Public Equity

Annual Review
October 2015

SUMMARY

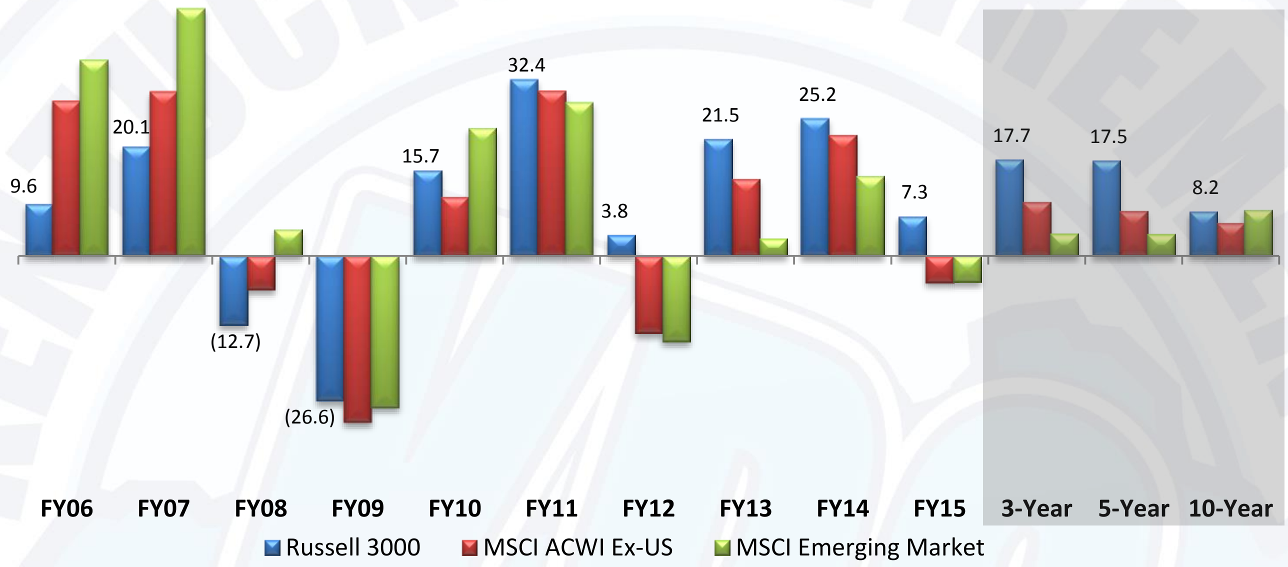
FY2015 was heavily influenced by geopolitical and macro events

- Russian invasion of Crimea Region
- China slowing – shift in domestic economy
- Commodity price declines – slowed global growth
- Uncertainty in Europe – Greece; European growth improvement/sustainability
- Strengthening USD
- U.S. interest rate hike anticipation – impact

- **U.S. broad equity market gained 7.3% (Russell 3000)**

- **International markets struggled; both developed (-3.8% MSCI EAFE) & emerging (-4.8% MSCI EM)**

Public Equity Index Returns



SUMMARY

Shorter Term - Total Equity portfolios have slightly outpaced their associated benchmarks

- Outperformance primarily driven by …
  - Strong relative performance within the active Non-U.S. mandates
  - Overweight to U.S. Equities (best performing public equity market for the FY)
  - Slight underweight to Emerging Markets (Insurance side)
  - Partially offset by weaker relative performance within the U.S. Equity portfolios
    - Mid Caps / Invesco / River Road

Longer Term – Both funds have outperformed over the trailing 3-yrs & fallen short over the trailing 5-yrs

Public Equity Performance Review (Returns are Net) – as of June 30, 2015							
		1 Year		3 Year		5 Year	
	% Fund	KRS	Index	KRS	Index	KRS	Index
Pension							
U.S. Equity	20.7%	6.0%	7.3%	17.2%	17.7%	16.9%	17.5%
Non-U.S Equity	20.0%	(4.0%)	(4.9%)	10.6%	9.9%	6.9%	8.4%
Emerging Markets#	3.1%	(6.7%)	(4.8%)	3.6%	4.1%	-	-
Total Equity	43.8%	0.7%	0.6%	13.3%	13.1%	11.7%	12.3%
Insurance							
U.S. Equity	23.5%	6.3%	7.3%	17.1%	17.7%	16.7%	17.4%
Non-U.S Equity	20.0%	(4.2%)	(4.9%)	10.4%	9.9%	6.3%	8.3%
Emerging Markets#	3.9%	(6.7%)	(4.8%)	3.6%	4.1%	-	-
Total Equity	47.4%	0.9%	0.7%	13.2%	13.0%	11.3%	12.2%

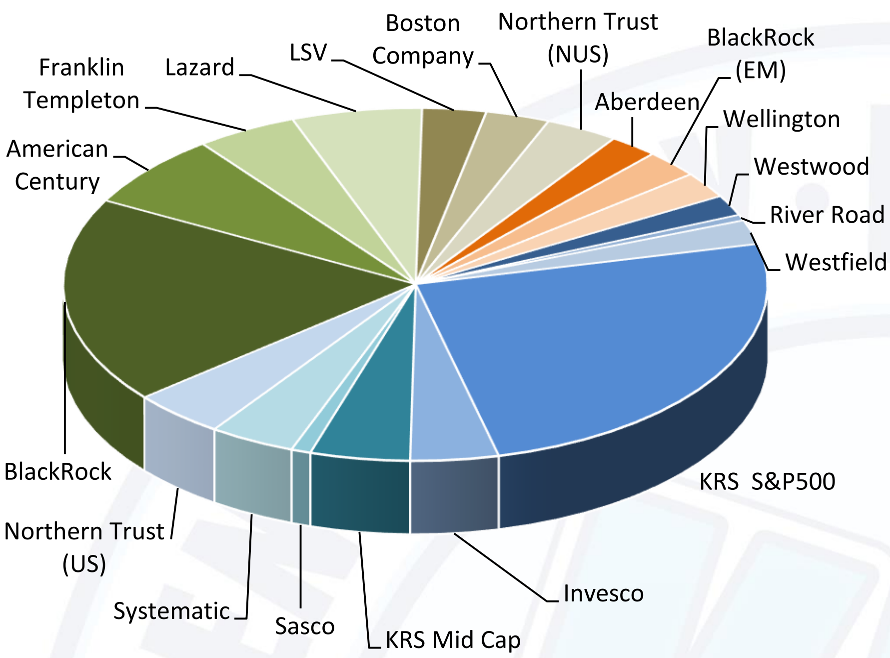
Emerging Markets became dedicated allocation as of June 30, 2011; thus, only the 1 & 3-year return is available. Prior EME performance is incorporated in Non-US trailing returns

Current Positioning

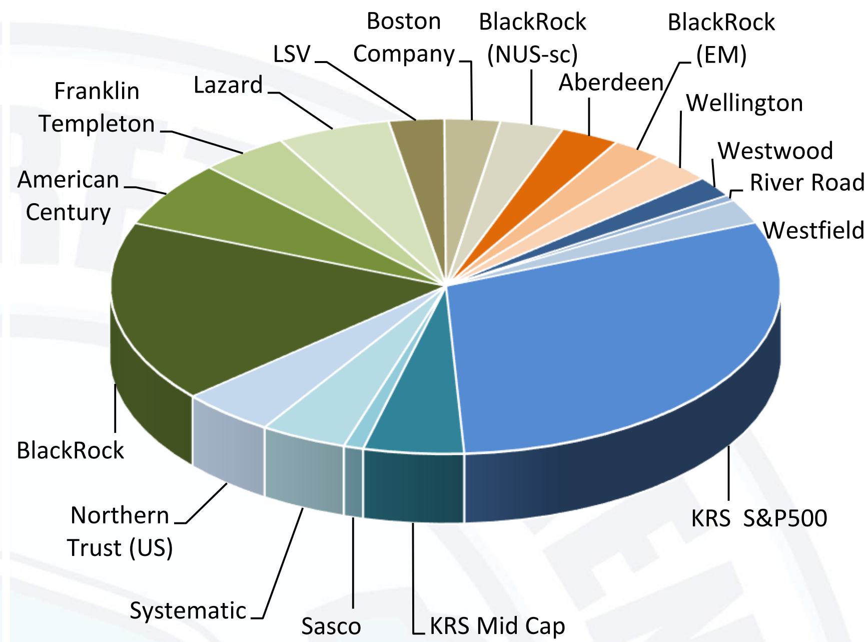
KRS's Total Equity Portfolios - as of June 30, 2015

- Pension: 43.8% of Fund, Valued at $5.0 Billion
- Insurance: 47.4% of Fund, Valued at $2.0 Billion
- Total of 15 External managers, 2 Internally Managed Funds (mandates: pension 19 / insurance 18)

Pension Fund



Insurance Fund



FY2015 Activity

Completed Non-U.S. Equity transition & funded July 1, 2014

- Core-satellite structure; concentrated mgrs added / diversified legacy mgrs downsized
  - Pyramis terminated primarily due to key staffing turnover ($380m to ACI & FT)
- FY15 Performance: KRS -3.99% vs MSCI ACWI Ex-US -4.85%

Transitioned Internal U.S. Mid Cap ETF portfolio in June 2015

- Shift from Spyder MDY to iShares IJH
  - Expected gross performance essentially the same
  - Associated expense ratio cut in half (0.25% => 0.12%)

Significant total fund rebalanced focused on Public Equity, Fixed Income, and Cash

- PEN: Generated $230m from U.S. Equity => Non-U.S. Equity, Core Fixed Income, and $61m Cash
- INS: Raised $60m from U.S. + $40m Cash => Non-U.S. & EM Equities, Core Fixed Income

U.S. and Non-U.S. portfolios utilized to raise funds for cash flow needs (outside of previous bullet point)

- $126 million raised across internal and external accounts
  - KERS systems $62 million

Items of Note

- **Westwood (6.2% vs 3.9%)**
  - Relative outperformance driven by allocation & good selection within materials
    - Underweight to energy & utilities; overweight to consumer discretionary

- **Westfield Capital (8.7% vs 10.7%)**
  - Absolute return outpaced the broad market; underperformed the style biased index
    - Poor stock selection within 6 of 10 sectors; buoyed by health care overweight

- **Invesco (4.5% vs 7.4%)**
  - Model predictability struggled amongst heightened volatility
    - Model top ranked stocks (4 broad fundamental/qualitative categories) were market laggards

- **Sasco Capital (-8.8% vs 3.7%)**
  - Vast majority of underperformance from sector allocation
    - Significant overweight to energy & materials accounted for 850 bps
    - Zero weight to healthcare accounted for 300 bps
  - Sector performance tends to mean revert

- **Systematic (-0.7% vs 3.7%)**
  - Underexposure to high-yielding stocks was a headwind
  - Weak stock selection in materials, industrials, IT, & consumer staples & overweight to energy

ITEMS OF NOTE (CONT.)

- **NTGI US Small Cap (7.6% vs 6.5%)**
  - Driven by solid stock selection within industrials, energy, & consumer staples
  - New PM/Research Analyst named …
    - Lead PM position remains stable – has been since product inception in 1999

- **Boston Company (-6.6% vs -4.9%)**
  - Structural bias continued to be a headwind; deep value tilt in a growth market
  - Market’s willingness to pay up for bond proxies
  - Overweight to energy and materials was a hindrance

- **American Century (-3.3% vs -4.9%)**
  - Positive sector allocation decisions; combination of underweight energy with overweight consumer discretionary & technology
  - From a regional perspective, benefited from both stock selection & allocation decisions
  - Firm added a co-PM replacing an individual who had left just prior to KRS hiring
    - Longer-term sitting PM has been on the portfolio for several years

- **Franklin Templeton (-1.9% vs -4.9%)**
  - From a country perspective, stock selection was beneficial; despite allocation headwinds
  - Benefited from underweight to energy combined with overweight to information technology

Items of Note (cont.)

- **Lazard (-0.1% vs -4.9%)**
  - Benefited from strong stock selection at both the sector & country levels
    - Added value in all sectors – financials, materials, energy
  - Net allocation effects were relatively modest both from a sector & country perspective

- **LSV (-3.4% vs -4.9%)**
  - Deeper value manager performed well despite style headwind; ACWI Ex-U.S. Value -8.4%
  - Strong stock selection at country level & within consumer staples; underweight energy sector

- **Aberdeen (-8.3% vs -4.8%)**
  - Underperformance was broadly based, sector allocation & stock selection decisions detracted
    - Overweight consumer discretionary combined with an underweight to IT
    - Poor stock selection within financials
  - Significant underweight to China cost over 200 bps of relative underperformance
  - Strategy experienced net outflows of approx. $420m due to client turnover
    - AUM continues to remain at level of concern for staff & consultant; staff has already reduced exposure, & will continue to do so. Continued monitoring is warranted.

- **Wellington (-6.4% vs -4.8%)**
  - Underperformance driven by poor macro calls; magnified by poor stock selection across both sector and country
    - Bolstered by underweight to materials combined with overweight to healthcare & IT
  - Strategy experienced net outflows of $1.5b; significant & concerning
    - AUM remains at $4b – staff & consultant will continue to monitor

COVERAGE – U.S. EQUITY

Current U.S. Equity Target Allocation

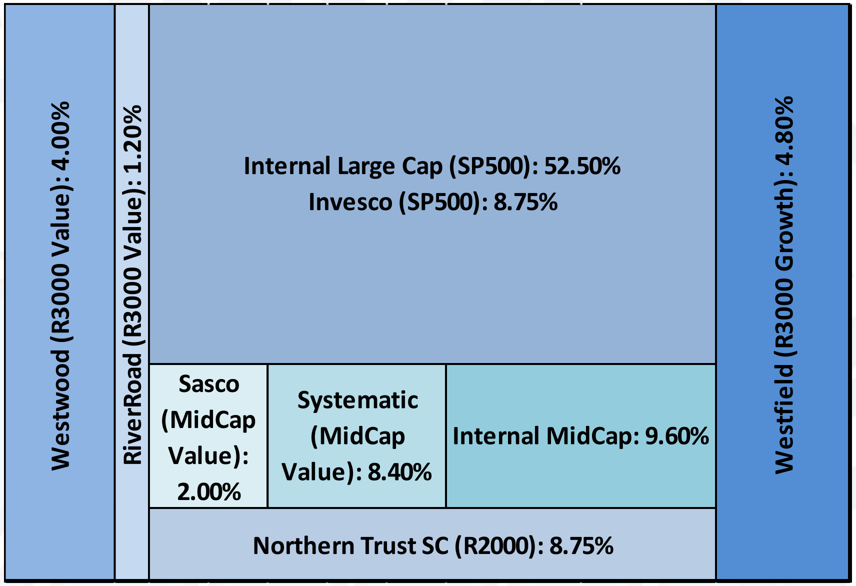
- Portfolio allocation across market capitalization is generally aligned with Russell 3000 Index
  - All Cap exposure provides (limited) dynamic market cap tilts
  - Portfolio is managed for style neutrality

Current Structure Concerns

- Too many managers – over-diversified (performance limitations), difficult to manage, not taking full advantage of fee tier schedules

Potential Remedy

- Re-create core-satellite structure utilized on Non-U.S. Equity side of the portfolio
- Evaluate current mandate sizing & fit in the context of a new structure
- Explore active / passive argument
  - Fundamental Indexing vs Capitalization Weighted Indexing



Coverage – Non-U.S. Equity

Current Developed Non-U.S. Equity Target Allocation

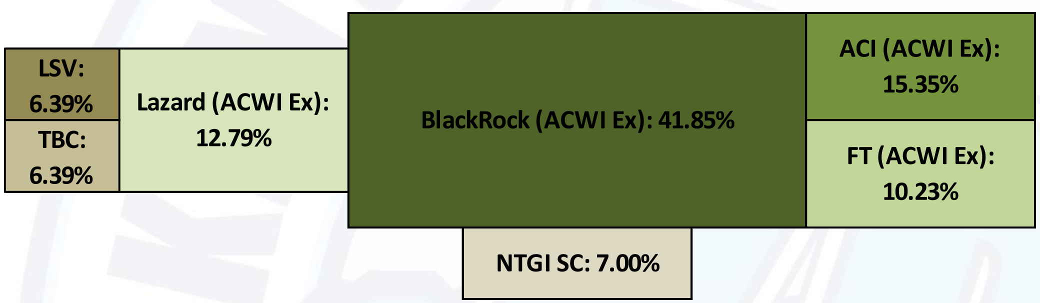
- Benefits over prior structure (pre July 1, 2014)
    - Improved manager diversification
    - Increased potential excess return with concentrated mandates
    - Diversified across market cap & region, including a dedicated allocation to small cap

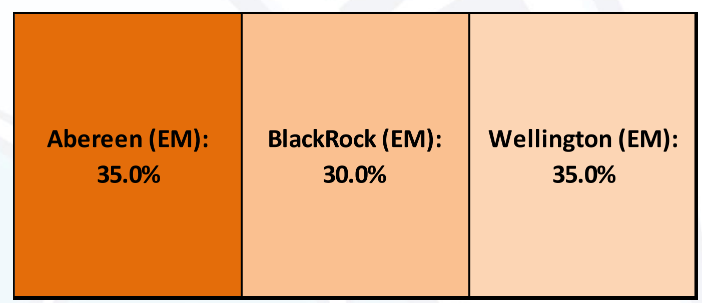
Current Emerging Market Equity Target Allocation

- Total allocation is a strategic target
- Active managers (Aberdeen and Wellington) have complementary styles
- Current passive allocation to BlackRock captures broad emerging market exposure

Evolution of Portfolio

- Continue to evaluate current mandates: both sizing & fit within structure
- Explore active / passive argument
    - Though developed international markets have become more efficient, they are still less so than in the U.S., potentially providing opportunity for active management





Looking forward

- **Anticipated new asset allocation will necessitate …**
    - Transition additional assets into the public equity space
    - A shift in invested dollars within the sub-asset classes

- **Staff has begun and will push to revamp U.S. structure**
    - Continue to evaluate staff's internal indexing capabilities
    - Core / satellite structure potential

- **Additional scrutiny of Non-U.S. Equity allocation …**
    - Manager termination & future changes create tilts that need to be addressed

- **Explore low/managed volatility strategies within the public equity space**

- **Evaluate the use of passive versus active strategies; and location of use**

- **Continue working with CIO, RVK, & other staff members to implement any necessary portfolio changes, rebalances, and meet cash needs**

Conclusions / Recommendations

Conclusions

U.S. Equity investors were rewarded in FY15, while investments outside the U.S. produced losses. The U.S. has been in recovery for some time, Europe struggles to get a foothold, and emerging countries are left wanting. A global economy starved for growth is turning to the U.S. as its safe haven to pull the rest of the world along. It remains to be seen who will influence whom.

KRS Total Public Equity portfolios posted modest results just edging their respective benchmarks.

- The portfolios benefited from a slight overweight to U.S. Equities, combined with a small underweight to Emerging Markets (Insurance only)
- Further, the Non-U.S. portfolio produced 86 bps of downside protection generated by the newly funded active mandates
- The emerging market allocation struggled as the fundamentally bottom-up active mandates failed to appreciate how influential the macro events of the year could be
- Individual managers
    - Relatively uneventful from an organizational standpoint; few material staffing changes
    - Performance was disappointing: 6 of 14 actively managed strategies added value over their respective indices

Recommendations

No recommendations at this time. With that said both Staff & RVK are closely monitoring several managers for either organizational or performance purposes and will promptly notify the committee if it is believed an action is required.