2014 Investment Year in Review

SACRAMENTO COUNTY EMPLOYEES' RETIREMENT SYSTEM

SCERS

2014 Investment Year in Review

Issued By:

Richard Stensrud
Chief Executive Officer

Scott Chan
Chief Investment Officer

Steve Davis
Deputy Chief Investment Officer

JR Pearce
Investment Officer

Sacramento County
Employees' Retirement System
980 9th Street, Suite 1900
Sacramento, CA 95814
www.scers.org

Table of Contents

INTRODUCTION

As Chief Executive Officer of the Sacramento County Employees' Retirement System (SCERS), I am pleased to present this report on SCERS' 2014 Investment Year in Review (the 'Report').

The purpose of the Report is to:

- Summarize the major events and developments in the investment program in the past year, including investment performance;
- Serve as a reminder of what has been accomplished over the year;
- Highlight the decisions that were made, the rationale for those decisions, and the direction going forward; and
- Preview the investment program's projects and objectives for the year to come.

Overall, it is hoped that this annual report on SCERS' investment program will be helpful for tracking SCERS' progress toward achieving its near-term and long-term investment objectives, and in particular, meeting the fundamental goal of providing the bulk of the funding for the benefits paid to SCERS' members.

In 2014, SCERS leveraged the expertise of its internal investment staff, investment consultants and key investment partners to continue to implement the asset allocation structure adopted in 2011, which was designed to reduce risk, increase diversification and improve investment performance across economic environments. The primary focus of SCERS' investment team in 2014 was to apply those same objectives to the construction and implementation of the individual asset classes, by establishing a customized investment manager structure for each asset class designed to meet the investment objectives of the asset class and assure that the asset class performs its assigned role relative to the overall investment portfolio.

Virtually every asset class was impacted by these activities in 2014, with SCERS' investment team analyzing numerous investment strategies and opportunities for potential consideration in the different asset classes. Those decisions also reflected another important premise in SCERS' investment program: While it is critical to remain disciplined and true to SCERS' asset allocation model, the portfolio cannot remain static, but rather, it must have the capacity to adjust within the parameters of the allocation model based on the status of the investment market cycle.

Asset class construction and implementation will continue in 2015, and for the alternative asset classes in particular, it will be a few years before the asset class structure is fully in place. An important reason to complete the portfolio transition is that when fully implemented, the asset allocation will be better positioned in challenging investment environments. This can be seen in the 2014 calendar year performance. In the last half of 2013 and the first half of 2014, the markets delivered solid returns and for the fiscal year ended June 30, 2014, SCERS earned 16.6%. In the second half of the calendar year, the markets were very tough resulting in a 2014 calendar year return of 5.5%. However, if the asset allocation model had been fully implemented, the calendar year return would have been 6.4%, illustrating the revised model's greater resilience in low return environments.

Overall, the investment performance continues to be strong over the long term, with a three year return of 11.9% per year, a five year return of 9.7% per year, and a return of 8.6% per year for the last twenty-eight years, all comfortably above SCERS current investment return assumption of 7.5%.

The success of SCERS' investment program since the global financial crisis in 2007-2009 ('GFC') has enabled SCERS' assets to grow to nearly $8 billion, which is more than $1.3 billion higher than the asset level before the GFC. Over this period, the strong investment performance has minimized the impact of the market collapse on employer pension costs, saving SCERS' employers millions of dollars. And this strong investment performance has not been driven by robust markets alone, as portfolio implementation decisions by SCERS' investment staff have added more than $300 million to the pension fund over and above base market performance over the past five years, as of fiscal year-end 2014.

The success of SCERS' investment program also led to recognition by the institutional investor community in 2014, with the international financial publication *Chief Investment Officer* selecting SCERS from a roster of global nominees as the winner of its annual 'Industry Innovation Award' for public pension funds with up to $15 billion in assets. Another financial publication, *Institutional Investor,* named SCERS one of four nominees in the small public pension fund category for its annual 'Hedge Fund Industry Awards.' This recognition demonstrates that SCERS' investment program is viewed as a worldwide leader among public pension fund investors.

While this success and recognition is gratifying, the work is not done. Going forward, SCERS will remain focused on identifying ways in which value can be added to the investment program so that it continues to be the funding engine for the benefits SCERS provides.

Respectfully Submitted,

Richard Stensrud

Richard Stensrud
Chief Executive Officer

Staff, Consultants, and Strategic Partners

Under the California Constitution, the SCERS Board has the exclusive authority and fiduciary responsibility for the management of SCERS' investment program. In carrying out this duty, the SCERS Board establishes the strategic direction, asset allocation, return and risk parameters, and investment policies for the retirement system. The SCERS Board receives guidance in making these decisions from its internal staff of investment professionals (Staff) and from expert investment consultants, all of whom also serve as fiduciaries with respect to the fund. Strategic Investment Solutions (SIS) serves as SCERS' general investment consultant; Cliffwater LLC (Cliffwater) serves as lead consultant for the alternative asset classes; and The Townsend Group (Townsend) serves as lead consultant for the real estate asset class.

Given the complexities of managing a large, multi-asset class investment program, the SCERS Board has delegated substantial responsibility for the day-to-day oversight and management of the assets of the retirement system to the internal investment Staff, who in turn, utilize and draw upon the investment expertise and resources of SCERS' investment consultants and key investment partners. SCERS believes that a strong, collaborative partnership between Staff, consultants and investment service providers not only assures the prudent oversight of the fund, but produces significant investment value over time in the form of higher returns, lower risk and lower costs.

The collaborative partnership between Staff, consultants and investment partners is grounded in the following principles:

- Staff focuses on and directly engages in those areas where it can add investment value;
- Consultants serve as an 'extension of staff' in those areas where they have greater expertise, capabilities and/or resources but Staff continues to be actively involved in any decisions involving such areas;
- Both Staff and consultants are responsible for monitoring and overseeing the investment portfolio;
- Both Staff and consultants are charged with developing ways to improve investment performance and manage risk;
- Strategic partnerships may be established with investment providers if they will allow SCERS to: (a) Develop an efficient, customized solution to an investment need; (b) Gain access to specialized investment knowledge or expertise; or (c) Improve access to niche investment markets or strategies that will add value to the portfolio; and
- Overlapping expertise and capabilities of Staff, consultants and strategic partners is beneficial because it brings multiple perspectives to the investment decision-making process.

Implicit in this approach is SCERS' belief that a strong internal investment Staff is central to the successful execution of the investment program, in that Staff: (1) Serves as the 'hub' and coordinator of the activities of consultants and strategic partners; (2) Provides a source of analysis independent from those partners; (3) Allows SCERS to be a generator of investment ideas and not simply a passive recipient of investment ideas; (4) Facilitates investment solutions specific to SCERS' needs; and (5) Enables SCERS to capture and institutionalize knowledge and expertise.

The effectiveness of the collaborative partnership between SCERS' Staff, consultants and strategic partners can be seen in the significant level of asset class construction/implementation activities and other investment program undertakings that occurred in 2014. In addition, as noted in the Introduction, the collective work of SCERS' investment team led to recognition by the institutional investor community and has added substantial value to the fund over and above that provided by market performance alone.

Asset class construction and implementation will continue in 2015, and as in 2014, SCERS' investment team will seek to:

- Eliminate the overlap of risk factors across the investment portfolio and create greater diversification;
- Combine investment strategies which produce lower correlation and covariance;
- Minimize uncompensated risk;
- Lower volatility;
- Create competition for investment allocations by comparing the relative value and risk/return profiles of assets and investment strategies;
- Identify areas where active engagement by Staff adds value;
- Align the interests of investment managers with the interests of SCERS; and
- Assess the status of the investment market cycle and position the portfolio accordingly.

Given the central role that SCERS' investment Staff plays in the investment program, and the central role that the investment program plays in funding the benefits SCERS provides, another important goal in 2015 will be to fully build out and maintain a high quality internal investment Staff. Their pivotal contributions to the success of SCERS' investment program has spurred not only the investment community's recognition of the investment program but has led to SCERS' investment Staff members being recognized as 'Rising Stars' and nominated for 'Chief Investment Officer of the Year' by the respected financial publication *Institutional Investor* as well as being named to the 'Power 100' of influential asset allocators by *Chief Investment Officer* magazine.

If SCERS is to continue to achieve a comparable level of success in 2015 and beyond, it is imperative that SCERS be able to attract and retain the highly qualified investment professionals needed to run SCERS' sophisticated investment program. This investment in SCERS' continued success will pay huge dividends to SCERS' stakeholders in the form of lower pension costs and greater retirement security.

Commentary on the ongoing development of SCERS' investment program from consultants SIS, Cliffwater and Townsend can be found in Appendixes 1-3 of this Report.

Portfolio Overview

Summary Overview

For the calendar year ended December 31, 2014, the Sacramento County Employees' Retirement System ('SCERS') achieved a 5.5% gross return. As explained in more detail below, SCERS' return was below the Policy Index return of 6.4%, but has exceeded the Policy Index over the 3- and 5-year periods, where SCERS returned 11.9% and 9.7% respectively, versus the Policy Index return of 11.2% and 9.5%. Due to the significant increase in the value of global assets since the Global Financial Crisis of 2007-2009 ('GFC') and the excess returns achieved by SCERS, SCERS has fully recovered from the GFC.

Market Overview

Coordinated monetary policy, which was a theme during previous years, diverged in 2014. The U.S., through the Federal Reserve ('Fed'), ended its quantitative easing ('QE') program during the fourth quarter of 2014, with a series of tapering measures. Economic data within the U.S. has been mostly positive, including moderate GDP growth, improving employment trends and rising consumer confidence levels, which has put the Fed in a position to move toward mild tightening sometime over the next year. However, other developed countries either continued or signaled the initiation of their own stimulus programs. Japan is in the midst of a significant QE program and is intent on providing support for its economy through aggressive monetary policy measures. Europe is facing a deflationary environment and the European Central Bank ('ECB') signaled potential quantitative easing measures during the year to address these issues, which transformed into a recent announcement by ECB President Mario Draghi of an aggressive €1 trillion bond buying program. China, which has been facing slowing growth, issued a series of small stimulus measures through a reduction in interest rates during the year.

There were several macro-economic events which impacted financial markets during 2014. A key event was the dramatic decline in oil prices during the second half of the year. Oil prices had spent much of the year above $90 per barrel, but starting in June collapsed into the $40 range by the beginning of 2015. The catalyst for the drop in oil prices was mostly supply driven. Though there was a softening of demand off of slowing global growth, there was also a surge in supply from US shale production. This was combined with an unexpected change in OPEC policy, which maintained production in order to support its market share, instead of cutting supply to support oil prices. The drop in oil prices has been positive for global consumers and importing oil countries like India and China, as it acts as a tax cut and has a stimulating effect on growth, but it has negatively impacted oil exporting countries such as Russia, and those areas that are reliant on oil related capital expenditures. In addition, investors who held direct and indirect oil exposures have been negatively impacted, but the drop in oil prices has also set up potential investing opportunities for patient investors. Toward that goal, Staff and Consultants have been performing due diligence on potential opportunities.

Financial markets experienced divergent results during 2014, especially within equity markets. U.S. equity markets generated strong returns during the year, while non-U.S. markets, including emerging markets, produced negative returns. The S&P 500 and the Russell 3000 were up 13.7% and 12.6% respectively during the year, while the MSCI EAFE and MSCI Emerging Markets Index were down 4.9% and 2.2%, respectively. Non-U.S. equity returns were impacted by slower growth prospects in international economies and a strengthening US dollar. Fixed income returns were positive during 2014, with the Barclays Capital Aggregate returning 6.0% and the Barclays Capital Corporate High Yield Index returning 2.5%.

While 2014 saw most asset prices, particularly U.S. equities, continue to increase, the history of market cycles demonstrates that asset price appreciation is difficult to sustain. Within the current cycle, opportunities to find cheaply valued assets are shrinking as the economic cycle matures with most asset classes becoming fairly valued and even overvalued, though there was more divergences within asset class performance in 2014, and dislocations (in the case of oil prices). Relative value and capital preservation are important areas to be cognizant of at this point in the cycle, and it is important that SCERS remain disciplined in its investing philosophy.

Looking toward 2015, divergent global growth rates, monetary policy initiatives and currency movements could produce increased levels of volatility, but also reduced correlations across regions and individual securities. Such an environment highlights the importance of having a diversified portfolio, and identifying managers and strategic partners with the skill to manage macroeconomic risks and dislocations to produce differentiated excess returns.

Portfolio Review and Considerations

In 2011, SCERS established the long-term asset allocation mix outlined in **Table 1**. SCERS' long-term asset allocation reduces risk by increasing diversification across asset classes. In particular, the asset allocation structure was developed to achieve the following goals: (1) Perform well across different economic environments and risk factors (such as interest rates, duration, foreign exchange, the equity risk premium and inflation); and (2) Maximize risk-adjusted returns (optimize returns given a level of volatility). SCERS' asset allocation structure is designed to keep up with its benchmarks during a growth market, but is also expected to perform well in a variety of economic environments on a relative basis. This latter point is important because as a cycle matures, investors are exposed to changing levels of business risk, market risk and valuation risk.

The changes in asset allocation targets, and structural changes that subsequently followed (and continue to follow), were significant, and the primary focus over the past several years has been implementing these changes within each asset class. Successful implementation of the asset allocation and manager structure is contingent on selecting and maintaining investment managers that will outperform their respective benchmarks. Full implementation is a progressive exercise and will take several more years, especially within the alternative asset classes. The progress in investing and moving SCERS' physical portfolio closer to the target allocation is displayed in Table 1. Table 1 compares the actual physical asset allocation as of the end of 2014 to the target asset allocation. Please note that SCERS utilizes an Overlay Program managed by State Street Global Advisors ("SSGA") in order to bring SCERS' fund in line with its target asset allocation. The Overlay Program uses proxies to replicate exposures within each asset class, and is particularly effective in rebalancing public market assets due to the low tracking error of the underlying proxies compared to public market managers. On the other hand, the Overlay Program is not as effective in replicating alternative asset exposure because it is limited to the use of public market proxies, and creates basis risk to the return and risk characteristics of the underlying asset class.

Table 1 - SCERS' Actual Asset Allocation Versus Target Policy Allocation			
Asset Class	Actual Allocation	Target Policy Allocation	Variance
Domestic Equity	25.2%	22.5%	2.7%
International Equity	17.5%	22.5%	-5.0%
Fixed Income	18.9%	20.0%	-1.1%
Hedge Funds	9.4%	10.0%	-0.6%
Real Assets	7.4%	15.0%	-1.0%
Private Equity	4.6%	10.0%	-5.4%
Opportunities	1.4%	0.0%	1.4%
Overlay Program	9.7%	0.0%	9.7%
Cash	5.9%	0.0%	5.9%

SCERS' asset allocation structure is designed to target diversified exposures across asset classes, which includes exposure to many less correlated segments. The structure gives SCERS the ability to allocate within ranges in segments of an asset class, in order to move capital toward those investment opportunities with the most attractive risk adjusted returns, a point which has become more important as the cycle matures. SCERS has invested towards more attractive relative value opportunities recently, including, for example, by bringing down its core real estate exposure in favor of better risk-adjusted return opportunities within real assets, including several real estate non-core equity and debt investments; a customized separate account with Pantheon Investments to invest in secondary investments and co-investments within private real assets; and several primary fund investments in private real assets funds.

As the cycle matures, however, capital preservation becomes an increasingly important concept, and hence it will be important to position SCERS' portfolio to better weather potential recessionary and dislocating periods. To that end, Staff and Consultants have been making direct private markets commitments to sectors of the economy that are less cyclical, and generate less correlated revenue streams to the broader economy. An example is the healthcare sector, in which SCERS recently committed capital to a healthcare specific buyout fund that gives SCERS exposure to multiple segments of the sector. SCERS also anticipates investing in another fund that makes structured credit investments specifically in healthcare companies. In addition, Staff and Consultants have focused on investing in debt investments that are higher in the capital structure, and are collateralized by hard assets. An example of this is the soon to be completed formation of a custom separate account that will invest in debt backed by real assets, which will reside in SCERS' private real assets sub-asset class, and will serve as a complement to illiquid equity investments in the private real assets segment.

Over the past couple of years, SCERS has been focused on creating more customized separate account structures with the objective to increase Staff engagement and become 'strategic partners' with its investment managers. These partnerships have the goal of increasing communication of the manager's investment insights and knowledge for the benefit of SCERS' total fund, as well as to gain greater control in the investment guidelines, terms and portfolio holdings. These are larger mandates that put more dollars to work with varying levels of discretion, and they give SCERS greater oversight over the mandate, including the ability to underwrite the manager's recommendations and built-in 'veto' rights to turn investments down for inclusion in SCERS' portfolio. The previously mentioned Pantheon separate account is an example of this type of mandate.

Strategic partnerships also allow SCERS to invest larger dollar amounts to complement SCERS' direct commingled fund investments, particularly within the alternative asset classes, and in areas where SCERS has limited resources to invest fully on a direct basis. An example of a current partnership is the diversified hedge fund portfolio that Grosvenor Capital Management manages on behalf of SCERS, which serves as a complement to SCERS' direct hedge fund portfolio. The Grosvenor portfolio has given SCERS diversified exposure to a variety of hedge fund strategies, and has generated strong risk adjusted returns.

Within SCERS' asset classes are segments and niches where SCERS has limited expertise and reach, or has difficulty accessing, or accessing with sufficient scale, given its constrained Staff resources. Going forward, SCERS will potentially utilize more of these types of relationships in these areas. An example could include segments of the Private Equity portfolio, such as venture capital ('VC'). It is difficult for SCERS to gain access to many of the bellwether VC funds with consistently small fund sizes that do not offer access to new investors, and due to transparency issues related to FOIA requests that make public pension plans a less attractive source of capital. A strategic partnership dedicated to VC, would give SCERS access to many of the bellwether VC funds in addition to emerging VC funds that might have spun out from established firms, but are too small or new for SCERS to consider for a full direct allocation. It would complement larger core VC allocations within SCERS' direct Private Equity portfolio, and would give SCERS access to expertise within other asset classes of the partner, as well as other firm resources.

Portfolio Performance and Attribution

Given the ongoing implementation of the asset allocation model, SCERS utilizes two different benchmarks when assessing performance of the total portfolio. The Allocation Index reflects the passive market performance for the SCERS portfolio as it currently stands. The Policy Index reflects the passive market performance for the SCERS portfolio if it was fully implemented at the asset allocation target levels. When implementation of the asset allocation model is complete, the Allocation Index and the Policy Index will be the same.

For 2014, SCERS generated a total gross fund return of 5.5%, which outperformed the Allocation Index by 0.2%. By contrast, the total gross return of 5.5% underperformed the Policy Index return of 6.4% by 0.9%. The difference in the performance of the two benchmarks illustrates the greater resiliency the portfolio will eventually have in low return environments.

SCERS' asset classes demonstrated mixed results relative to their respective benchmarks. Asset classes that exceeded their benchmarks include Fixed Income by 1.5%, Real Assets (excluding the SSGA Real Assets Strategy proxy) by 1.0% and Opportunities by 17.1%. All other asset classes trailed their respective benchmarks, including Domestic Equities by 0.9%, International Equity by 1.8%, Hedge Funds by 1.5% and Private Equity by 1.8%. Please recall that these are time weighted returns, and the performance of the Private Equity, Real Assets and Opportunities asset classes are better reflected through an IRR calculation, which accounts for asset inflows and outflows. SCERS' results are summarized in **Table 2.**

Over the past five years, SCERS' Staff, consultants and strategic partners have been building an investment program with the objective of adding value through the generation of excess returns in a variety of market environments. While 2014 resulted in returns that trailed SCERS' Policy benchmark, the longer-term results have exceeded the benchmark. Over the 3-year and 5-year periods, SCERS has generated excess returns above SCERS' Policy Index of 0.7% and 0.2%, respectively. More importantly, over these two periods, SCERS has generated absolute annualized returns of 11.9% and 9.7%, which exceed SCERS' actuarial rate of return of 7.5%, adding more than $300 million to the pension fund over what was generated by base market performance alone over the past five years, as of fiscal year-end 2014. In sum, the 5-year period has been a beneficial market environment for investors, and this, combined with the excess returns generated, has enabled SCERS to recoup all losses that resulted during the GFC.

Table 2 - Investment Results

	For the Period Ended December 31, 2014		
	Annualized		
	1 Year	3 Years	5 Years
Domestic Equity			
Total Domestic Equity	11.7%	20.5%	15.5%
Benchmark: Russell 3000 Index	12.6	20.5	15.6
IFx All DB US Eq Gross Median	11.1	20.2	15.6
International Equity			
Total International Equity	-5.2	9.7	4.8
Benchmark: MSCI ACWI ex-US Index	-3.4	9.5	4.9
IFx All DB ex-US Eq Gross Median	-3.5	10.6	5.7
Fixed Income			
Total Fixed Income	6.0	4.2	5.9
Benchmark: Custom*	4.5	2.2	4.2
IFx All DB Total Fix Inc Gross Median	4.7	4.5	5.9
Hedge Fund			
Total Hedge Funds	3.5	9.1	6.1
Benchmark: 91 day Treasury Bill + 5%	5.0	5.0	5.1
HFRI Fund-of-Funds Composite Index	3.3	5.7	3.3
IFx All DB Hedge Funds Gross Median	4.0	7.8	5.4
Private Equity			
Total Private Equity **	20.2	12.8	10.6
Benchmark: Russell 1000 + 3% 1 Quarter Lag	22.0	26.2	18.4
Thomson Reuters C/A All PE 1 Quarter Lag	17.9	16.9	15.7
IFx All DB Private Equity Net Median	10.5	11.1	11.3
Real Assets			
Total Real Assets***	6.8	7.0	6.0
Benchmark: CPI-U Headline + 5%	5.8	6.1	NA
Opportunistic			
Total Opportunistic	23.5	22.0	18.1
Benchmark: Policy Index	6.4	11.2	9.6
Total Fund			
SCERS Total Fund Gross	5.5	11.9	9.7
SCERS Total Fund Net	5.1	11.5	9.4
Benchmark: Asset Allocation Weightings****	6.4	11.2	9.5
IFx Public DB > $1B Gross Median	5.6%	11.4%	9.7%

Notes: Unless noted, returns were prepared by SCERS investment consultant, and shown on a gross of fee basis and included the overlay effect. Return calculations were prepared using a time weighted rate of return.

* The Benchmark consists of 75% Barclays Aggregate, 12% Citi WGBI, 5% BofA Merril Lynch US HY Master II, 5% Credit Suisse Leveraged Loans and 3% JPMorgan GBI EM Diversified.

** Investment return and index return are one quarter in arrears.

*** Includes SSGA Real Assets Strategy Overlay Proxy

**** The Benchmark consists of 22.5% Russell 3000, 22.5% MSCI ACWI ex U.S., 20% Fixed Income Custom, 10% T-Bill plus 5%, 10% Russell 1000 plus 3% and 15% CPI-U Headline plus 5%. From 1/1/2012 to 12/31/13, the Benchmark consisted of 22.5% Russell 3000, 22.5% ACWI ex U.S., 20% Barclays Aggregate, 10% T-Bill plus 5%, 10% Russell 1000 plus 3% 1Q Lag and 15% CPI-U Headline plus 5%.

This page intentionally left blank.

Asset Classes

U.S. Equity Market Overview

Similar to 2013, U.S. equity markets generated strong returns that significantly outpaced non-U.S. equity returns. For 2014, the S&P 500 and NASDAQ returned 13.7% and 13.4%, respectively. During the second half of the year, there was a significant divergence between large cap and small cap stocks. The Russell 1000 Index (large cap) returned 13.2%, while the Russell 2000 Index (small cap) returned 4.9%. The divergence occurred primarily due to increased valuations within small cap stocks relative to large cap stocks and partly due to collapsing oil prices.

During the year, investors gravitated toward U.S. equities as global monetary policy continued to keep interest rates low. U.S. growth and economic data has been stronger than that of other developed economies, which has led investors to favor U.S. stocks. S&P 500 company operating margins are running at a robust 9% rate, and companies are operating with low leverage and high cash levels, the latter of which is being returned to shareholders mostly through stock buybacks.

During the year, U.S. equity markets placed a greater emphasis on yield over growth, which translated to the higher yielding and more defensive sectors leading the markets, including utilities and health care, while the more economically cyclical sectors lagged. Energy, not surprisingly was the only sector that generated negative returns. While stock fundamentals remain strong, multiple expansion was the primary driver of U.S. stock returns in 2014, and valuations within the broader U.S. markets are running at higher than historical levels, which has reduced return expectations for U.S. equities going forward.

Domestic Equity Portfolio

SCERS' Domestic Equity portfolio is structured with a combination of large cap and small cap exposure, as well as active and passive mandates. A large cap passive allocation makes up over 50% of the Domestic Equity portfolio, which is complemented by a meaningful allocation to a group of active large cap managers who run concentrated, high conviction, benchmark agnostic and higher tracking error mandates. The Domestic Equity small cap portfolio is comprised of active mandates. Domestic REITs also fall within SCERS' Domestic Equity portfolio. SCERS' Domestic Equity portfolio maintains neutral style risk, with roughly equal allocations between growth and value.

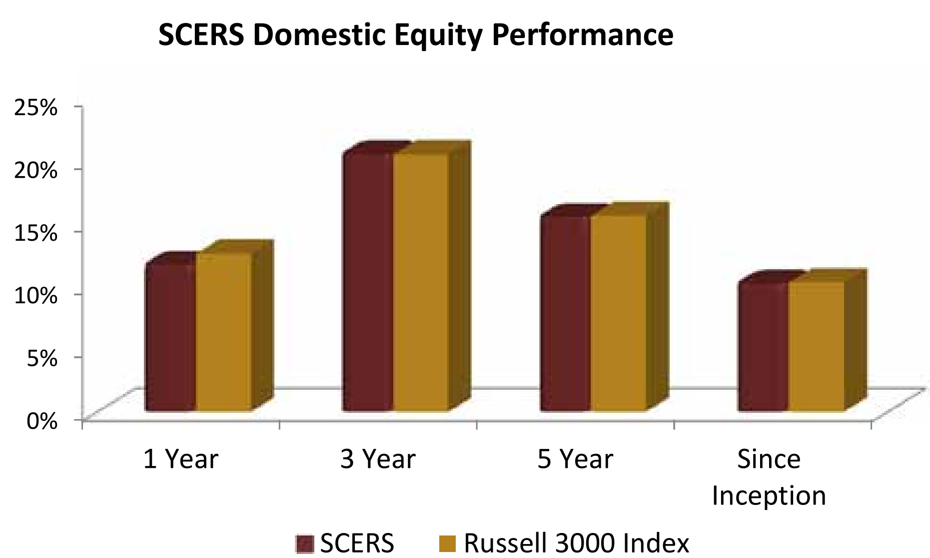
The objective of the structure is to allocate on an active basis to those sub-asset classes that are less efficient, and to managers that SCERS believes are better capable of earning excess returns, while using a passive allocation in those segments that are more efficient, and where active returns are more difficult to generate. Utilizing a higher passive equity component also reduces aggregate management fees and tracking error risk.

No changes to the Domestic Equity structure were made during 2014. However, SCERS did terminate one of its U.S. small cap growth managers during the year, due to poor performance and organizational changes. These assets were placed into a passive interim solution until a replacement search is completed, which is anticipated to conclude in 2015.

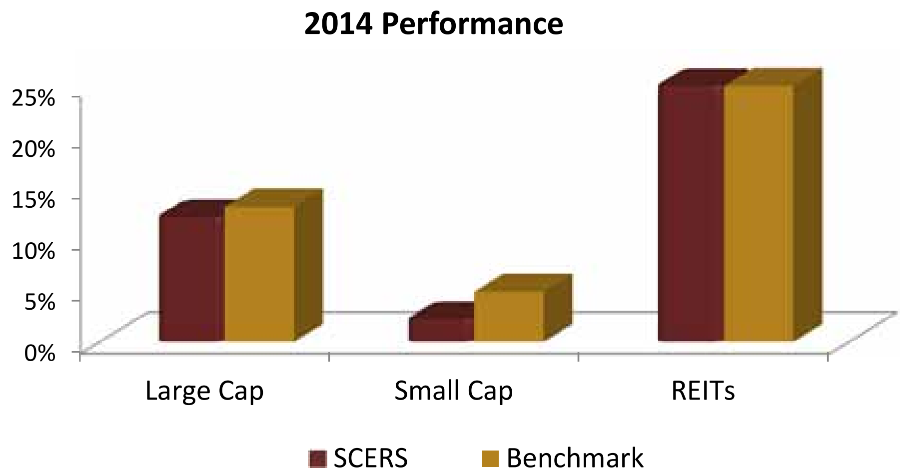
2014 ACCOMPLISHMENTS

- Terminated one of SCERS' U.S. small cap growth managers
  - Moved assets into a total return SWAP interim solution
  - Initiated the search for a replacement manager
- Reduced SCERS' U.S. equity passive exposure to bring SCERS' total U.S. equity weight closer to its target
- Conducted a 'soft dollar' audit of SCERS' domestic and international equity managers to review and analyze their soft dollar trading practices
- Oversaw, monitored and met with SCERS' existing Domestic Equity managers

PERFORMANCE AND ATTRIBUTION



SCERS' Domestic Equity portfolio generated strong absolute returns of 11.7% during 2014. Relative to the 12.6% return of SCERS' U.S. equity benchmark, the Russell 3000 Index, SCERS underperformed by 90 basis points. Over longer time periods, the Domestic Equity portfolio is generating returns similar to the benchmark.



2014 was a difficult year for active managers, especially fundamental based managers, and SCERS' large cap and small cap active managers in aggregate, underperformed their benchmarks. During the year, U.S. equity markets placed a greater emphasis on yield over growth in a low interest rate environment, which translated to the higher yielding and more defensive sectors leading the markets, including utilities and health care, while the more economically cyclical sectors lagged. Two of SCERS' high active share concentrated managers had especially poor years, mostly due to stock selection among a variety of sectors. Overall, SCERS' U.S. large cap portfolio underperformed its benchmark by 1.0%. SCERS' U.S. small cap portfolio also underperformed its benchmark by 2.7%. The underperformance of the Domestic Equity asset class was minimized by SCERS' REIT exposure, which is not part of the benchmark, and which generated a 32.8% return during the year.

2015 GOALS

- Conclude the U.S. small cap growth replacement search
- Continue to assess the Domestic Equity asset class structure and investment manager lineup
- Perform due diligence on alternative forms of passive exposure

International Equity

Market Overview

In 2014, non-U.S. equity markets significantly underperformed U.S. equity markets. A combination of slower growth, deflation worries, geopolitical risk factors, collapsing oil prices and weak currency performance versus the U.S. dollar led to the underperformance of non-U.S. markets. Within developed markets, the MSCI EAFE Index returned -4.9%, which significantly lagged U.S. equity returns. In local currency returns, non-U.S. developed market returns were generally positive, but several major currencies depreciated significantly versus the U.S. dollar, including the euro (-12.2%), the British pound sterling (-5.9%) and the Japanese yen (-12.0%). On a regional basis, Europe ex-UK returned -6.6%, the UK returned -5.4% and Japan returned -3.5%.

Emerging markets equity performance also suffered, but held up better than non-U.S. developed markets, returning -2.2%. Equity returns for heavy oil producing countries were poor, including Russia (-13.6%) and Brazil (-4.1%), while net energy import countries such as China (+6.9%) and India (+30.3%) performed well. China also benefited from monetary stimulus measures through a cut in interest rates in the face of slowing economic data. Adding to India market returns were improving reform prospects under the new Modi government.

International Equity Portfolio

SCERS' International Equity portfolio is comprised of a combination of developed and emerging markets exposure, as well as a combination of large capitalization and small capitalization mandates. Large cap developed markets comprise the bulk of SCERS' international equity portfolio, and international REITs also fall within the asset class. Similar to SCERS' Domestic Equity portfolio, International Equity maintains neutral style risk, between growth and value.

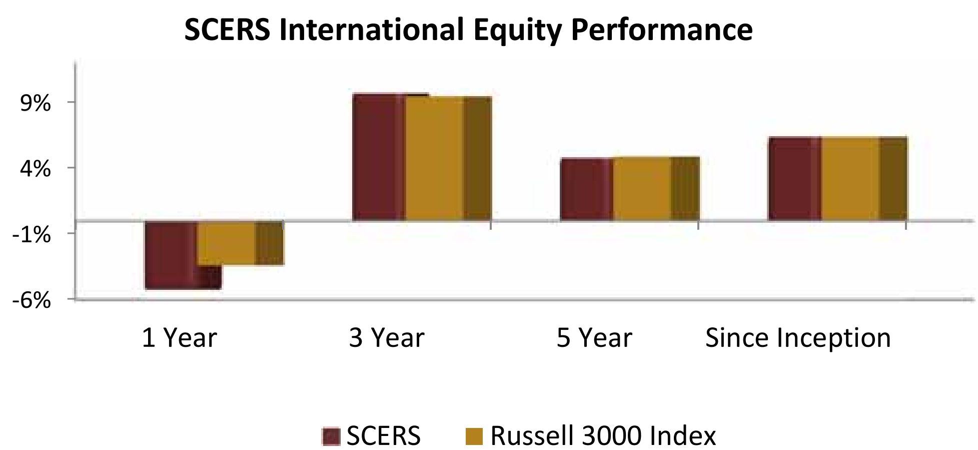
Active mandates make up the entire allocation to the asset class, as SCERS believes that there are more stock selection inefficiencies within the international equity markets. Investing in global equity markets introduces greater complexities when factoring in regions, countries and currencies, so incorporating a greater degree of flexibility into investment manager mandates is an important component of SCERS' International Equity portfolio (for example, by giving the manager the flexibility to allocate to both developed and emerging markets, and latitude within these ranges).

No changes to the International Equity structure were made during 2014. However, SCERS did terminate one of its international large cap developed markets equity managers during the year, due to poor performance and organizational changes. These assets were placed into a passive interim solution until a replacement search is completed, which is anticipated to conclude in 2015. The replacement search is looking at international large cap developed markets managers, but is also evaluating global equity mandates that can allocate capital between non-U.S. and U.S. markets as a consideration, which would require a modification to SCERS' equity structure.

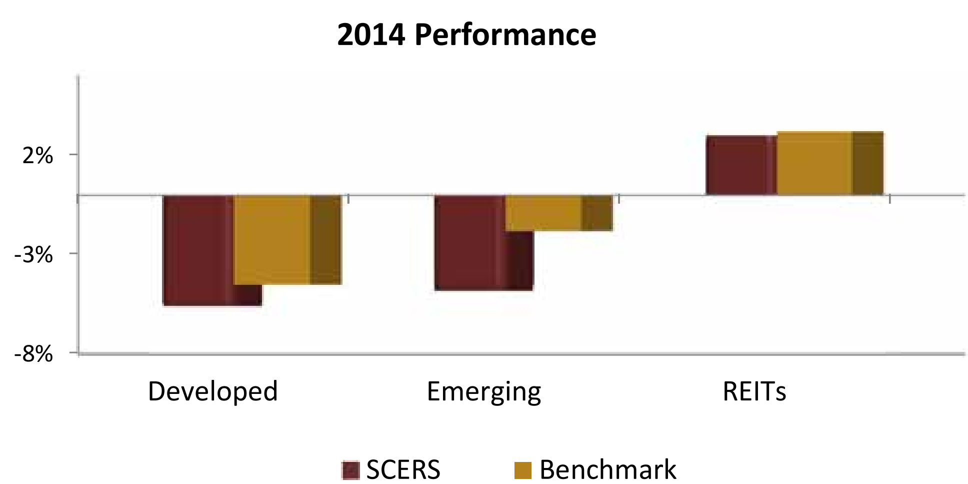
2014 ACCOMPLISHMENTS

- Terminated one of SCERS' international large cap developed markets equity managers
  - Moved assets into a total return SWAP interim solution
  - Initiated the search for a replacement manager
- Conducted a 'soft dollar' audit of SCERS' domestic and international equity managers to review and analyze their soft dollar trading practices
- Oversaw, monitored and met with SCERS' existing International Equity managers

PERFORMANCE AND ATTRIBUTION



During 2014, SCERS' International Equity portfolio generated poor returns on an absolute and relative basis, returning -5.2%, versus the -3.4% return of SCERS' benchmark, the MSCI ACWI ex-US Index. Over longer time periods, the International Equity portfolio is generating returns similar to the benchmark.



Looking closer at International Equity returns for the year, SCERS' developed International Equity managers underperformed the benchmark by 1.1%, which was mostly driven by the returns of SCERS' recently terminated international large cap developed markets equity manager. Within emerging markets, SCERS underperformed the benchmark by 3%, which was driven by poor returns produced by SCERS' all-capitalization emerging markets equity manager. SCERS' emerging markets small cap managers generated strong relative returns during the year. SCERS' international REIT exposure generated positive results for SCERS during 2014, and slightly underperformed its benchmark.

2015 GOALS

- Conclude the international large cap developed markets equity search
  - Broaden the search to consider a global equity mandate which would include a modification to the international equity manager structure
- Continue to assess the International Equity asset class structure and investment manager lineup
- Evaluate SCERS' all-cap emerging markets exposure
- Review SCERS' global currency exposures

Fixed Income

Market Overview

Within the fixed income markets, the growing divergence between central bank policy in the U.S. and the rest of the world, the rising geopolitical risk in Eastern Europe and the Middle-East, and the Greek political elections, along with the fall in energy prices contributed to a growing sense of uncertainty during the latter half of 2014. As a result, spreads on investment grade, high yield corporate, and emerging market bonds widened with the market's movement away from riskier assets and into the relative safety of U.S. Treasuries. The 10-year U.S. Treasury yield fell from 3% to 2% by the end of 2014, and Treasury bonds significantly outperformed equities, high yield bonds and leveraged loans during 2014. As reported by Barclays, long-dated U.S. government bonds returned 25.1% for 2014 compared to the S&P 500 index gain of 13.7%; with high yield bonds returning 2.5% and leveraged loans up only 2.1%.

The falling oil prices during 2014 exacted a heavy toll on fixed income sectors with exposure to the energy industry, such as US high yield bonds and emerging market debt. Debt issued by companies in energy-related industries account for a meaningful proportion of the high yield bond indexes. The collapse in the price of oil has lowered inflation expectations and with it lowered values for Treasury Inflation-Protected Securities ('TIPS').

The path that the Federal Reserve takes with respect to raising short-term interest rates will likely determine the performance of Treasuries, corporate bonds and other U.S. debt. Because accommodative monetary policy in Europe and Japan is expected to keep rates low in 2015, consensus is that yields in the U.S. will also remain low, particularly longer dated yields.

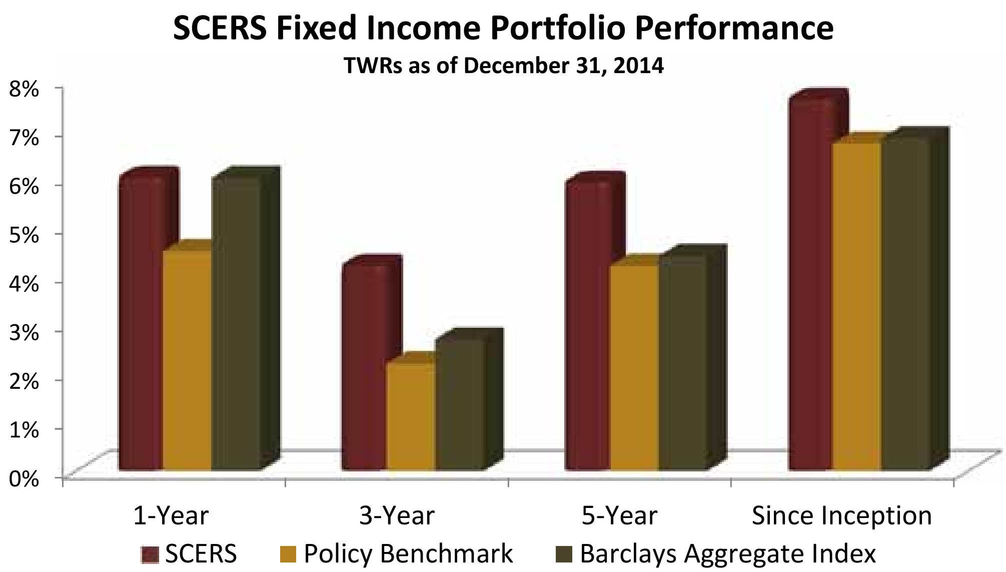
Fixed Income Portfolio

Over the past year and a half, SCERS' Fixed Income portfolio has undergone a restructuring, with the replacement of one of SCERS' Core Plus fixed income manager and the addition of a global opportunistic fixed income strategy and a strategic credit strategy. The addition of these mandates was designed to give SCERS diversified exposure to multiple fixed income sectors and regions. The global opportunistic strategy was a timely portfolio addition given the pace and timing of global central bank policies and divergent currency movements. The strategic credit mandate is also a broad and flexible mandate that factors in market cycle considerations, by giving the manager the ability to utilize macro hedges.

2014 ACCOMPLISHMENTS

- Replaced a core plus manager
    - Transitioned the core plus portfolio to the new manager, with the new manager serving as the transition manager, to minimize costs
- Created a custom benchmark (a weighted average of specific strategy indexes for each underlying manager) for SCERS' fixed income asset class
- Oversaw, monitored and met with SCERS' existing Fixed Income managers

PERFORMANCE AND ATTRIBUTION



For 2014, SCERS' Fixed Income portfolio returned 6.0%, which outperformed SCERS' custom benchmark return of 4.5%, and was in-line with the Barclays Aggregate Index return of 6.0%. SCERS' Fixed Income portfolio has exceeded both the Barclays Aggregate Index and the custom benchmark for the asset class over the longer-term periods, with a majority of the outperformance being driven by the strong performance of SCERS' spread sector investments, where it has had an overweight position. For the year, SCERS' global opportunistic strategy generated the best performance within the asset class, while the dedicated strategic credit strategy underperformed. The latter was negatively impacted by high yield bond performance within the energy sector. The core and core plus strategies performed in-line with expectations.

2015 GOALS

- Continue to assess the Fixed Income asset class structure and investment manager lineup
- Evaluate additional forms of credit and fixed income exposures, both liquid and illiquid
    - Possibilities include structured credit and direct lending strategies

Hedge Funds

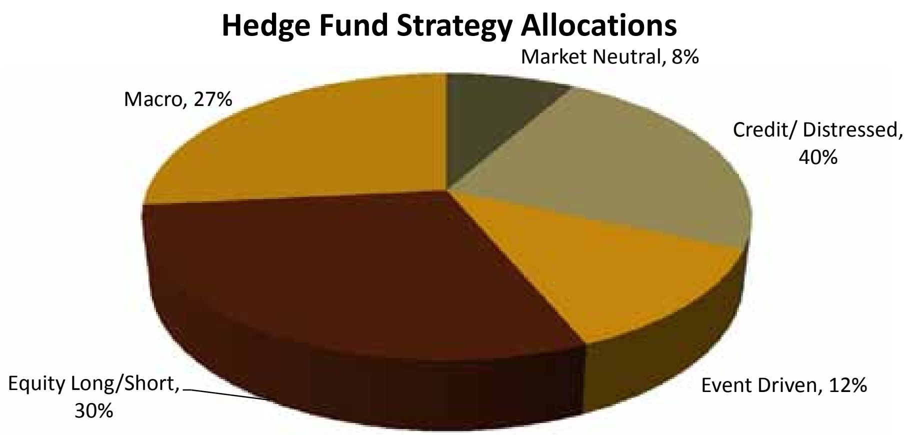
Market Overview

Overall, Hedge Fund performance was disappointing in 2014 and the HFRI Fund Weighted Index generated a modest 3.6% return. Throughout 2014, many hedge fund managers were hurt by: (1) Short positions, as equity markets rallied in the U.S.; (2) High yield credit, as the lowest credit grades underperformed; (3) Playing catch up to central bank policies; and (4) Idiosyncratic risks where many managers had exposures to similar events such as the mortgage GSEs (Fannie Mae and Freddie Mac) or mergers and acquisitions (Shire). Systematic macro managers (CTAs) performed very well in 2014 due to sustained trends in long equity, fixed income, the U.S. Dollar rise and the decline in energy prices. However, discretionary global macro had mixed but mostly positive performance betting on interest rate rises and Japanese equities in the first half of the year. Activist managers performed the best in the event driven strategy group with a wider acceptance of the strategy and a continued abundance of corporate transactions such as share buybacks, acquisitions and spin-offs. Equity long/short performed poorly due to the challenging short-selling environment. Credit managers performed poorly as a group due to low returns on the lowest credit grades, offset by positive returns in structured credit.

Hedge Funds Portfolio

SCERS' Hedge Fund allocation is structured as a broadly diversified program of multiple hedge fund strategies, which has historically produced enhanced returns with reduced risk. The asset allocation structure includes four components: (1) SC Absolute Return Fund ("SCARF"), a multi-strategy hedge fund separate account portfolio managed by strategic partner, Grosvenor Capital Management; (2) SCARF – B, an interim hedge fund component consisting of a more liquid version of SCARF, also managed by Grosvenor, which is intended to provide diversified exposure to a multi-strategy hedge fund portfolio and be drawn down over an intermediate period to fund direct hedge fund investments; (3) A strategy-based replication component; and (4) A direct hedge fund component.

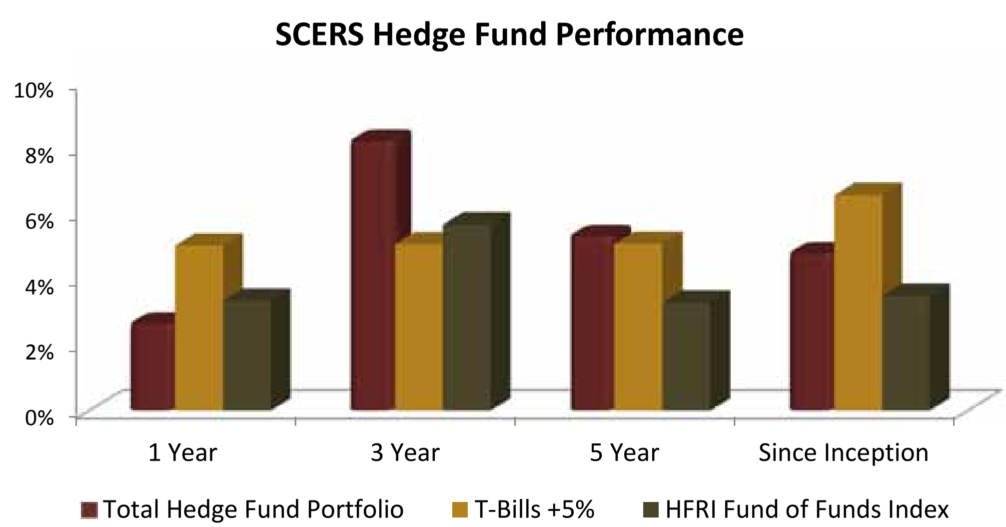
SCERS' Hedge Fund program has been structured to accomplish the dual objective of achieving near the total fund return objective while at the same time reducing total fund risk. SCERS has been building a 'hybrid' program, investing directly in external hedge fund managers, as well as utilizing customized 'fund of one' separate accounts, depending on the opportunity set. SCERS has been developing its direct hedge fund program to help deliver the same return and risk characteristics, but also reduce costs where possible. SCERS' hedge fund program is diversified across hedge fund strategies as outlined in the chart below.



2014 ACCOMPLISHMENTS

- Cliffwater and Staff identified candidates for direct Hedge Fund investments
  - Performed extensive due diligence on candidates, including onsite manager visits and consultations with hedge fund strategic partner, Grosvenor Capital Management
  - Prepared multiple reports for the Board evaluating potential investments
  - Finalized two direct investments in 2014

PERFORMANCE AND ATTRIBUTION



SCERS' Hedge Fund portfolio returned 2.6% in 2014. The Hedge Fund portfolio underperformed SCERS' benchmarks, the HFRI Fund-of-Funds Index by 0.7% and the absolute return benchmark of T-Bills + 5% by 2.4%. The Hedge Fund portfolio suffered from weak contributions across virtually all investment strategies, though global macro performed the best on a relative basis. The relative outperformance of SCERS' Hedge Fund portfolio compared to benchmarks over the 3-year period suggests the restructuring to diversify SCERS' Hedge Fund portfolio completed over 2011 and 2012 is helping SCERS better achieve its goals.

2015 GOALS

- Identify, perform due diligence and make investments in two funds within the direct Hedge Fund program
- Continue to monitor and assess the manager lineup
- Deepen expertise by increasing capabilities in operational due diligence

PRIVATE EQUITY

Market Overview

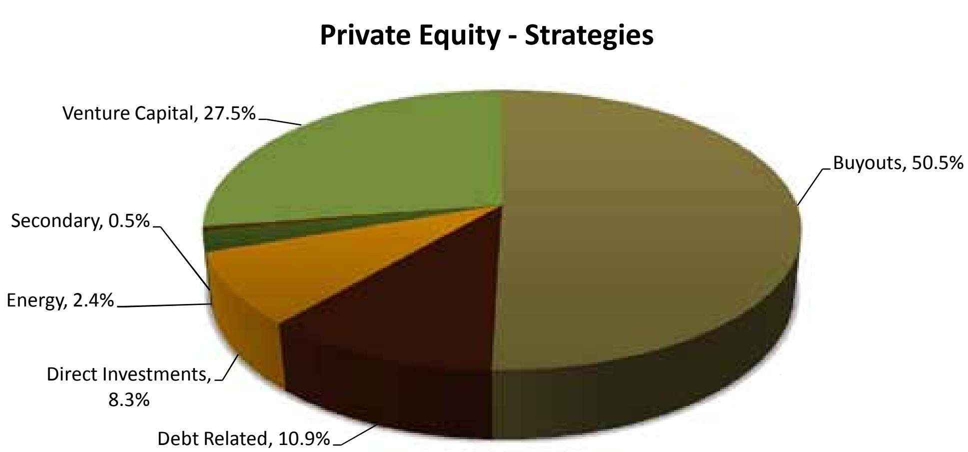
2014 marked a strong performance year for private equity. Exit opportunities were plentiful for the industry, as M&A and IPO activity moved past peak 2007 levels. Investment activity was also strong within the various segments of private equity, including U.S. buyout and venture capital. However, competition for investment opportunities has become heated in private equity, as reflected in valuations and the entry purchase price multiples that private equity funds are paying for portfolio companies, which are similar to multiples paid in 2007. Related to this point, it is important that fund managers demonstrate discipline in investing at these valuation levels, which has made this a focal point for SCERS in evaluating private equity funds for its direct program.

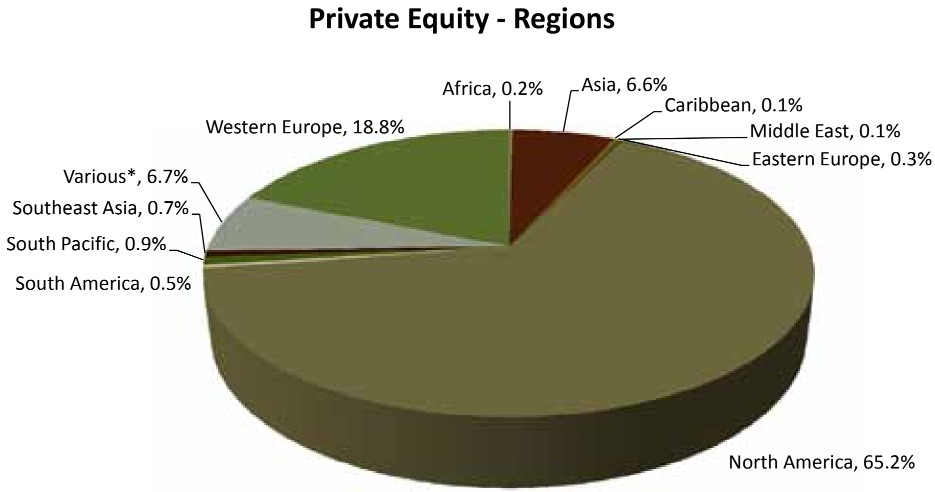
Global private equity fundraising increased 5% over 2013, and is at the highest level since 2008. Limited Partner allocations provided by private equity funds have become constrained, with many top-quartile funds being oversubscribed, especially those that demonstrate discipline in capping their fund sizes in-line with the investable opportunity set.

Regulatory scrutiny of private equity funds by the U.S. Securities and Exchange Commission ('SEC') was a theme during the year. Areas of focus included operating-partner compensation, expense disclosures and allocations, and other fees. Private equity firms have come under increased scrutiny by investors as result, and are being called upon to improve transparency and disclosures.

Private Equity Portfolio

SCERS' Private Equity portfolio is broken out by strategy, including buyout, venture capital, debt-related and 'other' less defined strategies, as well as by region. Since the asset class was re-structured in 2011, SCERS has been building a direct Private Equity program by making commitments consistent with the asset class's investment plan and investment structure. These direct commitments complement SCERS' existing Private Equity fund-of-funds, which were established during the 2006-2008 time period. SCERS' Private Equity investments are based on a multi-year plan to reach and maintain the 10% target allocation in Private Equity, by investing across the various strategies and regions within the Private Equity structure. The longer-term objectives of the Private Equity portfolio are to earn equity-like returns with an additional premium to compensate for the liquidity risk undertaken by investing in the asset class. The benchmark that SCERS uses to assess long-term performance of the Private Equity asset class is the Russell 1000 + 3%.





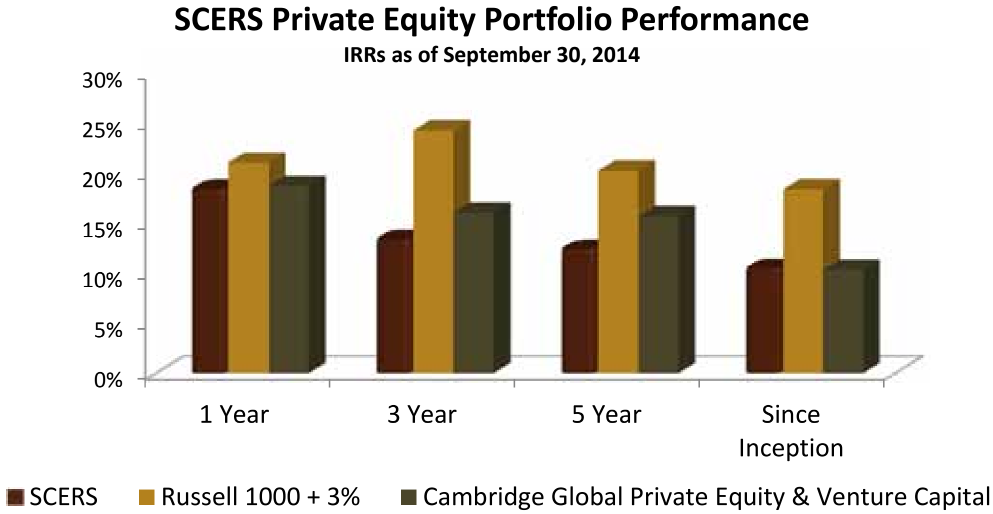
* "Various" includes partnerships with global or pan-regional mandates.

While SCERS has been successful making direct commitments consistent with the long-term and annual private equity investment plans, and within the investment structure of the asset class, there are segments of private equity that will prove challenging for SCERS to invest in exclusively through the direct program. These include segments where SCERS has limited expertise and reach, or has difficulty accessing, or accessing with sufficient scale, given its constrained Staff resources. An example, as described in the Portfolio Overview section of this report, is the venture capital segment. To this end, Staff anticipates creating various strategic partnerships within the Private Equity portfolio, to fully allocate to such segments and to complement those commitments made within the direct portfolio, similar to the role that the Grosvenor partnerships plays within SCERS' Hedge Fund portfolio.

2014 ACCOMPLISHMENTS

- Presented the annual report on Private Equity and developed the 2014 Private Equity annual investment plan
- Cliffwater and Staff identified candidates for direct Private Equity commitments
    - Performed extensive due diligence on candidates, including consultations with current private equity fund of funds managers and SIS
    - Prepared multiple reports for the Board evaluating potential investment opportunities
    - Finalized seven direct Private Equity commitments in 2014
- Assessed the landscape for strategic partners to assist SCERS in fully building out its private equity portfolio.

PERFORMANCE AND ATTRIBUTION



Performance numbers for SCERS' Private Equity investments are not fully comparable to the benchmark at this point, due to SCERS being in the earlier phase/cycle of investments within this assets class, and the unique cash flow characteristics within private equity. Once a commitment is made to a private equity fund, capital is not drawn down at once, but rather, over a 5-6 year investment period. Returns within private equity typically follow a 'j-curve', where negative returns are generated initially followed by increasing levels of positive returns over time.

However, SCERS' Private Equity portfolio is progressing through the j-curve and is generating increasing levels of positive performance. For the 1-year period ending September 30, 2014, SCERS' Private Equity portfolio generated a net IRR of 18.3%, which slightly trailed the Cambridge Global Private Equity & Venture Capital benchmark return of 18.7%. SCERS' public market benchmark, the Russell 1000 + 3%, returned 21.1%. SCERS' since inception net IRR of 10.4% is in-line with the Cambridge Global Private Equity & Venture Capital benchmark return of 10.3%. SCERS' fund-of-funds commitments made in 2006 and 2008 are a significant contributor to these returns, however, many of SCERS' direct commitments that have been made since 2011 are beginning to generate meaningful returns and are distributing capital back to SCERS.

2015 GOALS

- Identify, perform due diligence and make commitments to five to ten funds within the direct Private Equity program
    - Fund candidates include buyout, venture capital and distressed debt
    - Remain cognizant of risks later in the cycle, including increasing valuations and fund sizes
    - Place particular focus on sector-specific funds where a fund manager has differentiated expertise, experience managing multiple cycles and access to proprietary deal flow
- Continue to identify segments of the Private Equity portfolio where it could potentially be challenging to build a full portfolio of direct commitments, including venture capital, emerging markets and special situations segments, and assess strategic partners to assist in filling these gaps
- Present the annual report on Private Equity and the annual investment plan, including a reassessment of the cash flow model due to market conditions

Market Overview

Despite ending quantitative easing in 2014, the Federal Reserve has kept interest rates at historic lows. As such, investors continue to seek out higher yielding assets such as core real estate, infrastructure, energy partnerships and other real assets. The 'yield chasing' among institutional investors is resulting in asset values across many asset classes, reaching or exceeding prior peaks. This phenomenon is occurring globally, as many developed economies have become more aggressive in their monetary policies in an effort to keep their interest rates low.

Staff and consultants have been mindful of being in the later stages of the market cycle, as suggested by the high asset valuations, and are exercising caution when making investment decisions. Within the Real Assets asset class, Staff and consultant will be focusing on non-traditional, niche, and differentiated asset types during 2015, where SCERS can expect to achieve attractive investment returns that are less correlated to the macro risks.

During the first half of 2014, commodities were the best performing asset class, primarily due to market supply-demand fundamentals being impacted by severe weather conditions world-wide and geopolitical stresses. However, the second half of 2014 was dominated by the nearly 50% drop in oil prices, which is having an immediate impact on U.S. shale producers, which have either shut down or have slowed production. As oil supplies adjust to current demand levels, oil's pricing will eventually settle at an equilibrium level, the timing of which is not yet known. That being said, the commodities market will see continued periods of volatility, as oil finds its equilibrium price, geopolitical risks ebb and flow, and weather conditions change, but the volatility could present investment opportunities to patient investors, including SCERS.

Real Assets Portfolio

The Real Assets asset class is comprised of several sub-asset classes: (1) Core real estate; (2) Private real assets (infrastructure, energy, agriculture, timber, and other natural resources); (3) Commodities; and (4) Treasury Inflation-Protected Securities ('TIPS') (currently there is no allocation to TIPS). The objectives of the Real Assets portfolio are to generate moderate income, serve as an inflation hedge, and lessen the total fund's equity risk sensitivity.

SCERS' core real estate structure consists of a mix of core separate accounts ('CSAs') and core open-end commingled funds ("COEFs"). SCERS' CSAs have been outperforming the benchmark over every rolling-5-year period, partly due to Staff and Consultant's active engagement with the separate account managers. An example of the type of active engagement being exercised is illustrated these past three years, where Staff and Townsend have maintained discipline, as core real estate prices increased to levels now exceeding the previous peak, by rejecting numerous acquisition opportunities. Further, Staff and Townsend have been strategically identifying properties in the CSAs, which have achieved business plan objectives, for potential sale. Several properties were identified as having maximized their return potential resulting in three assets being sold during the year. It is expected that additional CSA properties will be slated for disposition during 2015.

With the high valuations in U.S. core real estate and in turn, lower expected future returns, SCERS initiated in 2013 and continued in 2014, a shift into non-U.S. and non-core real estate opportunities, including: (1) A European core logistics focused open-ended fund, where logistics valuations are significantly lower and non-core like returns could be achieved from high quality core assets; (2) An Opportunistic niche real estate closed-end fund targeting non-traditional assets with limited competition offering an attractive risk-return premium; and (3) A Nordic geographic focused value-add closed-end fund targeting logistics, retail, and residential assets at valuations and expected returns significantly higher than value-add investment opportunities in the U.S. Please note that non-core real estate investments are allocated to SCERS' Opportunities portfolio.

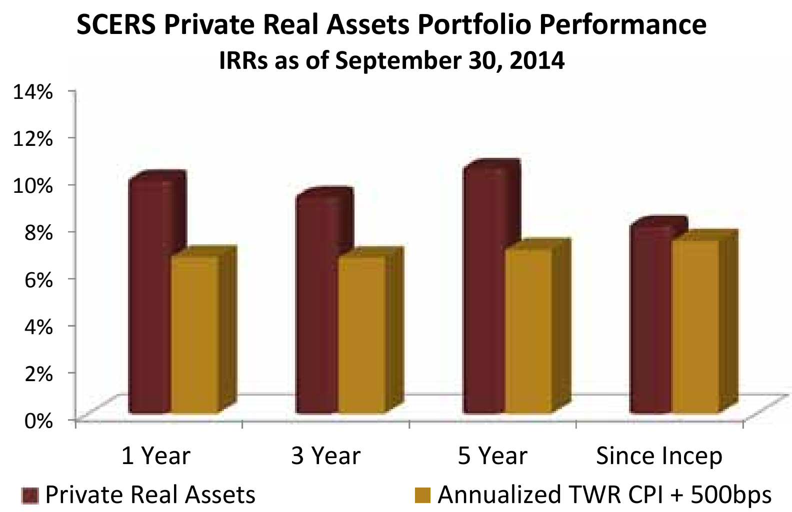
SCERS' actual Real Assets allocation is 7.4%, while the target allocation is 15%. SCERS utilizes the SSGA Real Assets Strategy as the proxy for Real Assets, which has a 6.6% allocation. It should be noted that the remaining 1.2% gap within Real Assets is allocated to investments within SCERS' Opportunities asset class. The large gap within Real Assets is primarily in the Private Real Assets sub-asset class, where Staff has been focused on making additional commitments. SCERS made a commitment to one energy infrastructure fund and initiated a custom separate account for a debt backed by real assets investment strategy during the year. Given the significant allocation gap, along with the diversification and relative value benefits, Staff will be targeting natural resource and agriculture investment opportunities, while continuing to identify differentiated infrastructure investments in 2015. And as previously noted, Staff and consultants will continue to evaluate potential investment opportunities related to the collapse of oil prices.

2014 ACCOMPLISHMENTS

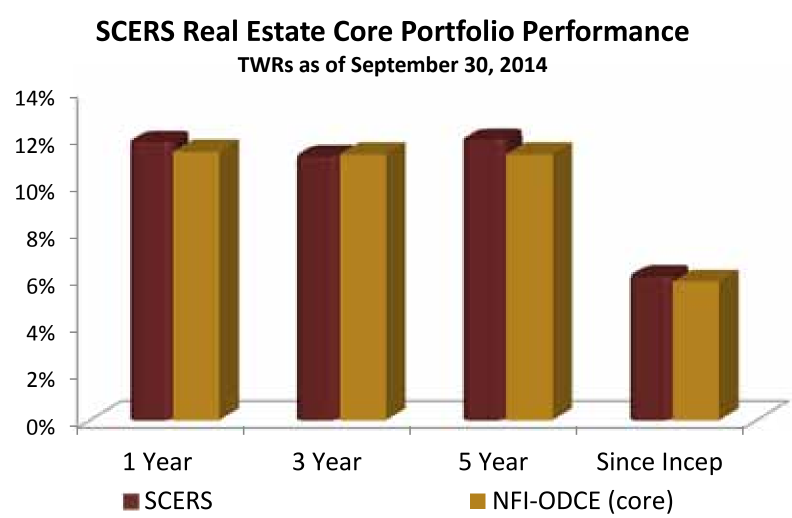
- Presented the Private Real Assets annual report and provided an annual investment plan
- Completed the custom separate account to invest in infrastructure secondaries with Pantheon, resulting in two investment transactions totaling $15.5 million during 2014
- Progressed on the formation of a custom separate account to invest in debt backed by real assets
- Disposed of three separate account properties at prices greater than appraised value:
- Finalized several direct investments within the Real Assets asset class including:
    - A U.S. and a European logistics fund
    - Two midstream energy funds
- Engaged in analysis with various SCERS managers and consultants, and in particular, managers invested in the energy sector, to identify investment themes around the collapse in the price of oil
- Researched and identified niche and non-U.S. real estate investment opportunities offering better relative value versus the U.S. real estate market, resulting in commitments made to three closed-end funds, which are discussed in the Opportunities asset class section of this Report

PERFORMANCE AND ATTRIBUTION

SCERS' Real Asset Class generated a 1-year net IRR of 9.9% in 2014 (as of 09/30/14), which outperformed SCERS' benchmark (CPI-U Headline + 5%) return of 6.7% by 3.2%. The Real Asset return does not include the return of the SSGA Real Asset Strategy, which serves as the proxy for the asset class within the Overlay Program. The proxy returned 4.9% during the same one year period, and 2.5% during the 1-year period ending 12/31/14. The 1-year Real Asset return including the proxy, through 09/30/14, was 6.6%. The proxy has a material impact on the return for the Real Assets asset class due to the 7.6% gap between the current and target allocation and certain inherent deficiencies in the proxy itself. SCERS' Staff and consultants will continue to actively target Real Assets investments in 2015 to help to close this gap as well as consider possible improvements to the proxy.

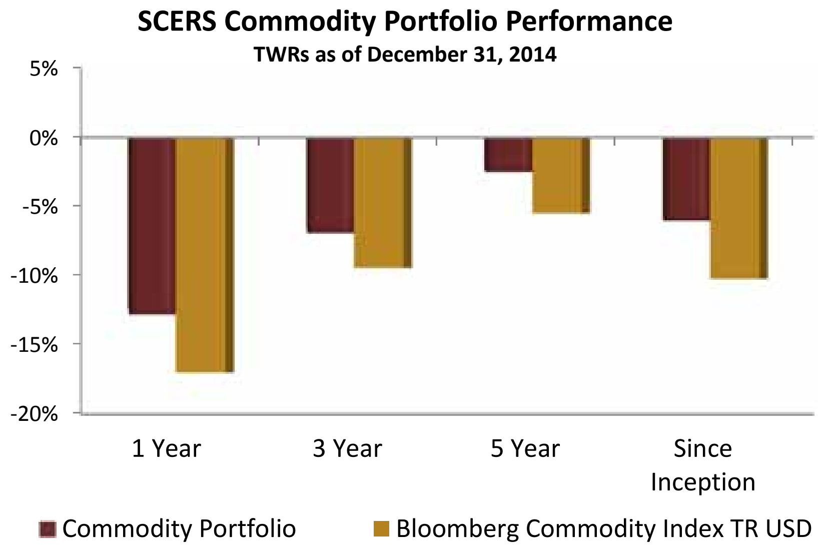


The core real estate portfolio has slightly outperformed the benchmark over the reporting periods, due to the positive performance of SCERS' core separate accounts, in which Staff and Consultants are actively engaged with the separate account managers. However, the core portfolio has suffered from the drag of two poorly performing older COEFs, which were liquidated in 2013 and 2014. The COEF portfolio performance has been strengthening with the addition of three core open-ended fund investments made in 2013 and two core open-ended funds committed in 2014, which have yet to draw down funds.



Commodities

While SCERS' commodities portfolio returns have been negative for all periods, it has consistently outperformed the policy benchmark. As seen in the 1-year return, the commodities market suffered greatly from the dramatic drop in oil prices that occurred during the second half of 2014. It is important that the diversification provided by commodity exposure has proven to be beneficial at key points in the markets, including during inflationary periods and major market dislocations.



2015 GOALS

- Finalize the custom separate account to invest in debt backed by real assets, and deploy capital prudently
- Identify and evaluate niche strategies, value-add/opportunistic, and non-U.S. real estate prospects that exhibit higher expected relative performance to U.S. core and non-core real estate investments
- Continue to assess the hold/sell scenarios in the SCERS direct real estate separate accounts
- Continue to identify and commit capital to closed-end and/or open-ended real estate, agriculture, natural resource, infrastructure, and energy funds
- Identify investment themes around the oil price collapse and determine if a tactical commitment is appropriate
- Present the Real Assets annual report and investment plan
- Continue evaluating interim solutions to the significant gap between the actual Real Assets allocation and the targeted allocation, including modifications to the proxy used in the Overlay Program

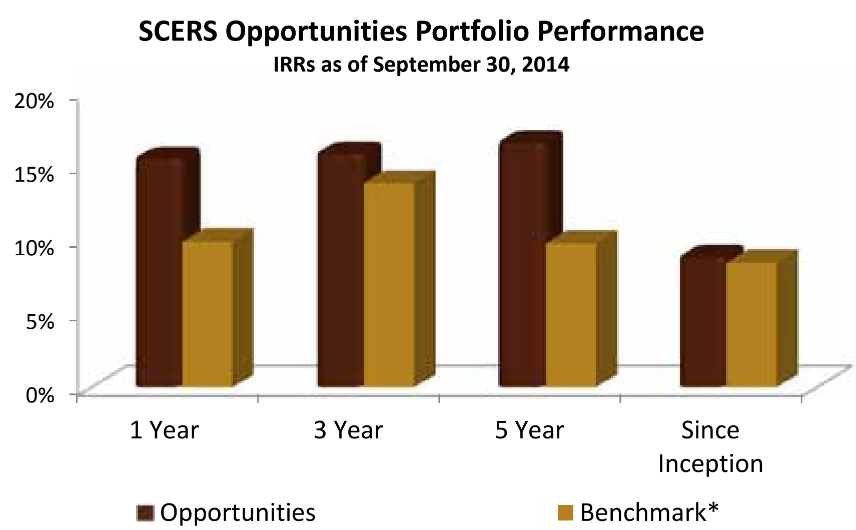
SCERS' Portfolio

The Opportunities asset class does not have a fixed allocation, but instead has a permissible range of 0% to 5%; currently the allocation is 1.4%. The asset class is designed to invest in tactical investment opportunities with attractive risk and return attributes. Such opportunities may be short-term, niche, non-traditional, or opportunistic in nature and may exist across a wide range of asset categories. If and when an Opportunities investment is identified, the Opportunities asset class draws its capital allocation from the asset class with the most comparable risk and return characteristics as the investment. In this way, the potential Opportunities investment is measured against and competes for an allocation relative to comparable investment opportunities among asset classes. Based on this assessment, it is possible that no investments will be made in the Opportunities asset class in some years.

2014 ACCOMPLISHMENTS

- Committed $95 million to three Opportunities investments, all drawn from the Real Assets allocation
    - A closed-end niche/opportunistic real estate fund
    - A Nordic based value-add real estate fund
    - An opportunistic/value-add real estate fund

PERFORMANCE AND ATTRIBUTION



SCERS' Opportunities performance over the reporting periods has been driven, predominately, from the returns earned by three real estate value-add funds SCERS made prior to the GFC and several, since liquidated, distressed debt funds that SCERS invested in out of the GFC. These older value-add real estate funds, vintage year 2006 and 2007, have benefited from the run-up in real estate values over the past few years; however, prior to the run-up, these funds were performing well below expectations. The distressed credit investments made coming out of the GFC performed very well. The real estate opportunistic funds, committed to during 2013 and 2014, are still in the investment period and are too early in their life-cycle to generate any meaningful performance contribution.

2015 GOALS

- Continue to identify and evaluate tactical investments in unique/ differentiated investment strategies offering an attractive risk-return prospect

Other Investment Activities

2014 ACCOMPLISHMENTS IN OTHER INVESTMENT ACTIVITIES

In addition to the activities within SCERS' investment program at the asset allocation and asset class levels, a number of enhancements and efforts were made in the day-to-day management of the investment program.

- Oversaw and monitored existing relationships
  - Met with most managers at least once
  - Visited a separate account real estate holding in Southern California – Crescent Park Apartments
  - Utilized the portfolio compliance monitoring system provided by State Street Bank (SCERS' custodian bank) as a 'check and balance' on manager guidelines
- Evaluated performance reporting compiled by SCERS' investment managers and investment consultants
- Continued to monitor and assess the direction of securities lending
- Continued evaluation of segments of SCERS' Overlay Program that expose SCERS to basis risk to the return and risk characteristics of the underlying asset class, particularly within the private markets asset classes
- Evaluated SCERS' trading costs and the commission recapture program on an ongoing basis during the year
- Wrote Investment Policy Statements ("IPS") for the Equity and Fixed Income asset classes
- Transition management – several transitions:
  - U.S. small cap growth – transitioned assets from terminated manager to a total return SWAP interim solution
  - International equity - transitioned assets from terminated manager to a total return SWAP interim solution
  - Core plus fixed income – transitioned assets from terminated manager to newly hired manager
- Conducted a 'soft dollar' audit of SCERS' equity managers

2015 GOALS FOR OTHER INVESTMENT ACTIVITIES

- Revise and update the overall IPS to reflect changes and incorporate individual asset class IPS's
- Increase capabilities in operational due diligence for alternative investments
- Conduct on-site due diligence on existing managers and existing real estate holdings
- Research risk management and software management systems for SCERS' total portfolio and asset classes
  - Including private markets portfolio/capital flows management software
- Continue to assess the securities lending program
- Continue to assess proxies within SCERS' Overlay Program

Investment Education

2014 BOARD EDUCATION

- Presentation by Accel-KKR Capital Partners on the growth equity private equity portfolio they manage for SCERS
- Educational presentation on Investment opportunities in ‘Build to Core’ real estate projects by Townsend and Staff
- SCERS’ separate account real estate portfolios educational presentation by Townsend and Staff
- Potential investment strategies for SCERS’ real assets asset class educational presentation by Cliffwater and Staff
- Educational presentation on high frequency trading by Zeno Consulting and Staff

2015 Board Education

- Hedge fund investment manager presentations
- Private equity fund investment manager presentations
- Educational presentations by consultants and Staff

APPENDIX

Appendix 1 - SIS 2014 Review and Outlook

MEMORANDUM

DATE: February 11, 2015

TO: Sacramento County Employees' Retirement System Board

FROM: SIS

SUBJECT: 2014 Review and Outlook

SIS recommends a strategic planning framework that allows for a continuous, four part process: first, develop an understanding of the goals and objectives of the plan; second, craft an ongoing implementation plan to pursue those objectives; third, execute the implementation plan; fourth, review the results of the implementation, and repeat. In the context of providing input for the review stage of SCERS' ongoing strategic planning, this memo will review the investment environment of 2014 in the major asset classes, and detail both current initiatives and those under consideration for the future.

US Equity

During 2014, the U.S. equity market provided another strong double digit year return (Russell 3000 Index calendar year return of 12.6%). This was the third double-digit annual return in a row, and the fifth positive year in the six years since the Global Financial Crisis (only 2011 was negative, albeit only very slightly). Consequently, the US Equity market has now returned a robust 204% since the bottom of the GFC in March of 2009, driving valuations from 10.3 times to 16.3 times forward earnings (the 25 year average multiple is 15.6). Given this change, from SIS' point of view, US equity has moved from being extremely cheap at the end of the crisis, to fully valued at year end 2014.

During the year large cap returns exceeded small cap returns by a wide margin while the spread in return between growth and value styles, in contrast, were fairly muted. Exposure to and investment in biotechnology, software as a service, energy and REIT stocks were significant drivers of return during the calendar year. Utilities, Health Care, and Information Technology were the strongest performing sectors in the Russell 3000 Index for the year, while Energy was the weakest, losing 9.8% during the year and 12.9% during the fourth quarter alone as oil prices plunged. This pattern of sector returns, the underperformance of smaller caps, and the ongoing investor preference for defensive and yield-oriented equities created a difficult environment for active managers, and an unusually high proportion (up to 80%) of active US equity managers performing below their benchmarks again in 2014.

SIS Memorandum to SCERS
2014 Review and Outlook
February 12, 2015

International Equity

While the U.S. economic expansion gained steam throughout 2014, growth in other major economies was weaker. Germany, and Europe generally, experienced slowdowns, Japan remained in a weakening business cycle, and China continued to face late-cycle pressures and high risk of a growth recession. EU countries are experiencing falling commodity prices and weaker inflation, but also promises of further monetary easing. Within the emerging markets, many countries are also facing a challenging environment characterized by falling commodity prices, a strong dollar, and continuing external financing pressures.

With the US dollar strengthening against other currencies, international equity market returns were generally disappointing for unhedged US dollar investors like SCERS. During 2014, both the Yen and the Euro fell more than 12% against the US dollar, and the UK Pound Sterling was down almost 6%. The developed equity markets as measured by the MSCI EAFE Index declined 4.5%, with the emerging markets, as measured by the MSCI Emerging Markets Index, edging down 1.9%. Within these broad indices, there was significant dispersion among individual country returns. Peripheral European countries Greece and Portugal, with notably weak economies, fell 40% and 38% respectively in US dollar terms. The Russian market was down almost 46% due to concerns about political risk and declining oil prices. Generally Latin American countries, such as Brazil, which are exposed to commodity prices, suffered. Bright spots included Turkey and Egypt, and some Asian countries such as the Philippines, Indonesia and India, all of which were up 20%-30%. Plans with a global outlook and relatively high allocations to non-US equity suffered from the disappointing returns in the foreign markets in 2014.

Fixed Income

Most fixed income market participants were surprised in 2014 by interest rates and oil prices. Despite the broad consensus of rising rates at the end of 2013, Treasury yields experienced fairly significant declines in 2014, especially at the longer end of the yield curve, creating a challenging environment for many bond managers who attempted to add value through active duration bets. Oil was in the $100 a barrel range for the first half of 2014 before falling almost 50% in the second half of the year. Such precipitous price decline caused significant spread widening for high yield issues in the energy sector, which spilled over to other high yield sectors and the bank loan market.

The Barclays Capital U.S. Aggregate Index ended the year with a return of just under 6%. Investment grade corporate credit has been the best performer for 2014, followed by mortgage-backed securities. However, lower quality corporate credit names performed much worse than their higher quality peers, with CCC posting negative returns for 2014. With U.S. dollar appreciating, non-dollar fixed income investments also had a challenging year in 2014. At the beginning of the year, developed world bond yields were discounting the imminent conclusion of quantitative easing and the beginning of the reversion to normal monetary conditions. Over the course of the year, yields re-adjusted to the new expectation of a prolonged period of unorthodox central bank intervention and disinflationary conditions.

SIS Memorandum to SCERS
2014 Review and Outlook
February 12, 2015

Private Equity

The realization of the market's low expectations for near term U.S. GDP growth, generally around 2% for 2014, limited private equity sponsors' ability to rely on organic growth to drive company returns. With interest rates expected to remain low for several years, the ongoing search for yield continues in private equity, just as in public equity, and is fueling support for both credit markets and assets with higher income expectations. The continued public equity surge and open IPO window in 2014 created a favorable exit market for sponsors to generate distributions and consequently for PE exposures to fall short of target allocations. Purchase price multiples for All LBOs were above 9.0x during the year, a level last seen in 2007 prior to the Financial Crisis. Another market indicator, discounts to NAV in the secondary market, send a similar signal, with the high bid for buyouts at 100% of net asset value in 2014, moving back toward overheated pre-crisis levels. Given healthy distributions, LPs committed to venture funds through 2014 at nearly the double the level of commitments seen 2013. Early stage VC may present the best relative value, as pricing of initial financing rounds are less influenced by strong public equity markets.

Real Estate

The same relatively slow economic growth and quest for yield evident in the other asset classes also affected real estate, which was widely considered by investors as attractive relative to the other asset classes, especially by foreign investors seeking preservation of capital. In response to strong demand, entry queues for core commingled funds built to historically high levels in 2014.

These capital flows drove up prices and created a challenge for investors seeking to underwrite new acquisitions of core stabilized assets to meet return objectives. Though prices seemed to outrun the fundamentals in core real estate, all the major property types experienced strong income growth. The large price increases in recent years has led SCERS to adopt a cautious posture in the asset class in order to avoid the overshoot phase of real estate cycle.

Hedge Funds

The broad Hedge Fund Index advanced by 3.6% in 2014,as equity markets approached record highs and many hedge fund managers kept exposures conservative. Macro strategies led returns, with the HFRI Maco Total Index up +6.4% in 2014 after three years of decline. Fixed Income-based Relative Value Arbitrage strategies posted a sixth consecutive year of positive performance, with the Index up +4.5% in 2014. Event Driven strategies posted a gain of 1.1% in 2014, the lowest performance since the Index declined in 2011.

Shareholder activism, trend-following, and long USD exposure contributed to hedge fund returns, while the oil price decline, tax inversion challenges in a number of merger transactions, and a fourth quarter 2014 spike in volatility impacted numerous managers on the downside. Going into 2015, managers seem to be mindful of capacity, paying particular attention to oil related opportunities, and poised to invest should a broad market opportunity or dislocation emerge throughout the year.

SIS Memorandum to SCERS
2014 Review and Outlook
February 12, 2015

Maturity of Market Cycle

Given the significant increase in asset prices in most asset classes in recent years, the capital markets now appear to have reached the point in the market cycle where valuations for many classes of risk assets are fully priced relative to their fundamentals. Given this, SCERS has begun to increase its focus on addressing price risk in the portfolio, while still trying to generate adequate returns to support its long-term goals. These sometimes competing goals are best accomplished through the pursuit of the greatest possible portfolio diversification and flexibility. SIS believes that risk aware, highly diversified, yet long term oriented, and return-seeking portfolios are truly "all weather" in that they are able to perform well in difficult market environments. The list below details current ongoing initiatives, as well as some that SCERS may consider pursuing in the future, to increase the diversification and flexibility of the portfolio.

Portfolio Initiatives

Real Assets Portfolio

The real assets portfolio contains a large position in the SSgA liquid real assets strategy as an asset class proxy exposure while SCERS builds out the portfolio. This SSgA portfolio is/will provide funding as needed for several of the initiatives below:

- Continue opportunistically pursuing real asset private funds (such as an Energy Opportunities fund)
- Continue buying private secondary infrastructure fund interests through Pantheon
- Consider dedicated Energy fund secondary purchases
- Within the SSgA real assets fund, consider replacing REIT exposure with MLP exposure, and or listed and liquid private infrastructure expose, which may reduce price risk while still providing an inflation hedge
- Continue to survey market for attractive Core Plus and Opportunistic private Real Estate investments
- Consider increasing actively managed commodities exposure
- Consider hedging out the real rate exposure from the TIPS holdings

Bond Portfolio

As a result of the recent bond Asset Class Structure Study, SCERS added dedicated allocations to Global (15%) and Opportunistic Credit (10%) bond mandates to the portfolio. SIS believes that specialist bond teams with flexible mandates improve bond portfolio return profiles.

- Consider increasing the existing dedicated specialist bond mandates
- Consider adding other specialist mandates such as structured credit and direct lending

SIS Memorandum to SCERS
2014 Review and Outlook
February 12, 2015

US Equity Portfolio

The recent US Equity Asset Class Structure Study led to a rationalization of the US equity manager roster, the confirmation of a high allocation (over 50%) to indexation, and the introduction of higher alpha-seeking managers.

- Replacement search for Small Cap Growth Manager
- Consider Global Equity mandate
- Consider Re-evaluating passive allocation
- Consider Energy Specialists
- Evaluate level of REIT exposure in the US Equity portfolio

International Equity Portfolio

The next Asset Class Structure Study in International Equity should address the issues below.

- Replacement search for one active International Equity mandate
- Consider Global Equity mandate
- Consider inclusion of Passive allocation
- Consider Frontier Markets Exposure
- Evaluate level of REIT exposure in the International Equity portfolio

Opportunistic Allocation

The Opportunistic bucket is intended to provide portfolio space for non-traditional or opportunistic investments.

- Evaluate a Collateralized Loan Obligation investment
- Consider an Equity Call writing program
- Evaluate a Risk Parity oriented exposure
- Consider a Currency for Alpha program

SCERS' highly diverse "all weather" portfolio is designed to provide the highest expected return possible at a sustainable (though not always entirely comfortable) level of risk. SIS believes that the portfolio, as currently structured, is well positioned to provide both strong returns and to hedge known, and to the extent possible, unknown future risks. By augmenting the portfolio through several of the initiatives detailed above, Staff and consultants will continue to strive for ever greater diversification, which remains the only true safety net for return-striving, long term portfolios.

To:	Richard Stensrud, Chief Executive Officer, SCERS
From:	Jamie Feidler, Cliffwater LLC
Date:	February 13, 2015
Regarding:	**Reviewing 2014 in SCERS' Alternative Assets**
CC:	Scott Chan, Chief Investment Officer, SCERS
	Steve Davis, Deputy Chief Investment Officer, SCERS
	JR Pearce, Investment Officer, SCERS

The Sacramento County Employees' Retirement System ("SCERS") continued to make significant advancements within its alternative assets portfolios over the course of 2014. Since much of the design and structuring of these portfolios was previously completed in the prior three years, the focus in 2014 was primarily execution and continued implementation of the SCERS investment plan. However, SCERS remained creative in its approach and disciplined in its implementation, which has improved the portfolio's expected return and risk profile and should help to position SCERS to continue to meet its investment objectives.

Private Equity

The primary focus within private equity during the last year was accessing attractive partnership investments to increase the portfolio's allocation and complement existing exposures. As you know, the private equity fundraising environment remained strong in 2014, with significant demand for funds being raised by top-tier General Partners. This created a competitive environment for accessing funds and compressed the time these funds needed to raise their targeted amount of capital. Despite the competitive environment, SCERS was able to access attractive funds, most of which were materially oversubscribed or only offered to select investors. SCERS also balanced the need to maintain vintage year diversification, through continuing new fund commitments, with discipline in avoiding certain areas of the market that look to be getting overheated. This resulted in SCERS primarily focusing on niche opportunities that were best suited for the current, and expected, economic environment. SCERS' 2014 private equity commitments spanned geographies and primarily included sector focused funds, smaller control oriented funds, and specialized debt funds. SCERS should continue its focus on unique opportunities within private equity in 2015 to take advantage of the best opportunities in the market and augment its existing exposures. Although SCERS only began making direct private equity commitments in 2011, it is encouraging to see these funds are beginning to generate meaningful performance gains despite their young age. We would expect this trend to continue given the quality and type of funds SCERS has been adding to its private equity portfolio over the last few years.

This report reflects information only through the date hereof. Our due diligence and reporting rely upon the accuracy and completeness of financial information (which may or may not be audited by the fund manager) and other information publicly available or provided to us by the fund manager, its professional staff, and through other references we have contacted. We have not conducted an independent verification of the information provided other than as described in this report. Our conclusions do not reflect an audit of the investment nor should they be construed as providing legal advice. Past performance does not guarantee future performance.

Hedge Funds

The SCERS hedge fund portfolio continues to include two separate account portfolios of hedge funds and a portfolio of direct hedge fund investments. While the aggregate hedge fund portfolio is appropriately diversified and near its targeted 10% allocation, SCERS remains below its desired allocation for the direct hedge fund portfolio, and this portfolio remains more concentrated that envisioned. The direct portfolio would benefit from additional hedge funds being added to further diversify its composition. The two new direct hedge fund investments SCERS made in 2014 provide good examples of the benefits, as these funds tend to produce returns with low correlations to broad asset classes and to the other hedge funds within the SCERS portfolio. The strategies and return profiles provided by these new funds will help to further diversify the direct portfolio's exposures and better deliver on its performance objectives. SCERS should look to continue to build out its direct hedge fund portfolio in 2015 to improve the diversification within this portion of the hedge fund portfolio. Although hedge funds overall produced returns that lagged our expectations in 2014, the SCERS hedge fund portfolio continues to provide good risk-adjusted returns and reduce volatility within the total SCERS portfolio – these performance attributes have been particularly evident since SCERS restructured its hedge fund portfolio beginning in late 2011.

Real Assets

Searching for better value was a major theme within the SCERS real assets portfolio in 2014. For example, SCERS looked to take advantage of continued strength in many core real estate markets by selling some of its core real estate holdings and looking to markets that offered better value, such as non-core, non-U.S., or other niche real estate markets. SCERS also evaluated increasing its real assets exposure to more liquid real asset classes, such as commodities, TIPS, or MLPs, though decided not to increase the exposure as most of those asset classes did not offer a compelling reward to risk trade-off during the year. SCERS did, however, continue to increase its exposure to private real asset investments through both direct partnership commitments and through the creation of separately managed accounts. SCERS created two such real asset-related accounts during the year: one focused on European real estate debt investments, and the other designed to take advantage of secondary opportunities in infrastructure and energy. SCERS also spent significant time evaluating other creative approaches to increasing its private real assets exposure, including the possibility of creating a customized debt-related separate account that would be aligned with the objectives of the real assets portfolio. This separate account structure, like many of SCERS' other dedicated accounts, will allow SCERS to define the desired opportunity set, shape portfolio construction, and provide better control of the investments. SCERS will continue to evaluate a diversified array of real asset investments in 2015, within both public and private markets, including a continued evaluation of potential opportunities created by dislocations in the energy markets.

Bigger Picture

The activity within SCERS' alternative investments over the past year is once again reflective of how SCERS has continued to successfully execute and implement the investment vision that the SCERS staff, Board, and Cliffwater have developed over the last four years. Importantly, SCERS remains thoughtful in its approach to managing the portfolio, diligent in its implementation, and dedicated to maintaining investment discipline and following a well-defined, rigorous process.

All of these efforts have positioned SCERS to take advantage of unique opportunities within the alternative asset classes, which should continue to bolster performance for years to come. The SCERS staff, Board, and Cliffwater also continue to have an interactive dialogue regarding opportunities and developments in the capital markets, which supplement discussions of the portfolio's investments and performance. As previously mentioned, the changes SCERS has made over the last several years should not only help SCERS to meet its near-term and long-term investment objectives, they also reflect industry best practices and a willingness by SCERS to adopt more advanced approaches to meeting the challenges presented by current capital markets.

TOWNSEND
GROUP

MEMORANDUM

TO:	**Sacramento County Employees' Retirement System**
DATE:	February 2015
SUBJECT:	Real Estate Investment Year in Review
FROM:	**The Townsend Group (Jennifer Young, Principal & Nick Rittenhouse, Consultant)**

The 2014 focus for the Sacramento County Employees' Retirement System (SCERS) Real Estate Portfolio (RE Portfolio) was "relative value investment," as executed through the implementation of the SCERS Investment Plan.

In reviewing all of the achievements SCERS made in 2014, it is important to reflect upon the steps that SCERS has taken to facilitate all of the activity during the last year. SCERS' ability to access top tier managers, improve the total portfolio's return and risk profile, and be creative and flexible in its investment approach are all a result of not only the work that was done throughout 2013, but in prior years as well. Although it is too early to judge the long-term impact of SCERS' recent activity, it is gratifying to see how SCERS has continued to successfully execute and implement the investment vision that the SCERS staff, Board, and Townsend have developed over the last few years.

Looking forward, Townsend expects US real estate to outperform. For USD-based investors, average ex-US real estate allocations average 5% (according to IPD). As a global investor, hedging foreign currency is important. Townsend is comfortable with the 30% constraint that SCERS has adopted for ex-US real estate. We recognize that to maintain a higher weighting, SCERS will also consider additional US investment through selective opportunities with niche property type operators. The pipeline of investments under consideration includes strategies centered around themes like China Logistics, US Alternative Property Types, West Coast Retail, Central Eastern Europe and Emerging Markets.

SCERS Real Estate Portfolio Activities (2014)

The SCERS 2014 investment activity includes the following themes.

- **Core Rebalancing Program**

  In 2014, SCERS continued to rebalance its Core Portfolio through commitments and redemptions from open-end funds and strategic dispositions from the separate account portfolios managed by BlackRock and Cornerstone.

  Following a year-end 2013 commitment and funding in MetLife's Core Fund ($35 million), three new open-end core fund commitments were approved in 2014. These 2014 commitments included a $25 million commitment to the Prologis Targeted US Logistics Fund, a $25 million commitment to the Prologis Targeted European Fund and a $35 million commitment to the Principal US Property Account. Each of the 2014-approved commitments is projected to fund in 2015.

TOWNSEND
GROUP

Total drawn contributions in 2014 included the full funding of a $15.0 million commitment to the Jamestown Property Fund, which was approved in 2013.

It is important to know that the new Core commitments follow the "relative value investment" thesis. On a stand-alone basis, each fund commitment approved in 2013 and 2014 presented SCERS with an opportunity to invest in a seed portfolio of assets with intrinsic value that we believe will generate near term net of fee returns above SCERS' actuarial rate of return and the long term historical average for Core real estate. On a blended basis, the newly constructed Core portfolio is well diversified by property type and geographic region, albeit with tactical overweight's (for example, to US and European Industrial) and forecasted underweight's (for example, Multifamily). The Core Portfolio is designed to allow for periodic rebalancing, as each of the new open-end fund commitments have a potential liquidity feature which allows for periodic redemption/contribution. No new Core assets were acquired directly by the SCERS Separate Account managers in 2014. SCERS continues to review the pipeline for attractive opportunities, but due to the competitive market environment for Core real estate, a majority of the direct individual transactions are expected to produce returns below that of the long-term historical average for Core real estate.

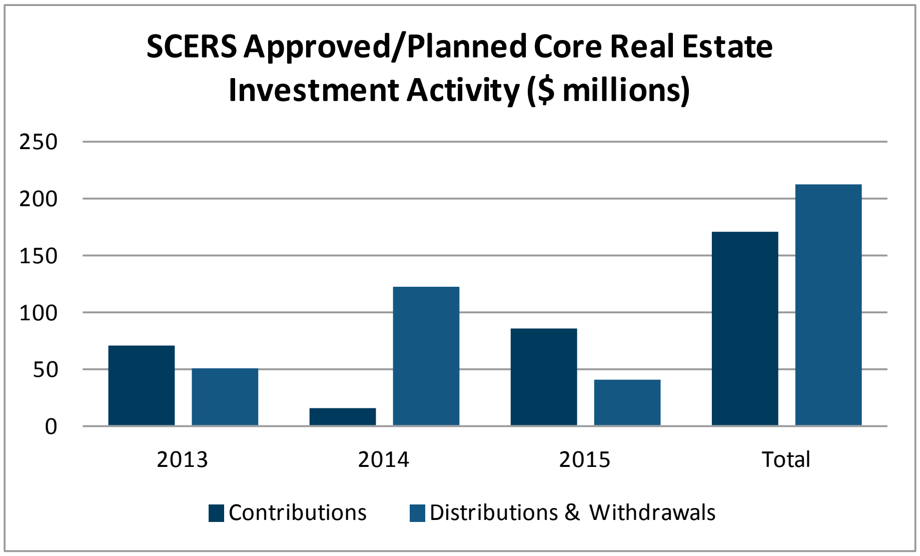
From time-to-time, dispositions are required to enhance or "upgrade" the quality of the Core Portfolio, especially in a highly competitive environment seeking Core exposure. As SCERS is a relative value investor, SCERS and Townsend recognized that the timing for certain asset sales was optimal in 2014.

Total distributions and withdrawals in 2014 were $122.6 million as a result of a partial redemption from the Cornerstone Patriot Fund ($50 million, approved in 2013, paid out in 2014) and separate account dispositions (Fontana Commerce, 11 DuPont Circle and Salt Pond, detailed below).

- 2014 Separate Account Dispositions:
    - Blackrock
        - Fontana Commerce, an industrial asset located in Fontana, California, realized a 7.9% net IRR (1.8x equity multiple)
        - 11 Dupont Circle, an office asset located in Washington DC, realized a 9.7% net IRR (1.8x equity multiple)
    - Cornerstone
        - Salt Pond, a retail asset located in Narragansett, Rhode Island, realized a 7.4% net IRR (1.6x equity multiple)

Based on capital contributions ($15 million) and distributions/withdrawals ($122.6 million), SCERS was a net seller of Core Real Estate in 2014. Taking in to account all "approved" activities that have not yet occurred, Townsend expects that SCERS will be a **net seller** of Core real estate between 2013 and 2015, as shown below.

TOWNSEND GROUP



The SCERS Core Rebalancing initiatives will continue in 2015 and 2016. Recent activities (2013-2014) have led to outperformance of the NFI-ODCE Index (measured net of fees) over the one-year period.

- **Tactical Non-Core Investment Themes**

SCERS and Townsend continued to source new Non-Core opportunities in 2014, specifically seeking those that provide SCERS with a "relative value" proposition and/or enhance the diversification for the overall SCERS Program. A total of $130 million in new Non-Core commitments were approved in 2014. However, only one investment manager has called a small amount of capital for fees during 2014 (Och-Ziff). These investment positions are projected to be fully funded in two to three years.

2014 Non-Core Commitments

New commitments (specifically those with pre-specified assets, which carry an intrinsic value and help to eliminate the J Curve) have led to strong near-term performance of the SCERS Non-Core Portfolio. A summary of each position recommended in 2014 is provided below and additional detail regarding the investment thesis is outlined in the SCERS quarterly reports and investment recommendations.

Och-Ziff Real Estate Fund III	$35 million
Nordic Real Estate Partners	$25 million
CIM Fund VIII	$35 million
ECE European Prime Shopping Centre Fund II	$35 million
	$130 million

- At the beginning of 2014, SCERS made a $35 million commitment to the Och-Ziff Real Estate Fund III ("Och-Ziff"), an opportunity fund sponsored by an existing manager in the SCERS ex-real estate portfolio. To date, Och-Ziff has only called a minimal amount of capital from SCERS and the investment is projected to yield a 15% net IRR to SCERS.

TOWNSEND
GROUP

- In mid-2014, SCERS approved a $25 million (~€19 million) commitment to the NREP Nordic Strategies Fund. When SCERS committed to NREP, the fund housed a seed portfolio of four closed transactions with an additional three transactions under exclusivity. Given the manager's proven track record of execution in their home region, stable platform and active management strategy, Staff and Townsend believe the fund will provide the SCERS portfolio with income and cash generation, as well as portfolio diversification. This follows the SCERS investment plan, which specifically targeted the Nordics Region for consideration in the SCERS Opportunities Portfolio to further diversify the total plan. The investment thesis is supported by the size, transparency, stable economy and positive real estate fundamentals of the Nordics region. Additionally, managers in the region have demonstrated an ability to identify and convert assets to Core institutional product as well as build-to-suit opportunities. This deal flow, coupled with attractive financing available from local lenders and its liquid exit market to local institutions, highlights an opportune time for value-add investing in the region.

- At year-end 2014, SCERS approved a $35.0 million commitment to CIM Fund VIII ("CIM"), a new manager and relationship for the SCERS portfolio. When SCERS approved its commitment to the fund, CIM had purchased nine assets. The portfolio of pre-specified assets contained intrinsic value and were underwritten to generate a 21% gross return (2.4x equity multiple). The initial portfolio had a high concentration to the New York City and California markets. CIM had yet to call capital from SCERS (as of September 30, 2014).

- SCERS approved a $35 million (~€31 million) commitment to the ECE European Prime Shopping Centre Fund II prior to year-end 2014. At the time of commitment, ECE had a pipeline of nine investment opportunities identified throughout Europe (primarily in Germany, Poland and Austria). Seven of these transactions are fully stabilized offering a level of current income to mitigate J-curve and volatility. ECE is projecting an 11% net IRR to SCERS. The investment is aligned with the SCERS investment plan, which identified regions outside of the United States for consideration. The European real estate cycle has entered the beginning stages of a slow recovery and provided an attractive entry point for US investors seeking global diversification. Consistent with Non-Core investments in the United States, this investment aligns with the SCERS and Townsend preference for operator-led portfolios with pre-specified pools of assets generating income, which ultimately help to limit J-curve and reduce volatility.

Three legacy funds in the Non-Core Portfolio (UBS Allegis Value Trust, AEW Value Partners II and Hines US Office Value Added Fund II) are in the liquidation phase, which will result in returned capital/proceeds for the SCERS Non-Core Portfolio.

TOWNSEND GROUP

- **Overall Portfolio: Continue to Negotiate Attractive Terms & Fees**

  In 2014, SCERS and Townsend continued to negotiate "better than market" fees and terms across its real estate investment portfolio. Fee savings will lead to improvement in net of fee performance for Core and Non-Core positions. Term negotiations allow for more flexibility and control.

  - Jamestown Premier Property Fund (2013): Townsend Voting Advisory Board Seat, Initial Fund Terms, Townsend Aggregated Fee Savings (60 bps Asset Management Fee vs. 90-125 bps Asset Management Fee for non-TTG investors; approximately 50% off market rates)
  - Metlife Core Fund (2013): Townsend Voting Advisory Board Seat, Initial Fund Terms, Townsend Aggregated Fee Savings (47 bps Asset Management Fee vs. 95 bps Asset Management Fee for non-TTG investors; approximately 50% off market rates)
  - CIM Opportunity Fund VIII (2014): Townsend Aggregated Fee Savings: Townsend negotiated a lower asset management fee (reduced by 25 bps) and a higher preferred return (increased from 8% to 9%) for TTG Investors
  - Nordic Real Estate Partners (2014): Townsend and SCERS negotiated a SCERS Advisory Board Seat, for which Townsend will serve as proxy

Appendix 4 - 2013/2014/2015 Road Map

Topic	2014 Preview	2014 Actual	2015 Preview
Consultant Roster	- Assess the need for specialty consultants including operational due diligence in alternative assets		- Assess the need for specialty consultants including operational due diligence in alternative assets
Asset Liability Study	- Work toward private equity and real assets target allocations	- Allocated capital to 7 private equity funds, 4 real assets funds and 1 real assets strategic partnership	- Work toward private equity and real assets target allocations
Equities	- Evaluate alternative forms of passive equity exposure including low volatility/ low beta and diversified factor exposures	- Conducted several meetings related to alternative forms of passive equity investing	- Evaluate alternative forms of passive equity exposure including low volatility equities
		- Terminated a U.S. small cap growth manager	- Conclude the U.S. small cap growth replacement search
		- Terminated an international large cap developed markets manager	- Conclude the international large cap developed markets manager search - broaden search to include a global equity mandate
		- Conducted a soft dollar audit of SCERS' domestic and international equity managers	
	- Evaluate SCERS' all-cap emerging markets exposure		- Evaluate SCERS' all-cap emerging markets exposure
	- Evaluation of global currency exposures	- Performed due diligence on total portfolio currency hedging solutions	- Further evaluation of global currency exposures

Appendix 4 - 2013/2014/2015 Road Map (Continued)

Topic	2014 Preview	2014 Actual	2015 Preview
Fixed Income	- Create a customized benchmark for the broad fixed income asset class to match the risk and return characteristics of the new structure	- Created a custom benchmark for the fixed income asset class consisting of a weighted average of specific strategy indexes for each underlying investment manager	- Evaluate addional forms of credit and fixed income exposures, both liquid and illiquid
		- Replaced one of SCERS' core plus fixed income managers	
Hedge Funds	- Evaluate additional potential direct hedge fund investments and invest in 4-6 funds directly	- Made 2 direct hedge fund investments	- Evaluate additional potential direct hedge fund investments and invest in 2 funds directly
	-Bring in 1-2 current direct hedge fund managers to educate SCERS' Board		-Bring in 1-2 current direct hedge fund managers to educate SCERS' Board
			- Deepen expertise and capabilities in operational due diligence
Private Equity	- Identify and commit to 7-10 potential direct private equity investments	- Made 7 direct private equity invest-ments	- Identify and commit to 5-10 potential direct private equity investments
	- Assess the need for strategic partners and advisors for private equity segments such as emerging markets, venture capital, etc.	- Assessed the landscape for strategic partners to assist SCERS in fully building out its private equity portfolio	- Continue to assess strategic partners to assist SCERS in fully building out its private equity portfolio within niche segments such as venture capital and emerging markets
	- Present annual report on private equity and approve 2014 Private Equity annual investment plan	- Presented annual report on Private Equity and approved 2014 Private Equity annual investment plan	- Present annual report on Private Equity and approve 2015 Private Equity annual investment plan
	-Bring in 3-5 current direct private equity managers to educate SCERS' Board	-Arranged for current direct private equity managers to educate SCERS' Board	-Bring in 3-5 current direct private equity managers to educate SCERS' Board

Appendix 4 - 2013/2014/2015 Road Map (Continued)

Topic	2014 Preview	2014 Actual	2015 Preview
Real Assets	-Continue to identify core properties to sell at favorable prices	Disposed of 3 separate account properties at prices greater than appraised value	-Continue to identify core properties as potential sell opportunities
	-Assess core real estate commingled fund lineup		-Assess core real estate commingled fund lineup
	- Identify and commit to 2-3 primary private real assets funds (infrastructure and energy)	-Committed to 2 primary private real assets funds	
	- Identify and commit to 1-3 secondary private real assets funds	- Committed to 2 secondary investment opportunities through SCERS' secondary/co-investment real assets separate account	- Identify and commit to 1-3 secondary private real assets funds
	- Reassess commodities managers		- Reassess commodities managers
		- Presented annual report on Real Assets and approved 2014 Real Assets annual investment plan	- Present annual report on Real Assets and approve 2015 Real Assets annual investment plan
		- Progressed in the formation of a cus-tom separate account to invest in debt backed by real assets	- Finalize the custom separate account to invest in debt backed by real assets
			- Identify investment opportunities around the significant decline in oil prices

Appendix 4 - 2013/2014/2015 Road Map (Continued)

Topic	2014 Preview	2014 Actual	2015 Preview
Opportunities	-Investigate potential distressed European debt	- Committed capital to a niche/ opportunistic real estate fund, which draws capital from the Real Assets asset class	
		- Committed capital to a Nordic based value-added real estate fund that draws capital from the Real Assets asset class	
		- Committed capital to an opportunistic/ value-added real estate fund that draws capital from the Real Assets asset class	
Other Investment Activity	- Conduct on-site due diligence of exisiting managers and real estate investments	- Oversaw and monitored existing managers	- Conduct on-site due diligence of exisiting managers and real estate investments
	-Conduct a soft dollar audit of SCERS' equity managers	-Conducted a soft dollar audit of SCERS' equity managers	
	- Research risk management systems		- Research risk management systems
	-Revise overall investment policy, including incorporating individual asset class policies	- Created Investment Policy Statements for the Domestic and International Equity Asset Classes	-Revise overall investment policy, including incorporating individual asset class policies
	-Deepen expertise by increasing capabilities in operational due diligence		-Deepen expertise by increasing capabilities in operational due diligence
		Executed on three transitions - 2 equity and 1 fixed income	

980 9th Street, Suite 1900 • Sacramento, CA 95814