

REPORT SUMMARY

The Total Market Fund returned -0.67% for the month and 1.90% YTD, outperforming its policy benchmark by 93bps. 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: currency, international microcap, Asian equities, and real assets.

CIO REPORT

June saw most global asset classes give back gains made earlier in the spring. Geopolitics and Greek debt negotiations in the Eurozone dominated headlines and soured investor sentiment late in the month, creating equity market volatility. Preliminary second quarter US GDP growth figures showed the US economy grew at 2.3% on the quarter, down from over 4% at this time last year. As a result, US GDP growth expectations for the entire year 2015 have moderated from 2.5% to 2.2%. Growth expectations in Europe continued to accelerate as measured by manufacturing indicators and confidence surveys, although absolute levels of GDP growth are expected to be about half of those in the US. New jobs added to the US economy somewhat disappointed economists' expectations with 223,000 jobs added in June. The headline unemployment rate fell to 5.3% as the labor force participation rate fell to 62.6%, its lowest since 1977. Overall, the US economy is expected to recover from its first quarter slowdown, and European and Japanese economies are also expected to continue growing modestly. Somewhat firmer economic data in the US now has the market prepared for a 25 basis point increase in the Fed Funds rate in September. As a result, fixed income and currency markets are expected to remain volatile throughout the year. Expectations for global GDP growth in 2015 have remained constant at around 2.8%. Improved credit conditions in Europe, lower energy prices, a lower currency, and their QE program are providing support for the economic recovery. However, on-going debt negotiations between Greece and the Eurozone are set to strain the political and social fabric of the continent. China's expected slow-down will most likely continue through 2015 with the stabilization of growth as the best outcome. As a reminder of ongoing market volatility, Chinese equities fell 25% on the month from their multi-year highs after nearly a 120% rally in the preceding nine months.



“

**To be prepared
is half the victory.**

”

— *Miguel de Cervantes*

The Total Market Fund returned -0.67% for the month, outperforming its policy benchmark (65% MSCI ACWI IMI/ 35% Barclays Global Aggregate) by 92bps. Equity markets drove overall fund performance for the month, returning -1.21%. Small cap and micro cap stocks outperformed large caps, returning 0.25% and 1.06% respectively. The story for the second quarter was similar with small and micro-cap outperforming core equity. Developing equities underperformed, returning -1.48% in June. However, developing equities outperformed on the quarter, returning 2.04% driven by emerging market small cap and frontier markets. Core fixed income returned -0.84% in June, driven by rising long term interest rates. Emerging market debt underperformed with a return of -1.75% last month. This capped a negative quarter for global fixed income, which returned -0.68% as interest rates increased throughout the world. Diversifying strategies provided upside to the portfolio with a return of 1.16% on the month driven by equity market neutral and credit hedge funds. Diversifying strategies returned 2.42% on the quarter. Real Assets also provided upside to the portfolio with a gain of 0.97% on the month. Returns in real assets were driven by a 2.33% gain in infrastructure, a 1.03% gain in real estate, and a 0.93% gain in commodities. As part of its Real Assets redesign, MERS fully exited its investment in passive commodities (Cargill) at the end of June. MERS total plan assets* are \$9.08 billion and total MERS assets are \$9.44 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.

CIO REPORT

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

- US Micro and Small Cap Equity
- Fixed Income Substitutes
Triple Net Lease
- Infrastructure
- Commodities
- Agriculture and Farmland
- Diversifying Strategies

What Didn't Work

- Core, Emerging Market, and Frontier Equities
- Core, Emerging Market, and Global Fixed Income
- Timber

** 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.*

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 - increasing

Investment Solutions

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

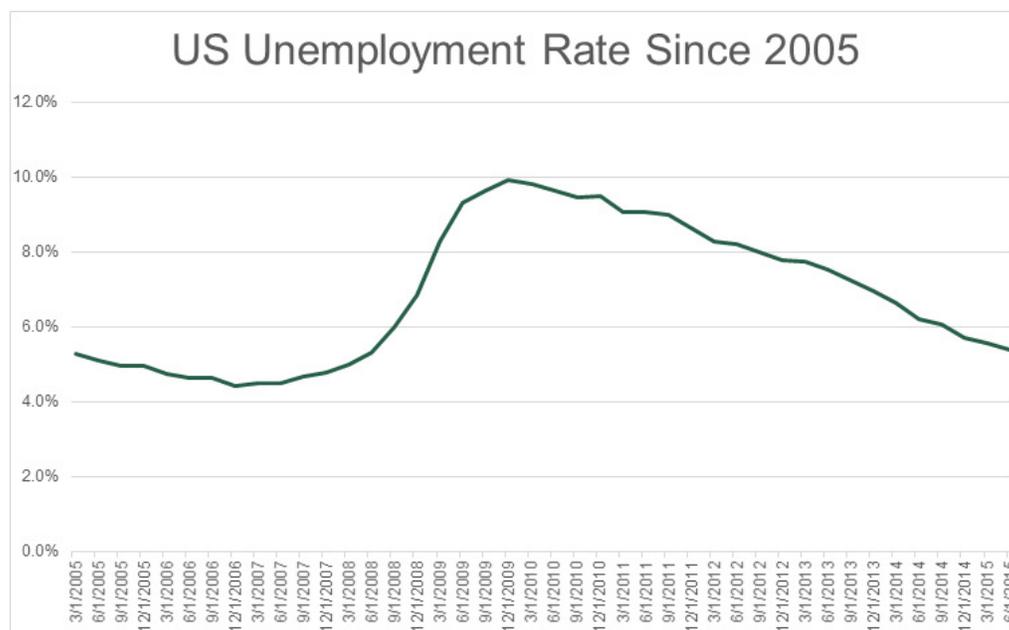
Economic risks

- Monetary policy mistakes - decreasing
- 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	\$573,990,628	6.32%
0 -30 Days	\$4,981,991,507	54.88%
30 – 60 Days	\$341,178,980	3.76%
60 – 90 Days	\$1,006,343,082	11.09%
90 + Days	\$2,173,711.153	23.95%
Total Fund	\$9,077,215,350	100.00%

Investment Programs AUM	Market Value
Defined Benefit	\$ 8,084,742,396.78
RHFV	\$ 628,277,294.83
HCSP	\$ 104,187,012.26 (\$ 99,647,992.66 in MERS Options)
ISP	\$ 46,833,497.73
MERS 457	\$ 24,106,750.04 (\$ 7,996,931.67 in MERS Options)
457	\$4,319,569.01
DC	\$ 510,576,666.02 (\$ 175,584,197.20 in MERS Options)
Total MERS Assets	\$9,403,043,186.67



In June, the US unemployment rate fell to 5.4%, its lowest level since 2008.