

REPORT SUMMARY

The Total Market Fund returned -0.59% for the month, outperforming its policy benchmark by 72bps, while outperforming for the quarter by 142bps at 1.45%. The portfolio continues to perform as designed, providing downside protection and capturing most of the upside. *The following manager/ strategy searches and research projects are ongoing: active frontier/emerging market equity, real assets, and diversifying strategies.*

CIO REPORT

The month of December was volatile for global markets as the S&P 500 experienced a sharp 5% correction and crude oil's bear market continued with another 20% decline on the month. The University of Michigan Consumer Confidence Survey reached a 10 year high of 93.6 as the effect of significantly lower gas prices boosted consumer's outlook. US GDP rose moderately to finish the year at a 2.4% annual growth rate. New jobs to the US economy far exceeded expectations with an increase of 349,000 in December. The headline unemployment rate remained relatively even from last month at 5.8%. Overall, the U.S. economy continues to move in a positive direction while many foreign economies are showing signs of slowing growth. Expectations for global GDP growth began the year at 2.83% but actual GDP growth for 2014 is now expected to slow to 2.4%. Improved credit conditions in Europe have not helped to strengthen their economies and high unemployment has remained an issue both politically and economically. Emerging markets also continue to disappoint in 2014 with Brazil and Russia taking the brunt of the abuse. China's expected slow-down will most likely continue through 2015 with the stabilization of growth as the best outcome. The economic strength of the US relative to the rest of the world was reflected in equity market performance with the S&P 500 returning 13.66% while the MSCI All Country World Index Ex-US return -3.27% for 2014. In addition, the global economic weakness continued to put downward pressure on interest rates across the globe, especially in Europe. The global economic weakness also put pressure on commodities, which declined by 17% on the year.



“ Change is the law of life. And those who look only to the past or present are certain to miss the future. ”

— John F. Kennedy

The Total Market Fund returned -0.59% for the month, outperforming its policy benchmark by 72bps, while outperforming for the quarter by 142bps at 1.45%. Micro cap equities lead equity returns at 7.61% for the quarter while the developing world took the largest hit with -7.73% though the sub-asset class outperformed its benchmark by nearly 80bps. Agriculture and farmland was the best performing sub-asset class, returning 34.18% for the quarter due to a large write-up for Adveq Harvested Resources which returned 76.31% for the previous month. Because of this write-up, Real Assets was the highest returning asset class for the quarter at 2.78% even while Commodities returned -16.27% because of declining oil prices. MERS core fixed income returned 0.84% in the fourth quarter, providing downside protection and stability. Finally, MERS Diversifying Strategies allocation remained steady with a quarterly return of 1.99%, outperforming its benchmark by over 50bps. MERS total plan assets* are \$8.98 billion and total MERS assets are \$9.31 billion. Asset class allocations are within target bands and adequate liquidity is available.

*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.

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MERS Portfolio Characteristics

- Positioned to outperform in down markets
- May lag in periods of extended bull markets
- Provided superior risk-adjusted returns
- Hedge against inflation
- Maintain adequate liquidity
- Minimize costs
- Exceed actuarial investment assumption on a long-term basis

What Worked

- Core Equities
- U.S. Fixed Income
- Diversifying Strategies
- U.S. Micro Cap Equity
- Infrastructure
- U.S. Large Cap Equities
- Private Real Estate
- Agriculture
- Fixed Income Substitutes
 - Triple Net Lease

What Didn't Work

- Private Equity
- Emerging Market and Global Fixed Income
- Global Equity
- Emerging Market Equity
- Passive Commodities

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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.

Long-term Trends

- Long-term Trends
- Global growth
- Demographics – aging populations/global population growth
- Emerging market middle class expansion
- Environmental concerns and competition for natural resources

Investment Solutions

- Expanded mandates – under review
- Global investing
- Opportunistic investing
- Disciplined portfolio management--dynamic rebalancing
- Long equities
- Real assets & inflation hedging – priority
- Strategic increases in emerging & frontier market investments

Medium-term Trends

- Government fiscal policy intervention - decreasing
- Political instability & high volatility - increasing
- Banking sector regulatory change implementation
- Lack of credit financing
- Developed country financial sector deleveraging
- Low interest rates
- Currency volatility

Investment Solutions

- Opportunistic investing
- Cash levels slightly elevated
- Fixed income substitutes
- Credit underweight & positioning for inflation
- Real asset investments
- Neutral to slightly overweight equities
- Active currency management

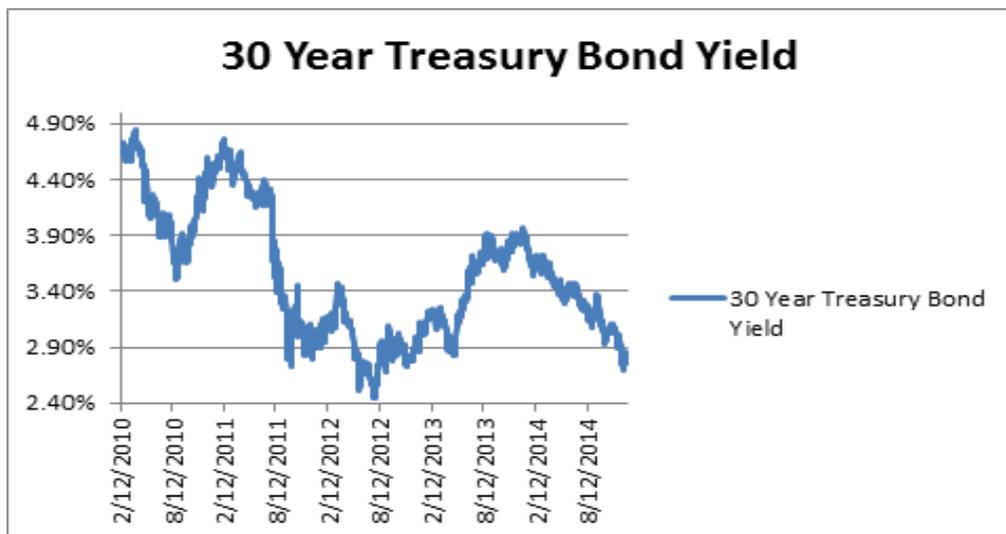
Economic risks

- Monetary policy mistakes - decreasing
- European credit crisis – developed world debt levels - neutral
- U.S. fiscal policy dysfunction - decreasing
- Demographics – aging population
- Social and political instability - increasing
- Global fiscal stress – structural realignments
- China hard landing – neutral

CIO REPORT

| Liquidity Overview | Market Value | % of Total Fund |
|--------------------|------------------------|-----------------|
| Immediate | \$629,259,818 | 7.03% |
| 0 - 30 Days | \$4,883,543,248 | 54.58% |
| 30 – 60 Days | \$349,905,452 | 3.91% |
| 60 – 90 Days | \$963,882,310 | 10.77% |
| 90 + Days | \$2,121,556,371 | 23.71% |
| Total Fund | \$8,948,147,199 | 100.00% |

| Investment Programs AUM | Market Value |
|--------------------------|---|
| Defined Benefit | \$ 8.03 billion |
| RHFV | \$ 594.20 million |
| HCSP | \$ 97.38 million (\$ 93.43 million in MERS Options) |
| ISP | \$ 86.15 million |
| MERS 457 | \$ 19.32 million (\$ 7.19 million in MERS Options) |
| 457 | \$4.64 million |
| DC | \$ 481.10 million (\$ 172.09 million in MERS Options) |
| Total MERS Assets | \$9.31 billion |



“Contrary to expectations entering 2014, interest rates in the US fell throughout the year, with the 30 year treasury bond yield nearing its all-time low set in 2012.”