

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

**EXECUTIVE SUMMARY**

JUNE 30, 2012

STRATEGIC INVESTMENT SOLUTIONS, INC.

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# TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

Second Quarter 2012

## Capital Market Review

- As the European crisis entered a crucial phase and growth prospects diminished throughout the developed world and in China, risk aversion increased, pushing up risk premiums across the developed and emerging markets.
- Fears of a Greek exit and Eurozone collapse led to rising risk premiums. However, despite the relatively benign outcome in the Greek elections, heightened risk aversion persisted. Fears of a systemic bank collapse led to a €100Bn European Financial Stability Fund loan made to the Spanish government to assist in bank recapitalization. However, Spanish sovereign yields spiked in the aftermath of the bailout, given that the loan would boost the country's debt ratio.
- The hope for policy action came to the fore of investors' minds. European leaders at the EU Summit at the end of June agreed to allow the European Stability Mechanism to directly recapitalize failing banks and to create a single banking supervisor run by the ECB.
- The final trading days of the quarter saw rebounds across global equity markets as policy action led to hopes for a Eurozone banking union. As a result, the MSCI Europe ex UK total return index rose 8.5% percent in June.
- Safe-haven demand was on the rise, which led to Treasuries returning 2.8% in Q2. Meanwhile, in the currency markets, the flight to safety led to a quarterly increase in the yen of 3.8%.
- The State Street Investor Confidence Index® measures risk appetite by analyzing buying and selling patterns of institutional investors. The index reached its highest level this year, rising to 93.5 by the end of June from 91.6 at the close of the second quarter, but still remains firmly below neutral level of 100. The increase in confidence was most pronounced in Northern America, while European institutional investors' appetite for equities is the strongest, at 102.5, above the 100 threshold marking a neutral risk appetite.
- For the period ending 6/30/12, the one quarter returns for, respectively, the NAREIT Equity index and the NCREIF Property index (one quarter lag), were 3.71% and 2.59%; one year, 12.92% and 13.41%; three years, 32.41% and 5.96%; and five years, 2.60% and 2.88%.
- The global economic growth outlook has softened over the second quarter. However real estate as an asset class continues to attract capital as opportunities persist for those investors with the capacity for illiquidity. According to Prequin, 27 closed-end private real estate funds reached a final close having raised an aggregate \$7.5 billion from investors. While the number of funds reaching a final close in Q2 2012 was similar to the previous year, the aggregate capital raised decreased slightly from the \$10.8 billion raised during Q1 2012. The amount of capital raised in Q2 was also considerably lower than in the same period in 2011, when 34 private real estate funds closed on an aggregate \$13.9 billion.
- The desire for yield has continued to support demand for commercial real estate investments, as evidenced by the Federal Reserve Bank of New York's auction of its Maiden Lane III portfolio, announced in April.
- Commercial real estate valuations show that the market is stabilizing if not improving. The NCREIF National Property Index registered a 2.68% positive gain according to the latest release. While this is slightly less than the 3.0% to 4.0% increases that were achieved quarterly since the second quarter 2010, it was nonetheless the ninth consecutive quarterly increase.

# TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

Periods Ending June 30, 2012

## Market Indices Review

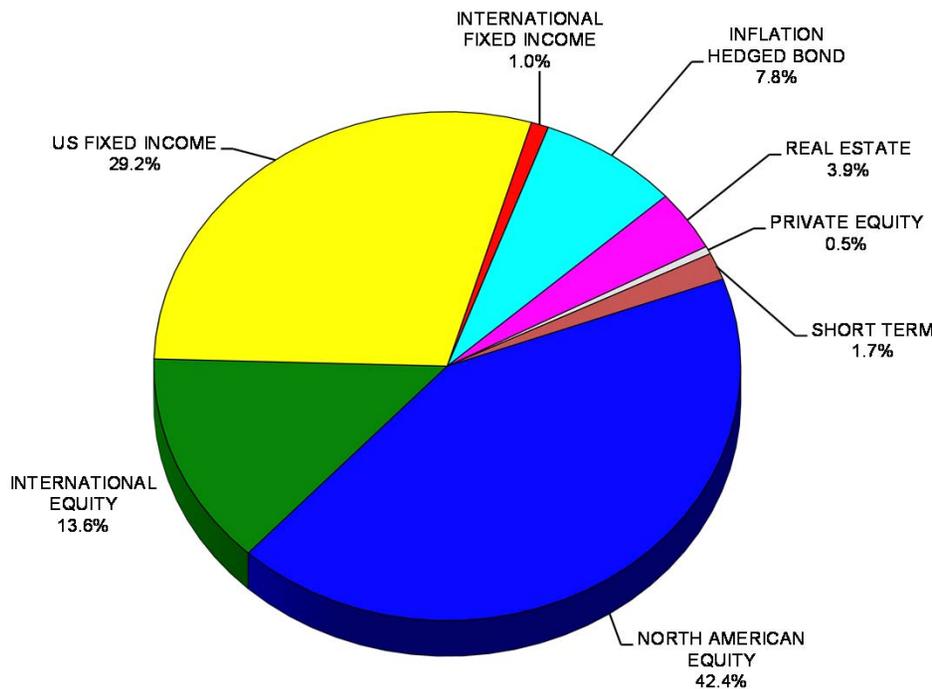
INDEX	STYLE	1 QTR	1 YEAR	3 YEAR	5 YEAR	7 YEAR	10 YEAR
<b>NORTH AMERICAN EQUITY INDICES</b>							
S&P 1500	Large Cap Broad	-2.96	4.63	16.76	0.46	4.31	5.67
S&P 500	Large Cap Core	-2.75	5.45	16.40	0.22	4.09	5.33
S&P MidCap 400	Mid Cap Broad	-4.93	-2.33	19.36	2.55	6.15	8.21
S&P Small Cap 600	Small Cap Broad	-3.58	1.43	19.78	1.83	5.43	7.91
Russell 3000 Growth	Large Cap Growth	-4.02	5.05	17.55	2.79	5.53	6.13
Russell 3000 Value	Large Cap Value	-2.26	2.64	15.93	-2.10	2.95	5.37
NASDAQ Composite	Large Cap Core	-5.06	5.82	16.95	2.43	5.22	7.21
DJIA	Large Cap Core	-1.85	6.63	18.24	2.01	6.06	6.01
S&P/TSX 60	Canadian Large Cap Broad	-7.22	-15.34	9.18	-0.17	7.94	12.04
<b>INTERNATIONAL INDICES</b>							
MSCI EAFE NET	International Equity	-7.13	-13.83	5.96	-6.10	2.31	5.14
MSCI AC World -ex US	International Equity	-7.38	-14.15	7.44	-4.18	4.38	7.20
MSCI Emerging Markets	Emerging Markets	-8.77	-15.67	10.10	0.21	10.39	14.42
Citigroup World Gov't	Global Fixed	0.92	2.68	5.35	7.31	5.54	6.80
Citigroup World Gov't ex US	International Fixed	0.20	0.44	5.13	7.39	5.55	7.15
<b>US FIXED INCOME INDICES</b>							
3-Month Treasury Bills	Cash	0.03	0.05	0.12	0.98	2.00	1.87
Barclays Aggregate	Core Fixed	2.06	7.47	6.93	6.79	5.58	5.63
Barclays Govt/Credit	Core Fixed	2.56	8.78	7.34	6.90	5.53	5.79
Barclays Mortgage	Mortgages	1.08	4.97	5.40	6.67	5.71	5.40
NAR Equity REIT	Real Estate	1.88	6.62	16.01	8.07	8.07	9.76
NCREIF Property - One Qtr lag	Real Estate	3.71	12.92	32.41	2.60	6.20	10.32
		2.59	13.41	5.96	2.88	7.09	8.17

# TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

As of June 30, 2012

## Asset Allocation Analysis - Total Plan

### CURRENT ALLOCATION BY ASSET CLASS



ASSET ALLOCATION	MARKET VALUE	%
NORTH AMERICAN EQUITY	14,763,362,094	42.4%
INTERNATIONAL EQUITY	4,727,963,487	13.6%
US FIXED INCOME	10,158,367,390	29.2%
INTERNATIONAL FIXED INCOME	333,546,044	1.0%
INFLATION HEDGED BOND	2,702,463,092	7.8%
REAL ESTATE	1,341,895,169	3.9%
PRIVATE EQUITY	172,255,438	0.5%
SHORT TERM	602,526,278	1.7%
<b>TOTAL</b>	<b>34,802,378,991</b>	<b>100.0%</b>

ASSET ALLOCATION	TARGET	ACTUAL	DIFF
NORTH AMERICAN EQUITY	40.0%	42.4%	2.4%
INTERNATIONAL EQUITY	15.0%	13.6%	-1.4%
US FIXED INCOME	26.0%	29.2%	3.2%
INTERNATIONAL FIXED INCOME	0.0%	1.0%	1.0%
INFLATION HEDGED BOND	8.0%	7.8%	-0.2%
REAL ESTATE	7.0%	3.9%	-3.1%
PRIVATE EQUITY	3.0%	0.5%	-2.5%
SHORT TERM	1.0%	1.7%	0.7%

ASSET ALLOCATION	3/31/2012	6/30/2012	DIFF
NORTH AMERICAN EQUITY	43.8%	42.4%	-1.4%
INTERNATIONAL EQUITY	13.5%	13.6%	0.1%
US FIXED INCOME	28.4%	29.2%	0.8%
INTERNATIONAL FIXED INCOME	1.0%	1.0%	0.0%
INFLATION HEDGED BOND	7.3%	7.8%	0.4%
REAL ESTATE	3.5%	3.9%	0.3%
PRIVATE EQUITY	0.4%	0.5%	0.1%
SHORT TERM	2.1%	1.7%	-0.4%

*As of 3/1/11, the asset allocation targets are 40% North American Equity / 15% International Equity / 26% US Fixed Income / 8% Inflation Hedge Bond / 7% Real Estate / 3% Private Equity / 1% Short Term.*

# TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

Periods Ending June 30, 2012

## Performance Summary

	1 QTR		1 YEAR		3 YEAR		5 YEAR		10 YEAR	
	RETURN	ALPHA	RETURN	ALPHA	RETURN	ALPHA	RETURN	ALPHA	RETURN	ALPHA
<b>TCRS Composite</b>	<b>-0.78</b>	<b>-0.43</b>	<b>5.61</b>	<b>0.32</b>	<b>11.66</b>	<b>-0.09</b>	<b>3.11</b>	<b>-0.40</b>	<b>5.67</b>	<b>-0.62</b>
<i>Policy Index<sup>1</sup></i>	-0.35		5.29		11.75		3.51		6.29	
<i>Total Fund Allocation Index<sup>2</sup></i>	-0.79		4.93		11.40					
<i>Total Public Funds &gt; \$100 Million Median</i>	-1.93		1.06		11.66		1.76		6.42	
<b>NORTH AMERICAN EQUITY MANAGERS</b>										
Large Cap										
Index	-2.75	0.00	5.52	0.07	16.38	-0.02	0.33	0.11		
Quant	-3.53	-0.78	5.13	-0.32	16.05	-0.35	0.97	0.75	5.77	0.44
Sector	-3.12	-0.37	5.85	0.40	16.58	0.18	0.46	0.24	5.52	0.19
<i>S&amp;P 500 Index</i>	-2.75		5.45		16.40		0.22		5.33	
Mid Cap										
Mid Cap <sup>3</sup>	-4.71	0.22	-1.96	0.37	19.39	0.02	0.73	-1.29	7.86	0.01
<i>S&amp;P MidCap 400 Index<sup>4</sup></i>	-4.93		-2.33		19.37		2.02		7.85	
Equity Futures	-3.29	0.29	-0.60	-2.03						
<i>S&amp;P SmallCap 600 Index</i>	-3.58		1.43							
Canada										
Canada	-7.23	-0.01	-15.09	0.25						
<i>S&amp;P/TSX 60 Index</i>	-7.22		-15.34							
<b>NORTH AMERICAN EQUITY COMPOSITE</b>	<b>-3.76</b>	<b>-0.27</b>	<b>2.55</b>	<b>0.58</b>						
<b>NORTH AMERICAN EQUITY w/o Futures</b>	<b>-3.78</b>	<b>-0.29</b>	<b>2.68</b>	<b>0.71</b>						
<i>87.5% S&amp;P 1500/ 12.5% S&amp;P/TSX 60 Index</i>	-3.49		1.97							
<b>US EQUITY COMPOSITE</b>	<b>-3.35</b>	<b>-0.39</b>	<b>5.03</b>	<b>0.40</b>	<b>16.89</b>	<b>0.13</b>	<b>0.50</b>	<b>0.04</b>	<b>5.65</b>	<b>0.07</b>
<i>US Equity Benchmark<sup>5</sup></i>	-2.96		4.63		16.76		0.46		5.58	
<i>Median</i>	-3.96		0.76		16.77		1.06		6.67	
<b>INTERNATIONAL EQUITY MANAGERS</b>										
Developed										
Baring Asset Management	-5.72	1.41	-8.82	5.01	9.62	3.66				
<i>MSCI EAFE NET Index</i>	-7.13		-13.83		5.96					
Marathon	-5.90	1.23	-9.51	4.32	9.14	3.17	-1.75	4.35	8.26	3.12
<i>MSCI EAFE NET Index<sup>6</sup></i>	-7.13		-13.83		5.97		-6.10		5.14	
PanAgora Asset Management	-5.88	1.25	-12.07	1.76	8.54	2.58	-4.35	1.75		
<i>MSCI EAFE NET Index</i>	-7.13		-13.83		5.96		-6.10			
TT International	-6.74	0.39	-16.19	-2.36	5.59	-0.37				
<i>MSCI EAFE NET Index</i>	-7.13		-13.83		5.96					
Walter Scott	-3.48	3.65	-4.37	9.46	12.32	6.36	1.53	8.60	9.69	4.40
<i>MSCI EAFE NET Index<sup>7</sup></i>	-7.13		-13.83		5.96		-7.07		5.29	
Developed Small Cap										
American Century Investment	-5.74	2.91	-12.47	2.59	13.02	3.85				
<i>MSCI EAFE Small Cap NET Index<sup>8</sup></i>	-8.65		-15.06		9.17					
Pyramis Global Advisors	-8.36	0.29	-12.77	2.29	10.51	1.34				
<i>MSCI EAFE Small Cap NET Index<sup>8</sup></i>	-8.65		-15.06		9.17					

<sup>1</sup> As of 7/1/11, the Policy Index is 35% S&P 1500/ 5% S&P/TSX 60/ 15% MSCI EAFE IM/ 26% Citigroup Large Pension Fund/ 8% Citigroup TIPS/ 7% NCREIF/ 3% S&P 500 + 300 bps/ 1% 91 Day T-Bill.  
<sup>2</sup> As of 7/1/11, the Total Fund Allocation Index is 36.8% S&P 1500/ 5.3% S&P/TSX 60/ 15.8% MSCI EAFE IM/ 29.8% Citi LPF/ 8% Citigroup TIPS/ 3.2% NCREIF/ 0.1% S&P 500 + 300 bps/ 1% 91 Day T-Bill.  
<sup>3</sup> As of 6/30/08; prior was SMid Cap Fund.  
<sup>4</sup> As of 6/30/08; prior was S&P 1000 Index.  
<sup>5</sup> As of 7/1/04 S&P 1500 Index; prior was S&P 500 Index.  
<sup>6</sup> As of 5/19/06; prior was MSCI Europe Index.  
<sup>7</sup> As of 2/2/09; prior was MSCI Europe Index.  
<sup>8</sup> As of 07/01/11, MSCI EAFE Small Cap NET Index; prior was MSCI EAFE Index.

# TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

Periods Ending June 30, 2012

## Performance Summary (Continued)

	1 QTR		1 YEAR		3 YEAR		5 YEAR		10 YEAR	
	RETURN	ALPHA	RETURN	ALPHA	RETURN	ALPHA	RETURN	ALPHA	RETURN	ALPHA
GE Asset Management	-6.73	0.74	-16.43	0.05	7.21	0.92				
MSCI Europe NET Index <sup>9</sup>	-7.47		-16.48		6.29					
Pacific Indexed Portfolio <sup>10</sup>	-5.85	0.53	-9.07	-0.78	5.36	-0.39	-4.75	-0.80	5.12	-0.03
MSCI Pacific NET Index <sup>11</sup>	-6.38		-8.29		5.75		-3.95		5.15	
<b>TOTAL INT'L EQUITY COMPOSITE</b>	<b>-5.77</b>	<b>1.54</b>	<b>-10.79</b>	<b>3.18</b>	<b>9.06</b>	<b>2.73</b>	<b>-3.37</b>	<b>2.36</b>	<b>7.07</b>	<b>1.51</b>
<b>TOTAL INT'L EQUITY w/o Currency Overlay</b>	<b>-5.77</b>	<b>1.54</b>	<b>-10.79</b>	<b>3.18</b>	<b>9.21</b>	<b>2.88</b>	<b>-2.78</b>	<b>2.95</b>	<b>7.39</b>	<b>1.83</b>
MSCI EAFE IM NET Index <sup>12</sup>	-7.31		-13.97		6.33		-5.73		5.56	
Median	-6.88		-12.98		8.07		-4.10		6.92	
<b>US FIXED INCOME</b>										
Corporate	4.32	0.23	15.93	0.65	14.72	2.72	9.65	0.82	7.44	0.14
Citigroup LPF Credit Index <sup>13</sup>	4.09		15.28		12.00		8.83		7.30	
Government 1-5	8.18	0.34	26.79	2.87	15.80	5.66	10.43	1.39		
Citigroup LPF Treasury/Gov't Sponsored <sup>14</sup>	7.84		23.92		10.14		9.04			
Government 5 Plus	7.82	-0.02	24.15	0.23	13.21	1.40	9.46	-0.93		
Citigroup LPF Treasury/Gov't Sponsored <sup>15</sup>	7.84		23.92		11.81		10.39			
Mortgage Backed Securities	1.31	0.24	5.62	0.57	6.27	0.74	5.78	-1.01	5.02	-0.45
Citigroup Mortgage Backed Securities Index	1.07		5.05		5.53		6.79		5.47	
<b>US FIXED INCOME COMPOSITE</b>	<b>4.54</b>	<b>-0.14</b>	<b>15.63</b>	<b>0.04</b>	<b>11.76</b>	<b>2.32</b>	<b>8.59</b>	<b>-0.03</b>	<b>6.50</b>	<b>0.09</b>
<b>US FIXED INCOME w/o Derivatives</b>	<b>3.37</b>	<b>-1.31</b>	<b>11.91</b>	<b>-3.68</b>	<b>10.51</b>	<b>1.07</b>	<b>7.86</b>	<b>-0.76</b>	<b>6.14</b>	<b>-0.27</b>
Citigroup LPF Index <sup>16</sup>	4.68		15.59		9.44		8.62		6.41	
Median	2.13		7.40		8.49		7.39		6.20	
<b>INFLATION HEDGED BOND**</b>	<b>3.32</b>	<b>-0.13</b>	<b>12.22</b>	<b>-0.14</b>	<b>9.39</b>	<b>-0.59</b>	<b>8.69</b>	<b>0.08</b>		
Inflation Hedged Account**	3.32	-0.13	12.22	-0.14	9.39	-0.59	8.70	0.09		
Citigroup TIPS Index	3.45		12.36		9.98		8.61			
Median	3.15		11.65		9.64					
<b>INTERNATIONAL FIXED INCOME COMPOSITE***</b>	<b>2.26</b>	<b>0.20</b>	<b>4.18</b>	<b>0.92</b>	<b>7.36</b>	<b>0.29</b>	<b>9.30</b>	<b>0.11</b>	<b>7.43</b>	<b>0.48</b>
International Fixed Income	2.26	0.20	4.18	0.92	7.36	0.29	9.30	0.11	7.43	0.48
Citigroup G5 -ex US Index <sup>17</sup>	2.06		3.26		7.07		9.19		6.95	
Median	1.10		2.71		6.61		8.22		6.95	
<b>REAL ESTATE</b>	<b>3.32</b>	<b>0.00</b>	<b>10.01</b>	<b>-3.40</b>	<b>2.06</b>	<b>-3.90</b>	<b>1.32</b>	<b>-1.56</b>	<b>6.95</b>	<b>-1.22</b>
NCREIF Property Index - One Qtr lag	3.32		13.41		5.96		2.88		8.17	
Median	3.32		10.71		5.49		-2.21		6.91	
<b>PRIVATE EQUITY<sup>18</sup></b>	<b>4.03</b>	<b>-9.42</b>	<b>7.22</b>	<b>-4.32</b>						
S&P 500 Index + 300 bps (One Qtr lag) <sup>19</sup>	13.45		11.54							
<b>SHORT TERM</b>	<b>0.33</b>		<b>0.86</b>		<b>1.77</b>					
Cash Account	0.16		0.34		1.48		2.22		2.43	
Short Duration	0.58		1.71		2.30					

<sup>9</sup> As of 07/01/11, MSCI Europe NET Index; prior was MSCI Europe Index.

<sup>10</sup> Performance was attributable to Amundi through 9/3/10; portfolio managed by TCRS staff afterward.

<sup>11</sup> As of 7/1/04; prior was MSCI AC Asia Pacific Free Index.

<sup>12</sup> As of 10/1/08; prior was MSCI EAFE NET Index.

<sup>13</sup> As of 7/1/2011, benchmark is Citigroup LPF Credit. As of 4/1/2011, benchmark is 50% Citigroup Credit Index, 50% Citigroup LPF Credit Index. Citigroup Credit Index: 7/1/05-3/31/11. Lehman Credit ex BBB prior.

<sup>14</sup> As of 7/1/2011, benchmark is Citigroup LPF Treasury/Government Sponsored. As of 04/1/2011, benchmark, is 50% Citigroup 1-5 Gov't/50% Citigroup 1-7 Gov't. As of 8/1/09, name switched from Fixed Income Overlay to Gov't 1-5 in order to reflect strategy change. As of 8/1/09, benchmark is Citi Treas/Gov't Sponsored 1-5; prior was Citi BIG Index.

<sup>15</sup> As of 7/1/2011, benchmark is Citigroup LPF Treasury/Government Sponsored. As of 4/1/2011, benchmark is 50% Citigroup Core 5+ Gov't/50% Citigroup 7+ Gov't. As of 8/1/09, name switched from Agency Debt to Gov't 5 Plus in order to reflect strategy change. As of 8/1/09, benchmark is Citi Core+5 Treas/Gov't Sponsored; prior was Citi Treas/Gov't Sponsored.

<sup>16</sup> As of 7/1/2011, benchmark is Citigroup LPF Index. As of 04/1/2011, benchmark is 50% Citigroup BIG/50% Citigroup LPF. As of 7/1/05 benchmark switched from Lehman Aggregate -ex BBB Index to Citigroup BIG.

<sup>17</sup> As of 7/1/04; prior was Citigroup World Government Bond -ex US Unhedged Index.

<sup>18</sup> Per TCRS' request: As of Q1 2012, Private Equity returns are from Cambridge Associates and are the prior quarter's performance returns.

<sup>19</sup> As of February 2011, index changed from S&P 500 Index + 300bps to S&P 500 Index + 300 bps (One Qtr lagged), since inception.

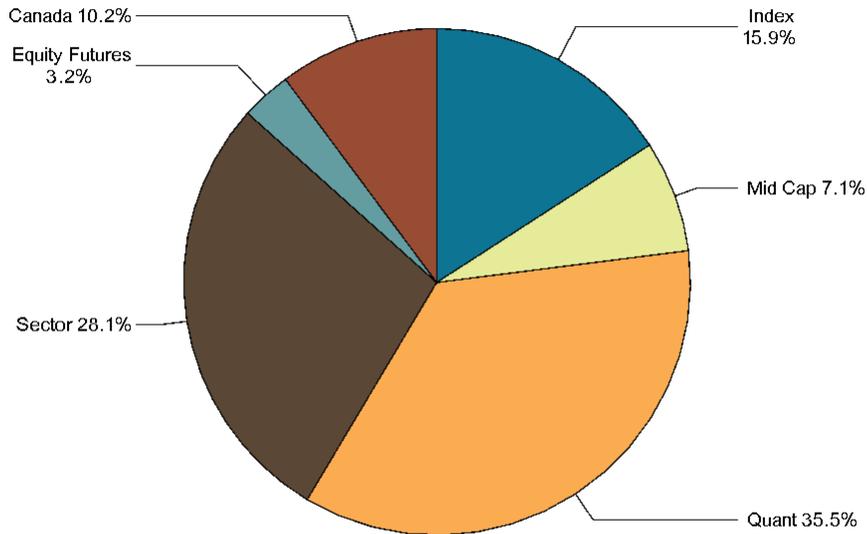
\*\* Inflation Hedged Bond is not ranked in years 5 and greater, because there are not enough observations available.

\*\*\* International Fixed Income is not ranked in the 10 Year period, because there are not enough observations available.

# TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

As of June 30, 2012

## Manager Allocation Analysis - North American Equity



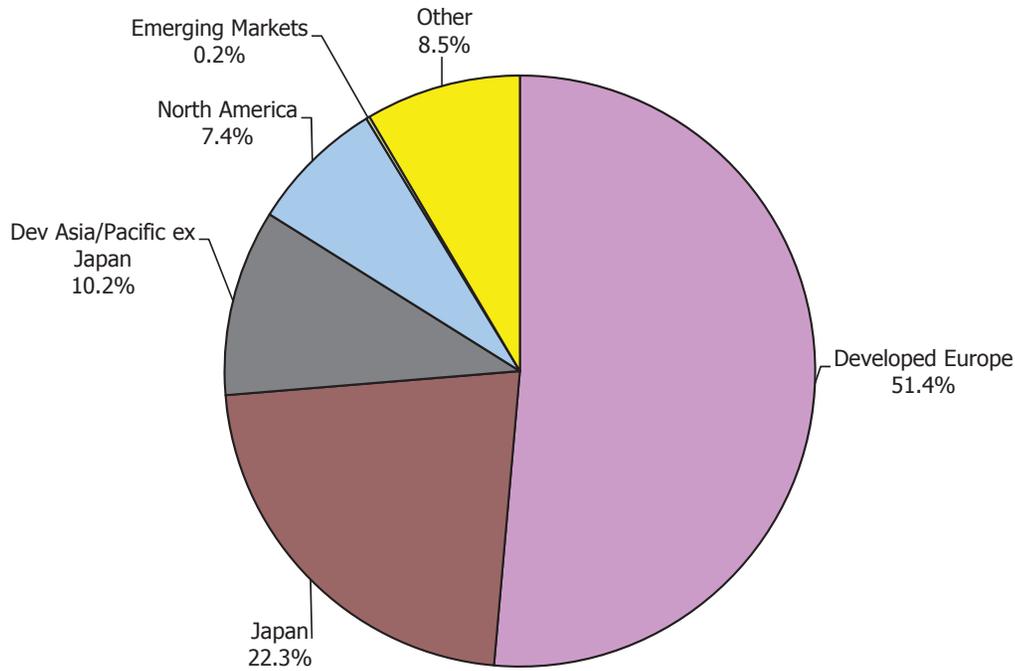
FUND	Ending Market Value	Current %
Index	2,349,281,540	15.9
Mid Cap	1,046,794,447	7.1
Quant	5,245,848,881	35.5
Sector	4,141,323,143	28.1
Equity Futures	473,263,000	3.2
Canada	1,506,851,083	10.2
<b>TOTAL</b>	<b>14,763,362,094</b>	<b>100.0</b>

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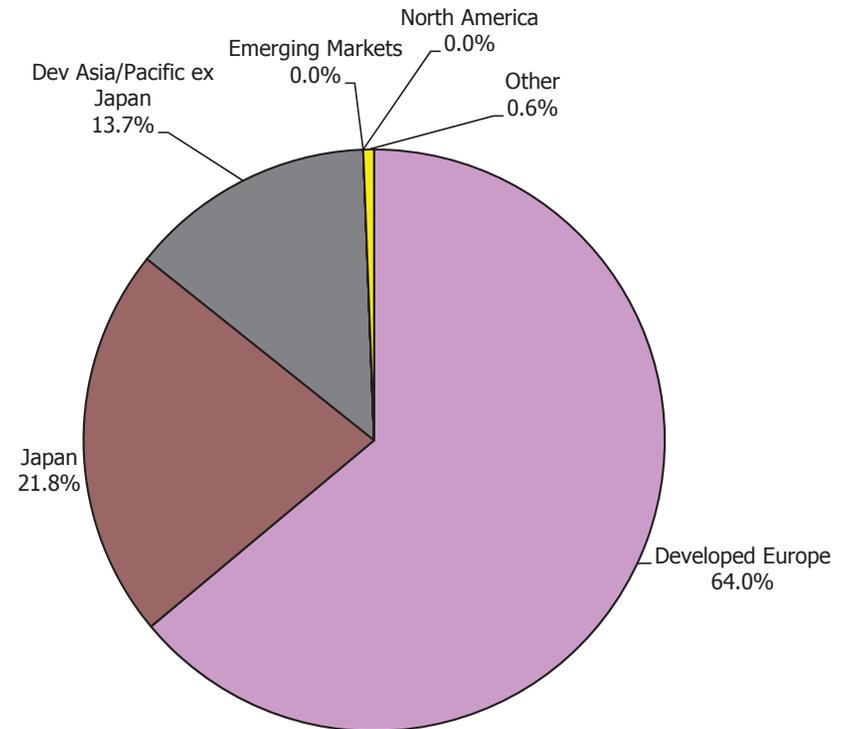
As of June 30, 2012

## International Equity Portfolio Regional Weights

### International Equity Composite w/o CO



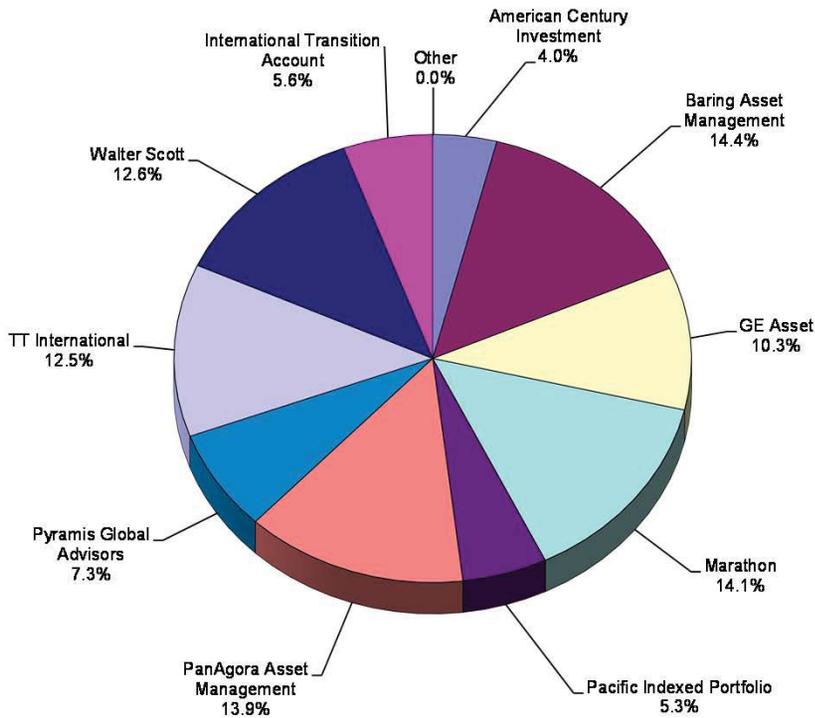
### MSCI EAFE



# TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

As of June 30, 2012

## Manager Allocation Analysis - International Equity w/o Currency Overlay

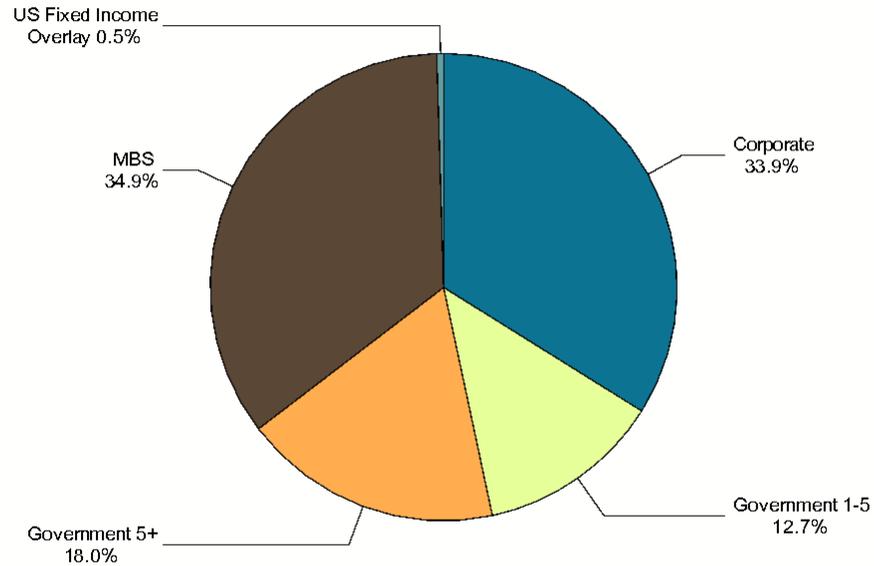


Fund	Ending Market Value	Current %
American Century Investment	188,499,419	4.0%
Baring Asset Management	681,698,699	14.4%
GE Asset	486,624,303	10.3%
Marathon	668,376,320	14.1%
Pacific Indexed Portfolio	250,623,602	5.3%
PanAgora Asset Management	656,243,950	13.9%
Pyramis Global Advisors	347,002,031	7.3%
TT International	589,057,715	12.5%
Walter Scott	594,955,560	12.6%
International Transition Account	264,788,000	5.6%
Other	93,887	0.0%
<b>TOTAL</b>	<b>4,727,963,487</b>	<b>100.0%</b>

# TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

As of June 30, 2012

## Manager Allocation Analysis - US Fixed Income



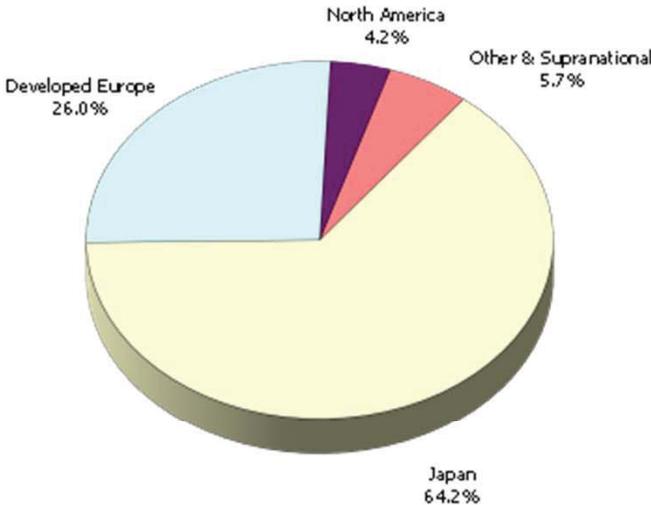
FUND	Ending Market Value	Current %
Corporate	3,446,818,550	33.9
Government 1-5	1,289,444,109	12.7
Government 5+	1,828,111,270	18.0
MBS	3,544,346,326	34.9
US Fixed Income Overlay	49,647,135	0.5
<b>TOTAL</b>	<b>10,158,367,390</b>	<b>100.0</b>

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## International Fixed Income Portfolio Regional Weights

INTERNATIONAL FIXED INCOME



CITIGROUP G-5 EX US INDEX

