"When I considered leaving my previous employer, MERS was at the top of the decision-making process. The retirement plan that they have here was great and I felt like I could stay. It's somewhere I could stay for the rest of my life. I had friends at my old job and it was hard to leave them, but the security I have with MERS was really the selling point.

I am MERS because I am secure."

Ron Coleman

investments section

Ron Coleman is an Electrical Distribution Tech II at Holland Board of Public Works.

He's been a MERS member since 1996.

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Chief Investment Officer Report

Dear Members:

I respectfully submit the investment activity report for the Municipal Employees' Retirement System of Michigan's Comprehensive Annual Financial Report for the fiscal year ending December 31, 2011.

It seems that every year investing becomes a little more challenging or at least more interesting than the prior year. Factors like extreme market volatility, increasing and often unpredictable government policy intervention, an interconnected global economy, and the communication of data at ever increasing speeds has dramatically magnified the complexity and challenges in managing institutional assets. Yet, while the market conditions are complicated, the perspective of a disciplined approach to investing, combined with sound governance, adds value and keeps MERS strong and viable for the future.

Prior to the drama of 2011, the U.S. was the world's triple-A safe haven. Market participants did not debate or care about the merits of raising the U.S. debt limit. Meetings between European heads of state were seen to be largely ceremonial, not transactional. Governments, whether democratic or autocratic, generally were in control of their citizenry. Central bankers did not see themselves as saviors. Regulators and legislators took small steps to improve markets, not large dramatic actions that could prove to be more damaging than good in the end. The current global uncertainty reflects a generational transition point. Old orthodoxies are giving way to new governance and market structures. While I expect this transitional period to continue for some time, I sincerely believe that an extended period of global growth and a stronger economic framework will be the result. Monitoring the situation and taking advantage of opportunities will be at the forefront of our investing strategy going forward.

The year 2011 can be divided into two parts. The first half from January through mid-July, was really a continuation of the equity rally that started in July of 2010. Optimism was cautiously high and the MERS Total Market Fund (DB) was up 22.28% for the rolling 1-year period ending June 30, 2011.

The second half of 2011 was much different and surprised on the downside — the S&P lost 226 points (approximately 20%) in just 12 trading days (see chart 1) and market turmoil eventually erased some $6 trillion of value in the global stock market. Although, if one reflects on the massive amount of deleveraging still left to be done, the markets negative view in the later part of the year was not that surprising.

By the end of the year, it was clear that the U.S. Treasury market and U.S. high grade fixed income - large, liquid, and still relatively safe — became the true winner as it continued its 25 year bull market run. And lest we forget, this run continued despite a generational low rate environment in which most prognosticators believed that rates could not go lower.

MERS Fund

Regardless of economic and financial turmoil, the defined investment objective of the MERS fund is to grow assets at a rate which, when coupled with contributions, satisfies earned benefits to our members. The Office of Investments strives to achieve a real rate of return of at least 3.50% annually over the rate of inflation, and/or exceed the actuarial assumption rate of 8.00% annually. On an absolute return basis, the MERS Office of Investments desires better performance but feels confident about MERS performance relative to our benchmarks.

MERS 2011 highlights:

- The MERS Total Market Fund (DB) return for 2011 was 2.30% gross of investment fees which underperformed the actuarially assumed rate of 8.00% by 5.7%.
- The MERS Total Market Fund (DB) outperformed its custom policy benchmark gross of investment fees by 1.33%. This outperformance is a testament of MERS portfolio asset allocation, active management, and tactical decision making. The fund generated $63 million above what would have been earned if it had been invested passively. The MERS portfolio is specifically designed to provide downside protection during turbulent markets.
- At the broad asset class level, absolute returns gross of investment fees were as follows:

Total Equity	-5.33
Real Estate	5.98
Fixed Income	7.83
High Yield	7.64
Commodities	-1.15
Private Equity	15.70
Cash	1.64

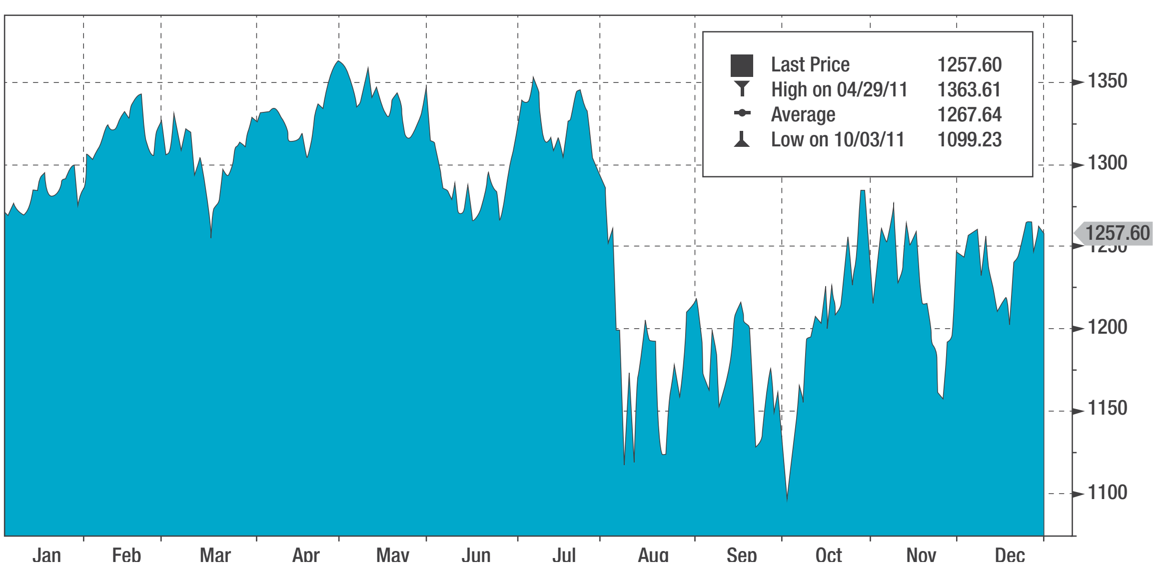
- A $10,000 Total Market Fund (DB) investment made in 1988 would have been worth $73,864 at the end of 2011.This is $19,706 above what would have been earned if the Total Market Fund (DB) had been invested passively, and $12,846 above MERS actuarial assumption rate of 8.00%.

In conclusion, I would like to thank the Retirement Board, the fiduciaries of the MERS Plan, for their enthusiasm in creating a structure that provides the Office of Investments the ability to be flexible and innovative. Our structure is continually praised by investment professionals and peers. This relationship makes for a more efficient decision making process, and ultimately leads to a better risk/return performance for our membership.

Respectfully,

Jeb Burns, CIO

Chart 1



REPORT ON INVESTMENT ACTIVITY

MERS was established under PA 135 of 1945, and granted independence from the State of Michigan pursuant to PA 220 of 1996, effective August 15, 1996. MERS is organized for the express purpose of using its collective resources to ensure that its member municipalities have sufficient financial resources to meet the pension obligations that each is individually responsible for under the State of Michigan's Constitution 1963, Article 9, Section 24. MERS is authorized to create subsidiary entities and to provide additional benefits and savings programs to its members at the direction of the Board. See PA 490 of 2004, Section 36(2)(a); MCL 38.1536(2)(a).

The MERS Retirement Board (Board), as "investment fiduciary" under the Public Employee Retirement System Investment Act (PERSIA), PA 314 of 1965, has the fiduciary responsibility and authority to direct the Retirement System's investment program. Members of the Board must follow the state law and prudent standards of diligence consistent with "discharging their duties for the exclusive benefit of plan participants." The prudent person standard requires that the Board "exercise the same judgment, care, skill, prudence, and diligence under the circumstances which persons acting in a like capacity and familiar with such matters would use in the conduct of a similar enterprise with similar aims." MERS has a Defined Benefit Plan, Defined Contribution Plan, Hybrid Plan, Health Care Saving Program, Retiree Health Funding Vehicle, Investment Services Program, and a 457 Program. The Board has granted full discretion to manage all investment management operations and activities to MERS Office of Investments, except those specifically reserved for the Board.

The MERS Investment Management Plan outlines how the policy objectives described in the MERS Plan Document, Investment Guidelines, and the Asset Allocation Policy are to be achieved. The investment activity goals are designed to provide the highest quality investment management and administrative support. These goals are measured against established industry benchmarks and peer groups. The objective is to ensure that the investment activities are carried out within the framework established by MERS policy and administrative documents. The Investment Management Plan offers a model to assist the Board and staff in making prudent and informed investment decisions.

In accordance with GASB 25, plan investments are presented at fair value. Short-term investments are valued at cost plus accrued interest, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Corporate bonds not traded on a national or international exchange are based upon equivalent values of comparable securities with similar yield and risk. Independent appraisals are the basis for valuing the fair value of real estate. Other investments that do not have established markets are recorded at an estimated fair value. Real estate investments typically have a quarter lag in reporting, which is an industry standard.

A. Defined Benefit Plan

INVESTMENT OBJECTIVES AND ACTIVITY

In conformity with PERSIA, the primary objective is to maximize the long-term total rate of return on investments. This should be done with a high degree of prudence to reduce risk. In addition, the Board and the Office of Investments have established Investment Guidelines that are updated annually. These Guidelines communicate long-term objectives, goals, and performance expectations to the staff, investment managers, consultants, and any other interested parties. The Board strives to add incremental returns relative to the market by employing active management strategies when needed. Every effort is made to minimize costs to the portfolio with the use of internal and external resources.

The defined fund objective, based upon actuarial valuations, is to grow assets at a rate which, when coupled with contributions, satisfies promised benefits to MERS members. The Office of Investments strives to achieve a real rate of return of at least 3.5% annually over the rate of inflation, and exceed the actuarial assumption rate of 8% annually.

FUND OBJECTIVE CONSIDERATIONS

- Adopt a strategic asset allocation plan that reflects future liabilities and incorporates risk parameters
- Structure investment goals over a long-term horizon (five years)
- Use actuarial methods that decrease the impact of volatility
- Concentrate on asset classes that have added value over the rate of inflation
- Measure comparability with other plans to stay within industry standards
- Use beta strategies to form a core base in the portfolio and reduce costs
- Use commission recapture to reduce transaction costs and increase earnings to the total fund
- Employ a manager (i.e. custodian bank) to lend held securities of the total portfolio to add incremental income
- Use all asset classes to capitalize on global economic growth
- Allow investment managers increased flexibility so they can tactically exploit broad market trends
- Take advantage of short and long-term market inefficiencies, trends and dislocations which can add moderate returns above the policy benchmark

PORTFOLIO HIGHLIGHTS

Asset Allocation

Determining the System's asset allocation is regarded as one of the most important decisions in the investment management process. With this in mind, the Office of Investments conducts a full asset allocation study every five years to assess portfolio construction and strategy. Factors considered are: expected rate of return for each asset class, expected risk of each asset class, the correlation between the rates of return and the investment objectives and risk constraints.

The Office of Investments uses risk management software to perform a strategic analysis of asset allocation levels on an ongoing basis. This process establishes a formal risk budget and quantifies asset allocation decisions.

The Board adopted the most recent asset allocation study in July 2010. The current plan is: Domestic Equity – 34.5%, International Equity 10%, Fixed Income – 30%, High Yield – 5%, Real Estate – 7%, Private Equity – 7%, Commodities – 5%, and Cash – 1.5%.

Dynamic Asset Allocation

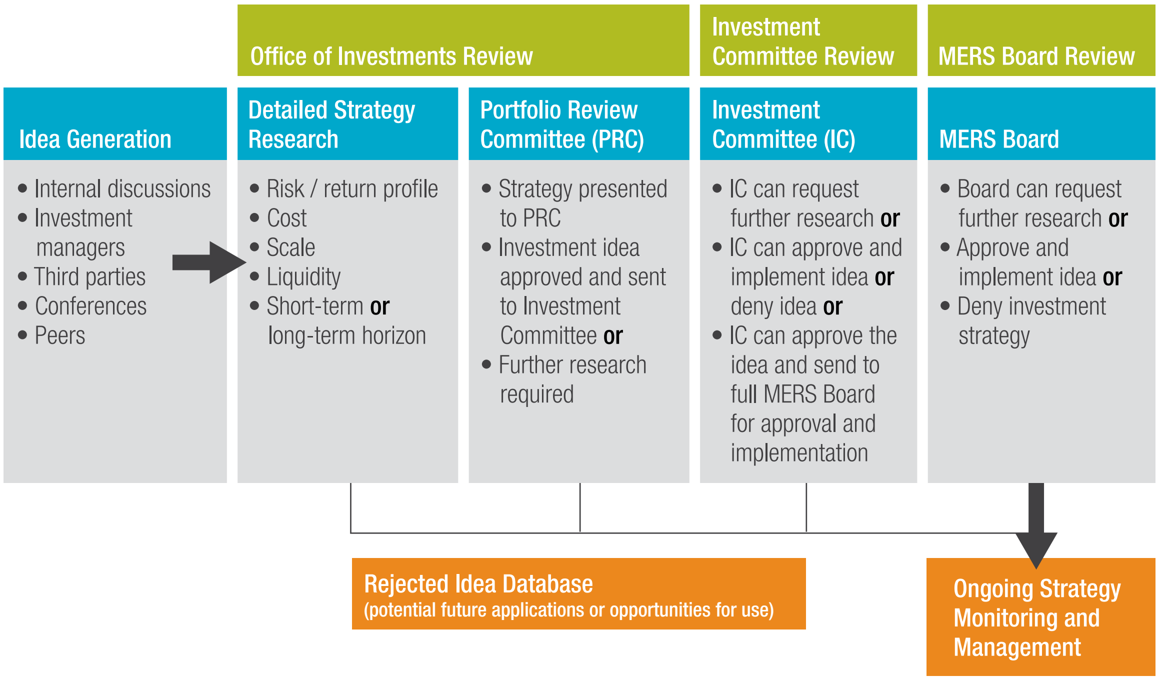
As the financial markets and economic conditions change, certain asset classes become more favorable than others. Therefore, it is necessary to engage in short and medium term tactical deviations from the strategic allocation in order to capitalize on unusual or exceptional investment opportunities. Since the markets are so dynamic, these moves will be made very quickly in an effort to take advantage of short-term systemic inefficiencies and broad market trends. The Office of Investments feels that engaging in such tactical deviations is necessary to produce superior investment returns from a risk/return perspective.

The team is well-positioned to identify appealing investment opportunities through the use of countless quantitative and qualitative tools. These tools include insight from existing investment managers, research databases, third-party research, financial publications and numerous others. There is no timetable for these tactical deviations, but they typically have a duration of less than one year and not more than three years. Once the short-term opportunities have run their course, the portfolio will be rebalanced to the overall strategic asset allocation.

Emerging Manager Program

Separating ourselves from a herd mentality is sometimes challenging and requires foresight. The MERS Emerging Manager Program seeks to do just that. The objective is to create additional alpha by establishing a "bullpen" of up and coming managers to replace probationary managers. Additionally, this program provides: access to a wider universe of talented investment managers, enhances internal manager searches and replacement processes, and creates a "think tank" or testing mechanism for new appealing investment strategies to determine if they should be included in the overall portfolio.

Investment Strategy Implementation Process



INVESTMENT THEMES

As the Fund continues to evolve, several prevalent themes have emerged as guiding philosophies. These broad-based themes will continue to be strongly considered in our decision-making process as we look for opportunities in the future.

Global Growth

Rapid economic growth in emerging markets such as China and India has created tremendous investment opportunities. Over the last few years, MERS has made numerous investments in an effort to diversify the portfolio and take advantage of global economic growth. MERS has made investments in commodities, emerging markets, frontier markets, and infrastructure bearing this theme in mind. Going forward, we expect to increase our allocation to these asset classes in addition to investing in new ones. We will make a shift toward global equity mandates rather than differentiating between international or domestic equity.

Active/Passive Mix

Historically, the Fund has tried to maintain an active/passive mix of 2/3 active and 1/3 passive. However, in light of recent market events and unique investment opportunities, the Fund will exhibit a more passive approach. The new allocation will likely be a minimum 50/50 split between active and passive management within the equity allocation. A more passive approach will allow for greater flexibility to invest in unique investment opportunities. Additionally, active managers have struggled in recent years to beat passive benchmarks, and during the recent market turmoil they have offered little downside protection. A more passive allocation will also drastically decrease management fees without sacrificing returns. Active management will continue to be used but targeted to the less efficient areas of the portfolio. The focus of MERS fixed income allocation will be primarily active management.

Opportunistic Investing

The recent turmoil in the financial markets and push for alternative energy and green technology has resulted in tremendous investment opportunities. In an effort to further diversify the portfolio and capture additional alpha, the Office of Investments will continue to seek out these opportunistic investments. This may result in the portfolio maintaining higher cash balances during certain time periods.

Expanded Mandates

In an effort to give skilled managers a better opportunity to deploy their skills, the Fund will move toward expanded mandates such as TAA Programs, all cap and core strategies, among several others.

TOTAL MARKET FUND REVIEW

MERS investments generated a gross return of 2.30% for calendar year 2011 using a time weighted rate of return based on the market rate of return of the portfolio. The Total Market Fund return exceeded its custom policy benchmark of 0.98%. Performance across all asset classes varied during the year with fixed income and high yield generating some of the highest returns, 7.83% and 7.64%, respectively. They were only exceeded by MERS private equity, returning 15.70%.

Asset Class Performance for 2011 (gross of fees) and Contribution to Total Return

Type	2011 Gross Returns	Contribution to Total Return
Domestic Stocks	-1.62%	-0.95
International Stocks	-17.46%	-0.18
Fixed Income	7.83%	-0.08
High Yield	7.64%	0.32
Real Estate	5.98%	0.00
Private Equity	15.70%	1.54
Commodities	-1.15%	0.28

Portfolio Rebalance Policy

It is the responsibility of the Office of Investments to ensure that the portfolio remains within the asset allocation parameters established by the Board, and adheres to the System's rebalancing policy. The policy is designed to minimize drift within the portfolio, allow tactical shifts to take advantage of market conditions, and ensure adequate cash levels are maintained within the cash account to meet ongoing pension fund expenses.

Daily Review and Optional Rebalance

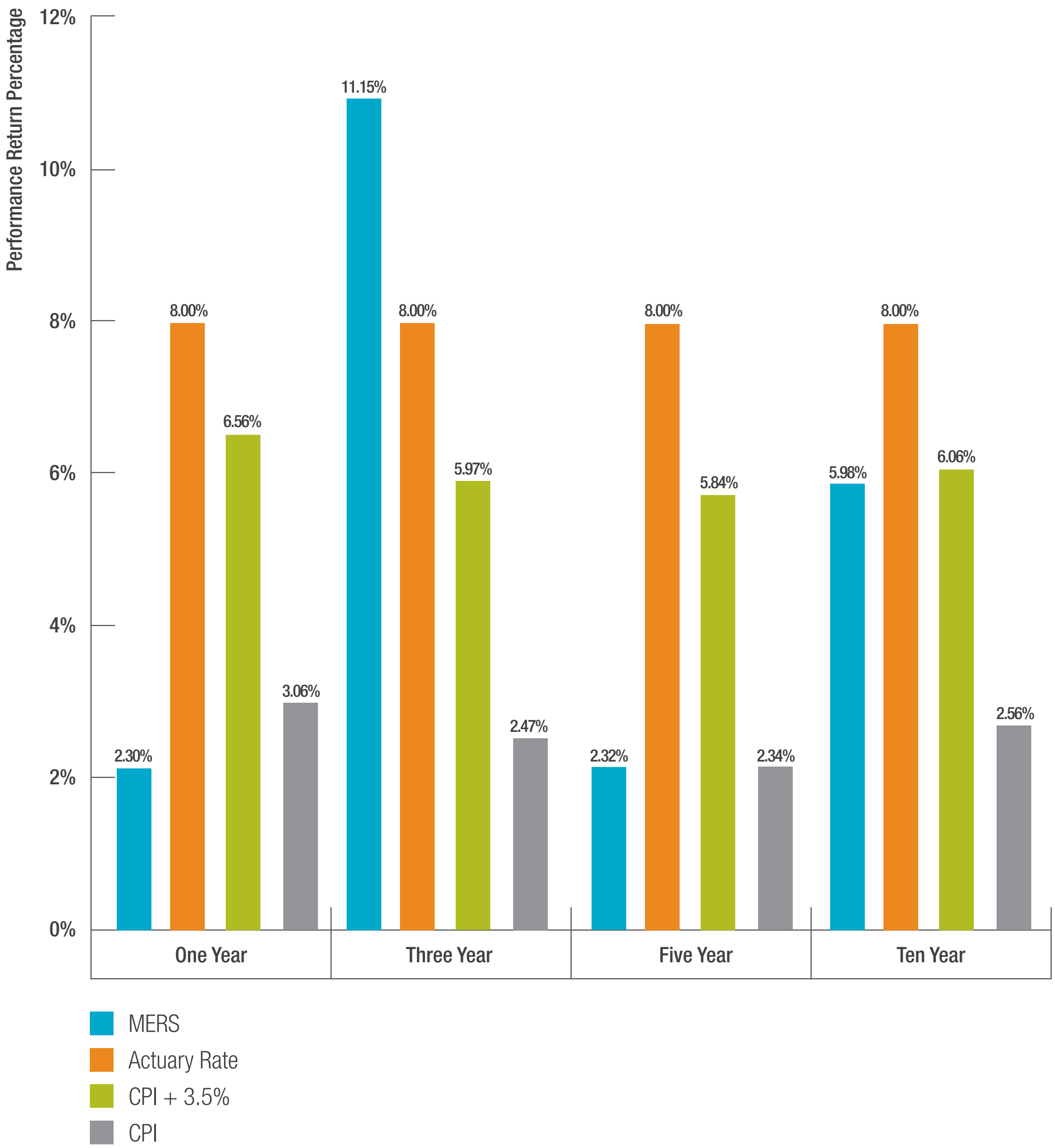
In an effort to minimize tracking errors at the total portfolio level, the Office of Investments works with the Clifton Group to implement a policy overlay using index futures.

Asset allocation levels for the various asset classes are monitored daily in relation to the predetermined variation bands, and rebalanced using appropriate index futures. Adequate cash to cover the initial and variation margins for the futures exposure, are made available and placed in accounts set up specifically for this purpose.

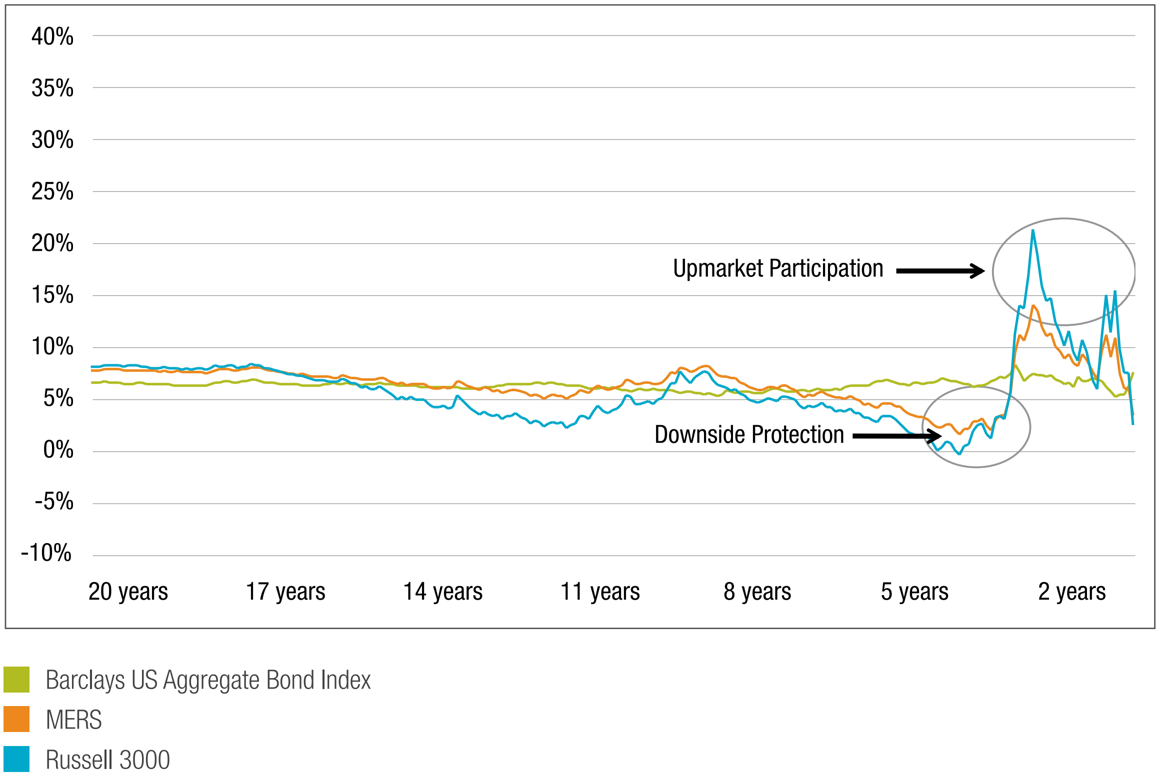
Annual Portfolio Rebalance

The Office of Investments performs an asset allocation analysis of the entire portfolio during the first quarter of every year. The Office of Investments has developed a rebalance plan based on this analysis.

Performance Versus Custom Benchmarks as of December 31, 2011 (gross of fees)



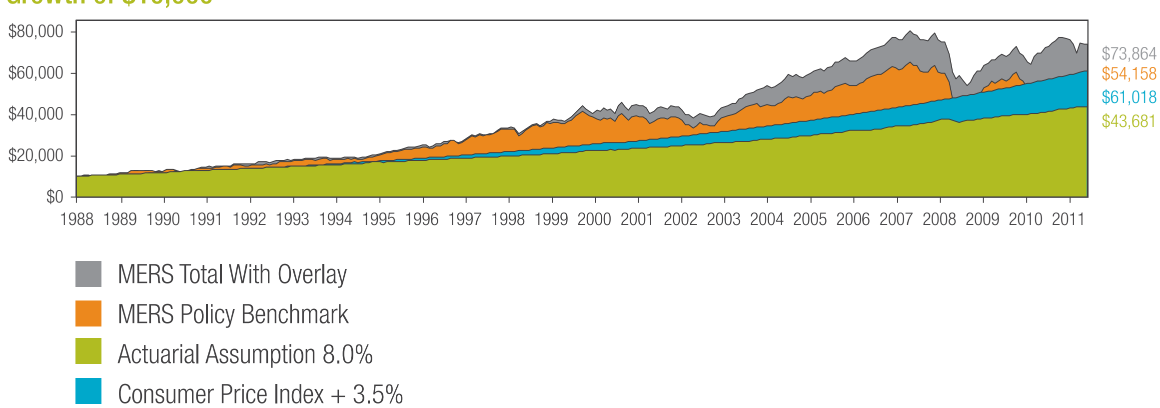
Downside Protection Upside Participation as of December 31, 2011



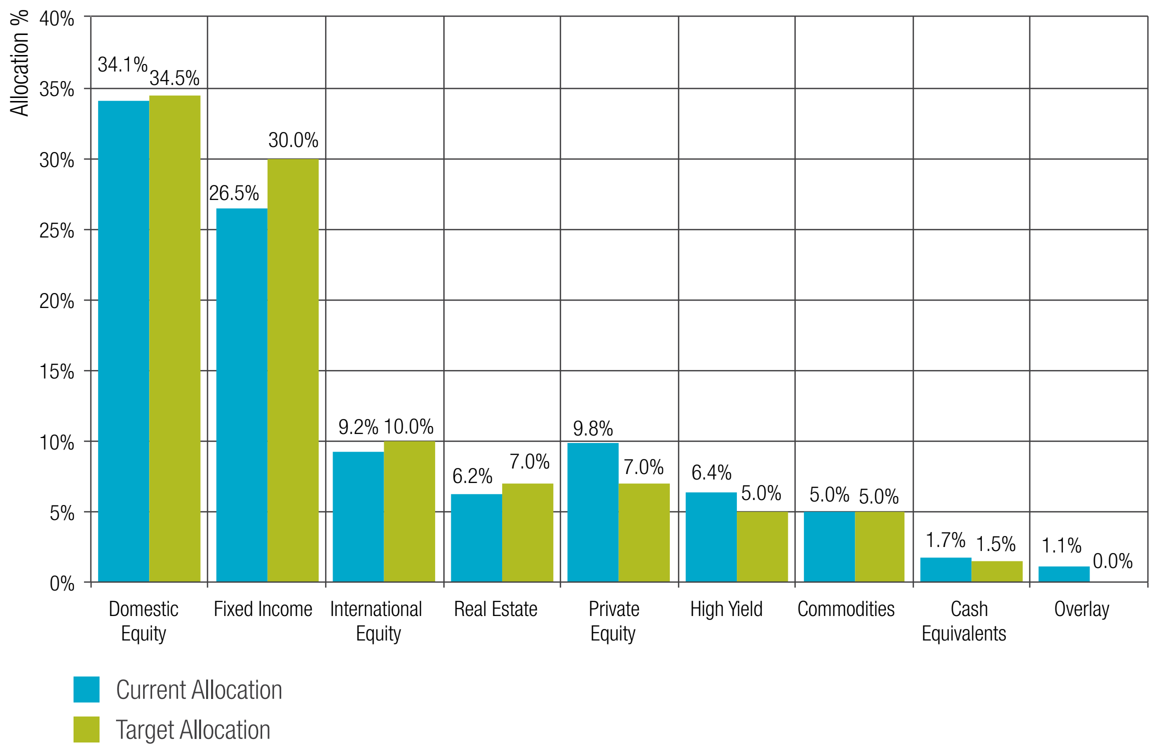
Diversification is a portfolio strategy designed to reduce exposure to the volatility of returns by combining a variety of investments (such as stocks, bonds, real estate, and commodities) which are unlikely to all move in the same direction. The goal of diversification is to reduce the risk in a portfolio.

While it is impossible to foresee all market risks, the strategic goal of the MERS asset allocation policy and the MERS Total Market Fund is to create a well-diversified portfolio that provides downside market protection with upside market participation.

Growth of $10,000



Current Asset Allocation versus Target Allocation as of December 31, 2011



Statistical Performance (gross of fees)

Portfolio Characteristics	1 Year	3 Year	5 Year	10 Year
Annualized Return	2.30%	11.15%	2.32%	5.98%
Annualized Standard Deviation	10.58	10.70	11.87	9.93
Sharpe Ratio	0.21	1.03	0.08	0.42
Excess Return	1.33	-0.98	-0.06	0.37
Beta	0.93	0.80	0.85	0.88
Correlation to Policy Benchmark	0.99	0.98	0.99	0.99

Commission Recapture

MERS requests that all domestic equity managers direct a target of 25% of commission trades with the State Street Global Markets LLC (SSGM) for the purpose of commission recapture. Brokerage transactions in the normal course of business should only be directed to this broker. By doing this, the obligation to achieve the best execution is fulfilled. The SSGM program provides a network of brokers where trades can be executed. The recaptured commissions are shared based on a contractual negotiated split of 90/10% MERS/broker. Recapture dollars are used to offset the administrative, custodial, accounting and performance measurement costs incurred by the Fund. For 2011, $313,091 was directed by equity managers to SSGM of which $173,759 was rebated to MERS.

Investment Summary for Defined Benefit Plan, Defined Contribution Plan, Retiree Health Funding Vehicle, Health Care Savings, and Investment Services Program as of December 31, 2011

Type of Investment	Market Value
Fixed Income	
Domestic and International Fixed Income	$2,158,709,915
Total Fixed Income	**2,158,709,915**
Equities	
Domestic and International Stock	2,742,721,846
Total Equities	**2,742,721,846**
Commodities & Private Equity	
Commodities	319,396,486
Private Equity	622,187,023
Total Private Equity & Commodities	**941,583,509**
Real Estate	
Real Estate	390,516,332
Total Real Estate	**390,516,332**
Subtotal Investments	**6,233,531,602**
Cash Equivalents	
Cash Equivalents	108,560,260
Total Cash Equivalents	**108,560,260**
Total Investments & Cash	**$6,342,091,862**

Reconciliation of Investments to Financial Statements

Total Investments from above	**$6,342,091,862**
Receivables - Sale of Investments & Interest	(309,983,580)
Total market portfolio in 457 portfolio not included in general ledger	(4,264,188)
Bonds in default	(3,579,122)
Small unit adjustments	(497)
Defined Contribution investments not in MERS State Street portfolio	237,529,028
Cash at State Street	(98,929,396)
Payables - Purchases of Investments	370,788,064
Investments on Financial Statements	**$6,533,652,171**

Note: Includes receivables and payables for sales and purchases of securities with settlement dates after December 31, 2011.

EQUITY ASSET CLASS SUMMARY

As of December 31, 2011, the public equity portfolio had a market value of $2.74 billion, representing 43.2% of the Total Market Fund. Performance for the total equity portfolio was -5.33% gross of fees.

Highlights

Fiscal year 2011 was relatively calm in terms of activity within the public equity portfolio. The only large allocation shift within the portfolio was the funding of the micro cap allocation. We made several incremental asset allocation shifts throughout the year, but the portfolio remained relatively unchanged from the prior year. Here are a few of the highlights:

- Funded four micro cap equity managers in February with $50M each – 3% of the portfolio at the time of funding
- Took our first equity stake in April as a part owner in manager Irving Magee
- Hired Mellon Capital Management and funded their Tangent Added Tactical Asset Allocation strategy in July. This strategy represents the value portion of our domestic large cap equity portfolio.
- In general, active management continued to struggle as economic headlines and government intervention drove the markets rather than fundamentals.
- Throughout the year we maintained a strategic overweight to U.S. equities since we felt the economic growth of the U.S. economy would continue to surprise on the upside and exceed other developed countries.
- Continued to underweight developed European equities as the ongoing European debt crisis weighed on economic growth and investor confidence.
- During the year, five managers were hired and one manager was terminated.

Summary of Portfolio

MERS maintains a significant allocation to publicly traded shares of corporations around the world. Broad exposure to the public equity markets is paramount to achieving the Fund's stated objectives and delivering the actuarial rate of return of 8%. The public equity portfolio has a target allocation of 44.5% of the total Fund. As of December 31, 2011, the portfolio includes domestic equity, international developed equity, and emerging and frontier markets equity. Exposure is achieved through portfolios diversified by geographic region, styles, sectors, and market capitalizations. Active management is used to take advantage of less efficient areas of the market, while passive management is deployed in more efficient areas, and used to reduce fees. Allocations are monitored in relation to asset class bands on an ongoing basis and rebalances take place if deemed appropriate. This portfolio is expected to perform well in periods of low to falling inflation and rising economic growth. It is also expected to provide ongoing income through dividend payments, as well as downside protection in volatile markets.

Market Overview

The world's equity markets experienced extreme volatility in 2011 and returns were mostly negative across the board. Fiscal year 2011 was a tale of two halves as equity markets posted strong returns in the first half but sold off sharply in late summer. When fears of a European sovereign debt crisis and a double dip in the U.S. reemerged, government support in the form of central bank liquidity programs set the stage for an impressive year-end rally. Domestic equity markets posted negative returns for the year but fared much better than international equities. The Russell 2000 finished the year down 4.18% while the S&P was up 2.11%. The defensive sectors within the Russell 3000 posted the strongest returns for the year with utilities leading the way at 19.0%. The consumer staples sector returned 13.9% and health care returned 10.6%. Returns for other developed market countries were weak across the board as the MSCI EAFE Index returned -11.7% for the year. Returns trailed U.S. indices as a result of European debt fears and slower economic growth. Following the strong performance of 2010, emerging market equities underperformed developed markets, returning -18.2% for the year. This underperformance was the result of higher levels of inflation forcing central banks to tighten monetary policy. Across all geographic regions, growth stocks outpaced their value counterparts, and large cap equities outperformed small cap equities.

It is tough to find consensus on what lies ahead for the markets but one thing is certain – market volatility is likely to persist as a sustainable economic recovery struggles to take hold. Fears of a Chinese hard landing, rising oil prices, and the ongoing European debt crisis remain in the back of investor's minds, but economic data out of the U.S. provides hope for a continued recovery. Although economic growth in the U.S. remains sluggish, corporate profitability is at an all time high, and corporate balance sheets are in the best shape they have been in decades. The housing market is showing signs of bottoming and the unemployment rate continues to improve. Barring a global recession, U.S. equities appear to offer a favorable risk/reward at this point, especially in relation to fixed income.

Public Equity Performance as of December 31, 2011 (gross of fees)

Portfolio Characteristics	1 Year	3 Year	5 Year	10 Year
Total Equity	-5.33%	14.25%	-1.23%	4.89%
MSCI World Index Net Daily	-5.54	11.12	-2.37	3.62
Excess	**0.21**	**3.12**	**1.14**	**1.28**
Domestic Equity	-1.62	16.16	0.00	4.65
Russell 3000 (Daily)	1.03	14.88	-0.01	3.51
Excess	**-2.65**	**1.29**	**0.01**	**1.14**
International Equity	-17.46	8.40	-4.88	5.40
MSCI ACWI EX US Gross (Daily)	-13.33	11.20	-2.48	6.76
Excess	**-4.13**	**-2.80**	**-2.39**	**-1.36**

Top Ten Equity Holdings as of December 31, 2011

Asset Description	Market Value	Percentage of Total Market Value
Apple, Incorporated	$39,097,485	0.62%
Qualcomm, Incorporated	13,600,334	0.21
Oracle Corporation	13,245,044	0.21
Chart Industries, Incorporated	12,910,780	0.20
Exxon Mobil Corporation	12,561,432	0.20
Altera Corporation	11,949,724	0.19
Google, Incorporated	10,474,560	0.17
eBay, Incorporated	10,063,221	0.16
The Toro Company	10,033,164	0.16
Atwood Oceanics, Incorporated	9,216,955	0.15

Note: A complete list of portfolio holdings is available upon request.

Public Equity – Investment Managers

Investment Manager	Style	Portfolio Market Value
External Investment Manager		
Blackrock	Frontier Markets Enhanced Index	$ 71,356,959
Acadian	International Small Cap	140,997,244
Driehaus	All-Cap Global Growth	275,069,764
Hexam	Emerging Markets	93,184,484
Wellington	Large Cap U.S. Growth	223,962,482
Mellon Tangent Added TAA	Large Cap Core/Value	324,595,331
BRC Investment Management	Large Cap U.S. 130/30	60,643,969
AMBS Investment	Large Cap U.S. Value	26,598,914
Punch Investments	Micro Cap	66,466,783
Morgan Dempsey	Micro Cap	68,532,652
Eudaimonia	Micro Cap	65,968,727
Kennedy Capital	Micro Cap	65,968,309
C.S. McKee	Small Cap U.S. Core	170,966,772
Irving Magee	Small Cap U.S. Value	145,351,047
Kennedy Capital	Small Cap U.S. Value	169,301,281
Hellman Jordan	All-Cap U.S. Core	25,082,700
Seizert Capital	SMID Cap U.S. Value	24,092,151
Wellington	Mid Cap U.S. Core	214,079,488
Internal Investment Manager		
MERS S&P 400	S&P 400 Index	159,404,247
MERS S&P 500	S&P 500 Index	351,038,363

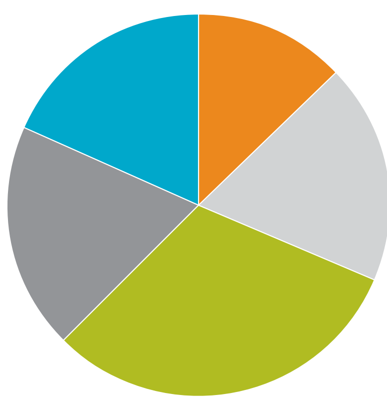
FIXED INCOME & HIGH YIELD ASSET CLASS SUMMARY

As of December 31, 2011, the Total Fixed Income portfolio had a market value of $2.088 billion representing 32.90% (fixed income of 26.50% and high yield of 6.40%) of the Total Market Fund. Performance for fixed income and high yield was 7.83% and 7.64% gross of investment fees, respectively.

Fixed Income

Fixed Income is the bedrock of the MERS Total Market Fund providing exposure to high quality fixed income instruments that create stable cash flow and liquidity to the overall portfolio. Total fixed income assets, excluding high yield, were $1.681 billion as of December 31, 2011, and were allocated into five strategies (see pie chart below). Fixed Income provides meaningful diversification to the Total Market Fund covering a variety of different macroeconomic environments. Core fixed income tends to perform well in times of falling growth and stable inflation providing critical downside protection to the portfolio.

Fixed Income Allocation as of December 31, 2011



Enhanced Index (passive)	12.93%
Infrastructure (active)	18.66%
Core (active)	31.15%
Global (active)	19.07%
Emerging Market Debt (active)	18.19%

Market Commentary

At the beginning of 2011, most investors were no longer worried about another "Great Depression," but instead, were focused on whether a perceived global recovery had legs that would lead us back to a sense of market normalcy. This is how it felt for the first half of 2011. Unfortunately, economic headwinds (high unemployment, a U.S. deficit, a struggling housing market, a European debt crisis, etc.) created numerous challenges for world leaders, the Federal Reserve, and other policy makers.

The U.S. Treasury yield curve remained steep in 2011. Short-term rates remained anchored near historic lows in response to the Feds zero interest rate policy. However, yields on longer dated maturities declined (prices rose) from a high of 4.766% to a low of 2.726% due to global uncertainty, Fed policies, and a deep concern over the Eurozone. Even in the midst of a U.S. credit downgrade, the U.S Treasury market continued its rein as the world's "safe haven" during global uncertainty.

The U.S. credit markets had another solid year as corporate profits rebounded, leading to improved fundamentals and credit quality. Global fixed income markets, including emerging markets, were largely driven by the search for yield, creating a divergence of performance between developed and emerging market countries. Generally speaking, the largest developed markets maintained low interest rate policies as a means to stimulate their respective domestic economies. These policies pushed fixed income investors toward higher interest rates offered by developing economies.

Fixed Income Performance as of December 31, 2011 (gross of fees)

	1 Year	3 Year	5 Year	10 Year
Fixed Income	7.83%	9.48%	6.84%	6.41%
BC Aggregate (Daily)	7.84	6.77	6.50	5.78
Excess	-0.01	2.71	0.34	0.63

Top Ten Fixed Income Holdings as of December 31, 2011

Asset Description	Market Value	Percentage of Total Market Value
United States Treasury 4.0% 12/01/2099	$39,057,213	0.62%
Fannie Mae 3.5% 12/01/2099	30,235,425	0.48
United States Treasury 0.01% 6/28/2012	18,794,454	0.30
United States Treasury 0.625% 4/15/2013	16,331,958	0.26
United States Treasury 2.125% 2/15/2041	15,031,895	0.24
Japanese Government Bond 2.0% 9/20/2041	12,768,124	0.20
United States Treasury 1.25% 7/15/2020	12,419,318	0.20
United States Treasury 0.625% 12/31/2012	11,568,982	0.18
Fannie Mae 1.0% 7/26/2012	10,946,126	0.17
United States Treasury 2.0% 4/15/2012	10,650,601	0.17

Note: A complete list of portfolio holdings is available upon request.

Fixed Income – Investment Managers

Investment Manager	Style	Portfolio Market Value
External Investment Manager		
BGI	Core Enhanced Index	$217,461,132
Credit Suisse	Infrastructure	313,807,880
C.S McKee	Core Fixed Income	263,504,120
First International Advisors	Global Bonds	320,543,715
Reams Asset Management	Core Fixed Income	260,174,523
TCW	Emerging Market Debt	305,772,660

High Yield

The MERS high yield allocation provides additional diversification to the Total Market Fund through allocations to domestic and global high yield, emerging markets, and inflation protected securities. Total high yield assets as of December 31, 2011, were $406,584,830 and were allocated into two strategies (see pie chart below). The strategy employs opportunistic mandates that allow for duration bets versus benchmarks. A blended approach is expected to deliver returns in excess of U.S. high yield benchmarks with less volatility.

High Yield Allocation

Global High Yield (active)	52.49%
Loan Credit Fund (active)	47.51%

Market Commentary

The year 2011 was marked with high volatility, disappointing both bears and bulls as the year ended with a sideways market. Sentiment was manic and rarely traded on fundamentals but more on European rumors and intended solutions. Trading volatility was amplified by a lack of intermediaries (primary banks) on Wall Street, largely due to forced deleveraging by regulators. Dealer inventories decreased more than 50% in the last year. As with high yield bonds, leveraged loans and equities were not immune to the volatility, and an opaque outcome in Europe drove correlations across markets sharply closer. While overall spreads ended 2011 at its median trading range (+500 to +900 bps), the CCC/B or “distressed premium” ended the year near its wides at +568 bps, and clearly trended higher from the early 2011 lows. Given the extreme volatility of prices, as well as fund flows, the compensation required to underwrite these less liquid bonds with a higher probability of default understandably rose despite low 2011 default rates.

Nearly $230 billion of new issues were priced in the high yield bond market during 2011, ranking second to 2010 for the largest total in history. The bulk of new issue proceeds were used to refinance existing debt (56%) while M&A transactions (22%) rose, albeit with reasonable transaction Debt/EBITDA multiples of about 4.5x.

High Yield Performance as of December 31, 2011 (gross of fees)

	1 Year	3 Year	5 Year	10 Year
High Yield	7.64%	22.90%	4.28%	6.5%
BofAML High Yield Master II (Daily)	4.38	23.72	7.33	8.59
Excess	3.26	-0.82	-3.06	-2.10

High Yield – Investment Managers

Investment Manager	Style	Portfolio Market Value
External Investment Manager		
Stone Tower	Loan Credit Fund	$193,160,789
Stone Harbor	High Yield/EMD/Tips	213,424,041

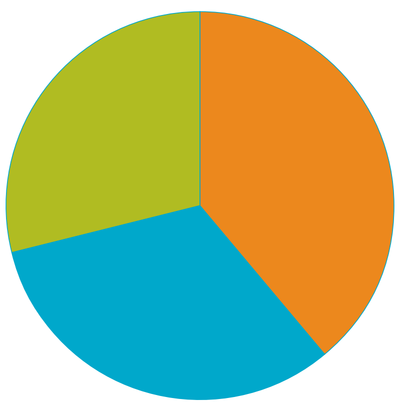
ALTERNATIVE ASSET CLASS SUMMARY

As of December 31, 2011, the alternative portfolio had a market value of $1.33 billion representing 21.0% (real estate of 6.20%, commodities of 5.00%, and private equity of 9.80%) of the Total Market Fund. Performance for real estate, commodities, and private equity was 5.98%, -1.15% and 15.70%, respectively.

Real Estate

MERS real estate target allocation represents 7% of the total plan, and is diversified among private property partnerships, global real estate investment trusts (REITs), and timber partnerships. The allocation provides diversification, consistent income, and uncorrelated returns to the Total Market Fund.

MERS Real Estate Allocation



Private Property Partnership	38.96%
Global REITs	32.29%
Timber	28.75%

Commodities

The MERS commodities target allocation represents 5% of the Total Market Fund. Commodities exhibit low correlations to most traditional asset classes and therefore behave differently during market cycles. Unlike stocks and bonds, commodities are expected to perform well during periods of inflation creating a natural hedge in the portfolio. Exposure to the commodity markets is obtained through an enhanced swap agreement with Cargill. A dedicated collateral pool is set aside to provide 100% coverage for the commodity allocation and maintain a credit rating of AAA.

Private Equity

MERS private equity target allocation represents 7% of the total plan, and adds diversification to the overall equity allocation of the Total Market Fund. Investments in private equity include U.S and international, venture capital, buyout, and special situation funds.

Alternative Performance as of December, 31, 2011 (gross of fees)

	1 Year	3 Year	5 Year	10 Year
MERS Real Estate	**5.98%**	**-1.21%**	**-1.84%**	**6.35%**
MERS Custom Real Estate Benchmark	5.50	4.52	2.56	8.29
Excess Return	0.48	-5.73	-4.40	-1.94
MERS Commodities	**(1.15)**	**10.80**	**1.42**	**-**
Goldman Sachs Commodity Index	(1.18)	6.93	(2.79)	5.64
Excess Return	0.03	3.87	4.21	(5.64)
MERS Private Equity	**15.70**	**5.00**	**6.83**	**4.04**
Russell 2000	(4.18)	15.63	0.15	5.62
Excess Return	19.88	(10.63)	6.68	(1.58)

Alternatives – External Investment Managers

Investment Manager	Style	Portfolio Market Value
Real Estate		
Townsend	Private Real Estate	$152,146,825
Urdang	Global REIT	126,105,487
Hancock	Timber	112,264,020
Commodities		
Cargill	Enhanced Index	296,931,511
Mt. Lucas	Commodity Hedge Fund	22,464,975
Private Equity		
Credit Suisse	Fund of Funds & Co Investments	585,926,927
Mesirow Capital Partners	Fund of Funds	36,260,096

Schedule of Investment Fees – as of December 31, 2011

Investment Managers	Average Assets Under Management	Annual Fee	Average Basis Points
Acadian Asset Management	$140,999,320	$784,662	55.65
AMBS Investment	26,598,913	53,904	20.27
Barclays Global Investors- Core Active	217,461,132	239,911	11.03
Barclays Global Investors- Frontier Markets	71,356,959	402,425	56.40
BRC Investment Management	60,645,215	126,413	20.84
Credit Suisse Customized Infrastructure	313,807,880	1,939,035	61.79
Credit Suisse Private Equity Fund	622,187,023	3,261,771	52.42
C.S. McKee	170,966,772	894,223	52.30
C.S. McKee- Fixed Income	263,494,102	421,187	15.98
Driehaus Global Growth	275,069,764	903,613	32.85
First International Advisors	320,543,715	821,974	25.64
Hellman Jordan	25,082,700	104,877	41.81
Hexam	93,184,484	585,778	62.86
Irving Magee	145,351,047	686,258	47.21
Kennedy Capital Management	169,301,280	792,663	46.82
Mount Lucas	22,464,975	50,000	22.26
Reams Asset Management	260,150,167	316,898	12.18
Seizert Capital	24,092,151	72,449	30.07
Stone Harbor	206,257,275	522,468	25.33
Urdang Investment Management	126,105,487	715,154	56.71
Wellington Management	223,962,482	791,759	35.35
Wellington Management- Mid Cap	214,079,488	1,190,859	55.63
The Townsend Group	152,146,826	225,139	14.80
Total Investment Manager Fees	**$4,145,309,157**	**$15,903,420**	**38.36**
Investment Custodian			
State Street Bank and Trust		$1,072,485	
Investment Performance Measurement Consultant			
State Street Bank and Trust		102,000	
Securities Lending Agent			
State Street Bank and Trust		724,501	
Total Investment Fees		**$17,802,406**	

Schedule of Investment Commissions as of December 31, 2011

Brokerage Firm	Shares Traded	Total Dollars	Commission/Share
State Street Bank and Trust	28,780,855	$178,006	0.0062
Instinet	27,163,497	328,508	0.0121
Citi Group Global Markets	21,567,961	168,225	0.0078
Merrill Lynch, Pierce, Fenner, and Smith Inc	17,809,453	183,719	0.0103
Credit Suisse Securities	12,821,901	120,551	0.0094
Morgan Stanley and Company Incorporated	12,214,537	69,448	0.0057
Knight Equity Markets, LP	9,782,869	153,698	0.0157
Cantor Fitzgerald & Company	8,854,921	217,335.	0.0245
Knight Direct LLC	8,775,070	131,805	0.0150
Bloomberg Tradebook, LLC	7,325,310	74,595	0.0102
Instinet Pacific Limited	6,881,165	1,485	0.0002
Macquarie Securities Incorporated	6,864,951	36,890	0.0054
Barclays Capital	6,513,019	67,225	0.0103
Capital Institutional Services, Incorporated	5,668,243	152,558	0.0269
Daiwa Securities Limited	5,279,896	7,200	0.0014
BNY ConvergEx Group	4,924,252	66,160	0.0134
The Royal Bank of Scotland	4,593,333	3	0.0000
Nomura Securities International, Incorporated	4,274,813	9,028	0.0021
Credit Suisse Securities, Incorporated	4,159,543	49,949	0.0120
Broadcort Capital Corporation	3,782,416	117,091	0.0310
Goldman Sachs & Company	3,375,897	106,872	0.0317
Instinet Singapore Services	3,103,000	394	0.0001
Pershing LLC	2,965,267	37,677	0.0127
Goldman Sachs International	2,522,372	35,039	0.0139
UBS Securities LLC	2,401,319	46,513	0.0194
Subtotal (25 Largest)	222,405,862	2,359,985	0.0106
Remaining Total	92,980,841	1,941,698	0.0209
Total Commissions	**315,386,703**	**$4,301,683**	**0.0136**

Securities Lending

	Gross Earnings	Rebates	Agent Manager Fees	Net Earnings
First Quarter	$994,598	$281,113	$142,626	$570,859
Second Quarter	1,022,547	97,314	184,956	740,277
Third Quarter	1,010,676	104,343	181,053	725,280
Fourth Quarter	1,123,522	43,661	215,866	863,995
Totals	$4,151,343	$526,431	$724,502	$2,900,411

In 2011, MERS earned $2,900,411 through its securities lending program managed by State Street.

B. MERS Investment Menu Summary for the Defined Contribution Plan, Hybrid (Part II) Plan, Health Care Savings Program, and 457 Program

The MERS Retirement Board, together with the Office of Investments, selects the menu of investment options for the MERS Defined Contribution Plan, Hybrid Plan (Part II), Health Care Savings Program, and the 457 Program. In addition, the Board establishes and maintains investment guidelines, approves any material changes, and directs staff to help participants with investment education.

The MERS Investment Menu is simplified into four categories or "sleeves" which help streamline the participant's selection process. For performance and fee information of individual funds, please review the MERS Investment Summary, which is updated on a quarterly basis and available on the MERS website at *www.mersofmich.com/investments*.

Retirement Strategies

Retirement Strategies are also known as Target Date Funds. Each fund is a complete, diversified investment program that changes its asset mix as the participant moves toward and through retirement. Retirement Strategies are the default investment selection for the Defined Contribution Plan, Hybrid Part II, and the 457 Program.

Diversified Portfolios

Diversified Portfolios are professionally managed by MERS, and allow access to some of MERS investments. Each fund is a fully diversified portfolio with a target allocation mix that is rebalanced quarterly. The Diversified Portfolios include the Established Market Fund, which is the default selection for the MERS Health Care Savings Program.

Expanded Funds

Expanded Funds gives experienced investors a variety of available funds to choose from. Used in conjunction with any of the other sleeves of the MERS Investment Menu or by themselves, these funds are designed to further diversify a participant's investment portfolio.

Self-Directed Brokerage Window

The Self-Directed Brokerage Window offers access to a broader selection of funds. Several requirements are needed to be eligible, as well as a minimum account balance. The Brokerage Window is not available for the MERS Health Care Savings Program.

C. MERS Retiree Health Funding Vehicle

The MERS Retirement Board and Office of Investments actively choose and monitor the fund lineup available to employers enrolled in the Retiree Health Funding Vehicle. MERS values a disciplined approach to investing and must also follow Michigan state law and established standards of diligence, with strict oversight and management. The funds are professionally managed by a dedicated team of experienced investment professionals and support staff, and are responsible for monitoring all investment activity.

The funds available in the Retiree Health Funding Vehicle are:

- MERS Total Market Fund
- MERS Established Market Fund
- MERS Diversified Bond Fund
- MERS Short-Term Managed Income Fund

D. MERS Investment Services Program

The Investment Services Program provides municipalities with non-membership access to the MERS Total Market Fund. Employers benefit from a professionally managed fund, economies of scale and lower administrative fees, while still maintaining local control of administration.

To view investment activity on the MERS Total Market Fund, see part A of the Investments Section.