

Absolute Return Review

November 2, 2016

Prepared at the request of:

Kentucky Retirement System



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Important Information (continued)

Customized solutions are speculative investments and are not suitable for all investors, nor do they represent a complete investment program. Customized solutions are available only to qualified investors who are comfortable with the substantial risks associated with investing in customized solutions. An investment in a customized solution includes the risks inherent in an investment in securities. There can be no assurance that an investment strategy will be successful.

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Potential loss of investment - No guarantee or representation is made that the investment program used by KKR Prisma will be successful. Customized solutions represent speculative investments and involve a high degree of risk. An investment in any customized solution should be discretionary capital set aside strictly for speculative purposes. Investors must have the financial ability, sophistication/experience and willingness to bear the risks of an investment in a customized solution. An investment in a customized solution is not suitable for all investors. An investor could lose or a substantial portion of his/her/its investment. Only qualified eligible investors may invest in a customized solution. Because of the nature of the trading activities, the results of a customized solution's operations may be volatile from month to month and from period to period. Accordingly, investors should understand that past performance is not indicative of future results. Customized solutions typically represent that their returns have a low correlation to the major market indices. Investors should be aware that customized solutions may incur losses both when major indices are rising and falling.

Important Information (continued)

Use of leverage – Customized solutions may utilize leverage and may also invest in forward contracts, options, swaps and over-the-counter derivative instruments, among others. Like other leveraged investments, trading in these securities may result in losses in excess of the amount invested.

Regulatory risk – No customized solution will be registered under the 1940 Act. As a result, investors will not receive the protections of the 1940 Act afforded to investors in registered investment companies (i.e. “mutual funds”). The offering documents for customized solutions are not reviewed or approved by federal or state regulators and its privately placed interests are not federally or state registered. In addition, a customized solution may engage in trading on non-U. S. exchanges and markets. These markets and exchanges may exercise less regulatory oversight and supervision over transactions and participants in transactions.

Valuations – The net asset value of a customized solution may be determined by its administrator in consultation with KKR Prisma, or based on information from the manager(s) of the underlying funds. Certain portfolio assets may be illiquid and without a readily ascertainable market value and accuracy of valuations of other managers may be difficult to verify. Since the value assigned to portfolio securities affects a manager’s or advisor’s compensation, the manager’s or advisor’s involvement in the valuation process creates a potential conflict of interest.

The value assigned to such securities may differ substantially from the value a customized solution is able to realize. Instances of mispriced portfolios, due to fraud or negligence, have occurred in the industry.

Fees and expenses – A customized solution may be subject to substantial charges for management, advisory and brokerage fees. It may be necessary for those pools that are subject to these charges to make substantial trading profits to avoid depletion or exhaustion of their assets. Please refer to the relevant Confidential Placement Memorandum for a more complete description of risks and a comprehensive description of each expense to be charged to the customized solution.

Reliance on key persons – A customized solution’s manager or advisor has total trading authority over the customized solution and may be subject to various conflicts of interest. The death, disability or departure of the manager or advisor may have a material effect on a customized solution.

Concentration – A customized solution may use a single advisor or employ a single strategy, which could mean a lack of diversification and higher risk. A fund of funds relies on the expertise of its underlying managers.

Counterparty and bankruptcy risk – Although KKR Prisma will attempt to limit its transactions to counterparties which are established, well-capitalized and creditworthy, a customized solution will be subject to the risk of the inability of counterparties to perform with respect to transactions, whether due to insolvency, bankruptcy or other causes, which could subject a customized solution to substantial losses.

Limited liquidity – Your ability to redeem Interests will be limited and subject to certain restrictions and conditions under the applicable Limited Partner Agreement. No secondary public market for the sale of the Interests exists, nor is one likely to develop. In addition, your Interests will not be freely transferable.

Tax risks – Investors in customized solutions may be subject to pass-through tax treatment of their investment. Since profits generally will be reinvested in the customized solution rather than distributed to investors, investors may incur tax liabilities during a year in which they have not received a distribution of any cash from the underlying investments. In addition, it is likely that the general partner will not be able to prepare its tax returns in time for investors to file their returns without requesting an extension of time to file.

Volatile markets – Market prices are difficult to predict and are influenced by many factors, including: changes in interest rates, weather conditions, government intervention and changes in national and international political and economic events. Please refer to the relevant Confidential Private Placement Memorandum for a more comprehensive description of volatility factors.

The above summary is not a complete list of the risks, tax considerations and other important disclosures involved in investing in customized solutions and is subject to the more complete disclosures in the relevant Confidential Private Placement Memorandum and related Subscription Agreement, which must be reviewed carefully prior to making an investment.

Contents

I. Portfolio Review	6
II. The KKR-KRS Partnership	10
III. Appendix	12

Portfolio Review

Absolute Return Allocation Overview

Definition

- Absolute return strategies, by definition, are not necessarily a separate asset class, but broaden the opportunity set within existing asset classes such as stocks, bonds, currencies and commodities by going long and short, employing derivatives and leverage, and shortening and extending investment horizons, amongst others

Purpose of the Portfolio

- Identify strategies that seek to provide both favorable stand-alone risk-adjusted returns as well as provide the benefit of diversification for the overall plan

KRS Investment Guidelines

- Achieve a rate of return that exceeds the appropriate benchmark (HFRI Diversified Fund of Fund Composite) annually net of all investment management fees, with similar risk relative to the benchmark
- For periods greater than five years or a full market cycle, achieve a rate of return that exceeds the appropriate long-term objective (1-year Treasury Bill rate + 500 basis points)

Key Differentiator

- A focus on absolute returns, largely uncorrelated to systematic market factors, such as equities or credit

Fiscal Year 2016 Review: Assets

Table 2: Manager Summaries

Direct Hedge Funds				Fund of Funds			
	Pension (\$000)	Insurance (\$000)	System (\$000)		Pension (\$000)	Insurance (\$000)	System (\$000)
Coatue	\$15,922	\$5,310	\$21,232	KKR Prisma	\$521,229	\$216,600	\$737,829
Davidson Kempner*	\$30,831	\$10,280	\$41,111	BAAM	\$289,127	\$113,930	\$403,057
DSAM+*	\$14,959	\$4,990	\$19,949	PAAMCO	\$14,756	\$3,980	\$18,736
Glenview*	\$12,821	\$4,270	\$17,091	Fund of Funds Total	\$825,112	\$334,510	\$1,159,622
HBK Fund II	\$31,049	\$10,350	\$41,399				
Jana Partners Qualified*	\$13,338	\$4,450	\$17,788	Absolute Return Total (Directs + FoFs)	\$1,090,168	\$422,870	\$1,513,038
Knighthood Domestic	\$14,014	\$4,670	\$18,684				
LibreMax Partners	\$15,107	\$5,040	\$20,147				
LiquidAlts H2O *	\$10,873	\$3,620	\$14,493				
Luxor Capital Partners	\$10,113	\$3,370	\$13,483				
Myriad Opportunities*	\$26,636	\$8,880	\$35,516				
Pine River	\$14,520	\$4,840	\$19,360				
QMS*	\$15,222	\$5,070	\$20,292				
Scopia PX LLC	\$14,216	\$4,740	\$18,956				
Tourbillon*	\$25,435	\$8,480	\$33,915				
Direct Hedge Funds Total	\$265,056	\$88,360	\$353,416				

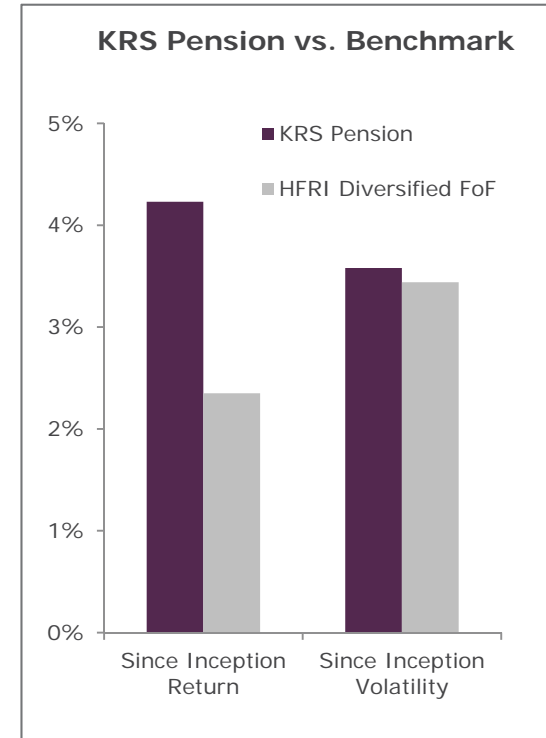
- Direct allocations represented ~25% of KRS' total absolute return portfolio as of June 30, 2016
- Allocations to Fund of Funds were consolidated in an effort to increase efficiency and provide cost savings

Note: Data as of June 30, 2016. *Manager added in Fiscal Year 2016. Direct Hedge Fund data based on best available information. Fund of Funds data based on best available information provided by KRS. Source: KRS Monthly Performance Update – July 2016 retrieved from www.kyret.gov on October 25, 2016.

Fiscal Year 2016 Review: Performance

Table 3: Performance Summaries (Net of Fees) *

	KRS Absolute Return Portfolio	HFRI Diversified FoF	Relative Performance
Fiscal YTD			
KRS Pension	-4.98%	-4.87%	-0.11%
KRS Insurance	-4.91%	-4.87%	-0.04%
3-Year Annualized Performance			
KRS Pension	2.72%	2.03%	0.69%
KRS Insurance	2.76%	2.03%	0.73%
Since Inception Annualized Performance			
KRS Pension	4.23%	2.35%	1.88%
KRS Insurance	4.22%	2.35%	1.87%



Note: Fiscal YTD performance has been calculated from July 2015 – June 2016. Since Inception performance has been calculated from September 2011 – June 2016. Volatility has been calculated based on the standard deviation of returns, annualized since the inception of the portfolio. Data is based on best available information provided by KRS. **Past performance does not guarantee future results.** *Source: KRS Monthly Performance Update retrieved from www.kyret.gov on October 25, 2016.

The KRS-KKR Prisma Partnership

Value-Added Services

✓ Cost Savings

- Cost efficiency is a key aspect of this partnership
 - KKR Prisma is focused on negotiating fees with underlying managers and passing the savings along to KRS
 - As KKR Prisma helped KRS build out their direct program, the need for multiple providers was minimized, potentially resulting in a fund of hedge funds fee reduction of over 50% or ~\$8.4M*

✓ Extensive Resources

- Seasoned team of absolute return specialists have conducted full due diligence (Investment, Risk, and Operations)
- Presented a complete review of the KRS Absolute Return Portfolio at KRS' Annual Board Meeting
- Conducted quarterly manager review calls with legacy managers
- Collaborated with Albourne on manager selection and due diligence
- Facilitated regular contact with KKR Prisma investment professionals, including a local presence in Kentucky

✓ Risk Transparency

- Our risk team has conducted comprehensive risk analysis including:
 - Risk due diligence and risk reporting at both the KRS portfolio- and manager-levels
 - RiskMetrics onboarding of all managers (both legacy and new positions) for improved analytics
 - Risk education for the KRS Investment Committee
 - Developing a customized risk report for KRS' public website

Note: Please see important information regarding the risks associated with investing in Absolute Return Strategies. For illustrative purposes only.

*Assumes a program size of \$1,600M. Calculated based on actual FoFs fees; incentive fees include an assumed return of 5%.

Appendix

Endnotes

Indices

The risk/return profile of the indices is materially different from that of a KKR Prisma account, and an investment in a KKR Prisma account is not comparable to an investment in the securities that comprise the indices. Investments of the KKR Prisma account may be illiquid, making at times, fair market valuation impossible or impracticable. As a result, valuation of the KKR Prisma account may be volatile, reducing the utility of comparison to any index whose underlying securities are priced according to market value, such as the indices. Investors should be aware that KKR Prisma accounts may incur losses both when major indices are rising and when they are falling.

The **HFRI Fund of Funds Diversified Index** includes FOFs classified as 'Diversified.' These FoFs typically exhibit one or more of the following characteristics: invests in a variety of strategies among multiple managers; historical annual return and/or a standard deviation generally similar to the HFRI Fund of Fund Composite index; demonstrates generally close performance and returns distribution correlation to the HFRI Fund of Fund Composite Index. A fund in the HFRI FOF Diversified Index tends to show minimal loss in down markets while achieving superior returns in up markets. For more information please visit www.hedgeindex.com.

Unless otherwise indicated, all performance data is as of June 30, 2016 and was retrieved on October 25, 2016.

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