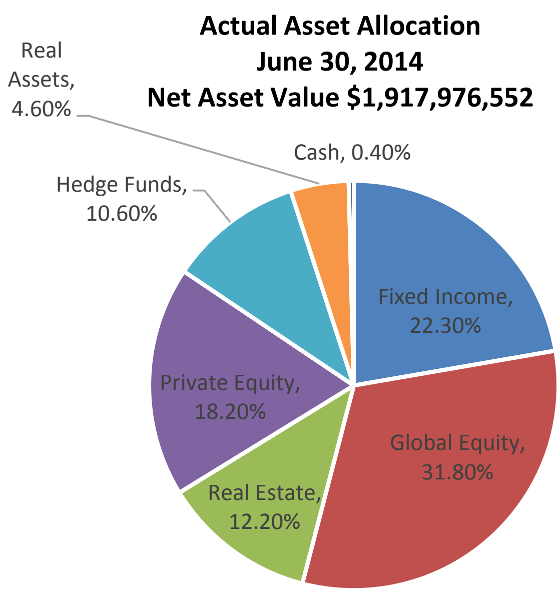
Chief Investment Officer
MPERS Board Meeting – September 25, 2014

- **2nd Quarter & Fiscal Year 2014 Investment Performance Report**

  Kevin Leonard from New England Pension Consultants (NEPC) will present the 2nd Quarter and Fiscal Year 2014 Investment Report (provided under Tab 9). My high-level comments and themes from the report are listed below.

  Big Picture Perspective on Investment Performance:



1-year Return:	17.56%
Benchmark:	14.47%
Excess Return:	3.09%
3-year Return:	11.07%
Benchmark:	9.10%
Excess Return:	1.97%
5-year Return:	13.50%
Benchmark:	11.65%
Excess Return:	1.85%
10-year Return:	7.63%
Benchmark:	7.41%
Excess Return:	0.22%

- Most major asset classes continued to trade higher in the 2nd quarter of 2014, as economic growth picked up after a weather-induced slowdown in the 1st quarter. Growth assets around the world posted strong returns, led by emerging market equities (6.5% return for the quarter) and the S&P 500 (5.2% return). While somewhat counter-intuitive, fixed income investors shrugged off the improved growth outlook and drove bond prices higher (yields lower) on the belief that inflationary pressures are still a distant risk.
- MPERS' portfolio generated a 5.7% return in the quarter, which ranked in top 1% of the peer universe. The fund now ranks in the 15% of the peer universe over the past 1, 3, 5, and 10 year periods. The allocation to Master Limited Partnerships (MLPs) generated a 16.5% return, driven by their strong yield relative to other fixed income investments. The private equity portfolio posted a 13.6% return, led by a number of large write-ups to calendar year end valuations.
- The strong quarterly performance boosted the fiscal year 2014 return to 17.56%, versus a policy index (benchmark) return of 14.47%. All major asset classes generated positive returns, led by the private equity portfolio with a 25.3% return and the global equity portfolio with a 23.8% return. The real estate portfolio also posted a healthy 17.8% return for the year. Relative performance was strong across all asset classes.
- As we look forward to fiscal year 2015, the massive amounts of liquidity in the market have driven asset values to all-time highs across most major asset classes. We've used this time to position the portfolio back towards the long-term targeted asset allocations, and continue to review opportunities and strategies that are attractively priced relative to the broader markets.

- **Current Asset Allocation Overview / Positioning Relative to Targets**

  Below is a chart showing MPERS' current asset allocation relative to policy targets, along with a brief narrative on the rationale behind the positioning. The markets continue to benefit from the massize amounts of stimulus and liquidity in the market, which has driven volatility (the primary measure of market risk) down to pre-crisis levels. While not the only measure of an investor's risk appetite, low volatility can lead to complacency on the part of investors and the potential to overlook macro-economic risks. Two macro risks that we are closely monitoring include the potential for rising interest rates and the geo-political risk in Russia/Ukraine and the Middle East. With the combination of asset valuations at or near all-time highs and volatility at multi-year lows (which increases the risk of complacency), we've used this as an opportunity to re-position the portfolio closer to long term strategic allocations. The one exception remains within the hedge fund portfolio, which we expect to remain near the bottom of the permissible range for the foreseeable future. We continue to favor other alternative asset strategies (real assets, real estate, private equity, and opportunistic debt) over hedge funds in today's environment.

  As of September 16, 2014, each of MPERS' sub-asset class allocations are within the acceptable ranges established by the investment policy.