2015

Investment Year in Review

SACRAMENTO COUNTY EMPLOYEES' RETIREMENT SYSTEM

2015 Investment Year in Review

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Introduction

As Chief Executive Officer of the Sacramento County Employees' Retirement System (SCERS), I am pleased to present SCERS' 2015 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 2015, SCERS leveraged the expertise of its internal investment staff, investment consultants and key investment partners to continue to implement and refine the asset allocation structure in order to reduce risk, increase diversification and improve investment performance across economic environments. The primary focus of SCERS' investment team in 2015 was to apply those 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 2015, with SCERS' investment team analyzing numerous investment strategies and opportunities for potential consideration in the different asset classes. Asset class construction and implementation will continue in 2016, and for the alternative asset classes in particular, it will be a few years before the asset classes are fully built-out. These efforts are important as the portfolio will be better positioned to deal with challenging investment environments when the asset allocation structure is fully implemented.

The continued refinement of the investment portfolio reflects two important premises in SCERS' investment program: (1) Understanding and managing risk is an ongoing exercise; and (2) 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 risk factors operating in the markets, including the status of the investment market cycle. Accordingly, to these ends, in 2016 the asset allocation structure will be analyzed through different risk 'lenses' in order to assure that the portfolio is properly aligned with the risk exposures in the investment markets.

Calendar year 2015 marked the second consecutive year where the investment markets experienced greater volatility and provided lower overall returns due to macro-economic considerations, including slow and/or slowing global economic growth and continued downward pressure on oil prices. The nearly flat investment return in 2015 (-0.5%) combined with the low investment return in 2014 (5.5%) have pulled down the three year return and five year return to 6.8% and 6.9% per year, respectively. Overall, however, the investment performance continues to be strong over the long term, with a return of 8.2% per year for the last twenty-nine years, which is comfortably above SCERS' current investment return assumption of 7.5%.

The macro-economic headwinds are likely to continue in 2016. Accordingly, going forward SCERS will remain focused on identifying ways in which risk can be reduced and 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
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. SCERS' general investment consulting services are provided by Verus Advisory Services (Verus), which merged with the prior general investment consultant Strategic Investment Solutions (SIS) in January 2016. 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 (a) allow SCERS to develop an efficient, customized solution to an investment need; (b) allow SCERS to 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 2015.

Asset class implementation and refinement will continue in 2016 as SCERS' investment team seeks to:

- Identify and determine the appropriate relative weight of the various risk factors in the investment portfolio;
- 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 opportunities to expand the reach, scope and resources of the investment program through strategic investment partnerships;
- Assess the status of the investment market cycle and position the portfolio accordingly; and
- Assure that the interests of investment managers are properly aligned with the interests of SCERS.

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 2016 will be to fully build out and maintain a high quality internal investment Staff. To do so, SCERS must 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 cost and greater retirement security.

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

Summary Overview

For the calendar year ended December 31, 2015, the Sacramento County Employees' Retirement System ('SCERS') achieved a -0.5% gross return. As explained in more detail below, SCERS' return was below the Policy Index return of 0.4%, but has slightly exceeded the Policy Index over the 3-year period and is in-line over the 5-year period, where SCERS has returned 6.9% and 6.9% respectively, versus the Policy Index return of 6.8% and 6.9%.

Market Overview

The extremely low volatility environment that had been prevalent over the past several years came to an end in 2015, due to a number of factors including divergent central bank monetary policy, slowing global growth, and deflation concerns. In correlation to this, global financial markets experienced divergent returns across asset classes, and even within asset classes.

Following several years of coordinated central bank monetary policy, global central bank policy diverged in 2015. After six years of zero percent interest rates, and after ending its quantitative easing ('QE') program in 2014, the Federal Reserve ('Fed') initiated a long anticipated interest rate hike of 25 bps in December. In contrast, the Bank of Japan ('BOJ') has kept interest rates at zero, and in early in 2016, even adopted a negative interest rate of -0.1% in order to achieve its price stability target of 2.0%; current Japanese inflation forecasts from the BOJ are only 0.8%. The BOJ has also maintained its QE program, purchasing assets at a rate of 80 trillion yen a year. European interest rates also remain at zero, as European inflation remains well below target. In early 2015, the European Central Bank ('ECB') embarked on a €1 trillion government bond purchasing QE program (six years after the U.S. first initiated QE).

The U.S. has experienced moderate growth (2.4% in 2015), mostly positive economic data and an improving jobs market, which gave the Fed enough confidence to initiate raising interest rates late in 2015. However, inflation remains well below the Fed's target rate of 2% both at the headline and core levels. While the Fed appears intent on continuing to raise interest rates, further increases will be heavily data dependent, which could cause the Fed to be episodic in its actions, and many anticipate that the pace and ultimate level of rate increases will be more modest than a typical cycle. While fears of a recession are lower in the U.S., significant economic growth does not appear to be on the horizon either.

Outside of central bank monetary policy, global financial markets were influenced by other factors as well during 2015. Two significant factors included the continued collapse in oil prices and global fears surrounding a slowdown in China. Oil prices have been in a downward spiral since the middle of 2014, with price pressure continuing into 2016. Major global producers, including U.S. shale producers and members of OPEC, have maintained production levels even as the commodity price has plummeted, by reducing capital expenditures and increasing efficiency measures for extracting oil. The continued stalemate between global oil producers seeking to maintain production share, and increasing fears of a slowdown in global demand, especially out of China, has led to oil trading in the $20 and $30 dollar range, lows not seen since the mid-2000's. At current prices, many oil producers will be forced to continue to cut capital expenditures and at some point supply, which would most likely be the catalyst toward any potential sustainable rebound in oil prices.

2015 saw increasing fears of an economic slowdown within China, as this nation continues to transition from a manufacturing-based economy to a services-based economy. China's economy appears to be operating at two different speeds, with the Chinese consumer and services sectors growing at a robust rate, while the industrial and manufacturing sectors continue to weaken. In aggregate, China's economy is growing at a sub-7% rate, with many market experts believing the true growth is lower than estimates coming out of China. Of significant concern in 2015, was China's fiscal and monetary policy response to its slowing economy and volatile equity markets. Investor uncertainty rose as a result of the lack of transparency into and frequent policy reversals.

Within the global equity markets, there was a significant divergence between developed market returns and emerging market returns. The Russell 3000 and the MSCI EAFE Indexes were mostly flat during the year, returning 0.5% and -0.8%, respectively, while the MSCI Emerging Markets Index was down -14.9% during the year. Emerging markets equities were particularly impacted by slowing global economic growth concerns, geopolitical risks, strength in the U.S. dollar and commodity price weakness. Fixed income returns were mixed during 2015, with the Barclays Capital Aggregate returning 0.5%, while high yield corporate debt experienced significant spread widening, returning -4.5% during the year. Commodity prices, as represented by the Bloomberg Commodity Index, were down 24.6% in 2015.

With the divergence in financial markets returns in 2015, several asset classes including core real estate and U.S. equity markets have become fully valued, while others, such as the energy and high yield credit markets have become dislocated. This creates an environment where investors need to be increasingly cautious within those segments that are fully valued, while carefully considering potential opportunities in those that have experienced significant sell offs. Relative value and capital preservation continue to be important areas to be cognizant of in the current cycle, and it is important that SCERS remain disciplined in its investing philosophy, with the expectation of episodic bursts of market volatility continuing into 2016.

Portfolio Review and Considerations

SCERS' current long-term asset allocation mix is outlined in **Table 1**. An important objective of the long-term asset allocation is to reduce 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 (e.g., interest rates, duration, currency, inflation and equity exposure); and (2) Maximize risk-adjusted returns (i.e., optimize returns within an acceptable 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 asset allocation structure features a number of changes from its predecessor, 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. While significant progress has been made, full implementation is a progressive exercise and will take a few more years, especially within the alternative asset classes.

The progress in investing and moving SCERS' physical portfolio closer to the target allocations is displayed in **Table 1**, which compares the actual physical asset allocation as of the end of 2015 to the target asset allocation. Please note that while an asset class is being built out, 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	26.4%	22.5%	3.9%
International Equity*	17.3%	22.5%	-5.2%
Fixed Income	18.7%	20.0%	-1.3%
Absolute Return	9.7%	10.0%	-0.3%
Private Equity	6.3%	10.0%	-3.7%
Real Assets	8.3%	15.0%	-6.7%
Opportunities	2.1%	0.0%	2.1%
Overlay Program	8.0%	0.0%	8.0%
Cash	3.2%	0.0%	3.2%

* There is an additional 4.4% allocation for the International Equity asset class that is held in SCERS' Overlay Program as passive exposure in the form of total return swaps

SCERS' asset allocation structure is designed to achieve diversified exposure across asset classes, which includes exposure to several less correlated segments of the investment universe. The structure also gives SCERS the ability to allocate within ranges in the segments of an asset class, in order to allocate capital toward those investment opportunities with the most attractive risk adjusted returns, something that becomes more important as cycles mature. Staff along with SCERS' investment consultants, Verus Advisory, Cliffwater and The Townsend Group ('Consultants') continued to take advantage of the flexibility within the asset allocation structure over the past year in its implementation of SCERS' portfolio. As an example, SCERS has reduced exposure in areas where it is believed that valuations are exceeding fundamentals, such as core real estate in secondary and tertiary markets, by investing capital in more attractive relative value opportunities in the non-core, non-U.S. and niche segments of the real estate markets.

Given the increasing risks in the global economy and financial markets, Staff and Consultants continue to have an eye toward capital preservation when underwriting investment opportunities. This has included an emphasis on investments with contracted yield, consistency in the cash flows, and/or less correlation to the broader economy. Examples of these types of investments that have been made in SCERS' portfolio include core infrastructure; debt that is over-collateralized with real assets; direct lending opportunities that include contracted yields with upside through equity optionality; sector specific funds that invest in segments that are less cyclical (i.e., healthcare) and generate recurring and less correlated revenue streams to the broader economy; and niche segments of real assets with contracted yields and low correlation to the broader economy and energy markets.

Over the last few years, SCERS has sought to establish customized investment solutions to meet SCERS' investment needs rather than simply rely on 'off the shelf' investment approaches. To that end, SCERS has established several customized separate account structures within the alternative asset classes that are intended to increase Staff engagement and become 'strategic partners' with the investment managers. These partnerships not only increase communication of the manager's investment insights and knowledge for the benefit of SCERS' total fund, but also provide greater control in the investment guidelines, terms and portfolio holdings, including the ability to underwrite the manager's recommendations with built-in 'veto' rights. Staff believes having veto rights is useful, particularly later in the current cycle, and in turn has only judiciously approved those investments where the downside risk is mitigated, and the returns adequately reward SCERS for the risks undertaken. These structures include a diversified absolute return portfolio managed by Grosvenor Capital Management; real estate separate accounts managed by BlackRock Realty and Cornerstone Real Estate Advisors; a strategy that invests in infrastructure/ real assets secondary and co-investments opportunities managed by Pantheon Ventures; and a debt backed by real assets strategy managed by Atalaya Capital Management. For 2016, Staff and Consultants will continue to look to identify potential strategic partnerships within SCERS' portfolio, including segments and niches where SCERS has limited reach, or has difficulty accessing, or accessing with sufficient scale, given constrained resources. This could include segments of the Private Equity and Real Assets portfolios.

Two key high level projects have been identified for SCERS' portfolio in 2016, including: (1) Expansion of the risk management program for SCERS' investment portfolio; and (2) A review of SCERS' asset allocation structure.

Risk management has always been a key consideration with respect to SCERS' portfolio, but since the Global Financial Crisis ('GFC') the way risk is analyzed and measured has evolved considerably. While portfolio volatility, measured through standard deviation, has been and continues to be a common metric to identify portfolio risk, today it is possible for institutional investors to utilize formal risk management tools that can dynamically measure and disaggregate risk across the investment portfolio.

The objective of risk management is not to eliminate risk, but to understand risk and be able to measure and manage it, especially as it relates to potential portfolio drawdowns. An institutional investment program like that of SCERS is exposed to six primary risk and return factors: (1) Equity; (2) Credit; (3) Interest rates; (4) Inflation; (5) Currency; and (6) Alternatives. A risk management program is not intended to drive portfolio related decisions, but rather to serve as a complement in setting SCERS' asset allocation and effectively implementing it. Another objective of a risk management program is to be able to better keep track of portfolio liquidity as more investments are made in the less liquid private markets, especially in making sure that SCERS is able to meet its actuarial cash flow obligations in stressed and/or dislocated markets.

With the potential to integrate risk management tools and processes into SCERS' portfolio, Staff believes it would be advisable to analyze SCERS' asset allocation through different risk lenses, which could potentially lead to re-classifying and re-allocating portions of the portfolio in order to better align with risk exposures that are identified within the portfolio. During the last asset allocation study the idea of evaluating SCERS' portfolio through different risk lenses was introduced, as demonstrated with the creation of the Real Assets asset class, and a follow-up asset allocation analysis would continue on this path.

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 full implementation of the asset allocation model is complete, the Allocation Index and the Policy Index will be the same.

For 2015, SCERS generated a total gross fund return of -0.5%, which underperformed the Policy Index return of 0.4%, by 0.9%. The underperformance of SCERS' portfolio was primarily driven by the performance of the Overlay Program, as the total gross fund return without the impact of the Overlay Program was 0.7%. The Overlay Program was particularly affected by the Private Equity and Real Assets proxies. The Private Equity proxy is comprised of Russell 2000 Index futures, and small cap stocks underperformed large cap stocks by over 5% during the year. The Real Assets proxy has meaningful exposure to energy related segments, which dragged down performance. While SCERS has made significant progress investing in these asset classes, Private Equity and Real Assets have the largest gap between the target and actual allocations, so the performance of the Overlay proxies has a greater impact within SCERS' portfolio, compared to the other SCERS asset classes, until these gaps are narrowed.

SCERS' asset classes demonstrated mixed results relative to their respective benchmarks. Asset classes that exceeded their benchmarks included Domestic Equity by 0.3%, International Equity by 2.6%, Private Equity by 12.5% and Opportunities by 11.6%. Asset classes that trailed their respective benchmarks included Fixed Income by 0.9%, Absolute Return by 5.5% and Real Assets (excluding the SSGA Real Assets Strategy proxy) by 1.1%. Please recall that these are time weighted returns as calculated by Verus, 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. The performance results of these segments in the asset class sections of this report utilize an IRR calculation, as calculated by Cliffwater and Townsend.

Over the past five years, SCERS' Staff, consultants and strategic partners have been building an investment program with the objective of meeting SCERS' actuarial rate of return over the long-term, and adding value through the generation of excess returns in a variety of market environments. Over the 3-year and 5-year periods, SCERS has generated gross returns of 6.9% and 6.9% respectively, exceeding to the Policy Index returns of 6.8% and 6.9%. While longer term returns decreased on an absolute and relative basis as a result of the muted 2015 returns, since inception (as of June 1986), SCERS' portfolio has generated a gross return of 8.2%, which exceeds SCERS' actuarial return assumption of 7.5%.

SCERS' investment results (as calculated by Verus) are summarized in **Table 2.**

Table 2 - Investment Results

	For the Period Ended December 31, 2015		
	Annualized		
	1 Year	3 Years	5 Years
Domestic Equity			
Total Domestic Equity	0.8%	14.4%	11.9%
Benchmark: Russell 3000 Index	0.5	14.7	12.2
IFx All DB US Eq Gross Median	0.3	14.4	11.7
International Equity			
Total International Equity	-2.7	2.9	1.9
Benchmark: MSCI ACWI ex-US Index	-5.3	1.9	1.5
IFx All DB ex-US Eq Gross Median	-3.5	3.4	2.6
Fixed Income			
Total Fixed Income	-1.6	0.9	3.6
Benchmark: Custom*	-0.7	0.5	2.7
IFx All DB Total Fix Inc Gross Median	-0.5	1.4	3.8
Absolute Return			
Total Absolute Return	-0.5	5.1	4.2
Benchmark: 91 day Treasury Bill + 5%	5.0	5.0	5.1
HFRI Fund-of-Funds Composite Index	-0.2	4.0	2.1
IFx All DB Hedge Funds Gross Median	-0.9	4.7	3.8
Private Equity			
Total Private Equity **	14.5	16.8	13.4
Benchmark: Russell 1000 + 3% 1 Quarter Lag	2.0	15.5	16.2
Thomson Reuters C/A All PE 1 Quarter Lag	8.1	14.5	14.1
IFx All DB Private Equity Net Median	8.3	11.4	10.9
Real Assets			
Total Real Assets (excluding SSgA Overlay Proxy)	3.8	7.3	5.2
Total Real Assets (including SSgA Overlay Proxy)	-4.9	1.7	1.9
Benchmark: CPI-U Headline + 5%	4.9	5.5	NA
Opportunities			
Total Opportunities	12.0	16.8	15.9
Benchmark: Policy Index	0.4	6.8	8.3
Total Fund			
SCERS Total Fund Gross	-0.5	6.9	6.9
SCERS Total Fund Net	-0.8	6.6	6.6
Benchmark: Asset Allocation Weightings***	0.4	6.8	6.9
IFx Public DB > $1B Gross Median	0.4%	7.5%	7.3%

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.

*** 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%.

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Asset Classes

Domestic Equity

U.S. Equity Market Overview

In contrast to previous years, U.S. equities generated lower returns with higher levels of volatility in 2015. For the year, the Russell 3000, S&P 500 and NASDAQ returned 0.5%, 1.4% and 6.7%, respectively. Within the U.S. equity markets, there was a significant divergence between investment styles and market capitalizations. With respect to investment style, growth stocks meaningfully outperformed value stocks (Russell 1000 Growth Index returned 5.7% versus a -3.8% return for the Russell 1000 Value Index), as investors gravitated towards growth oriented stocks in the technology, consumer and healthcare sectors, while value names in the energy, materials and industrial sectors were abandoned. With respect to market capitalization, investors gravitated toward the largest capitalization companies over their smaller capitalization counterparts. The large capitalization Russell 1000 Index returned 0.9% versus a -4.4% return for the small capitalization Russell 2000 Index.

During the year, U.S. equity markets were pulled in different directions. Domestically, the U.S. has been experiencing a mild economic recovery, with improving consumer spending data, which should have translated to stronger equity returns. However, the negative influence of weaker global economic growth and falling energy prices had an impact on corporate profits and equity prices. S&P 500 companies on average are expected to post a 4.1% drop in earnings for the fourth quarter of 2015 compared to the prior year, according to Thomson Reuters. However, excluding energy companies, earnings are expected to rise 2.1%, which demonstrates the influence that falling energy prices have had across asset classes.

Overall, corporate financial statements look strong with solid profit margins, low leverage and high levels of corporate cash. Valuations are also reasonable, with the S&P 500 measuring a forward price to earnings (‘P/E’) ratio of 16.1x, which compares to the 25 year average forward P/E of 15.8x. However, there are significant valuation differences between industry groups, with valuations in the beaten down industrial and commodity groups appearing much more attractive than the premium valuations within sectors than have been more insulated from the macroeconomic headwinds.

Domestic Equity Portfolio

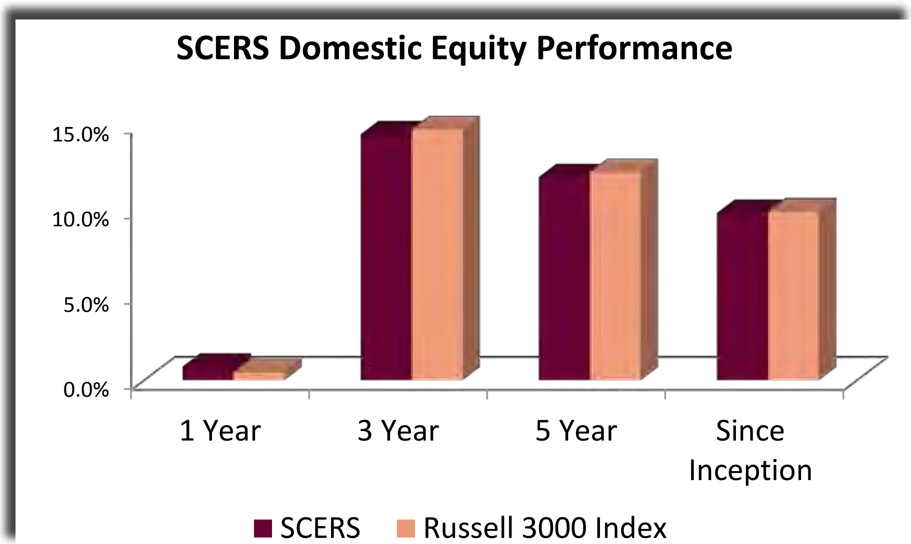
SCERS’ Domestic Equity portfolio is structured with a combination of large cap and small cap exposure, as well as active and passive mandates. A large cap passive allocation makes up over 50% of the Domestic Equity portfolio, which is complemented by a meaningful allocation to a group of active large 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.

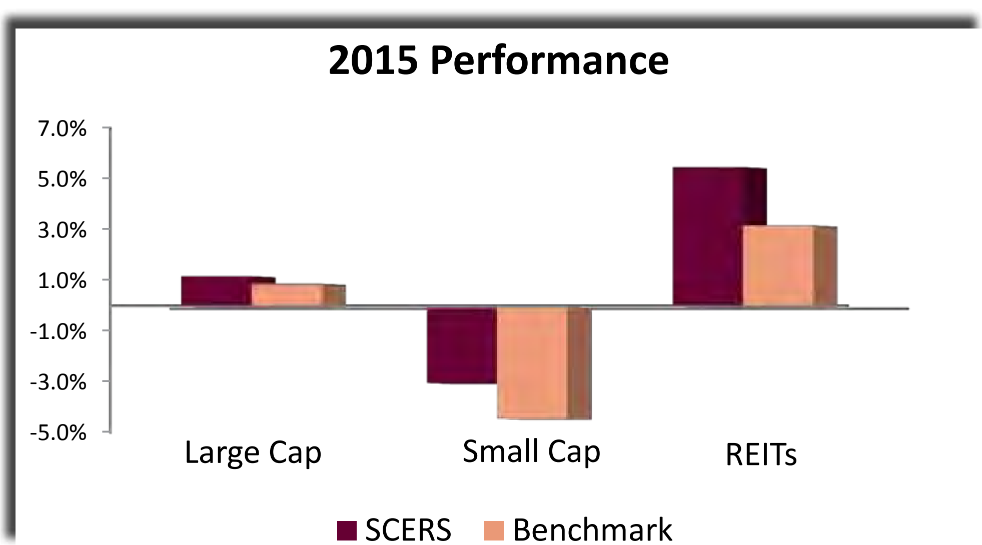
2015 ACCOMPLISHMENTS

- Hired a U.S. small cap growth manager to replace an investment manager that was terminated in 2014
- Performed due diligence on alternative forms of passive U.S. equity exposure
  - Smart beta and low volatility equity strategies
- Oversaw, monitored and met with SCERS' existing Domestic Equity managers

PERFORMANCE AND ATTRIBUTION



SCERS' Domestic Equity portfolio generated minimal returns of 0.8% during 2015. The Domestic Equity portfolio outperformed the U.S. equity benchmark, Russell 3000 Index, return of 0.5% by 30 basis points. Over longer time periods, the Domestic Equity portfolio is generating returns slightly below the benchmark.



Looking closer at Domestic Equity returns for the year, SCERS' U.S. large portfolio returned 1.2% and outperformed the Russell 1000 Index benchmark return of 0.9%. SCERS' U.S. small cap portfolio also outperformed, returning -3.0% versus the Russell 2000 Index return of -4.4%. SCERS' domestic REIT exposure, which is not part of the benchmark, generated a return of 5.5% during the year, also outperforming its benchmark return. 2015 was a good year for active management, as nearly all of SCERS' U.S. equity managers outperformed their respective benchmarks across styles and market capitalization.

2016 Goals

- Continue to assess the Domestic Equity asset class structure and investment manager lineup
- Perform due diligence on alternative forms of passive exposure
  - Derivatives replication strategies
  - Low volatility equities

International Equity

Market Overview

In 2015, non-U.S. equity markets generated negative returns, as reflected by the -5.3% return of the MSCI ACWI ex-U.S. Index. A combination of factors impacted returns, including tepid global economic growth, geopolitical risks, strength in the U.S. dollar, concerns within emerging markets and commodity price weakness. However, there was a significant divergence between developed and emerging markets ('EM') returns.

Within developed markets, the MSCI EAFE index returned -0.8%, which was fairly in-line with U.S. equity returns. However, emerging markets returns suffered as the MSCI Emerging Markets Index generated a return of -14.9%. The brunt of poor EM performance came out of Latin America, and Brazil in particular, which was plagued by political scandal, economic recession, inflation and a materially declining currency. EM Asia fared better on a relative basis, though the region was still down for the year. India and Korea were down approximately 4% for the year, and China was down 6.4%. The China 'A' Share Market (Shanghai Index) was up 7.1%, even though it fell over 30% in the third quarter.

Volatility has picked up in the global equity markets to start 2016, as many of the concerns that affected markets during 2015 have intensified in early 2016. One difference, however, is that equity market declines are being felt across the globe, not just in the emerging markets. China continues to be of particular focus, as market participants are concerned over the trajectory of China's growth (as it transitions to a services based economy), the decline of its foreign exchange reserves and potential devaluation of its currency (the renminbi) against the U.S. dollar.

International Equity Portfolio

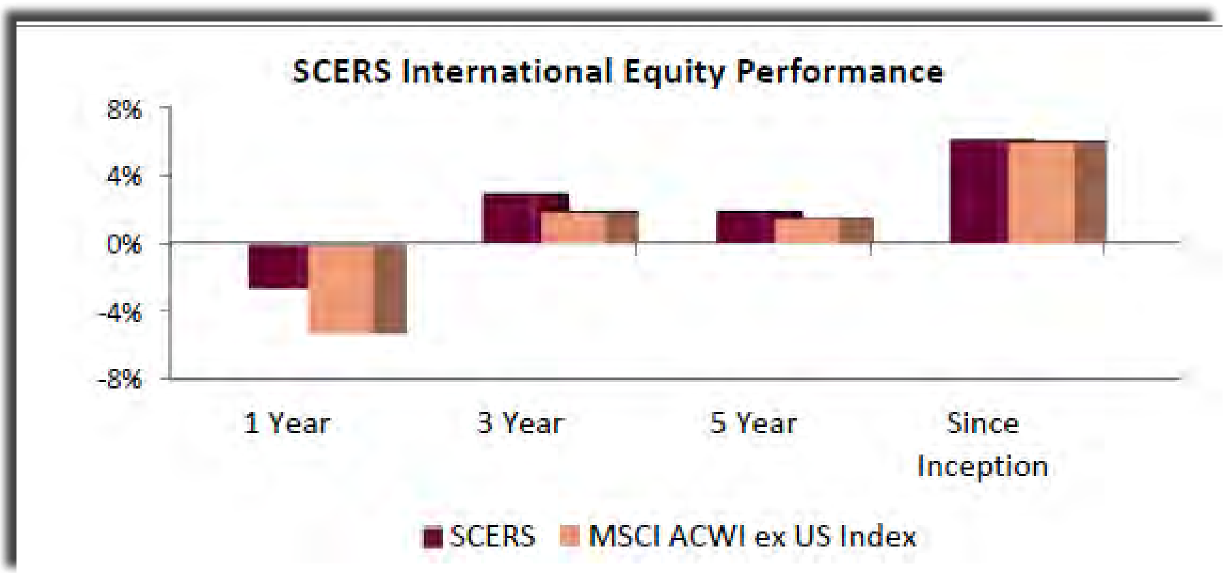
SCERS' International Equity portfolio is comprised of a combination of developed and emerging markets exposure, as well as a combination of large capitalization and small capitalization mandates. Large cap developed markets comprise the bulk of SCERS' international equity portfolio, and international 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).

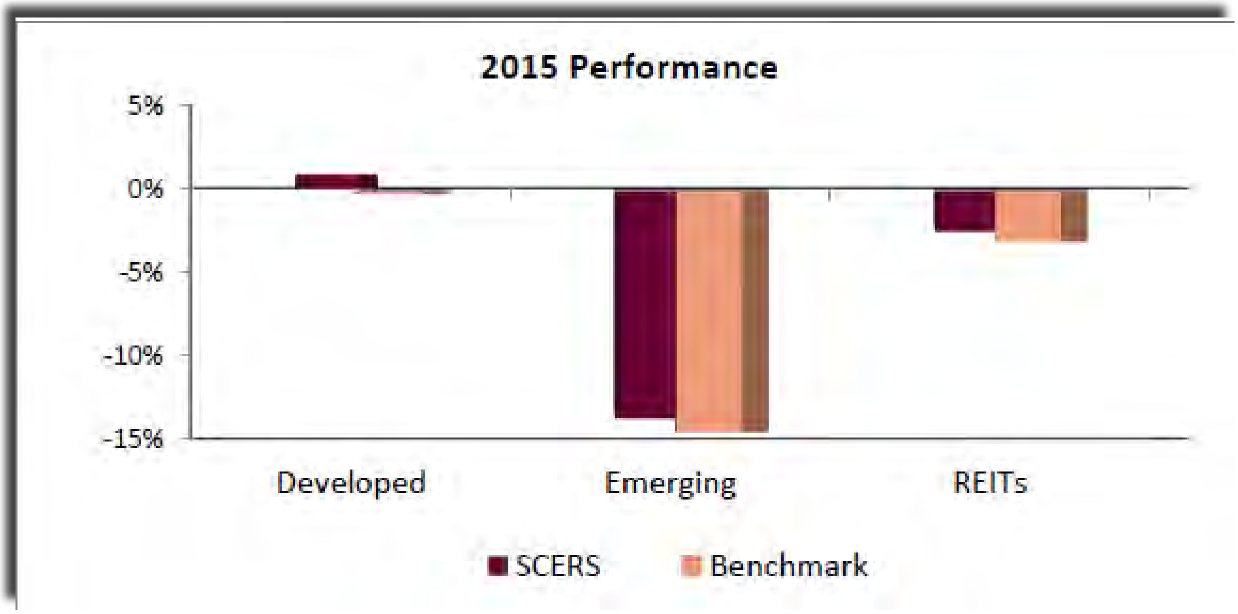
2015 Accomplishments

- Initiated a manager replacement search in all-cap emerging markets equities
- Rolled the total return swaps being used as interim passive non-US developed markets equity exposure for an international equity large cap manager terminated in 2014
  - Reviewed potential replacement managers for the terminated investment manager
- Oversaw, monitored and met with SCERS' existing International Equity managers

PERFORMANCE AND ATTRIBUTION



During 2015, SCERS' International Equity portfolio generated poor returns on an absolute basis, but outperformed on a relative basis, returning -2.7%, versus the -5.3% return of SCERS' benchmark, the MSCI ACWI ex-US Index. Over longer time periods, the International Equity portfolio has generated returns above the benchmark.



Looking closer at International Equity returns, 2015 was a good year for active management, as most of SCERS' investment managers within the international equity portfolio outperformed their respective benchmarks. At the sub-asset class level, SCERS' developed markets international equity managers outperformed the benchmark by 1.2%. Within emerging markets, SCERS outperformed the benchmark by 80 bps, mostly due to its dedicated allocation to EM small cap. The MSCI Emerging Markets Small Cap Index returned -6.6% for the year compared to the MSCI Emerging Markets Index (all-cap) return of -14.6%. SCERS' dedicated EM all-cap strategy underperformed its benchmark by 60 bps. SCERS' international REIT exposure generated a return of -2.6% during 2015, and outperformed its benchmark by 60 bps.

2016 Goals

- Conclude the emerging markets equity all-cap search
- Conduct the international developed markets equity manager replacement search
  - Potential to broaden the search to include global equity strategies, which would include a modification to the international equity manager structure
- Continue to assess the International Equity asset class structure and investment manager lineup

Fixed Income

Market Overview

The fixed income market faced a number of headwinds during the year, including the uncertainty surrounding when the Federal Reserve would raise interest rates. The decline in commodity and oil prices throughout 2015 placed downward pressure on emerging market and natural resource based economies. The U.S. dollar strengthened against most global currencies, which had a negative impact on U.S. based companies with significant overseas business. In addition, a divergence between central bank policy in the U.S. (tightening) and the rest of the world (accommodating), rising geopolitical risk in the Middle East, and China's slowing economy reduced investors' confidence in both the bond and equity markets during 2015.

Though there was increased volatility and macroeconomic concerns during the year, a flight to U.S. Treasuries did not take place, due to anticipation that the Fed would raise interest rates during the year. The 10-year U.S. Treasury yield rose in 2015 to 2.27%, from 2% at the end of 2014, which translated to slightly negative returns. The worst performing segment of fixed income was high yield, which was down 4.5% during the year. The lower-rated segments of the high yield markets suffered greater losses, as high-yield spreads widened significantly across the segment, and especially within the energy sector. The best performing sector for the year was emerging market debt, which returned 1.2%. The Barclay's Aggregate Bond Index returned 0.5% during the year.

The pace and timing of Federal Reserve rate increases during 2016 could potentially put pressure on U.S. Treasuries, corporate bonds, and other fixed income markets. Accommodative monetary policy in Europe, China, and Japan is expected to support a stronger U.S. dollar, and lower global economic growth and macro-economic concerns could cause the Fed to exercise caution in increasing interest rates. Expectations are interest rates will remain muted through 2016, particularly longer dated yields.

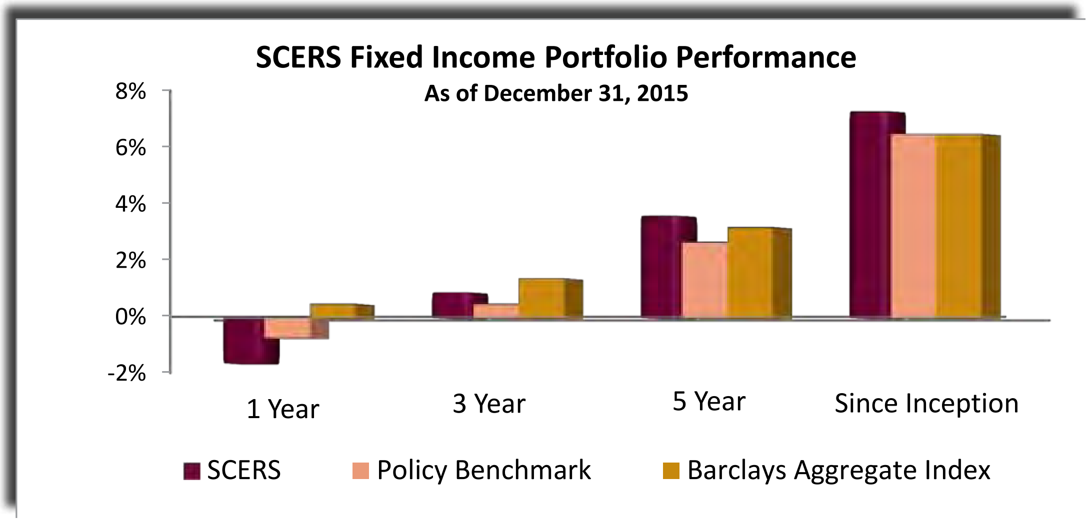
Fixed Income Portfolio

SCERS' Fixed Income portfolio was restructured and rebalanced over the last couple of years, and as such, 2015 was a period of monitoring and measuring manager performance. 2015 was a difficult year for SCERS' dedicated credit and global fixed income managers, as both performed below expectations, and well below that generated by SCERS' enhanced index and core plus managers. Therefore, Staff and consultant will closely monitor the exposures among SCERS' investment managers in the upcoming year, but do not contemplate changes to the Fixed Income portfolio in 2016.

2015 Accomplishments

- Oversaw, monitored and met with SCERS' Fixed Income managers

PERFORMANCE AND ATTRIBUTION



For 2015, SCERS' Fixed Income portfolio returned -1.6%, which underperformed SCERS' custom benchmark return of -0.7% and the Barclays Aggregate Index return of 0.5%. While 2015 was a difficult year for SCERS' Fixed Income portfolio, it has exceeded both the Barclays Aggregate Index and the custom benchmark for the asset class over the longer-term periods. SCERS' global opportunistic strategy and dedicated strategic credit strategy underperformed significantly in 2015, returning -8.0% and -9.9%, respectively, versus their benchmark returns of -5.9% and -2.5%. In 2015, the global opportunistic manager positioned the portfolio in anticipation of reflationary central bank policies better reviving the global economy, and was particularly impacted by the strength of the U.S. dollar versus several Latin America EM currencies, where exposures had been accumulated. The strategic credit manager was negatively impacted by a portfolio tilt toward lower rated high yield bonds that the market has in aggregate traded away from, but which the manager has maintained high conviction in. The core and core plus strategies performed in-line with expectations, returning between 0.1% and 0.7%.

2016 Goals

- Continue to assess the Fixed Income asset class structure and investment manager lineup
- Evaluate additional fixed income exposures, either liquid and/or illiquid, including direct lending strategies

Absolute Return

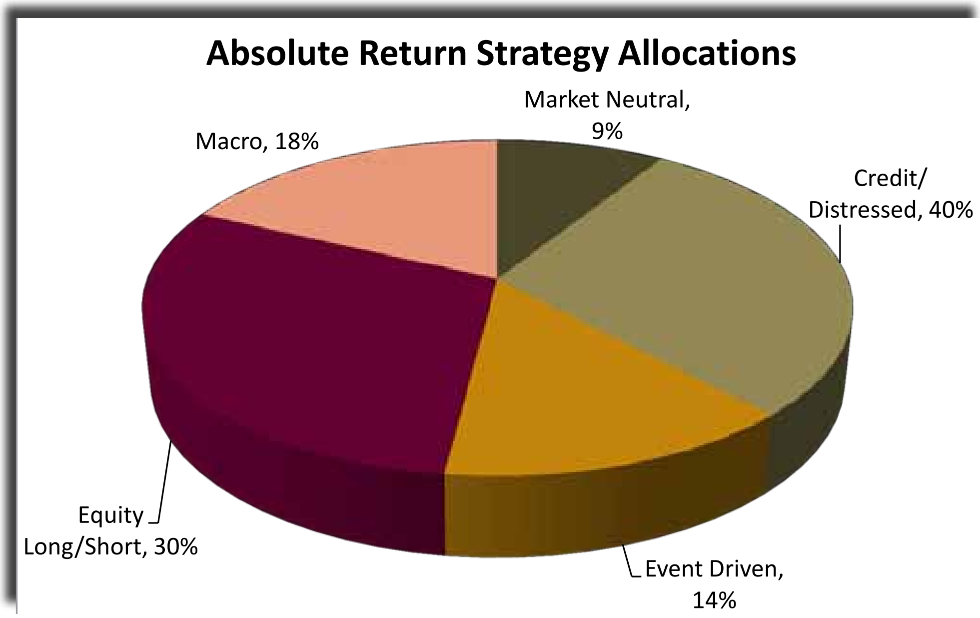
Market Overview

In aggregate, absolute return performance was mostly flat for 2015, with limited deviation among absolute return strategies. The HFRI Fund of Fund Composite Index returned -0.4%, which was in-line with developed market equity returns and many segments of the fixed income markets. Equity long/short returned -0.4% for the year, with managers allocated to the growth sectors benefitting on the long side, and those with short positions in the cyclical sectors, especially energy, benefitting on the short side. Overall, investment manager net exposures decreased during the year as risk was taken off the table. Corporate Credit returned -0.8% and distressed/restructuring funds returned -8.4%. Managers with long exposure to lower rated high yield credit issues (B's and CCC's) struggled during the year. Those managers that looked for opportunities on the long side in the more distressed parts of the credit markets were typically early and struggled. The better performing credit managers had low net exposures and short positions in commodity-related issuers. Relative value funds in aggregate returned -0.2% in 2015. Within the segment, volatility arbitrage managers performed well, especially in the second half of the year as implied volatility spiked. Event driven was the worst performing absolute return segment in 2015, returning -2.9%. Within the event driven segments, equity special situations positons underperformed, whereas merger arbitrage and activist equity positions generated positive performance. Global macro discretionary strategies were mostly flat for the year, while systematic macro strategies lost 1.0% after starting the year strong. Systematic macro generated very strong returns in 2014.

Absolute Return Portfolio

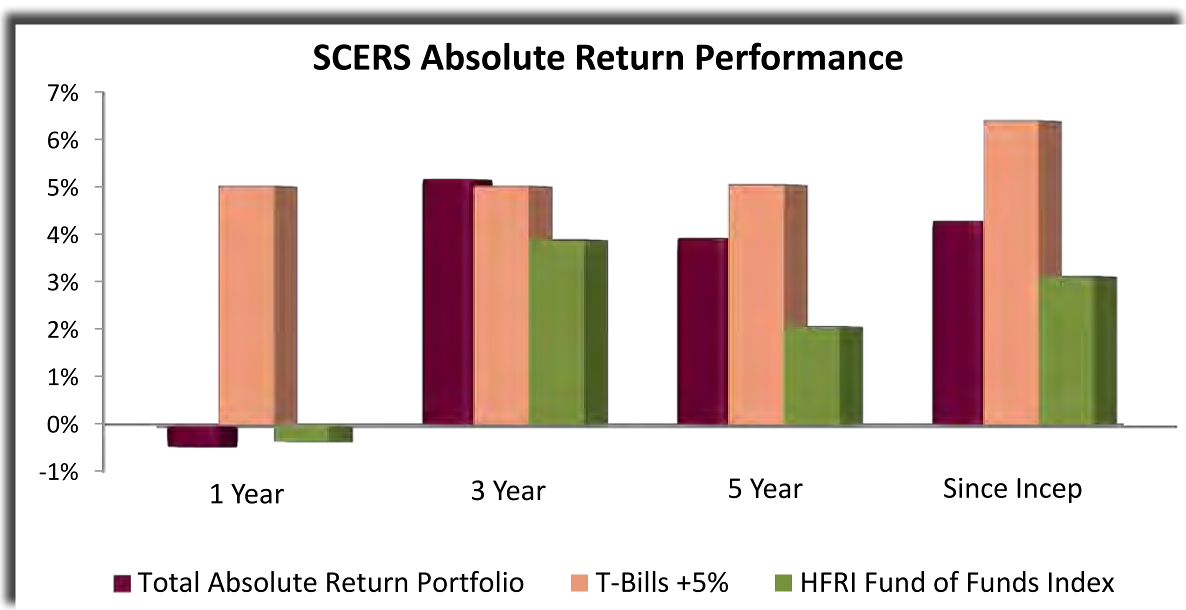
SCERS' Absolute Return allocation is structured as a broadly diversified program of multiple absolute return strategies, which has historically produced enhanced returns with reduced risk. The asset allocation structure includes four components: (1) A direct absolute return component; (2) SC Absolute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

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



2015 Accomplishments

- Put in full redemption requests from two funds within SCERS' direct absolute return portfolio
  - Global macro discretionary fund with outsized exposure to a currency trade that worked against the fund
  - Long/short credit fund that experienced multiple outsized losses as a result of poor risk management practices
  - Moved assets from both funds into SCARF B, until replacement strategies/managers are identified
- Cliffwater and Staff identified potential strategies and investment managers for SCERS' direct Absolute Return portfolio for further due diligence in 2016



SCERS' Absolute Return portfolio generated performance of -0.5% in 2015. The Absolute Return portfolio slightly underperformed SCERS' benchmarks, the HFRI Fund-of-Funds Index by 11 bps and the absolute return benchmark of T-Bills + 5% by 5.5%. Though SCERS' Absolute Return performance was almost flat for the year, the underlying portfolio of funds experienced a wide range of returns, with the less correlated strategies tending to outperform, and the more cyclical strategies underperforming. At the high end were a volatility arbitrage fund and bottom-up multi-strategy-based replication fund that returned 14.6% and 10.0%, respectively. At the low end were the two aforementioned funds from which SCERS has redeemed, which returned -2.8% and -10.2%, respectively, as well as one of SCERS' event driven funds, which returned -5.4%. The relative outperformance of SCERS' Absolute Return portfolio compared to benchmarks over the 3-year and 5-year periods suggests the restructuring to diversify SCERS' Absolute Return portfolio completed over 2011 and 2012 continues to benefit SCERS.

2016 Goals

- Identify, perform due diligence and make investments in two to four funds within the direct absolute return program
    - Focus on less correlated strategies
- Continue to monitor and assess the manager lineup
- Deepen expertise by increasing capabilities in operational due diligence

Private Equity

Market Overview

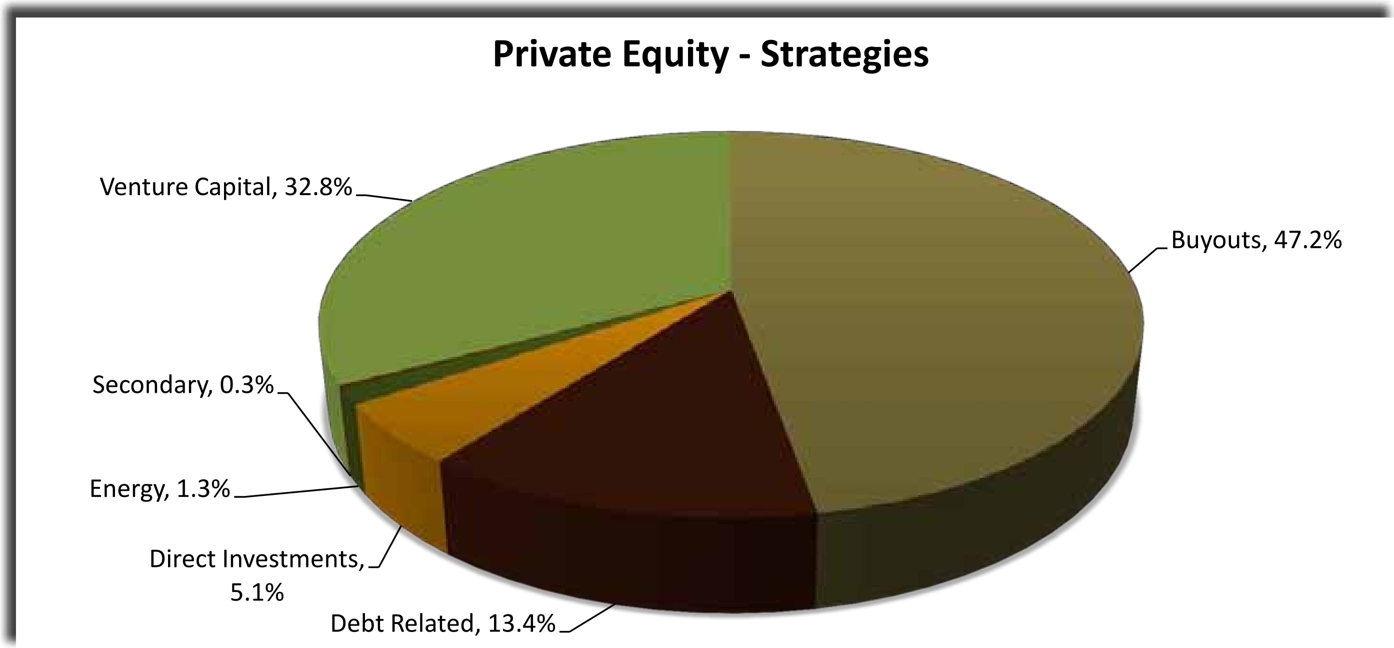
Similar to last year, performance was strong in the private equity markets for 2015. The market was flush with exit opportunities during the year, as global M&A activity reached record levels, surpassing levels set in 2007 by 13.9%. However, competition for investment opportunities remains high, which puts greater pressure on private equity funds to demonstrate discipline when deploying capital into new investments. A good gauge to evaluate this discipline is the average entry multiples that are being paid. In 2007 the average purchase price/EBITDA multiple within U.S. buyout was 9.7x. In 2014, this figure was also 9.7x, and in 2015 it has increased moderately to 10.3x, indicating that entry valuations are in-line with those figures at the peak of the last cycle. However, 2015 transaction volume of $262 billion is significantly less that the $600 billion of volume in 2007. Hence, private equity funds might be paying similar entry multiples, but are much more selective in the types of deals they are investing in, which is somewhat encouraging. Entry valuations have been a focal point for SCERS in evaluating private equity funds for its direct program.

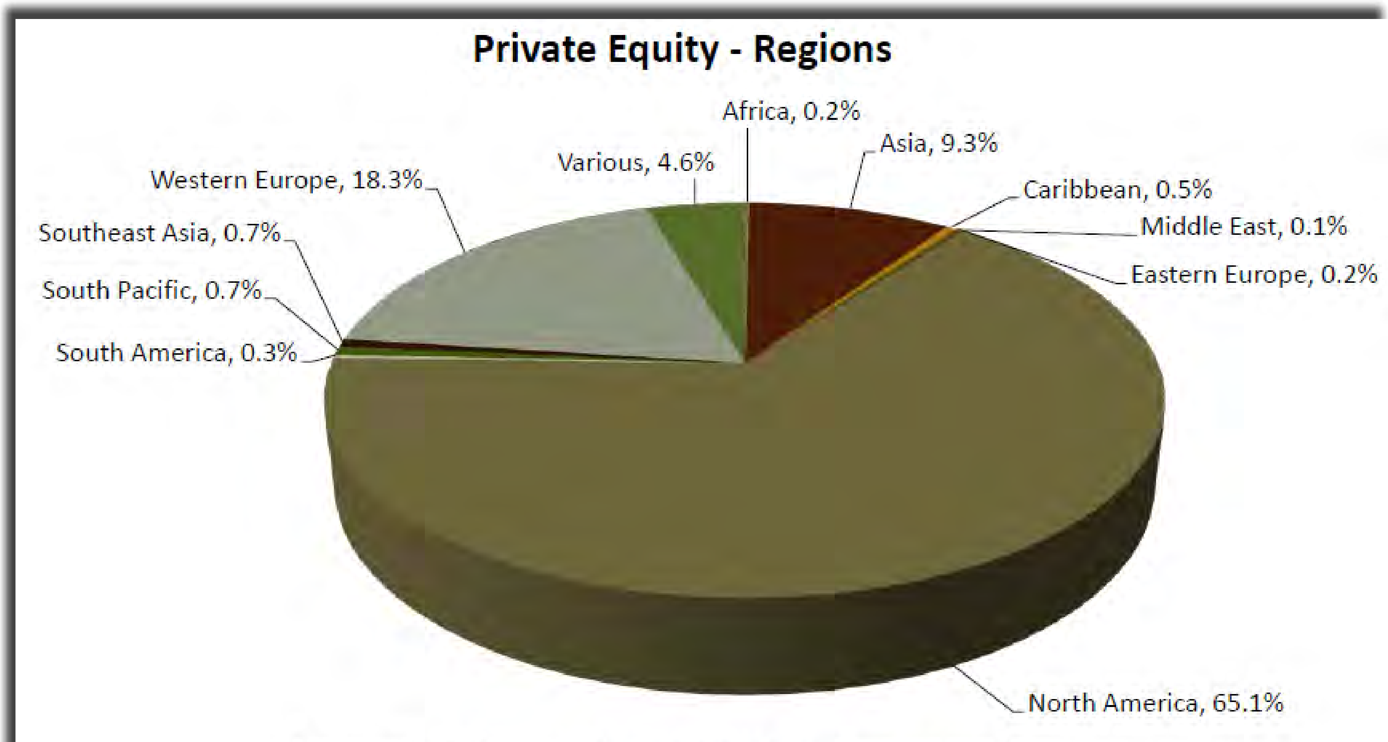
Private equity fundraising remained robust in 2015, but slightly lower than the pace set over the past couple of years. Fundraising activity for 2015 totaled $311 billion, an 8% decrease compared to 2014, which represented the first decrease in fundraising since 2009. Within private equity segments, worldwide buyout funds raised $166 billion, which was a decrease of 7% compared to 2014, and worldwide venture capital funds raised $44 billion, a 9% decreased compared to 2014. This demonstrates that while investors and private equity funds remain bullish on the asset class, they are also becoming more selective later in the cycle.

Regulatory scrutiny of private equity funds continued in 2015. Fee and expense transparency is becoming a greater area of importance by private equity investors, and progress is slowing being made in working with private equity general partners to provide better transparency.

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%.





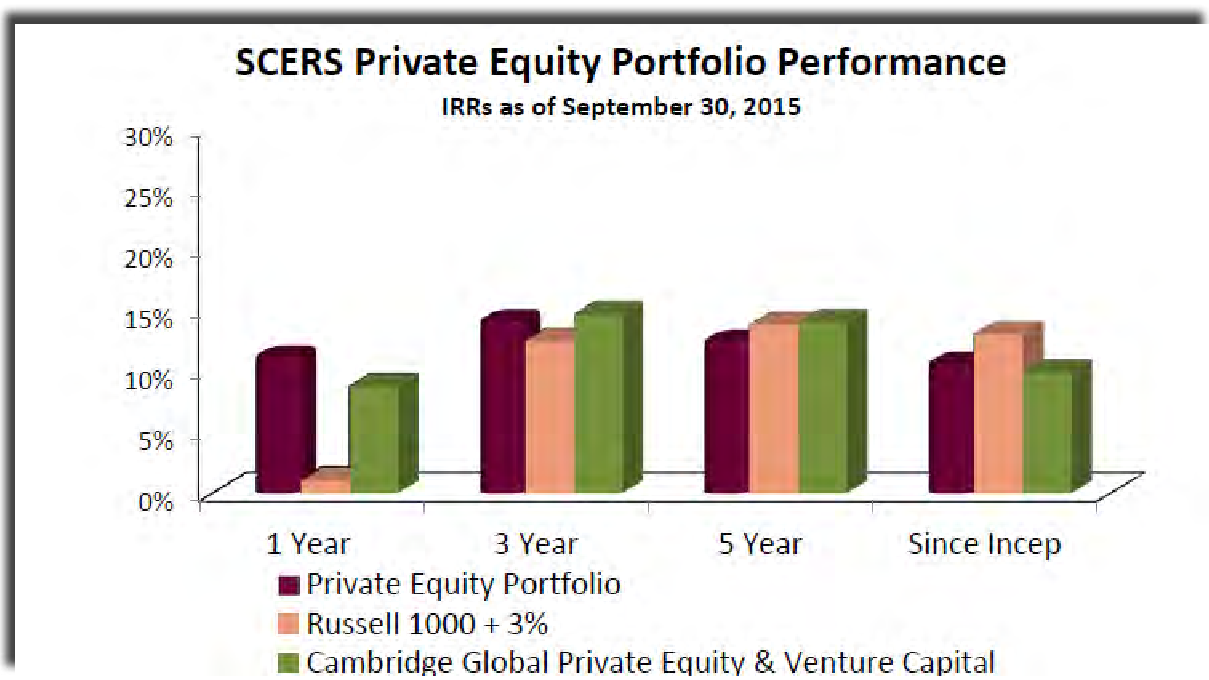
* "Various" includes partnerships with global or pan-regional mandates.

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 could 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 constrained Staff resources. In the upcoming year Staff and Consultants will continue to consider potential strategic partnerships within SCERS' Private Equity portfolio to help access investments within segments that would complement those commitments made within the direct portfolio. This type of mandate could provide added scale for SCERS, but the benefits would need to outweigh the extra layer of management fees in pursuing this type of structure.

2015 Accomplishments

- Presented the annual report on Private Equity and developed the 2015 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, Verus and other limited partners
  - Focused on sector specific funds in less cyclical industries with a demonstrated track record of maintaining pricing discipline
  - Prepared multiple reports for the Board evaluating potential investment opportunities
  - Finalized nine direct Private Equity commitments in 2015 – three new funds/investment managers and six 're-ups' with existing managers
- 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 to middle phase/cycle of investments within this asset 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 continues to progress through the j-curve and is generating increasing levels of positive performance. For the 1-year period ending September 30, 2015, SCERS' Private Equity portfolio generated a net IRR of 11.2%, which outperformed the Cambridge Global Private Equity & Venture Capital benchmark return of 8.9%. The Private Equity return also outperformed SCERS' public market benchmark, the Russell 1000 + 3%, which returned 1.2%. SCERS' since inception net IRR of 10.7% is now outperforming the Cambridge Global Private Equity & Venture Capital benchmark return of 10.0%. While SCERS' fund-of-funds commitments made in 2006 and 2008 are a contributor to these returns, many of SCERS' direct commitments that have been made since 2011 are beginning to generate meaningful returns and are distributing capital back to SCERS.

2016 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, while maintaining vintage year diversification
  - Place particular focus on sector-specific funds where a fund manager has differentiated expertise, experience managing multiple cycles and access to proprietary deal flow
  - Includes potential 're-ups' with existing funds that will be in the market fundraising
- 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, small market buyout 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

Central banks around the world continued to maintain aggressive monetary policies and kept interest rates at historic lows in 2015. As such, real assets 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.

The real estate market remains flush with capital from all corners of the world, from domestic institutional investors to sovereign wealth funds searching for yield in a low yield environment. Transaction activity has been widespread, with all property sectors seeing large year-over-year increases. Transaction activity, which had been principally in the prime markets at the start of the year, is now growing significantly in the secondary and tertiary markets. Staff and Townsend are mindful that commercial real estate is cyclical and experiences periods of boom and bust, which translates to volatile swings in price movements, even though income returns tend to remain fairly consistent over a cycle. With the run up in core valuations, especially in the U.S., core real estate return expectations have declined considerably, and as described below, SCERS has been a net seller of core separate account properties.

2015 was a difficult year for commodities, and in particular the energy sector with the swoon in oil prices. The downward direction of oil prices in 2015 was forced by an oversupply emanating from the U.S. shale producers and the unabated production from OPEC. Also contributing to oil's price decline has been China's slowing economy lowering demand, further exacerbating the supply glut. As a result, investors who hold direct and indirect oil exposures have been impacted, including SCERS' active commodity managers, SCERS' SSGA Real Assets proxy (which has exposure to commodities and energy related stocks), and SCERS' indirect energy exposure through the other asset classes. Even with the dislocation in energy prices, energy focused funds experienced a record year, with approximately $38 billion in capital raised during the year, though interest dwindled during the second half of 2015. This represented a 6% increase over the prior year, and demonstrates investors' willingness to opportunistically invest in the sector given the dislocation in prices.

Real Assets Portfolio

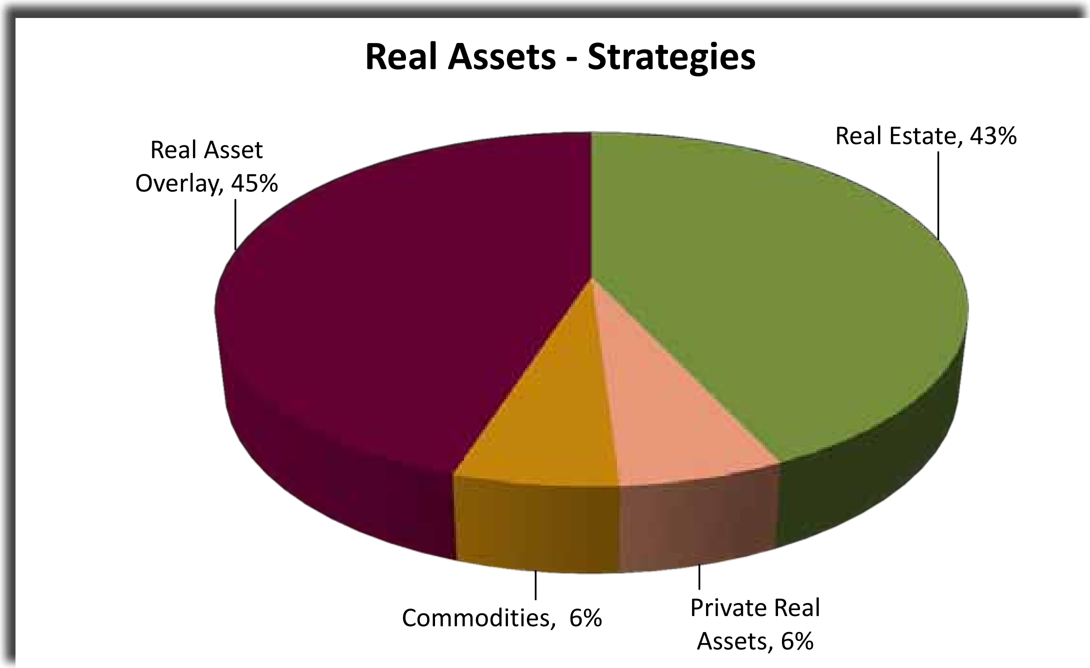
SCERS' Real Assets asset class is comprised of several sub-asset classes: (1) Core real estate; (2) Private real assets (infrastructure, energy, agriculture, timber, and other natural resources); (3) Commodities; and (4) Treasury Inflation-Protected Securities ('TIPS') (currently there is no strategic 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'). Over the last few years, as real estate prices have reached or exceeded prior peak, Staff and Townsend have been maintaining buying discipline, while strategically selling properties in the CSAs that have achieved their investment objectives and have limited future return potential. During the year, several properties were identified as having maximized their return potential, with four assets being listed for-sale resulting in one sale at greater than appraised value. The remaining assets in the CSA are expected to achieve increasing returns and; therefore, no additional CSA properties will be slated for disposition during 2016. While not an active buyer of core CSA properties, Staff and Townsend have been evaluating redevelopment and build-to-core opportunities in select primary markets with SCERS' separate account managers BlackRock and Cornerstone, with a commitment made to a re-develop to core office project in Portland, Oregon in 2015. In addition, over the past couple of years, SCERS has rotated its legacy COEF holdings into COEFs with more attractive geographic and property-type exposures, better operating fundamentals, and which offer embedded value.

With the high valuations in U.S. core real estate and in turn, lower expected future returns, SCERS has also found attractive relative value opportunities in non-U.S. and non-core real estate. In 2015, SCERS made several non-core investments, including: (1) A European retail closed-end fund, where retail property valuations are significantly lower and non-core like returns could be achieved from high quality core assets; (2) A U.S. healthcare property closed-end fund targeting on-campus ambulatory and acute care facilities 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 included in SCERS' Opportunities portfolio.

Within SCERS' broader Real Assets portfolio, Staff and Consultants have placed an emphasis on investments with contracted yield, consistency in the cash flows, and/or less correlation to the broader economy. Examples of these types of investments that have been made in SCERS' portfolio include core infrastructure, debt that is over-collateralized with real assets, and niche segments of real assets with contracted yields and low correlation to the broader economy and energy markets.

At the end of 2015, SCERS' Real Assets allocation, excluding the SSGA overlay proxy, was 8.3%, which is well below the policy target of 15.0%. Please note that several non-core real estate investments within the Opportunities asset class draw capital from the Real Assets asset class, as this is the asset class with the closest risk and return profile of the opportunity being invested in. Accounting for these funds would bring SCERS' Real Assets allocation to approximately 10.1%. However, SCERS' Private Real Assets allocation is only 1.2%, which is well below the 6% target, and is the primary driver of the allocation shortfall in Real Assets. In order to minimize the gap between the target allocation (15%) for the Real Assets asset class and the current allocation (10.1%), SCERS' Overlay manager, SSGA, utilizes the SSGA Real Assets Strategy to balance SCERS' real assets allocation to the 15% target. However, the proxy is comprised entirely of public traded securities, with a meaningful allocation to energy-related investments, which is not as effective in replicating the higher returns and lower volatility achieved historically by private market investments.



The proxy's equity and energy risk sensitivity illustrates the importance of consistently deploying capital in the Real Assets asset class over time. As noted, the large gap within Real Assets is solely in the Private Real Assets sub-asset class, where Staff has been focused on making additional commitments. During the year, SCERS made commitments to: (1) An upstream energy infrastructure closed-end fund; (2) A midstream energy infrastructure closed-end fund; (3) A power generation infrastructure closed-end fund; (4) A global core infrastructure open-end fund; and (5) A U.S. wastewater/bioenergy closed-end fund.

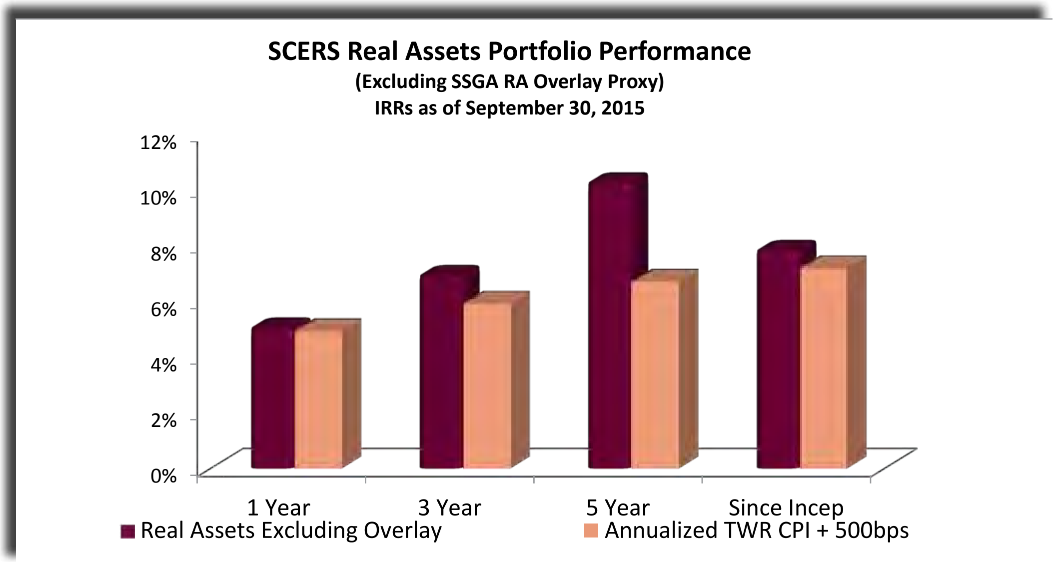
Given the significant allocation gap, along with the diversification and relative value benefits, Staff will be targeting natural resource (timber) and agriculture (permanent/row crop) investment opportunities, while continuing to identify differentiated infrastructure investments in 2016.

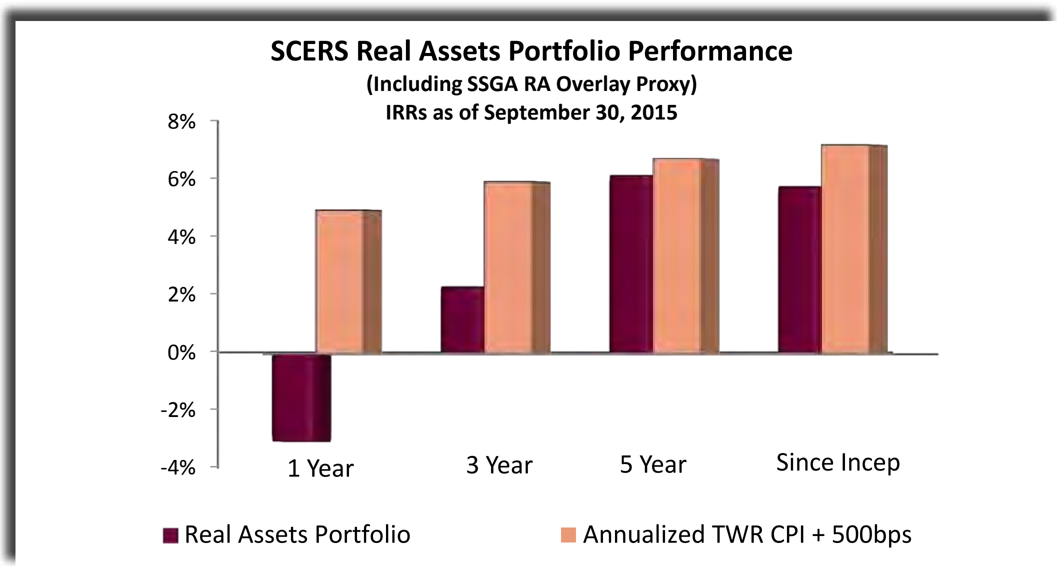
2015 Accomplishments

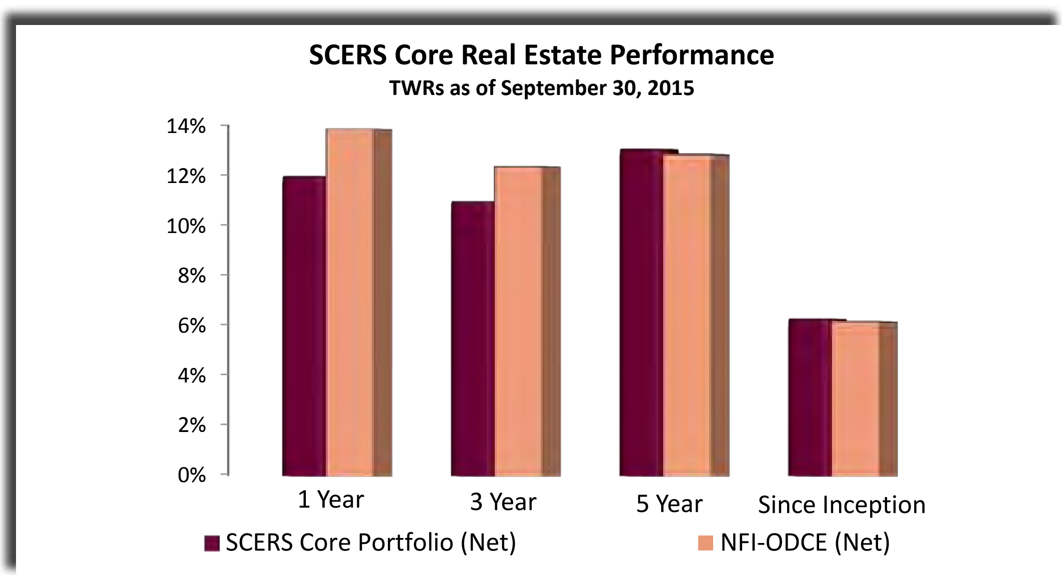
- Presented the Private Real Assets annual report and provided an annual investment plan for 2015
- Completed a $100 million commitment to a custom separate account to invest in debt backed by real assets with Atalaya, resulting in the execution of two investment transactions totaling $11 million during 2015
- Disposed of one separate account property at a price greater than appraised value and placed three separate account properties for-sale
  - Committed to a re-develop to core office property project in Portland, Oregon within SCERS' separate account real estate portfolio
- As noted above, finalized ten direct investments within the Real Assets asset class including:
  - A U.S. core real estate open-end fund
  - Three energy/power infrastructure funds
  - A U.S. wastewater and bioenergy closed-end fund
  - A customized separate account investing in debt backed by real assets
  - A global core infrastructure open-end fund
  - Two non-U.S. closed-end real estate funds – held in Opportunities portfolio
  - A U.S. ambulatory care closed-end real estate fund – held in Opportunities portfolio
- Assessed the landscape for strategic partners to complement SCERS' direct Real Assets portfolio
- Made modifications to the Real Assets proxy to improve diversification across the investable segments of the real assets universe

PERFORMANCE AND ATTRIBUTION

SCERS' Real Asset Class generated a 1-year net IRR of 5.0% in 2015 (as of 09/30/15), which performed in-line with SCERS' benchmark (CPI-U Headline + 5%) return of 5.0%. 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 -12.9% during the same 1-year period. The 1-year Real Asset return including the SSGA proxy, through 09/30/15, was -3.1%. The SSGA proxy had a material impact on the return for the Real Assets asset class due to the 4.9% gap between the current and target allocation, which was particularly evident in 2015 given volatility in the energy markets. SCERS' Staff and Consultants will continue to focus on Real Assets investments in 2016 to help close this gap.


SCERS Real Assets Portfolio Performance
(Excluding SSGA RA Overlay Proxy)
IRRs as of September 30, 2015
12%
10%
8%
6%
4%
2%
0%
1 Year
3 Year
5 Year
Since Incep
Real Assets Excluding Overlay
Annualized TWR CPI + 500bps

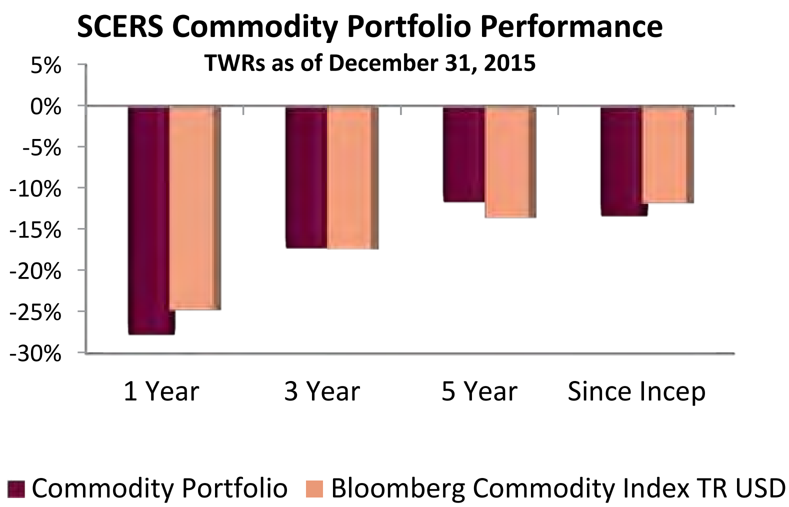

SCERS Real Assets Portfolio Performance
(Including SSGA RA Overlay Proxy)
IRRs as of September 30, 2015
8%
6%
4%
2%
0%
-2%
-4%
1 Year
3 Year
5 Year
Since Incep
Real Assets Portfolio
Annualized TWR CPI + 500bps


SCERS Core Real Estate Performance
TWRs as of September 30, 2015
14%
12%
10%
8%
6%
4%
2%
0%
1 Year
3 Year
5 Year
Since Inception
SCERS Core Portfolio (Net)
NFI-ODCE (Net)

The core real estate portfolio has underperformed the benchmark over the 1- and 3-year reporting periods due to asset write-downs in the separate accounts and the drag of two poorly performing older COEFs, which have since been liquidated. Staff and Townsend have been actively engaged with the separate account managers in improving the separate account performance. In addition, Staff and consultant have been rebalancing SCERS' core real estate portfolio over the past three years with a mix of open-end and close-end fund investments, which have been outperforming the benchmark over the 1-year and 3-year periods.

Commodities

SCERS' dedicated active long-only commodities allocation currently sits at 0.9%, which is below the target of 2.0%, but within the allowable range. However, SCERS has an approximate 1.1% commodity allocation within the SSGA Real Assets proxy used in SCERS' overlay program, which brings SCERS' aggregate commodity specific allocation to 2.0%. With the decline in commodity prices over the past year and a half, SCERS' dedicated active commodity portfolio is generating negative returns over all measurable periods. The objective for holding a small allocation to commodities over the long-term is the diversification benefits at key points in the markets, including inflationary periods.



2016 Goals

- Finalize the sale of the three separate account properties placed for-sale in 2015
- Conduct due diligence on closed-end and/or open-end funds in agriculture, natural resource (timber), and infrastructure (core/core plus)
- Continue to underwrite investment opportunities within the customized separate accounts within SCERS' Real Assets portfolio, including deploying capital prudently and utilizing veto rights where appropriate
- Identify and evaluate U.S. redevelopment and build-to-core opportunities with SCERS' separate account real estate managers
- Identify potential investment opportunities surrounding the dislocation occurring in the energy sector
- Identify un-correlated investment strategies in real assets that may be formed in a custom separate account
- Present the Real Assets annual report and investment plan

OPPORTUNITIES

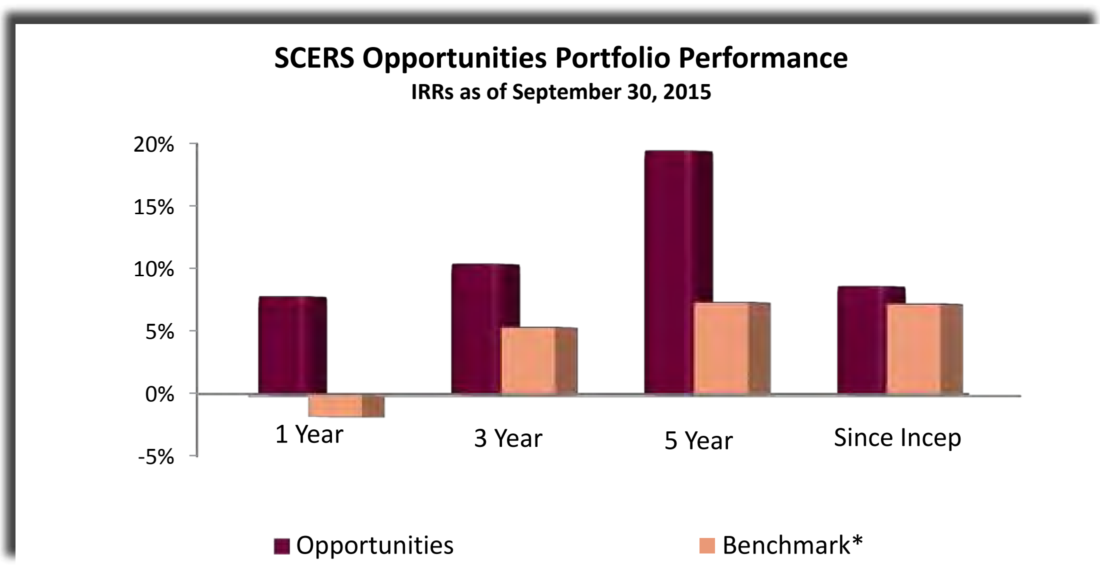
SCERS' Portfolio

The Opportunities asset class does not have a fixed allocation, but instead has a permissible range of 0% to 5%; currently the allocation is 1.9%. 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. When an Opportunities investment is identified, the investment draws its capital allocation from the asset class with the most comparable risk and return characteristics as the investment being made. 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.

2015 Accomplishments

- Invested in three Opportunities investments, all drawn from the Real Assets allocation
  - A U.S. ambulatory care closed-end real estate fund
  - A Nordic based value-add real estate fund
  - A Europe based retail value-add real estate fund

PERFORMANCE AND ATTRIBUTION



SCERS' Opportunities' performance over the reporting periods has been driven, predominately, from the returns earned by several vintage year 2006 and 2007 value-add real estate funds SCERS made prior to the Global Financial Crisis ('GFC') and several, since liquidated, distressed debt funds that SCERS invested in out of the GFC. The value-add real estate funds 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 value-add and opportunistic funds SCERS committed to over the past couple of years, though early in their investment periods, have been making a meaningful performance contribution.

2016 Goals

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

Other Investment Activities

2015 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 SCERS investment managers
  - Visited real estate holdings within SCERS' core separate accounts
- 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 consultants
- Continued to monitor and assess the securities lending program
- Continued evaluation of segments (illiquid asset classes) of SCERS' Overlay program that expose SCERS to basis risk
  - Made modifications to the Real Assets proxy to improve diversification across the investable segments of the real assets universe
- Evaluated trading costs and commission re-capture program on an ongoing basis
- Successful (i.e., low cost) transition management
  - US small cap growth – transitioned assets from a total return swap to an investment manager portfolio
  - Overlay program – transitioned assets related to approved modifications to the Real Assets proxy
- Evaluated SCERS' currency exposure in the face of a rising US dollar

2016 GOALS FOR OTHER INVESTMENT ACTIVITIES

- Revise and update SCERS' broad IPS to reflect changes and incorporate individual asset class IPS's
- Increase capabilities within 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 asses proxies within the Overlay Program

Investment Education

2015 BOARD EDUCATION

- Educational presentation on potential investment opportunities in the energy sector by Staff and Consultants
- Presentation by Thoma Bravo on the information technology buyout private equity portfolio they manage for SCERS
- Presentation by Spectrum Equity Investors on the growth equity private equity portfolio they manage for SCERS
- Educational presentation on options and applications for the management of currency exposure by SIS and Staff
- Educational presentation on investing in timberland by Cliffwater and Staff

2016 BOARD EDUCATION

- Hedge fund investment manager presentations
- Private equity fund investment manager presentations
- Educational presentations by Consultants and Staff
    - Risk management
    - Asset allocation
    - Systematic CTAs – trend following

Appendix

Verus

Memorandum

To: Sacramento County Employees' Retirement System Board

From: Verus

Date: February 17, 2016

RE: 2015 Review and Outlook

Executive Summary

Investment returns from equity to fixed income and beyond left a lot to be desired in 2015. Emerging markets and commodity-related assets had a particularly difficult year. Domestic and developed markets were mostly flat for the year, failing to provide much cover to diversified portfolios. As we enter 2016, market volatility is on the rise, equity markets and commodities are down sharply in the first few weeks of the year, with credit spreads widening further. As in past year-end reviews, we emphasize taking a long-term strategic approach to allocating capital and in markets like we find today, patience and steadfastness will be rewarded in the future. In this memo we plan to review the investment environment of 2015 in the major asset classes, and detail both current initiatives within SCERS and those under consideration for the future.

US Equity

Following three double digit return years, the US Equity market (Russell 3000) rose just 0.5% in a choppy 2015. A large drawdown in the 3rd quarter was costly to the year's return, but a strong rebound in the 4th quarter, up 6.3%, brought the year slightly above even. Concerns around slowing global growth (particularly China) and falling oil prices overwhelmed strong US job growth and high consumer confidence.

Of note was the outperformance of growth (Russell 1000G up +5.7%) relative to value (Russell 1000V down -3.7%), driven by strong performance from leading technology companies and also the markets aversion to companies with cyclical earnings or shaky balance sheets. Additionally, large cap (Russell 200 +2.4%) swamped small cap (Russell 2000 -4.4%), which was primarily due to excessive valuation premiums applied to small caps early in the year. Given the dramatic decline in commodity prices, there was significant dispersion in specific sectors with energy falling 22.7% for the year while healthcare rose 7.2%. This environment favored active management in the value sector where volatility typically creates opportunity. The growth sector experienced the opposite as the benchmark proved difficult to beat due to a small number of large cap names driving performance.

International Equity

The strong US dollar was the big story for the non-US equity investors in both developed and emerging markets. The dollar appreciated 11.4% versus the Euro and by over 50% versus commodity producing countries like Brazil and Russia. From an economic perspective, European growth is beginning to accelerate while Japan has flattened-out and emerging markets growth is in decline. 2015 saw the divergence of monetary policy in global markets as Europe, Japan and China initiated loosening policy moves while the US decided to tighten rates in December. Continued weakness in the markets may put a halt to this divergence.

Developed international equity markets fell by 0.87% while the emerging markets fell 14.97%, both in dollar terms. A similar divergence in growth vs value occurred in international markets with value dramatically underperforming growth in both developed and emerging markets. No surprise, countries with significant commodity export dependency experienced the largest drawdowns (i.e. Canada declining -24.2%).

Fixed Income

The Barclays Capital U.S. Aggregate Index ended the year with a return of 0.6%. The big story during 2015 in bonds was the Fed decision to raise rates after nearly seven years of near-zero interest rates. However, the pain in the bond market was felt in the spread sectors as the high yield index fell 4.5%. More than half of the high yield decline was attributable to the worsening credit situation in energy. Expected default rates for CCC bonds rose to nearly 14% by year-end. Outside the US, monetary policy has been loosening leading to negative short term deposit rates in several European nations and Japan. Yields on longer dated government bonds in Germany, France and Japan were below 1%, by the end of 2015.

Outlook

The Fed hike in December was generally priced into the market through much of 2015 but the volatility in global markets has possibly forced a policy shift from additional rate hikes, in the near-term. Overall, the US remains a bright spot in an otherwise troubled global economy. Japan and Eurozone saw marginal improvements in the 4th quarter of 2015 but export weakness from EM countries, particularly China, may prove a challenge in 2016. Emerging markets, with perhaps the exception of India, remains the most concerning to global GDP growth. While a recession in China is considered unlikely, the importance of China's growth to the overall rate of global growth explains the market's concern with declining growth (China is currently growing at 6.9%). The commodity sector remains even more troubled with expectations for a major asset restructuring event in both energy and mining throughout 2016. There seems to be a reasonable expectation that oil prices will see a partial recovery by the second half of 2016 (think oil prices in the $40-50's) but a number of unknowns make price predictions fraught. As for other commodities, it's a case-by-case basis as to a recovery but few, beyond perhaps gold, have bullish momentum.

The SCERS portfolio was faced with a headwind relative to many similarly sized public plans due to an equal weighting in international equities relative to domestic equities. Given valuations within both emerging markets and much of the developed international markets versus the US, we think this positioning will be a tailwind longer-term. Further, SCERS has been actively diversifying exposure away from traditional stocks and bonds to asset classes that should provide a more balanced set of risk exposures over market cycles. While we are still waiting on full results, it looks as though real estate and private equity will provide meaningful outperformance relative to global stocks in 2015, with absolute return performing in-line with developed market equity and fixed income returns

Portfolio Initiatives

Asset Allocation Review

SCERS will be reviewing the asset allocation in 2016.

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. The SSgA real assets proxy was modified during 2015 to add exposures in infrastructure and midstream energy, while reducing exposure to commodities, natural resource equities and REITs.

- Look for additional opportunities in private infrastructure which has been a difficult space to find interesting opportunities up until recently
- Look for opportunities within private energy and/or mining given the global turmoil in both markets
- Continue buying private secondary infrastructure fund interests through Pantheon
- Continue to survey the market for attractive Core Plus and Opportunistic private Real Estate investments

Bond Portfolio

Verus views the role of fixed income as diversification to equity risk, as a capital preservation instrument, a source of income and a way to capture credit and duration premiums. SCERS has added exposure to global and opportunistic credit funds that have sought to diversify rate and credit risk while also capturing a yield premium. We think this strategy will continue to add value and are looking for ways to build out the portfolio.

- Review the mandate with Brigade Capital
- Identify superior credit opportunities related to bank retrenchment from their traditional lending practices

US Equity Portfolio

The 2011 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. SCERS made one change in small cap growth to the manager line-up in 2015, adding UBS. SCERS also renegotiated the manager fee arrangement with small cap manager, Weatherbie Capital to one with a favorable performance incentive structure.

- Monitor Huber Capital's underperformance
- Review the role of REITs in the US equity portfolio

International Equity Portfolio

The international equity portfolio has been more active of late, relative to its domestic counterpart, with a replacement search in international developed equity that ultimately resulted in a temporary passive allocation. A current emerging markets manager search will be wrapped up in 2016.

- Replacement search for one active emerging markets mandate
- Replacement search for one active international equity mandate
- Consider inclusion of passive allocation
- Evaluate level of REIT exposure in the international equity portfolio

Opportunities Allocation

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

- Evaluate capital preservation strategies (non-correlated to equities and fixed income)
- Consider distressed opportunities in commodity related sectors

CLIFFWATER LLC

To: Richard Stensrud, Chief Executive Officer, SCERS
From: Jamie Feidler, Cliffwater LLC
Date: February 8, 2015
Regarding: **Reviewing 2015 in SCERS' Alternative Assets**

Capital markets across the globe saw a resurgence of volatility and performance dispersion during 2015. Diverging central bank policies, plummeting oil prices, surprising currency movements, and changing global growth expectations were just a few of the factors that drove markets throughout the year, generally pushing risk assets lower in 2015.

While the Sacramento County Employees' Retirement System ("SCERS") portfolio was not immune to the downturn experienced in these markets, the allocation to alternative assets helped to lessen the impact of increased market volatility on the total portfolio. Recall that one of the primary objectives in structuring the allocations to alternative assets was to better position the SCERS portfolio to face more challenging investment environments, which became increasingly pertinent in 2015. The focus within the SCERS alternative assets portfolios during 2015 was, not surprisingly, execution and continued implementation of the SCERS long-term investment plan. SCERS remained creative in its approach yet disciplined in its implementation of the investment plan, which is intended to improve the portfolio's expected return and risk profile and position SCERS to continue to meet its investment objectives through a variety of investing environments.

Private Equity

The focus within private equity during the last year was once again accessing attractive partnership investments to increase the portfolio's allocation and complement existing exposures. The private equity fundraising environment remained strong in 2015, with significant demand for funds being raised by top-tier general partners. Despite the competitive environment and compressed fundraising timelines, SCERS was able to access attractive funds, most of which were materially oversubscribed or only offered to select investors. SCERS balanced the need to maintain vintage year diversification through new fund commitments, with discipline in avoiding areas of the market that look to be getting overheated.

SCERS' 2015 private equity commitments spanned geographies, in both developed and emerging markets, and strategies, from venture capital to specialty lending. These new commitments primarily targeted small and middle-market opportunities, and included a number of funds with sector specialization. New private equity commitments in 2015 included commitments to new funds being raised by SCERS' existing general partners as well as commitments to new relationships.

The SCERS private equity primary fund investments have continued to generate meaningful performance gains, including in several cases strong realizations with material distributions. While many of these funds remain relatively young, it is encouraging to see their positive performance contributions in the SCERS portfolio. We would expect this trend to continue given the quality and type of funds SCERS has been adding to its private equity portfolio since it began making its first direct private equity commitments in 2011.

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.

Absolute Return Portfolio

SCERS experienced a greater dispersion of returns across the funds and strategies within its Absolute Return portfolio in 2015 as compared to prior years' results. Although some of the funds in the Absolute Return portfolio struggled in 2015, SCERS also had direct allocations to funds that produced double digit gains during a year that presented challenging market conditions. This increased performance dispersion, while reflective of the broader hedge fund industry's performance in 2015, highlights the importance of SCERS continuing to build out the direct component of its Absolute Return portfolio.

The Absolute Return portfolio includes two separate account portfolios of hedge funds and a portfolio of direct hedge fund investments. While the aggregate Absolute Return portfolio is sized appropriately for its 10% targeted allocation, SCERS remains below its desired allocation for the direct portfolio. SCERS should look to increase the allocation to the direct portfolio through new fund investments in 2016 while maintaining its overall Absolute Return allocation at the 10% target. Adding new funds into the direct portfolio would also further diversify its composition and capture additional alpha sources that would be additive to the portfolio. Performance of the total Absolute Return portfolio in 2015 lagged our expectations; however, longer-term results remain strong on both an absolute and risk-adjusted basis. The Absolute Return portfolio has also been meeting its objective of helping to reduce volatility within the total SCERS portfolio.

Real Assets

Collapsing oil prices and the resultant poor performance of energy-related asset classes in 2015 often dominated discussion of real asset portfolios during the year. While some of the SCERS liquid real asset investments were negatively impacted, activity and exposures within the private real assets portfolio were impacted to a much lesser degree. Within real estate, SCERS was a net seller of core real estate properties during 2015, selling into the strength of many core real estate markets and selectively investing in opportunities that offered better value. Areas where SCERS looked to deploy new capital in 2015 included niche build-to-core and redevelop-to-core projects, as well as other value-add and opportunistic real estate projects primarily outside of the U.S.

SCERS was active making new commitments to other private real assets funds as well during the year. New commitments within other private real asset categories spanned infrastructure, energy, and specialized mandates. New infrastructure fund commitments included strategies focused on large, core infrastructure investments and a smaller commitment to a specialized renewable energy infrastructure fund. Commitments to new energy funds were diversified across the energy value chain, including midstream energy, downstream energy, and power generation. SCERS also created a customized separate account focused on debt-related investments backed by real assets. The customized mandate is designed to meet the objectives of the real assets portfolio, and the separate account structure allows SCERS to define the desired opportunity set, shape portfolio construction, and provide better control of the investments. This separate account, like many of SCERS' other dedicated accounts, provides further examples of SCERS' creative approach to reaching its long-term target allocations and developing tailored solutions to meet its needs. SCERS overall in 2015 was able to further diversify its private real assets exposure, without significantly expanding its manager relationships, as it builds the portfolio to meet the objectives of income generation, inflation protection, and risk factor diversification.

Continuity of the Investment Process

Reflecting on the alternative assets activity within the SCERS portfolio in 2015 may at first evoke images of the activity during 2014. This should not be entirely surprising given that the SCERS staff, Board, and Cliffwater have developed strategic investment plans which require disciplined implementation over the course of several years. However, while the high level implementation goals remain largely the same, the underlying investment decisions reflect a more dynamic approach that is intended to capitalize on the best opportunities across markets globally. Importantly – and as stated in previous annual reviews – SCERS maintains a thoughtful approach to managing the portfolio, which is diligent in its implementation and is dedicated to maintaining investment discipline and following a well-defined, rigorous process.

All of these efforts continue to position SCERS to take advantage of unique opportunities within the alternative asset classes, which should further bolster performance for years to come. The decisions SCERS has made over the last several years should not only help SCERS meet its near-term and long-term investment objectives, they also reflect industry best practices and a willingness by SCERS to adopt creative approaches to meeting the challenges faced by public retirement systems.

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TOWNSEND GROUP

MEMORANDUM

TO:	**Sacramento County Employees' Retirement System**
DATE:	February 2016
SUBJECT:	Real Estate Investment Year in Review
FROM:	**The Townsend Group**

The 2015 focus for the Sacramento County Employees' Retirement System (SCERS) Real Estate Portfolio (RE Portfolio) was focused on culling the real estate portfolio through asset sales and identifying opportunities that would provide downside protection and additional diversification.

In reviewing the 2015 calendar year, we once again reflect upon the active role that the SCERS Staff and Consultants have played in re-balancing the Portfolio. A tremendous amount of time and attention has been dedicated to positioning the portfolio with accretive, yet defensive investments that will help SCERS to perform well across multiple real estate cycles.

For US real estate investors, it's a perplexing time as we enter a more mature stage of the real estate cycle. On one hand, we recognize that real estate remains an attractive investment relative to other asset classes. On the other hand, we caution investors to expect a reversion to the mean. We continue to observe cap rate compression in the Core sector, which has led to strong returns in the NFI-ODCE Index. The NFI-ODCE has reported seven consecutive years of net returns in excess of 10% (compared to the long term historical net return of 7.6%, dating to 1978). Despite strong fundamentals and continued capital flows, we believe that US real estate returns will begin to moderate to historical levels over the short term. As we continue to observe threats to global stability, we also expect lower economic growth in many regions of the world.

Despite a looming reversion to the mean, we believe there could be 3-5 years of strong real estate returns given strong fundamentals. In this mature market environment, SCERS and Townsend continue to focus on the following themes:

1. Selling Non-Strategic Assets
2. Diversifying the Real Estate Portfolio by Vintage Year, Strategy and Region
3. Remaining Selective
    - Exposing the Portfolio to Defensive Strategies / Regions
    - Targeting pre-specified portfolios
    - Curbing excessive use of imprudent leverage
    - Focusing on strategies that generate income to support the total return

The pipeline of investments under consideration includes strategies centered on themes like China Logistics, US Alternative Property Types, European Student Housing & Central Eastern Europe / Emerging Market Exposure.

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SCERS Real Estate Portfolio Activities (3Q15)

The SCERS 2015 investment activity includes the following themes.

- **Core Rebalancing Program**

In 2015, 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. As of 3Q2015, the Core Portfolio reported a market value of 6.1%. SCERS continued to be a net seller of Core real estate over the last three year period while still maintaining its total exposure within the 4.0% to 9.0% permissible range.

	2013	2014	2015	YTD 2016
Acquisitions	• Prime Property Fund • MetLife Core Property Fund	• Jamestown Premier Property Fund • Refinancing of Lake Washington Park (now unlevered)	• Prologis US Targeted Logistics Fund • Prologis European • Principal US Property Account • Targeted Logistics Fund • Townsend Core Real Estate Fund	N/A
Dispositions	• BlackRock Granite Fund (Full Redemption)	• Cornerstone Patriot Fund (Partial Redemption) • Salt Pond • Fontana Industrial • Dupont	• Cornerstone Patriot Fund (Remaining Investment Redemption) • Weston, Inc	• Gateway Corporate Center • Flying Cloud (TBD) • Stonefield Apartments (TBD)

**The chart above categorizes new investments according to the first drawdown or expected drawdown of capital, not the formal commitment date.*

The new Core commitments follow the "relative value investment" thesis. On a stand-alone basis, each fund commitment approved between 2013 and 2015 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 or 2015. 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 and the SCERS actuarial rate of return.

In 2015, SCERS and its separate account managers have been focused on dispositions in order enhance or "upgrade" the quality of the Core Portfolio, especially in a highly competitive

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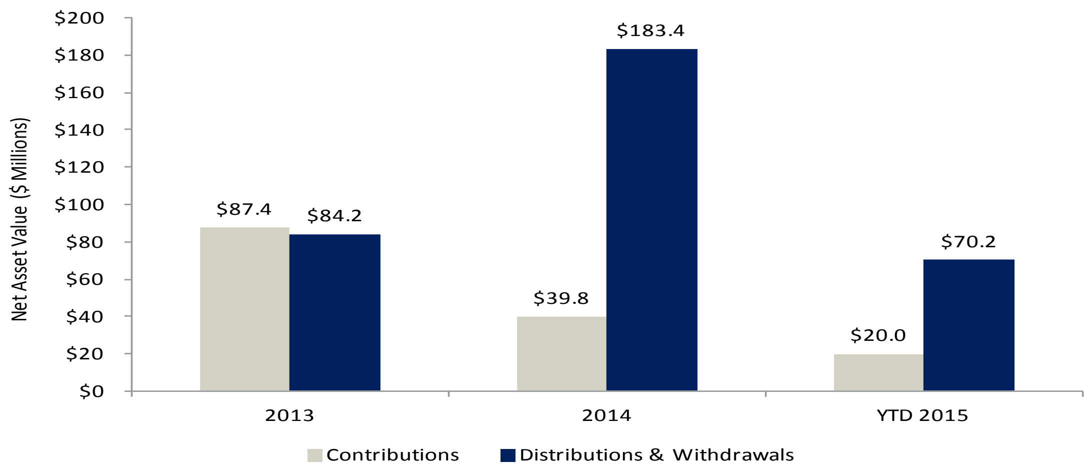
environment seeking Core exposure. As SCERS is a relative value investor, SCERS and Townsend recognized that the timing for certain asset sales was optimal in 2014 and 2015. Distributions and withdrawals through 3Q2015 totaled $70.2 million.

SCERS Core Activity: Net Seller of Core Real Estate
Data as of 3Q2015



Based on capital contributions ($20 million) and distributions/withdrawals ($70.2 million), SCERS was a net seller of Core Real Estate in 2015. On the acquisition side, SCERS added $10 million ($20 million total) to its commitment to previously approved funds: ProLogis Targeted US & European Logistics Funds. Before year-end 2015, SCERS also approved a $70 million commitment to the Townsend Real Estate Fund. This investment, which is a liquid core real estate fund containing multiple underlying positions, will be reported as a real estate investment in the SCERS Core Portfolio and is intended to serve as an investment as SCERS receives separate account asset sale and commingled fund distributions. It is expected to fund in the First Quarter of 2016.

Recent additions to the Core commingled portfolio have been accretive, each outperforming the NFI-ODCE over the shorter one year and since inception period, net of fees. The true measure of success will be the aggregate Core portfolio over longer periods of time once it is fully re-balanced. With the planned sales in 2016, we expect the majority of re-balancing activity will conclude by year-end. Going forward, we will continue to re-balance the portfolio (but to a lesser degree) to improve performance.

- **Tactical Non-Core Investment Themes**

SCERS and Townsend continued to source new Non-Core opportunities in 2015, specifically seeking those that provide SCERS with a "relative value" proposition and/or enhance the diversification for the overall SCERS Program. These allocations pull from the Core real estate and broader real assets allocations. A total of $60 million in two new Non-Core commitments were approved in 2015, which is well below the pace of last year ($130 million in new 2014 Non-Core commitments). These investment positions are projected to be fully funded in two to three years.

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2015 Non-Core Commitments

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.

Nordic Real Estate Partners II	$35 million
Hammes Partners II	$25 million
	$60 million

- In the second quarter of 2015, SCERS made a $25 million commitment to Hammes Partners II, a Value Add medical office fund. Hammes Partners II has a pre-specified portfolio generating a current income return. Given the manager's resources and relationships and past track record along with a defensive property type and unique investment space, Staff and Townsend believe the fund will provide the SCERS portfolio with income and cash generation, while mitigating J-curve. Additionally, Hammes provides exposure to the healthcare industry, which SCERS remains significantly underweight to at the Total Plan level.

- In the fourth quarter of 2015, SCERS approved a $35 million (€27.1 million) re-up commitment to NREP Nordics Strategies Fund II. Given the manager's proven track record, 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 greater portfolio diversification.

New commitments in 2013 and 2014 (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.

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.

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

In 2015, 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.

  - Nordic Real Estate Partners II (2015): Townsend and SCERS negotiated a SCERS Advisory Board Seat, for which Townsend will serve as proxy
  - Hammes Partners II (2015): Townsend and SCERS negotiated SCERS an observer seat on the Limited Partner Advisory Board, for which Townsend will serve as proxy as needed. Further, Townsend and SCERS negotiated the implementation of a formal valuation policy for the Fund
  - Townsend Core Real Estate Fund (2015): SCERS negotiated an Advisory Board Seat and lower total fee (in addition to the favorable fee savings Townsend negotiates for the underlying investments)

Appendix 4 - 2014/2015/2016 Road Map

Topic	2015 Preview	2015 Actual	2016 Preview
Consultants	• 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
			• Monitor progress of recent consultant merger and sale activity
Asset Allocation	• Work toward private equity and real assets target allocations	• Allocated capital to 9 private equity funds, 9 real assets funds and 1 real assets strategic partnership	• Continue implementation on current asset allocation structure; especially within private markets
			• Revisit SCERS' asset allocation and analyze portfolio through different risk lenses
Equities	• Evaluate alternative forms of passive equity exposure including low volatility equities	• Conducted research related to alternative forms of passive equity investing	• Continue to evaluate alternative forms of passive equity exposure including low volatility equities and derivatives replication strategies
	• Conclude the U.S. small cap growth replacement search	• Hired a U.S. small cap growth manager to replace an investment manager that was terminated in 2014	
	• Conclude the international large cap developed markets manager search - broaden search to include a global equity mandate	• Rolled the total return swaps being used as interim passive non-US developed markets equity exposure for the international equity large cap manager terminated in 2014 - reviewed potential replacement managers for the terminated investment manager	• Conclude the international large cap developed markets manager search - potential to broaden search to include a global equity mandate
	• Evaluate SCERS' all-cap emerging markets exposure	• Initiated a manager replacement search in all-cap emerging markets equities	• Conclude the emerging markets equity all-cap search
	• Further evaluation of global currency exposures	• Performed due diligence on total portfolio currency hedging solutions and provided education on options and applications to SCERS' Board	

Appendix 4 - 2014/2015/2016 Road Map (Continued)

Topic	2015 Preview	2015 Actual	2016 Preview
Fixed Income	• Evaluate additional forms of credit and fixed income exposures, both liquid and illiquid	• Performed due diligence on direct lending credit stratgies; no new investments were made	• Continue to evaluate additional forms of credit and fixed income exposures, both liquid and illiquid
			• Assess the fixed income strucure, including the dedicated credit exposure
Absolute Return	• Evaluate additional potential direct absolute return investments and invest in 2 funds directly	• Redeemed assets from 2 direct absolute return funds	• Evaluate additional potential direct hedge fund investments and invest in 2 funds directly
	• Bring in 1-2 current direct absolute return managers for Board education		• Bring in 1-2 current direct absolute return managers for Board education
	• Deepen expertise and capabilities in operational due diligence		• Deepen expertise and capabilities in operational due diligence
Private Equity	• Identify and commit to 5-10 potential direct private equity investments	• Made 9 direct private equity investments	• Identify and commit to 5-10 potential direct private equity investments
	• Continue to assess strategic partners to assist SCERS in fully building out its private equity portfolio within niche segments	• Assessed the landscape for strategic partners to assist SCERS in fully building out its private equity portfolio, but no conclusions were reached	• Continue to assess strategic partners to assist SCERS in fully building out its private equity portfolio within niche segments
	• Present annual report on Private Equity and approve 2015 Private Equity annual investment plan	• Presented annual report on Private Equity and approved 2015 Private Equity annual investment plan	• Present annual report on Private Equity and approve 2016 Private Equity annual investment plan
	• Bring in 3-5 current direct private equity managers to educate SCERS' Board	• Two of SCERS' current direct private equity managers provided education to SCERS' Board	• Bring in 1-2 current direct private equity managers to educate SCERS' Board

Appendix 4 - 2014/2015/2016 Road Map (Continued)

Topic	2015 Preview	2015 Actual	2016 Preview
Real Assets	• Continue to identify core properties as potential sell opportunities	• Disposed of 1 separate account properties at a price greater than appraised value, and identified 3 additional properties for sale in 2016	
	• Assess core real estate commingled fund lineup	• Committed capital to a open end commingled real estate fund	• Assess core real estate commingled fund lineup
	• Identify and commit capital to 1-3 primary private real assets funds	• Committed capital to 5 primary private real assets funds	• Identify and commit capital to 1-3 primary private real assets funds
	• Reassess commodities managers		• Reassess SCERS' overall commodity/ energy exposure
	• Finalize the custom separate account to invest in debt backed by real assets	• Completed a $100 million commitment to a custom separate account that invests in debt backed by real assets, and executed on two investment transactions totaling $11 million during 2015	• Continue to underwrite investment opportunites within customized separate accounts in the Real Assets portfolio; using 'veto rights' where appropriate
	• Present annual report on Real Assets and approve 2016 Real Assets annual investment plan	• Presented annual report on Real Assets and approved 2016 Real Assets annual investment plan	• Present annual report on Real Assets and approve 2017 Real Assets annual investment plan
	• Identify investment opportunities around the significant decline in oil prices		• Cautiously identify and evaluate investment opportunities around the significant decline in oil prices

Appendix 4 - 2014/2015/2016 Road Map (Continued)

Topic	2015 Preview	2015 Actual	2016 Preview
Opportunities		• Committed capital to a European closed end retail real estate fund, which draws capital from the Real Assets asset class	
		• Committed capital to a Nordic based value-add real estate fund that draws capital from the Real Assets asset class	
		• Committed capital to a U.S. healthcare property closed-end 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 property investments	• Oversaw and monitored existing managers and visited two real estate properties	• Conduct on-site due diligence of exisiting managers and real estate property investments
	• Research risk management systems		• Seek to expand SCERS' risk management capabilities
	• Revise overall investment policy, including incorporating individual asset class policies		• 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 two transitions - 1 equity and 1 overlay proxy	

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