

REPORT SUMMARY

The Total Market Fund returned 2.91% for the month of September and 4.49% for the third quarter, underperforming its policy benchmark by 13bps and 10bps. The portfolio continues to perform as designed, providing downside protection and capturing most of the upside. The investment team is moving forward with an asset allocation study which will be presented to the Board for final approval in October. *The following manager/strategy searches and research projects are ongoing: active frontier/emerging market equity, small cap emerging market equity, real assets, diversifying strategies, strategic planning and custodial banking RFI.*

CIO REPORT

The third quarter of the year saw a marked increase in volatility, softening of economic data, and generally positive markets for investors. In September, the global financial markets rebounded across all geographies although commodities trended down of lower demand. Market volatility remained elevated on policy uncertainty, as the Fed unexpectedly withheld on tapering its QE program at its September meeting. Budget talks in Washington made little progress as a shutdown neared. In the Eurozone, recessionary conditions eased as GDP moved into positive territory at 0.3% for the second quarter, up from -0.3% in the previous quarter. In China, the economy remained strong relative to developed markets at 7.8% annualized for the third quarter, up from 7.5%. Emerging markets economies continued to have a difficult time as economic activity slowed, although markets moved up strongly for the quarter as investor sentiment improved. The DJIA, moved once again above 15,000. The University Of Michigan Survey Of Consumer Confidence Sentiment declined to 77.5, but U.S. economic growth remained positive with US GDP at 2.5% in the second quarter. Headline unemployment in the U.S. dropped to 7.2% in September. The more robust U6 declined slightly to 13.6%. New jobs continue to be added to the economy at a pace of 148,000 well below economists' estimates of 180,000 for the month of September. The private sector accounted for 126,000. Initial jobless claims trended lower to post-recession lows, a positive indicator of employment growth. The deleveraging process will have a negative impact on headline GDP growth for several years to come; therefore, a more opportunistic and patient investment approach will be necessary to maximize returns. Recent results show that slower economic growth does not mean that asset prices will not appreciate. U.S. markets are showing signs of overvaluation, and a shift toward investments in Europe and the developing world is being implemented.



“ We don't get fooled again. ”
— The Who

The Total Market Fund returned 2.91% for the month and 4.49% for the quarter, underperforming its policy benchmark by 13bps and 10bps. All asset classes produced positive absolute returns for the month, with the exception of commodities which returned -1.85%. Global markets outperformed domestic markets with small and mid cap equities outperforming large cap equities. The developing markets (Frontier and EM) returned 5.61% following micro cap equities at 6.67% as the top performing equities sub asset classes. Fixed income markets were positive, with emerging markets and global bonds producing the strongest returns of 2.41% and 3.70% versus the Barclays Aggregate which returned 0.95% for the month. MERS fixed income substitutes lagged with triple net lease real estate returning 0.61% and 0.00% respectively, while bank regulatory capital returned 0.11%. Infrastructure surprised on the upside at 1.65% but lags historically. MERS total plan assets* are \$8.02 billion and total MERS assets are \$8.33 billion. Asset class allocations are within target bands and adequate liquidity is available.

What Worked	What Didn't Work
<ul style="list-style-type: none"> • Global and emerging market exposures <ul style="list-style-type: none"> ◦ Fixed income ◦ Equities • Growth equities • Private equity • Real estate 	<ul style="list-style-type: none"> • Commodities w/currency hedging

* Total Plan Assets (TPA) – includes the MERS Defined Benefit portfolio, assets in the RHFV, HCSP, ISP, 457, and DC assets invested in the MERS Total Market Fund or one of its portfolios. Total MERS Assets includes all TPA plus DC assets invested in outside mutual funds.

CIO REPORT

Investment Trends

The world can change at a moment's notice, but markets tend to run in cycles lasting a year or in some cases several years. Because of this it is important to track the economic and political trends nationally, as well as globally. Knowing the trends and understanding the possible investment solutions allow for strategic investing with little opportunity wasted.

<p>Long-term Trends</p> <ul style="list-style-type: none"> • Global growth • Demographics – aging populations/global population growth • Emerging market middle class expansion • Environmental concerns and competition for natural resources <p>Investment Solutions</p> <ul style="list-style-type: none"> • Expanded mandates/Global investing • Opportunistic investing • Disciplined portfolio management – dynamic rebalancing • Long equities • Real assets & inflation hedging • Strategic increases in emerging & frontier market investments 	<p>Medium-term Trends</p> <ul style="list-style-type: none"> • Government fiscal policy intervention • Political instability & high volatility - increasing • Lack of credit financing - improving • Developed country deleveraging • Low interest rates <p>Investment Solutions</p> <ul style="list-style-type: none"> • Opportunistic investing • Fixed income substitutes • Credit underweight & positioning for inflation • Real asset investments • Neutral to slightly overweight equities 	<p>Economic risks</p> <ul style="list-style-type: none"> • Monetary policy mistakes • European credit crisis – developed world debt levels • U.S. fiscal policy dysfunction • Demographics – aging population • Social and political instability • Global fiscal stress – structural realignments • China hard landing – decreasing
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<p>Performance Insights for the Month</p> <ul style="list-style-type: none"> • Micro cap was the top performing sub asset class at 6.67% for the month and 33.86% YTD • Currency detracted for the month from our Australian holdings • Many asset classes reversed last month's negative returns

Value Added

	1 Year			3 Year			5 Year		
	Allocation	Selection	Total	Allocation	Selection	Total	Allocation	Selection	Total
Global Equity	0.35	1.20	1.55	(0.29)	1.25	0.96	(0.42)	1.11	0.69
Fixed Income	1.12	0.45	1.57	0.50	0.36	0.86	0.49	0.38	0.87
Real Estate	(0.07)	(0.07)	(0.14)	(0.10)	0.01	(0.09)	(0.23)	(0.26)	(0.49)
Private Equity	0.11	(1.11)	(1.00)	0.14	(0.67)	(0.53)	(0.11)	(0.91)	(1.02)
Commodities	(0.40)	(0.40)	(0.80)	(0.19)	0.01	(0.18)	0.10	0.14	0.24
Cash	(0.75)	0.01	(0.74)	(0.67)	0.04	(0.63)	(0.95)	0.11	(0.84)