

Kentucky Teachers' Retirement System

2014



**Investment
Section**

REPORT ON INVESTMENT ACTIVITY

This report is prepared by the Investment staff of the
Kentucky Teachers' Retirement System.

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Mr. Paul L. Yancey, CFA
Chief Investment Officer



December 1, 2014

To the members of the Board of Trustees and participants of the Teachers' Retirement System of Kentucky:

The KTRS investment program continued to perform exceptionally well in the fiscal year ended June 30, 2014, producing a total return of 18.1%. This exceeded the policy benchmark return of 17.6% and ranked in the top 23% of returns in a peer group universe of 77 public pensions with over \$1 billion in assets. The performance was driven by a relatively high weighting in U.S. and international equities, which performed extremely well, as well as strong relative performance generally within the fund's various asset classes.

The markets' strong, relatively steady, performance was underpinned by consistent monetary support from the Federal Reserve and a continuing, if modest, global economic recovery. One hiccup in the uptrend, in the summer of 2013, followed the Federal Reserve's initial comments about a future reduction in monetary stimulus. Another came in early 2014 when monetary stimulus actually began to be scaled back in coincidence with a harsh winter in the U.S. Economic growth temporarily stalled in early 2014. After both minor setbacks, markets quickly resumed their positive performance.

The system's public equity exposure, which totaled 63.2% of assets at June 30, 2014, returned 25.2%. Domestic equities returned 26.3% versus 24.7% for the S&P 1500 Index. International equities returned 22.9% versus 22.3% for the MSCI All Country World (ex-U.S.) Index.

Fixed income returns were lower at 4.8% but exceeded the benchmark Barclays Government/Credit Index return of 4.3%. Exposure to fixed income continued to decline, from 21.3% of assets a year earlier to 19.9% on June 30, 2014, as the relative attractiveness of the asset class continued to deteriorate.

Less traditional investment strategies, including real estate, private equity, and alternative credit strategies rose to 14.6% of assets over the fiscal year, up from 13.1% a year earlier. Returns were generally strong across the various strategies and contributed meaningfully to overall performance.

A sound investment philosophy and implementation through a robust professional process are the keys to a successful program. We believe the consistently strong relative returns achieved over the past several years evidence the soundness of the system's philosophy, asset allocation strategy, and execution. We are grateful to be a part of the process. We would like to express that gratitude to the Board of Trustees, Investment Committee, and investment staff for their continuing confidence.

Respectfully,

Patrick J. Kelly, CFA, CAIA
Partner

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RETIREMENT ANNUITY TRUST FUND

INVESTMENT POLICY SUMMARY

The KTRS Board of Trustees has a statutory obligation to invest the members' assets in a manner consistent with the fiduciary standards set forth in the "prudent person rule." Consistent with these fiduciary standards, the board has recognized certain principles that guide investment-related decisions. First, the board will preserve the long-term corpus of the fund. Second, the board will seek to maximize total investment return within prudent risk parameters. Third, the board will act in the exclusive interest of the members and beneficiaries of the System. This broad summary is a reference point for management of retirement assets and outlines the investment philosophy and practice of KTRS.

INVESTMENT OBJECTIVES

KTRS invests the members' funds in several diverse classes of assets, including equities, bonds and real estate. This diversification helps us earn the highest possible long-term rate of return within appropriate risk levels. In turn this enables us to pay guaranteed benefits to members and their beneficiaries at the lowest possible cost to participating employers and the taxpayers that fund them. Generally, the retirement system's liabilities will not be paid for as many as 30-40 years. Therefore, as a long-term investor, KTRS holdings can withstand some short-term volatility. The retirement annuity trust fund's long-term investment objective is to achieve an annualized rate of return of 7.5%.

RISK CONTROLS

The KTRS investment program faces various risks; however, the primary risk to KTRS is that the assets will not support liabilities over long periods of time. In order to control this risk and any other risks, the board has taken the following steps on an ongoing basis:

- Actuarial valuations are performed each year to evaluate the funding objectives of the retirement system. In addition, every ten years an external audit of the actuary is conducted to ensure that the assumptions made and calculation methods used are resulting in properly computed liabilities of the System.
- Asset/liability studies are conducted approximately every five years. These studies ensure that the portfolio design is structured to meet the liabilities of the retirement system.
- The KTRS Investment Committee adopts, and regularly reviews, detailed investment strategies for implementation of the investment policy.

ASSET ALLOCATION

Operating within relevant regulatory limitations, the retirement system's investment consultant, on an annual basis, presents to the Investment Committee for approval target percentages and ranges for the retirement system's various asset classes. Annually approved asset allocation parameters serve to balance the retirement system's liquidity requirements, volatility tolerance, and return requirements to meet both short-term and long-term obligations. The retirement system's assets are diversified across a variety of asset classes, investment management styles, and individual securities in order to reduce volatility and enhance the potential of the investment portfolio to achieve the retirement system's long-term goals.

Asset allocation decisions for pension plans are highly dependent on the unique characteristics of a particular plan. Factors such as liability requirements, the level of funding, and statutory investment restrictions are important considerations within the context of the asset allocation decision making process. Consequently, asset allocations may differ markedly between various pension plans due to their unique circumstances.

The information below shows the retirement system's asset allocation by fair value as of June 30, 2014, and June 30, 2013, as well as the target and strategic range for each asset class for fiscal year 2014.

Retirement Annuity Trust

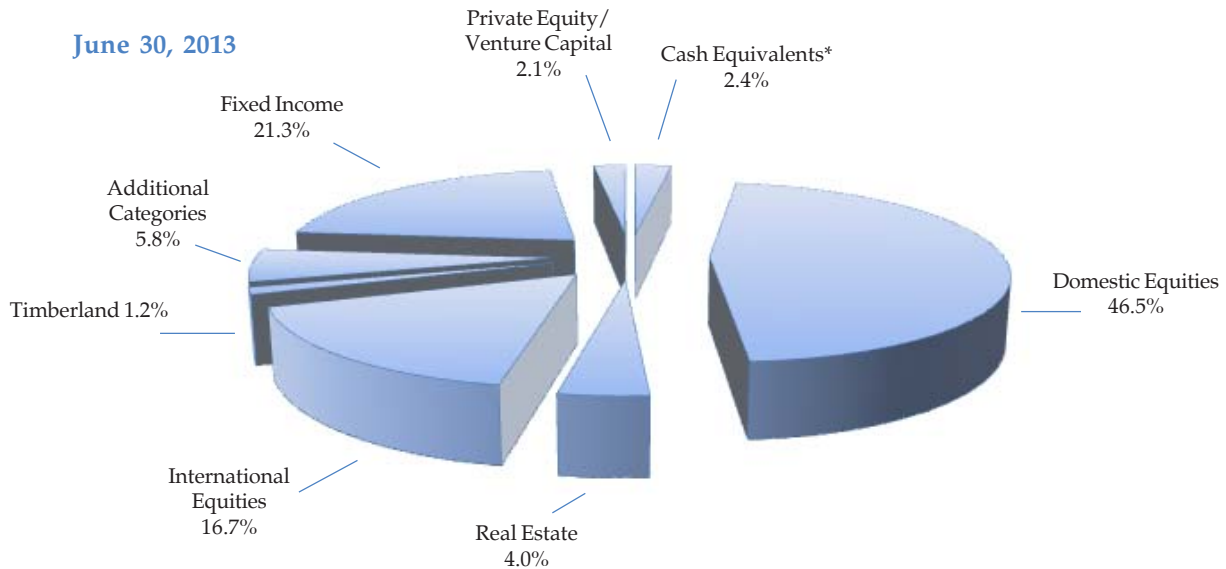
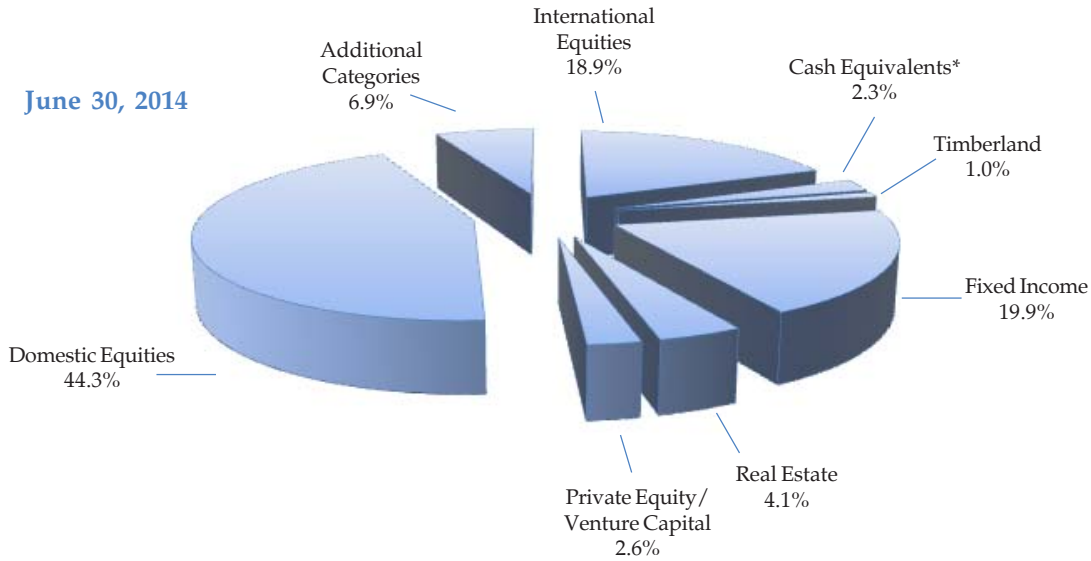
	<u>June 30, 2014</u> *	%	<u>June 30, 2013</u> **	%
Cash Equivalents***	\$ 420,338,047	2.3	\$ 386,683,234	2.4
Fixed Income	3,594,965,963	19.9	3,434,080,377	21.3
Domestic Equities	7,982,520,773	44.3	7,511,572,763	46.5
International Equities	3,411,422,169	18.9	2,698,774,335	16.7
Real Estate	733,045,846	4.1	642,611,173	4.0
Private Equity	457,408,593	2.6	343,259,092	2.1
Timberland	186,481,696	1.0	197,480,029	1.2
Additional Categories	1,248,651,062	6.9	935,376,476	5.8
TOTALS	\$ 18,034,834,149	100.0	\$ 16,149,837,479	100.0

* Includes Life Insurance Trust values of \$89,250,576, Tax Shelter Annuity value of \$377,268, and 401(h) value of \$41,237,374.

** Includes Life Insurance Trust values of \$88,623,343, Tax Shelter Annuity value of \$391,095, and 401(h) value of \$2,193,497.

*** Reflects only cash balances not allocated to other asset classes. Uninvested cash balances allocated to various asset classes are represented in the respective asset classes.

Distribution of Investments
Retirement Annuity Trust**
Fair Values



* Reflects only cash balances not allocated to other asset classes. Uninvested cash balances allocated to various asset classes are represented in the respective asset classes.

** Includes Life Insurance Trust values.

Strategic Weightings by Asset Class

Asset Class	Regulatory Limits (Mkt Value)	Strategic Range (Mkt)	Target (Mkt)	6/30/2014 (Mkt)**
Cash		1 - 3%	2.0%	2.3%
Fixed Income		16 - 22	19.0	19.9
Government/Agency/Other	Unlimited			10.1
Corporate	35%			9.8
Equity	65%	58 - 65	62.0	63.2
Domestic Large Cap		34 - 44	39.0	38.0
Domestic Mid Cap		1 - 5	3.0	3.8
Domestic Small Cap		1 - 3	2.0	2.5
International***	30%	15 - 21	18.0	18.9
Real Estate	10%	3 - 7	5.0	4.1
Alternative Investments*	10%	2 - 8	5.0	3.6
Additional Categories	15%	4 - 10	7.0	6.9
TOTAL			100.0%	100.0%

* Includes private equity, venture capital, timberland, and infrastructure investments.

** Starting with 7/2008, Cash is only the unallocated cash balance. Manager cash balances will be included with the asset type of the managers investments.

*** As of 6/30/14, 18.2% of Total International Equities was invested in Emerging Markets.

PORTFOLIO RETURNS

For the fiscal year, the retirement annuity trust fund's portfolio generated a total return of 18.1%, exceeding the policy benchmark return of 17.6%. Domestic equities returned 26.3% versus 24.7% for the Standard & Poor's 1500 Index, while international equities returned 22.9% versus 22.3% for the MSCI All Country World (Ex-US) Index. Fixed income investments outperformed, returning 4.8% versus 4.3% for the Barclays Government/Credit Index. Less traditional asset classes such as real estate, private equity, timberland, and alternative credit are beginning to contribute meaningfully to total return as those programs are expanded.

The table below details historical performance for the retirement annuity trust fund and its component asset classes for the period ended June 30, 2014. The retirement annuity trust fund's returns were generated by the Segal Rogers Casey performance reporting system using a time-weighted rate of return calculation based upon the modified Dietz methodology.

INVESTMENT SECTION

Portfolio Returns continued ...

	<u>1 Yr⁽²⁾</u>	<u>3 Yr⁽²⁾</u>	<u>5 Yr⁽²⁾</u>	<u>10 Yr⁽²⁾</u>	<u>20 Yr⁽²⁾</u>
Total Fund					
KTRS	18.1	11.3	13.7	7.2	8.2
Policy Index ⁽¹⁾	17.6	11.0	13.3	-	-
Equities					
Domestic Equities	26.3	16.8	19.4	8.3	10.2
S & P Blended Index ⁽³⁾	24.7	16.5	19.2	8.0	9.9
International Equities ⁽⁴⁾	22.9	7.4	12.9	-	-
MSCI AC World (Ex US)	22.3	6.2	11.6	-	-
Total Equities	25.2	14.3	17.7	7.7	9.9
Fixed Income					
Total Fixed Income	4.8	5.0	6.3	5.8	6.6
Barclays Govt/Credit Index	4.3	4.1	5.1	4.9	6.2
Real Estate					
Non-Core Real Estate	21.6	18.3	-	-	-
NCREIF Index	11.2	11.3	-	-	-
Core Real Estate	13.8	12.7	7.5	-	-
NCREIF ODCE	12.8	12.5	10.0	-	-
Triple Net Lease Real Estate	6.6	7.7	7.8	8.6	9.0
CPI plus 2%	4.1	3.9	4.1	4.4	4.4
Alternative Investments					
Private Equity ⁽⁵⁾	18.6	12.2	15.5	-	-
Timberland	-1.0	3.2	2.3	-	-
NCREIF Timberland Index	9.9	6.7	3.3	-	-
Cash					
Cash (Unallocated)	0.1	0.1	0.1	2.0	3.2
90 Day Treasury Bill	0.0	0.1	0.1	1.6	2.8
Additional Categories					
High Yield					
High Yield Bond Fund	11.0	9.1	-	-	-
B of A Merrill Lynch	11.8	9.3	-	-	-
High Yield Master II					
Alternative Credit					
KTRS Credit Fund	14.1	-	-	-	-
Special Situations Fund	15.1	5.8	-	-	-
Oaktree Opportunities Fund	11.2	-	-	-	-
AG Select Partners Adv Fund	-	-	-	-	-
B of A Merrill Lynch	11.8	9.3	-	-	-
High Yield Master II					
Shenkman Capital Mgmt	6.6	-	-	-	-
Highbridge Pr Str III	8.6	-	-	-	-
Golub Pearls 11	-	-	-	-	-
Oaktree Eur Dislocation Fund	-	-	-	-	-
Marathon Eur Cr Opp Fund	-	-	-	-	-
S & P LSTA Leverage Loan Index	5.6	-	-	-	-
Non-US Dollar Fixed Income					
Rogge Global Intl Fixed Income	10.0	-	-	-	-
Barclays Global Aggregate ex	9.5	-	-	-	-
USD 25% EUR 25% JPY Index					

(1) Prior to July 1, 2008, KTRS did not benchmark overall fund performance. Effective July 1, 2008, the Board of Trustees approved a Policy Index which represents the returns of appropriate benchmarks for the various asset classes weighted by the mid-point of the strategic range for the current fiscal year.

(2) Annualized

(3) Total Domestic Equity is benchmarked to a S & P Blended Index. Total domestic equity was benchmarked to the S & P 500 through the fiscal year ending 6/30/2007. As of 7/1/2007, domestic equity is benchmarked to the S & P 1500 Index since the System's domestic stock mix is most comparable to this index.

(4) As of 06/30/14 18.2% of Total International Equities were invested in emerging markets.

(5) For a period of five years private equity investments will be benchmarked against their own returns. The primary reason for this is that these investments have a minimum investment horizon of ten years and there is no market benchmark that would be expected to track these types of assets in their early years. Beginning five years after the first capital call, investments in this class shall be benchmarked versus the S & P 500 plus 3%, which is the System's long-term expected return for this asset class.

SCHEDULE OF INVESTMENT RETURNS - RETIREMENT ANNUITY TRUST

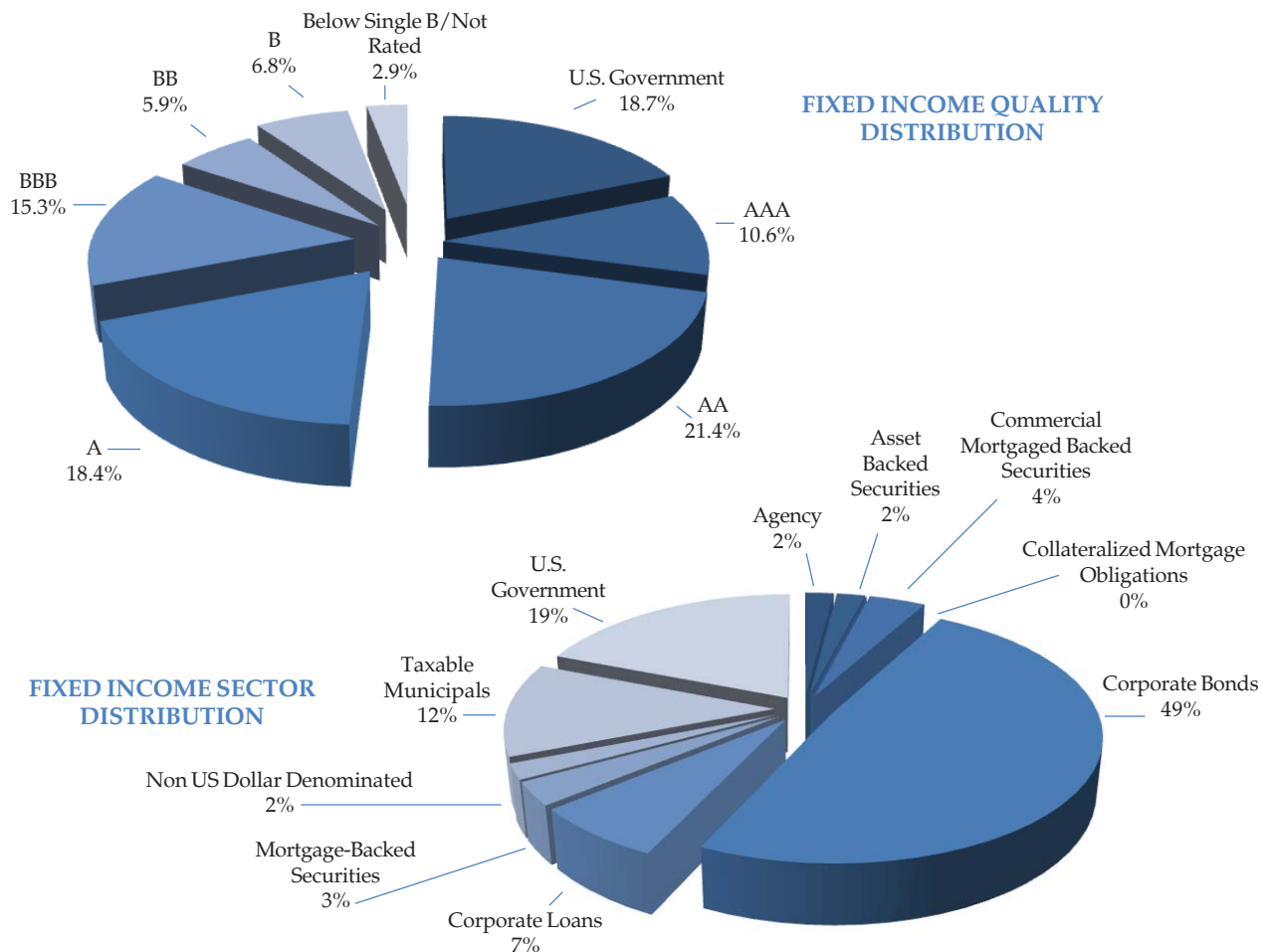
2014 Annual Rate of Return Net of Investment Expense 17.95%

FIXED INCOME INVESTMENTS

As of June 30, 2014, the retirement annuity trust fund had approximately \$3.59 billion, 19.9% of total assets, in the fixed income category of investments. The retirement annuity trust fund's fixed income investments maintained the average investment grade rating required by administrative regulation as of June 30, 2014.

In addition, the retirement annuity trust fund had \$1.25 billion, 6.9% of total assets, in other debt related investments under a regulatory provision which allows for up to 15% of assets in "additional categories of investments" approved by the Board of Trustees. Investments under this authorization included a high yield bond portfolio, an international fixed income portfolio, and a syndicated bank loan portfolio. Also under this provision are several alternative credit portfolios including a multi - strategy opportunistic credit portfolio as well as distressed debt and specialty lending funds.

The credit quality distribution for the retirement annuity trust fund is illustrated below. This chart includes the fixed income category of investments as well as the high yield bond, international fixed income, and the syndicated bank loan portfolios included in "additional categories of investments". Also illustrated below is the distribution of fixed income assets by sector, again including the high yield bond, international fixed income, and the syndicated bank loan portfolios held under "additional categories of investments".



FIXED INCOME MARKET OVERVIEW

The retirement annuity trust fund's investment grade fixed income portfolios returned 4.8% for the fiscal year ending June 2014. This compares favorably to the trust fund's fixed income benchmark, the Barclays U.S. Government / Credit Index, which returned 4.3%. The outperformance was driven by the system's overweighting in corporate bonds which outperformed government bonds by a substantial margin.

Yields on benchmark U.S. Treasuries ended fiscal year 2014 largely unchanged from the close of the previous year. It was hardly uneventful in the rates markets, however, as rates were pushed higher throughout the first half of the year and then drifted back down during the second half. As was the case in fiscal 2013, market participants were focused mainly on the development of the Federal Reserve's monetary policy, but additional factors seemed to have a significant influence on the level of interest rates as the year progressed.

Shortly before the beginning of fiscal year 2014, in May 2013, the Federal Reserve surprised the markets by suggesting that it may start to "taper" its program of purchasing U.S. Treasuries and mortgage backed securities earlier than market participants were expecting. The market adjusted to this new guidance by pushing interest rates sharply higher, causing a substantial selloff in U.S. Treasuries and, to a lesser extent, investment grade fixed income in general as the fiscal year began.

The move higher in interest rates was exacerbated by stronger than expected GDP reports in the first two quarters of the fiscal year. The economy grew by 4.5% in the quarter ended September 2013 and 3.5% in the quarter ended December 2013. These were the second and fifth strongest quarters of GDP growth since June 2006. The robust growth was driven by a significant increase in personal consumption as healthcare and medical procedure expenditures were pulled forward ahead of the rollout of the Affordable Care Act. The yield on 10 year U.S. Treasuries rose from 2.13% at the start of the fiscal year to 3.03% on December 31, 2013, just six months later.

The quick and substantial rise in longer term interest rates, along with unusually cold winter weather, curtailed growth in the quarter ending March 2014. GDP fell 2.1% from the previous quarter, the worst performance since the financial crisis in early 2009. The effects of tighter monetary policy and higher interest rates were especially felt in interest sensitive areas of the economy such as housing. Year over year home price appreciation slowed from 13.3% in June 2013 to 3.7% by the end of fiscal year 2014. The volume of mortgage loan applications for home purchases fell 29% from its peak when rates had bottomed in April 2013. U.S. Treasury rates responded to the slower growth by reversing course, with short rates falling modestly and longer term rates falling sharply.

Despite the slow quarter, the Federal Reserve continued with its pace of tapering asset purchases, a process it started in December 2013 and is expected to complete in October 2014. The decision was well received by market participants, and proved to be the correct course of action. GDP rebounded in the fourth quarter of the fiscal year growing 4.2% on the back of a significant inventory build and catch up from economic activity that was delayed due to the previous quarter's poor weather.

Despite the bounce back in GDP growth, long term interest rates continued their decline while short term rates remained relatively stable causing the term structure to flatten. Market participants' anticipation of the Federal Reserve raising the Federal Funds rate supported shorter term rates while tighter monetary policy lessened the threat of future inflation and caused long term rates to fall. The spread between 30 year U.S. Treasuries and 2 year U.S. Treasuries narrowed to 290 basis points at fiscal year end from 359 basis points at the end of December 2013. By fiscal year end, U.S. Treasury rates had fallen to levels close to where they were at the beginning of the fiscal year. Shorter term rates finished slightly higher and long term rates slightly lower than when the year began in June 2013. Meanwhile, the strength of the economy over the course of the fiscal year proved to be a good environment for corporate bonds. The yield on the Barclay's Investment Grade Long Corporate Index fell from 5.19% to 4.57% as risk premiums shrank consistently throughout the fiscal year.

With U.S. Treasury rates and risk premiums on corporate bonds both near the low end of their historical range, investment grade fixed income is an asset class with moderately unfavorable risk / reward characteristics and below average upside potential. The retirement system continues to adjust the structure of its fixed income portfolio to control risk and maintain required liquidity. Specifically, the retirement system continues to increase exposure to nontraditional debt-related investments, reduce exposure to investment grade fixed income, and limit interest rate risk.

EQUITY INVESTMENTS

As of June 30, 2014 the retirement annuity trust fund's public equity investments had a fair value of \$11.39 billion, representing 63.2% of total assets. Strong equity returns over the fiscal year prompted several rebalancing sales to reduce equity exposure back to target levels and to raise cash to fund pension benefits. The retirement annuity trust fund divides its public equity into two broad categories: domestic and international.

The domestic portfolio had a fair value of \$7.98 billion as of June 30, representing 44.3% of total assets. This is a \$470 million increase over last year despite rebalancing sales. The benchmark for the domestic portfolio is the S&P 1500. The S&P 1500 is made up of three well known component indices based upon market capitalization: the S&P 500 large cap, S&P 400 mid cap, and the S&P 600 small cap. The retirement annuity trust fund's domestic equity holdings are comprised of eleven portfolios. Three of the portfolios are internal passively managed index portfolios benchmarked to the S&P 500, 400, and 600. The other eight portfolios are managed externally by four different asset managers, with each portfolio representing a specific strategy and measured against an appropriate benchmark. The collective array of portfolios provides diversification by capitalization, manager, style, and strategy.

The fair value of the international equity holdings as of June 30, 2014 was \$3.41 billion, representing 18.9% of total assets, up from 16.7% a year earlier. The benchmark for international equities is the Morgan Stanley Capital International All Country World Index ex US (MSCI ACWI ex US), which represents the markets of 22 developed countries and 23 emerging market countries. Five external asset managers manage the retirement annuity trust fund's international equities, one of which is a passively managed international index fund. The retirement annuity trust fund plans to continue increasing the international equity exposure during the coming fiscal year.

EQUITY MARKET OVERVIEW

Stocks rallied steadily throughout fiscal year 2014. The upward trend was fairly consistent starting in October after a moderate first quarter. This strong, steady rise saw few hiccups, with the most pronounced setback coming in late January to early February 2014. Returns of domestic stocks as measured by the S&P 1500 and Russell 2000 were 24.7% and 23.6%, respectively. Within the S&P 1500, small (S&P 600) and mid-cap (S&P 400) stocks were up 25.5% and 25.2%, while the large-cap S&P 500 was up 24.6%. Non-U.S. stocks also performed very well on the year, but with higher volatilities. The Morgan Stanley Capital International (MSCI) All Country World (ex-U.S.) Index returned 22.3%. The MSCI Emerging Markets Index was up 14.7%, showing strong returns across international markets.

The domestic markets were propelled by rising housing prices and stronger consumer confidence in the first half of the fiscal year. Despite rumors to the contrary, in September the FOMC announced it would not reduce the pace of its monthly bond buybacks, better known as quantitative easing. This kept key interest rates low and markets rallied. Political infighting, however, kept stock prices in check in the first half of the year, primarily in September and October. There was political stalemate over a Federal Funding Bill, primarily over the funding allocation to be given to the Affordable Care Act. Without a bi-partisan resolution, this may have caused a government shutdown of most federal programs, resulting in thousands of people being furloughed from their jobs nationwide. Additionally, there were heated debates over the soaring national debt. A decision had to be made to raise the federal debt limit. Without a higher debt ceiling, the federal government would have had to default on select payment obligations, possibly sending the markets into a tailspin. While the looming government shutdown and possible defaults accounted for a pullback in the market, this pullback was relatively short lived as politicians ultimately reached an agreement on the budget issues. The markets rallied strong to finish out the first half of the fiscal year with the S&P 500 posting a gain of 16.3% for the first two quarters.

The second half of the fiscal year continued an upward trend domestically, as stocks rallied on better employment data and continued signs of strength in the manufacturing sector. Consumer confidence was also at favorable levels. Manufacturing was primarily led by a jump in the housing market. Rising employment numbers coupled with low borrowing costs were the main drivers of the housing market. Stocks did see a significant pullback at the end of January which was primarily attributed to the brutal winter. The cold winter coupled with higher than average snowfall took a bite out of retail sales and consequently lowered manufacturing numbers. This proved to be a minor bump in the road however, as consumer confidence remained undeterred and continued to rise. As a result, the equity markets rallied steadily in the second half, finishing the fiscal year at all-time highs. Another attribute of the strong equity market was the historically low volatility the markets experienced.

Internationally, there was a similar story as the European Central Bank (ECB) and the Bank of Japan (BOJ) continued quantitative easing programs. The MSCI EAFE and ACWI ex US posted similar returns to the US markets in

INVESTMENT SECTION

the first half of the fiscal year. European markets stabilized with the ECB's bond purchase program and the UK saw strong rises in their housing market. Asia continued to experience a favorable reaction to QE. Japan started slower than the rest of Asia, but rallied strong due to concerted efforts to devalue the Yen and boost its export economy. As a result, their manufacturing numbers saw heavy gains bolstering the economy as a whole.

In the second half of the fiscal year emerging markets rallied as China announced the issuance of several new IPOs. This showed confidence in their stabilizing economy. Europe and Japan also continued to post gains on the heels of their respective low interest rate environments and their improving housing and manufacturing markets.

In summary, we experienced a very strong equity market for the fiscal year. Small and mid-cap domestics were technically the drivers, but domestic and international large caps also enjoyed double digit gains on the year. Having been buoyed by monetary stimulus over the past couple of years, markets are wary going forward of any potential reduction or elimination of that stimulus. This, coupled with rising valuations in the market and growing geopolitical tension, may give some investors pause for the coming year. On the other hand, FOMC Chair Janet Yellen has already announced continued use of accommodative monetary policy that will keep rates low in the near future and consumer confidence seems undeterred by most external factors.

REAL ESTATE

The retirement annuity trust fund's real estate investments had a fair value of \$733.0 million as of June 30, 2014, representing 4.1% of total assets. The retirement annuity trust fund's investments in real estate are intended to provide attractive long-term returns, generate reliable cash flow, and provide diversification, thereby reducing the volatility of the overall investment portfolio.

The retirement annuity trust fund's real estate exposure is currently provided through seven portfolios. The retirement annuity trust fund maintains an internally managed portfolio of directly owned properties under long-term lease agreements with high credit quality tenants. The retirement annuity trust fund is also invested in a commingled real estate fund (PRISA Fund), which is managed by Prudential Real Estate Investors. This fund is a core real estate equity fund which invests primarily in existing income-producing properties with strong cash flows and the potential for capital appreciation. The fund is diversified across several property types including office, retail, industrial, apartment, self-storage and hotel.

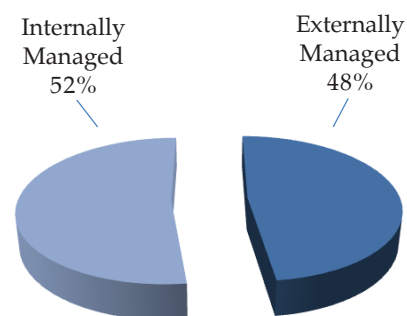
Additionally, the retirement annuity trust fund is invested in five real estate limited partnerships: Carlyle Realty Partners VI, Blackstone Real Estate Partners VII, Rockwood Capital Real Estate Fund IX, TA Realty Associates Fund X, and AG Net Lease Realty Fund III. Going forward, investment staff will continue to opportunistically add to the annuity trust fund's real estate investments.

REAL ESTATE OVERVIEW

Demand for commercial real estate remained strong during the fiscal year as investors sought both higher yields than those offered by other asset classes and the potential upside created by improving supply/demand factors. Property rents are expected to grow from 2.0% to 3.5% during the year due to improving fundamentals which include: a strengthening economy, falling vacancies, low financing rates, and moderate levels of new construction activity. Due to the run-up in prices of prime properties located in gateway markets, many investors are now focusing on non-core assets located in secondary markets.

One factor that has energized the real estate markets is the increase in lending activity. Commercial and multi-family loan originations are at their highest levels in six years. According to the Mortgage Bankers Association, an estimated \$280 billion in new loans was originated in 2013, up from \$244 billion the previous year. In conjunction with this increase in lending, a tremendous volume of existing commercial and multi-family mortgage loans will be rolling off the books in coming years, with approximately \$330 billion maturing in 2014 and another \$981 billion expected to mature between 2015 and 2017. As borrowers

Real Estate Investments
\$733.0 Million Fair Value
As of June 30, 2014

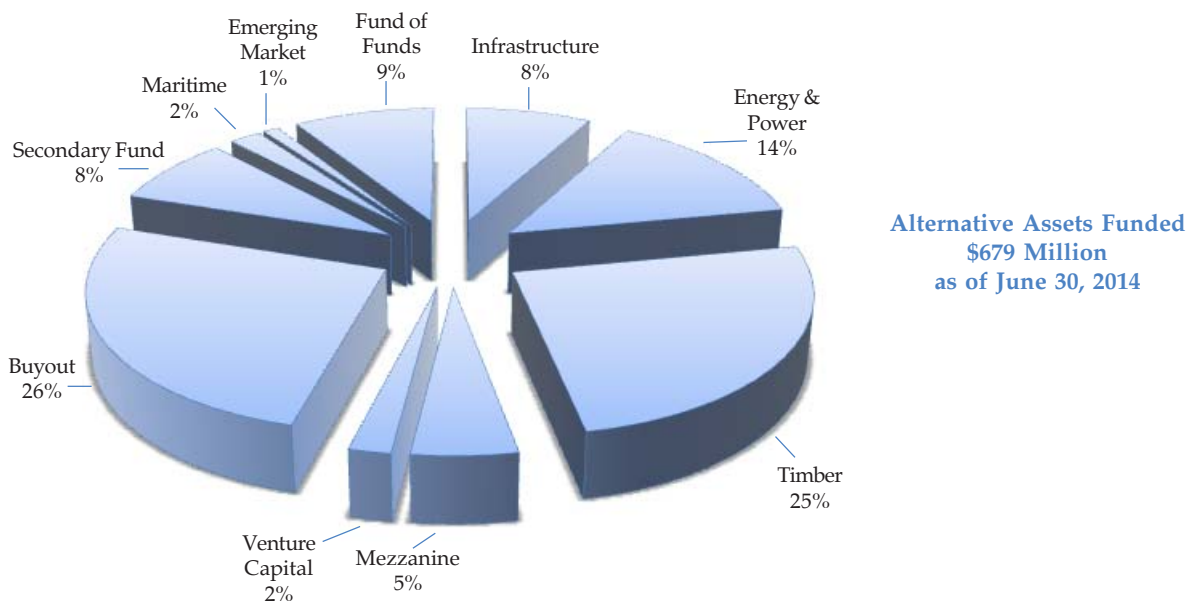
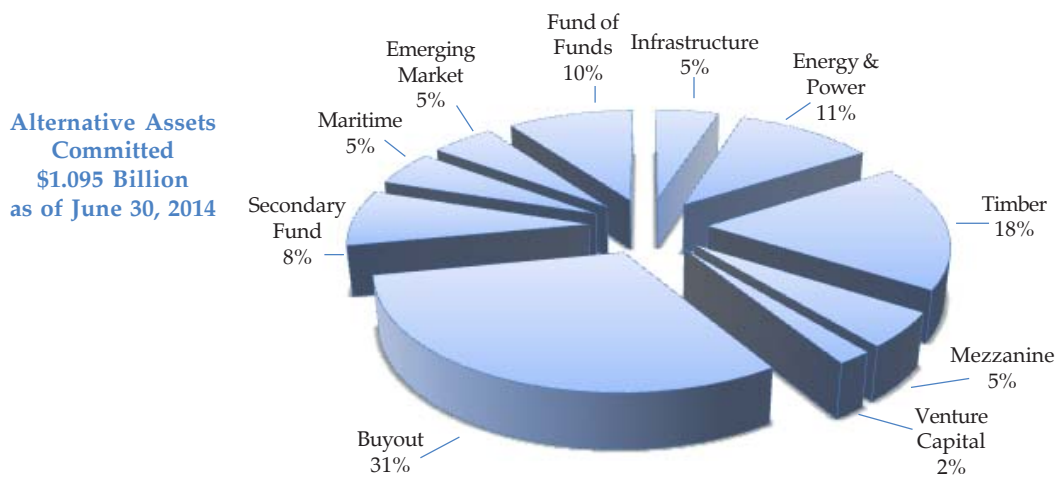


look to recapitalize this maturing debt, both equity and mezzanine debt investors will have ample opportunities to provide financing at attractive levels.

Investor demand for real estate investments should remain strong over the next year due to the sector's solid income yields and improving fundamentals. Interest rates are expected to remain low over the upcoming year while demand for property space continues to grow, providing a favorable environment for lower vacancy rates, higher rents, and competitive returns.

ALTERNATIVE ASSETS

As of June 30, 2014, the retirement annuity trust fund had committed \$1.095 billion to alternative investments and had funded \$679 million of those commitments. The percentage of the retirement annuity trust fund's portfolio in alternative assets was 3.6%. The retirement annuity trust fund's current alternative asset portfolio consists of private equity investments and timberland.



PRIVATE EQUITY

The retirement annuity trust fund has exposure to venture, buyout, infrastructure, energy, mezzanine and several other private equity sectors via participation in limited partnerships as well as investments in funds of funds. The retirement annuity trust fund is in the early stages of its private equity investment program, which it intends to grow with a disciplined plan of commitments over the next several years. The retirement annuity trust fund looks to diversify its private equity portfolio by firm, country, strategy, and vintage year. Vintage year diversification is achieved by building out the portfolio with disciplined levels of commitments over time. A commitment to any given partnership shall not exceed 20% of the partnership's total commitments.

The Board and staff understand that private equity (along with many other forms of alternative assets) are illiquid and have a long-term holding period. When added to a portfolio with other publicly traded assets, this asset class can help to diversify and reduce risk for the retirement annuity trust fund's overall portfolio while enhancing returns. Private equity returns for the first several years of a partnership's life are routinely negative due to the J-curve effect. Positive returns are typically realized only several years into a partnership's existence, during the harvesting period.

PRIVATE EQUITY MARKET OVERVIEW

The private equity markets continue to be positively affected by the strong public equity markets. Strength in the public equity markets enabled older vintage funds to shed many of their portfolio companies either through a sale or an IPO. This return of capital has encouraged investors, especially on the institutional side to continue to increase their allocation to alternative investments, including private equity. However, fundraising continues to remain challenging for all but the top tier funds.

The bifurcation in the private equity market continues with the top tier funds raising capital much easier than less desirable funds. This should, over the long term, provide a shakeup in this space as the weaker firms are forced to exit. The past fiscal year has also seen a large amount of buyout funds returning to the marketplace with mixed results. We continue to see more opportunity in the middle market space and in other niche areas such as energy, infrastructure, distressed credit, and emerging markets. Additionally, the stress in the European markets should continue to present investment opportunities in the private equity space over the next fiscal year.

TIMBERLAND

In addition to private equity, the retirement annuity trust fund has invested in timberland in the alternative asset class. As of June 30, 2014 the retirement annuity trust fund owns approximately 73,000 acres of timberland outright, has a 7.15% interest in a commingled fund that holds approximately 98,000 acres of timberland and is a member of a joint venture that purchased an interest in approximately 124,000 acres of timberland located across seven southern states. Timberland is, by nature, a long term investment as our anticipated time horizon in this asset category is generally a minimum of ten to fifteen years. Timberland provides valuable diversification, current income, and a hedge against inflation. Due to the low correlation of returns with other asset classes, timberland investments should lower the overall volatility of the retirement annuity trust fund's portfolio. Timberland should earn real returns comparable to traditional equity investments with volatility between equities and fixed income over the long-term.

The retirement annuity trust fund diversifies its timberland investments by geography, species of trees, and maturity of timber stands. Investment returns from timberland are primarily driven from net cash flow generated from the sale of trees (referred to as stumpage sales) and capital appreciation from the biological growth of the trees. Both of these return factors depend to some degree upon the direction of forest commodity prices (paper goods and lumber products). There can also be gains from the timely sale of timberland from the conversion of timberland into higher and better uses, such as vacation property sales.

TIMBERLAND MARKET OVERVIEW

An increase in construction activity during the year provided support to lumber prices as the U.S. housing market continues to steadily rebound. Demand from China softened somewhat over the past year as their economic growth has slowed. However, demand for hardwood has remained strong and as a result, hardwood pulpwood and hardwood sawtimber prices have moved to levels well above their long-term trend lines. Transaction activity in the

North America timberlands space is picking up momentum, which is a positive sign for a sustained recovery in timberland prices.

The forest products industry is seeking to increase its use of existing assets and add capacity in order to meet current and expected product demand, a welcome development for timberland owners and further evidence that markets for timber products are improving. In the U.S. South, prices for all products continued to strengthen, although some species at a slower pace than others. Despite the usual pricing volatility associated with late spring and early summer, market fundamentals have continued to be strong.

INVESTMENT SECTION

RETIREMENT ANNUITY TRUST PORTFOLIOS FAIR VALUES *

June 30, 2014

Internally Managed

Cash Equivalents	
Cash Collections Fund (Unallocated)	\$ 420,338,047
Fixed Income	
Intermediate Bond Fund	903,853,177
Broad Market Bond Fund	656,009,896
Long Term Bond Fund	530,521,107
Internal Bond Fund	367,876,859
Life Insurance Trust	89,250,576
Tax Shelter Fund	377,267
Equity	
S & P 500 Stock Index Fund (Large Cap)	2,674,052,873
S & P 400 Stock Index Fund (Mid Cap)	369,830,139
S & P 600 Stock Index Fund (Small Cap)	259,503,908
Converted Equity Holdings	4,303,142
Real Estate	
Internally Managed Fund	382,542,197
Subtotal	6,658,459,188

Externally Managed

Fixed Income	
Galliard Capital Management	535,942,448
Ft. Washington Broad Market	511,134,634
Domestic Equity	
Todd Asset Management (Large Cap Core)	1,321,587,395
UBS (Large Cap Value)	1,053,855,212
GE Asset Management (Large Cap Growth)	711,928,370
Wellington (Large Cap Core)	616,936,214
Wellington (Mid Cap Core)	315,532,711
Todd Asset Management Opportunity Fund	306,837,942
UBS (130/30)	177,464,526
Wellington (Small Cap Core)	170,688,341
International Equity	
Baillie Gifford EAFE Alpha	858,783,524
Todd Asset Management International	834,105,006
UBS All Country World ex US	610,033,944
Baring All Country World ex US	527,320,034
BlackRock All Country World ex US IMI	493,949,410
Todd Asset Management	
International Intrinsic Value	87,230,251
Real Estate	
Prudential PRISA Fund	223,183,257
Blackstone Partners VII, LP	41,935,778
The Realty Associates Fund X	33,550,648
Carlyle Realty Partners VI	31,821,452
Rockwood Capital Real Estate Fund IX	18,109,844
AG Net Lease Realty Fund III, LP	1,902,669

Externally Managed continued ...

Alternative Investments	
Molpus Woodlands Group	
Lake Superior Timberlands LLC	101,664,498
KKR & Co European Fund III	70,201,067
Molpus Seven States LLC	57,028,605
Alinda Infrastructure Fund II	44,390,951
Riverstone/Carlyle E & P Fund IV	33,217,261
Ft. Washington Fund VI	33,180,145
Hellman & Friedman Fund VII	32,670,143
NGP Natural Resources X, LP	32,183,738
Hancock Bluegrass LLC - Oregon	27,788,593
Lexington Capital Partners Fund VII	19,989,023
Landmark Equity Partners Fund XIV, LP	19,305,809
KKR & Co Fund 2006	19,175,706
Chrysalis Venture Fund III	18,944,406
J. P. Morgan Maritime Fund	17,917,553
Riverstone E & P Fund V	15,161,443
Ft. Washington Fund V	14,621,971
Oaktree European Principal Fund III	14,226,029
Stepstone Pioneer Capital Fund III, LP	13,556,822
Oaktree Mezzanine Fund III	11,971,475
Audax Mezzanine Fund III	11,433,600
Actis Global Fund IV	10,967,792
APAX VIII, LP	7,929,973
Audax Private Equity Fund IV, LP	7,030,126
Landmark Equity Partners Fund XV, LP	4,505,775
Carlyle Global Financial Services Partners II	3,690,622
Ft. Washington Fund VIII	581,426
CapitalSouth Partners Fund III	555,737
Additional Categories	
Fort Washington High Yield Bond Fund	320,156,739
Marathon KTRS/Credit Fund LP	277,608,701
Shenkman Capital Management	263,576,820
Avenue Special Situations Fund VI	111,561,330
Rogge Global International Fixed Income	100,725,256
Golub Capital Pearls 11, LLC	63,159,049
Marathon European Credit Opp Fund II	33,731,503
Oaktree Opportunities IX, LP	33,508,417
Highbridge Principal Strategies III	31,722,781
AG Select Partners Advantage Fund	8,246,270
Oaktree European Dislocation Fund, LP	4,621,038
AG GECC PPIF, LP	33,158

Subtotal \$ **11,376,374,961**

TOTAL ASSETS \$ **18,034,834,149**

* Detailed information concerning the market values of all KTRS investments is available upon request.

Investment Summary
Fair Value – Retirement Annuity Trust*
June 30, 2014

Type of Investment	Fair Value 07/01/13	Acquisitions	Appreciation (Depreciation)	Sales Redemptions, Maturities & Paydowns	Fair Value 06/30/14
Cash Equivalents \$	800,978,300	\$ 4,457,688,600	\$ -	\$ 4,429,302,100	\$ 829,364,800
Fixed Income	3,179,986,300	2,917,329,700	38,124,700	2,806,306,800	3,329,133,900
Real Estate	642,611,200	88,488,500	23,972,100	22,026,000	733,045,800
Alternative	540,739,200	175,148,100	41,996,200	113,993,200	643,890,300
Equities	10,102,552,800	2,805,808,600	2,254,541,600	3,896,714,200	11,266,188,800
Additional Categories	882,969,700	692,687,400	65,369,500	407,816,100	1,233,210,500
TOTAL	\$ 16,149,837,500	\$ 11,137,150,900	\$ 2,424,004,100	\$ 11,676,158,400	\$ 18,034,834,100

* Includes Life Insurance Trust values of \$89,250,576, Tax Shelter Annuity value of \$377,267, and 401(h) value of \$41,237,374.

Contracted Investment Management Expenses
Fiscal Year 2013-14
(in thousands)

Investment Counselor Fees	Assets Under Management	Expense	Basis Points ⁽¹⁾
Equity Manager(s)	\$ 8,086,253	\$ 13,713	
Fixed Income Manager(s)	1,047,077	442	
Real Estate	350,504	4,198	
Additional Categories	1,248,651	5,980	
Alternative Investments ⁽²⁾	643,890	9,290	
TOTAL	\$ 11,376,375	\$ 33,623	29.6
Other Investment Services			
Custodian Fees ⁽³⁾	\$ 18,035,374	\$ 354	0.2
Consultant Fees		446	0.3
Legal & Research		90	0.0
Other Administrative and Operational		2,664	1.5
TOTAL	\$ 18,035,374	\$ 3,554	2.0
GRAND TOTAL		\$ 37,177	20.6

(1) - One basis point is one hundredth of one percent or the equivalent of .0001.

(2) - Private equity fees are either withheld from the Fund operations or paid by direct disbursement, depending on contract terms.

(3) - Includes J. Losey Scholarship Fund.

INVESTMENT SECTION

Schedule of Contracted and Administrative Investment Expenses Retirement Annuity Trust June 30, 2014

INVESTMENT COUNSELOR FEES

EQUITY MANAGERS

Baillie Gifford	\$ 2,946,160
Baring Asset Management, Inc.	2,408,105
GE Asset Management	800,000
Todd-Veredus Asset Management LLC	1,358,058
UBS Global Asset Management	2,914,577
Wellington Management Company	3,063,448
BlackRock	222,724
Total Equity Managers	\$ 13,713,072

FIXED INCOME MANAGERS

Fort Washington Investment Broad Market	175,713
Galliard Capital Mangement	266,027
Total Fixed Income Managers	\$ 441,740

REAL ESTATE

Prudential PRISA	1,551,710
Angelo Gordon Net Lease Fund III	129,986
Blackstone Partners Fund VII, L.P.	745,513
Carlyle Realty Partners Fund VI, L.P.	746,918
Carlyle Realty Partners Fund VII, L.P.	57,534
Rockwood Capital Real Estate Fund IX, L.P.	583,788
TA Realty Associates Fund X, L.P.	382,657
Total Real Estate Managers	\$ 4,198,106

ADDITIONAL CATEGORIES

Angelo Gordon Select Partners Advantage Fund	26,584
Avenue Capital Special Situations Fund VI, L.P.	854,665
Fort Washington Investments High Yield	626,443
Golub Capital - Pearls 11, LLC	193,866
Highbridge Principle Strategies Fund III, L.P.	278,595
Marathon Credit Fund	2,153,091
Marathon European Credit Fund II	136,651
Marathon Legacy Securities PPIP	2,785
Oaktree European Dislocation Fund, L.P.	58,567
Oaktree Opportunities Fund IX, L.P.	471,420
Rogge Global International Fund	240,384
Shenkman Capital	936,777
Total Additional Category Managers	\$ 5,979,828

ALTERNATIVE INVESTMENTS

Actis Global Fund IV, L.P.	499,000
Alinda Core Fund III, L.P.	185,366
Alinda Infrastructure Fund II, L.P.	367,370
APAX Fund VIII, L.P.	415,747
Audax Mezzanine Fund III, L.P.	284,571
Audax Private Equity Fund IV, L.P.	105,675
Capital South Fund III, L.P.	-
Carlyle Global Finacial Services Fund II, L.P.	672,399
Chrysalis Fund III, L.P.	427,342
Fort Washington Fund V, L.P.	98,964
Fort Washington Fund VI, L.P.	247,000
Fort Washington Fund VIII, L.P.	48,113
Hancock Bluegrass LLC Oregon	222,822
Hellman and Friedman Fund VII, L.P.	548,105
JP Morgan Maritime Fund , L.P.	524,742
KKR Fund 2006, L.P.	78,455
KKR European Fund III, L.P.	497,544
Landmark Equity Partners Fund XIV, L.P.	375,000

ALTERNATIVE INVESTMENTS continued ...

Landmark Equity Partners Fund XV, L.P.	424,315
Lexington Capital Partners Fund VII, L.P.	239,298
Molpus Lake Superior Michigan	766,830
Molpus Lake Superior Hiwassee	65,875
Molpus Seven States	546,311
NGP Natural Resources Fund X, L.P.	319,266
Oaktree European Principal Fund III, L.P.	375,858
Oaktree Mezzanine Fund III, L.P.	375,000
Stepstone Partners Fund III, L.P.	195,217
Riverstone/Carlyle Energy and Power Fund IV, L.P.	164,423
Riverstone Energy and Power Fund V, L.P.	219,825
Total Alternative Managers	\$ 9,290,433

ADMINISTRATIVE AND OPERATIONAL EXPENSES

CUSTODIAN

The Bank of New York Mellon	353,749
Total Custodian Fees	\$ 353,749

CONSULTANT

Hewitt EnnisKnupp + Associates	358,850
Bevis Longstreth	54,553
George Philip	33,056
Total Consultant Fees	\$ 446,459

LEGAL & RESEARCH

Reinhart Boerner Van Deuren	2,237
Wolters Kluwer	8,254
Ice Miller	79,848
Total Legal & Research	\$ 90,339

OTHER

Other Administrative and Operational (includes Personnel, Subscription services, etc...)	2,664,024
Total Other Administrative and Operational	\$ 2,664,024

TOTAL INVESTMENT EXPENSES

\$ 37,177,750

**Ten Largest Stock Holdings Ranked ^{(1) (2)}
by Fair Value
June 30, 2014**

Rank	Description	Fair Value	Percentage of Equities
1	Apple Inc	211,831,798	2.460
2	JP Morgan Chase	101,866,859	1.183
3	Wells Fargo & Co	94,439,125	1.096
4	Exxon Mobil Corp	89,301,247	1.037
5	Qualcomm Inc	87,166,411	1.012
6	Gilead Sciences	86,274,654	1.002
7	Chevron Corp	79,825,189	0.927
8	Citigroup Inc	78,453,622	0.911
9	Schlumberger Ltd	73,009,281	0.848
10	Pepsico Inc	72,335,828	0.840

**Top Ten Fixed Income Holdings ⁽²⁾
by Fair Value
June 30, 2014**

Rank	Description	Maturity	Coupon	Par Value	Fair Value	Percent of Fixed Income
1	U S Treasury	10/15/2016	0.630	75,000,000	75,076,500	2.255
2	U S Treasury TIPS	4/15/2016	0.130	55,825,000	61,532,188	1.848
3	U S Treasury	9/30/2017	0.630	55,375,000	54,687,243	1.643
4	U S Treasury	4/30/2018	0.630	50,290,000	49,103,659	1.475
5	U S Treasury Bonds	8/15/2023	6.250	31,900,000	42,078,014	1.264
6	U S Treasury	11/30/2015	0.250	30,980,000	30,993,321	0.931
7	U S Treasury Bonds	8/15/2029	6.130	22,000,000	30,707,160	0.922
8	U S Treasury	5/31/2015	0.250	30,000,000	30,037,500	0.902
9	U S Treasury	6/30/2020	1.880	26,000,000	25,975,560	0.780
10	U S Treasury	3/31/2017	1.000	23,180,000	23,317,689	0.700

(1) Includes only actively managed separate accounts.

(2) Detailed information concerning these values along with book values and cost of all KTRS investments is available upon request.

INVESTMENT SECTION

Transaction Commissions Fiscal Year 2013-2014

COMPANIES	SHARES TRADED	COMMISSIONS	COMMISSION PER SHARE	% OF TOTAL
Academy Securities, Inc.	27,649	\$ 967.73	\$ 0.035	0.04 %
Allen & Co	700	382.20	0.546	0.02
B. Riley & Co. LLC	18,614	651.49	0.035	0.03
Barclays	779,804	34,366.53	0.044	1.44
Barclays Capital, London	14,789	318.31	0.022	0.01
Bay Crest Partners, LLC	400	14.00	0.035	0.00
BB & T Capital Markets	6,100	213.50	0.035	0.01
Blair, William & Co	126,546	4,643.80	0.037	0.19
BMO Capital Markets	94,892	4,760.05	0.050	0.20
BNP Paribas Securities Bond	15,208	537.28	0.035	0.02
BNY ConvergeX Group	1,400	49.00	0.035	0.00
Brean Murray, Carret & Co., LLC	11,525	403.38	0.035	0.02
BTIG	189,705	7,787.10	0.041	0.33
Burke & Quick Partners LLC	4,040	141.40	0.035	0.01
Cabrera Capital	2,540	88.90	0.035	0.00
Canaccord Genuity, Inc.	92,083	3,229.72	0.035	0.14
Cantor Fitzgerald & Co	46,533	1,124.34	0.024	0.05
CIBC Worldmarket	23,510	822.86	0.035	0.03
Citigroup Global	342,471	37,118.33	0.108	1.56
ConvergeX - Algos	19,501,259	97,470.30	0.005	4.09
ConvergeX - FS	1,570,165	23,689.98	0.015	0.99
ConvergeX ADR Conversions	3,310,550	118,697.31	0.036	4.98
Cowen & Co	50,487	8,955.06	0.177	0.38
Credit Agricole Securities	99,075	3,457.31	0.035	0.15
Credit Research & Trading LLC	27,911	1,197.41	0.043	0.05
Credit Suisse Sec. LLC	2,223,098	60,670.45	0.027	2.55
Cuttone & Co Inc	8,066	288.82	0.036	0.01
D A Davidson & Co	700	24.50	0.035	0.00
Deutsche Bank	463,266	36,404.24	0.079	1.53
Drexel Hamilton LLC 3	26,224	917.86	0.035	0.04
Evercore Group LLC	2,260	79.10	0.035	0.00
FBR Capital Markets	9,500	332.50	0.035	0.01
Fig Partners, LLC	81,840	2,571.30	0.031	0.11
First Kentucky Securities Corp	584,600	17,538.00	0.030	0.74
Freidman Billings	48,720	1,705.21	0.035	0.07
GFI Securities LLC	1,300	45.50	0.035	0.00
Goldman Sachs	1,744,538	69,381.60	0.040	2.91
Imperial Capital	12,700	571.50	0.045	0.02
Instinet	67,524	1,364.88	0.020	0.06
Investment Tech Grp Transition	41,174,306	401,213.95	0.010	16.83
Investment Technology Grp	16,767,580	241,556.47	0.014	10.13
ISI Group	2,271,997	63,848.84	0.028	2.68
J.J.B. Hilliard, W.L. Lyons	2,225,709	66,771.27	0.030	2.80
Janney Montgomery Scott Inc	65,820	2,305.16	0.035	0.10
Jefferies & Co.	375,291	20,919.41	0.056	0.88
JMP Securities	23,790	832.65	0.035	0.03
Jones & Associates	19,385	829.64	0.043	0.03
JP Morgan & Chase	696,953	24,805.84	0.036	1.04
Keefe Bruyette & Woods	115,710	4,953.06	0.043	0.21
Keybank Capital	75,400	3,468.66	0.046	0.15
King, CL, & Associates, Inc.	4,650	165.75	0.036	0.01
Knight Equity Markets	29,300	1,031.76	0.035	0.04
Lazard Freres & Co.	1,768,320	53,049.60	0.030	2.23
Leerink Swann & Co.	25,885	1,521.07	0.059	0.06
Lexington Investment Co.	191,400	5,742.00	0.030	0.24
Liquidnet Inc	14,265,435	142,628.34	0.010	5.98
Liquidnet Inc - Transition	13,297,700	99,732.85	0.008	4.18

Transaction Commissions continued . . .

COMPANIES	SHARES TRADED	COMMISSIONS	COMMISSION PER SHARE	% OF TOTAL
Longbow Securities LLC	200	7.00	0.035	0.00
Loop Capital Markets, LLC	1,170	39.70	0.034	0.00
MacQuarie Securities Inc	37,744	695.86	0.018	0.03
Merrill Lynch	4,924,017	109,542.82	0.022	4.60
Merrill Lynch ADR Conversions	409,781	12,293.43	0.030	0.52
Merrill Lynch, Pierce, Fenner	37,712	15,400.42	0.408	0.65
Mischler Financial Group Inc	3,310	115.85	0.035	0.00
Mizuho Securities, USA	20,445	715.58	0.035	0.03
MKM Partners	7,450	260.75	0.035	0.01
Morgan Keegan	1,190,500	35,715.00	0.030	1.50
Morgan Stanley	414,118	19,631.61	0.047	0.82
Morgan Stanley Smith Barney-Huntington	1,224,200	36,726.00	0.030	1.54
Morgan Stanley Smith Barney-Louisville	1,661,450	49,843.50	0.030	2.09
Morgan Stanley Smith Barney-Northern KY	1,648,000	49,440.00	0.030	2.07
National Financial Services Corp	1,700	59.50	0.035	0.00
OTA Limited Partners	16,010	609.46	0.038	0.03
Pacific Crest Securities	2,060	272.10	0.132	0.01
Pershing LLC	85,390	2,988.66	0.035	0.13
Piper Jaffray	111,425	8,944.97	0.080	0.38
Pulse Trading	88,162	881.62	0.010	0.04
R W Baird	300,704	10,523.10	0.035	0.44
Raymond James & Assoc	3,106,239	94,486.05	0.030	3.96
RBC Capital Markets	201,936	7,157.44	0.035	0.30
Rosenblatt Securities LLC	400	18.00	0.045	0.00
Ross Sinclair & Assoc	202,320	6,069.60	0.030	0.25
Sanford C Bernstein	272,223	3,405.82	0.013	0.14
Scotia Capital, USA	14,080	497.27	0.035	0.02
SG AMERICAS SECURITIES	5,300	238.50	0.045	0.01
Sidoti & Company LLC	4,050	141.75	0.035	0.01
Simmons & Co	14,150	495.25	0.035	0.02
State Street Global	24,040	1,081.80	0.045	0.05
Stephens Inc.	53,780	1,896.01	0.035	0.08
Sterne, Agee & Leach	37,160	1,369.80	0.037	0.06
Stifel, Nicolaus & Co	1,448,747	76,513.60	0.053	3.21
Stifel, Nicolaus & Co-Louisville	199,100	5,973.00	0.030	0.25
Suntrust Robinson	63,240	2,298.13	0.036	0.10
Susquehanna Brokerage	1,480	66.60	0.045	0.00
Telsey Advisory Group LLC	186,207	6,517.34	0.035	0.27
The Benchmark Company LLC	14,700	661.50	0.045	0.03
The Seaport Group	53,705	69.11	0.001	0.00
UBS/Paine Webber Securities	558,817	10,460.66	0.019	0.44
UBS/Paine Webber-Louisville	1,131,610	33,948.30	0.030	1.42
Wachovia / First Clearing Corp	3,840	134.40	0.035	0.01
Wedbush Morgan Securities	21,770	815.95	0.037	0.03
Weeden & Co	2,491,557	76,081.80	0.031	3.19
Wells Fargo Securities, LLC	222,843	16,637.71	0.075	0.70
Wunderlich Securities Inc	8,265	3,293.58	0.398	0.14
TOTAL	147,554,030	\$ 2,383,394.97	\$ 0.02	100%

The acquisition of initial public offerings (IPOs) represented a portion of small capitalization stock purchases. IPOs usually have a high commission rate; however, the security issuers and not the investors pay the commissions. In 2013-14, the retirement annuity trust fund bought small capitalization IPOs that generated \$324,724 in commissions. Although these commissions were not paid by the retirement system, they resulted from the retirement annuity trust fund's investment activities and are included in the total commissions of \$2,383,395. Typical stock transactions occur at lower commission rates than IPO transactions, frequently \$.03 per share or less. Investment companies usually provide investment research for brokerage clients.

PROXY VOTING AND CORPORATE BEHAVIOR

The System regularly votes proxy statements associated with its equity ownership. The positions assumed by the System are intended to represent the financial interests of the membership. The Board of Trustees has adopted a policy that directs the staff not to subjugate the financial concerns of the System to social or political protests. At the same time, the System expects the companies in which it acquires stock to be solid corporate citizens that abide by federal, state, and local laws. The Board has adopted the following position on corporate behavior:

The Board's stated fiduciary duty is to obtain the highest return for the Fund commensurate with acceptable levels of risk. This implies that non-financial considerations cannot take precedence to pure risk/return considerations in the evaluation of investment decisions. However, action taken by the Fund as a shareowner can be instrumental in encouraging action as a responsible corporate citizen by the companies in which the Fund has invested.

The Board expects the managements of the companies whose equity securities are held in the Fund's portfolio to conduct themselves with propriety and with a view toward social considerations. A level of performance above minimum adherence to the law is generally expected. If any improper practices come into being, the Board expects corporate management to move decisively to eliminate them and effect adequate controls to prevent recurrence.

On the other hand, the Board does not intend to supplant the duties which are the responsibility of federal or state regulatory agencies, such as the Equal Employment Opportunity Commission, the Environmental Protection Agency, the Occupational Safety and Health Agency, the Nuclear Regulatory Commission, the Securities and Exchange Commission, and others which are covered by the laws of the United States Government or the State of Kentucky.

Should satisfaction of the Board's criteria by any company not be adequate, the Board will consider what action to take, which may include, but not be limited to, correspondence with the company, meetings with company officials, sponsoring of shareholder resolutions or, as a last resort, liquidation of the System's holdings in the company, if the sale is consistent with sound investment policy.

SECURITY LENDING

The System operates a security lending program in which it temporarily lends securities to qualified agents in exchange for a net fee and high quality collateral. U.S. Government and agency securities and select stocks and bonds are the types of securities loaned. The System's custodian, The Bank of New York Mellon, acts as lending agent in exchanging securities for collateral. The collateral, at the time of the loan, has a value of not less than 102% of the market value of the lent securities plus any accrued, unpaid distributions. The collateral consists of cash, marketable U.S. Government securities, and selected marketable U.S. Government agency securities approved by the System.

Cash collateral is invested in short term obligations fully guaranteed by the United States Government or select Government agencies and Government Repurchase Agreements with qualified agents. The System cannot pledge or sell collateral securities unless the borrower defaults. The lending agent also indemnifies the System from any financial loss associated with a borrower's default and collateral inadequacy. The weighted average maturity of cash collateral investments is typically two days. The System has no credit risk exposure to borrowers, since the amounts the System owes borrowers exceeds the amounts the borrowers owe the System.

Security lending programs can entail considerable interest rate risk and credit risk. The System has structured its program to minimize these two main categories of risk. The interest rate risk is managed, as mentioned above, by limiting the term of cash collateral investments to several days. The credit risk is controlled by investing cash collateral in securities with qualities similar to the creditworthiness of lent securities.

KENTUCKY INVESTMENTS

The retirement system is always cognizant of its significant role in the Commonwealth's economy. Over \$1.6 billion in benefits are distributed to members and annuitants living in Kentucky annually. Approximately \$300 million of the retirement annuity trust fund's investments directly impact the Commonwealth. These investments include: commercial real estate; bonds issued by public agencies of the Commonwealth and those of local municipalities; pools of single-family mortgages in Kentucky; financing for multi-family housing, and; investments in companies which have an impact on the Commonwealth's economy but receive earnings from global operations. Fiduciary duty requires that investments be made solely for the benefit of the retirement system's members and annuitants. Investments which benefit the Commonwealth's economy are made only when fully consistent with this fiduciary duty.

PROFESSIONAL SERVICE PROVIDERS

Investment Consultant

Hewitt EnnisKnupp, Inc.

Investment Custodian

The Bank of New York Mellon

Fixed Income Managers

Galliard Capital Management
Ft. Washington Investment Advisors

Domestic Equity Managers

Todd Asset Management LLC
UBS Global Asset Management
Wellington Management Company
GE Asset Management

International Equity Managers

Todd Asset Management LLC
UBS Global Asset Management
Baring Asset Management, Inc.
Baillie Gifford
BlackRock Institutional Trust Company

Real Estate Managers

Prudential Real Estate Investors
Carlyle Realty Partners
Blackstone Real Estate Partners
Rockwood Capital Real Estate
TA Associates Realty
Angelo Gordon & Co.

Alternative Investment Managers

Molpus Woodlands Group
Hancock Natural Resources Group
Kohlberg Kravis Roberts & Co.
Chrysalis Ventures
Ft. Washington Private Equity Investors
Alinda Capital Partners, LLC
Riverstone Holdings, LLC
CapitalSouth Partners
Landmark Partners
Lexington Partners
Oaktree Capital Management
Stepstone Pioneer Capital
Audax Group
J.P. Morgan Asset Management
Hellman & Friedman Capital Partners
Natural Gas Partners
Apax Partners
Actis LLP
Carlyle Global Partners

Additional Categories Investment Managers

Avenue Capital Group
Marathon Asset Management
Ft. Washington Investment Advisors
Oaktree Capital Management
Shenkman Capital Management, Inc
Rogge Global Partners
Highbridge Principal Strategies, LLC
Angelo Gordon & Co.
Golub Capital

Attorney

Ice Miller LLP

HEALTH INSURANCE TRUST FUND

INVESTMENT POLICY SUMMARY

The statute that created the health insurance trust fund on July 1, 2010, KRS 161.677, obliges the Board to “manage the assets of the fund in the same general manner in which it administers the retirement funds, except that the asset allocation may differ and separate accounting and financial reporting shall be maintained for the trust fund.” KRS 161.430, which governs the investment of funds for the retirement funds, requires that members’ assets be managed in a manner consistent with fiduciary standards set forth in the “prudent person rule.” Subject to this statute, administrative regulation 102 KAR 1:178 establishes investment policies for the health insurance trust fund. This regulation requires the Board and Investment Committee to prudently diversify assets and to consider the fund’s “liquidity and its capability of meeting both short and long-term obligations” in setting asset allocation policy.

Due to an imbalance of required distributions over contributions early in the fund’s existence, liquidity needs have dominated investment policy. This will evolve as contribution rate increases provided in statute improve cash flow in future years. As near-term liquidity needs recede in importance, the focus will increasingly be on establishing an investment policy which achieves the required rate of return and matches the health insurance liability.

INVESTMENT OBJECTIVES

The definitive objective of the health insurance trust fund is to provide for beneficiaries’ health insurance benefit obligations, both short and long-term. In support of this objective, investment policy will be designed, on an ongoing basis, to: (1) meet all liquidity needs, (2) achieve the actuarially assumed 8.0% rate of return over the long-term, and (3) do so within appropriate risk levels.

RISK CONTROLS

Any investment program faces various risks; as with the retirement funds, the primary risk is that the assets will not support liabilities over the long-term. Risk control measures for the health insurance trust fund mirror those of the retirement annuity trust fund, but are customized to reflect the fund’s unique liability. Primary risk control measures include the following steps:

- Actuarial valuations are performed each year to evaluate the funding objectives of the health insurance trust fund. Every ten years an external audit of the actuary is conducted to ensure that the assumptions made and calculation methods used are resulting in properly computed liabilities of the fund.
- Asset/liability studies are conducted approximately every five years. These studies ensure that the portfolio design is structured to meet the liabilities of the fund.
- In accordance with administrative regulation 102 KAR 1:178, which governs investment policies for the fund, the KTRS Investment Committee adopts and regularly reviews an asset allocation policy designed to meet the fund’s needs.

ASSET ALLOCATION

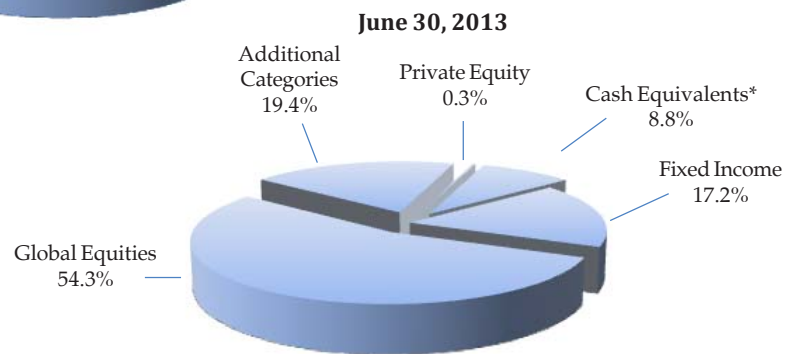
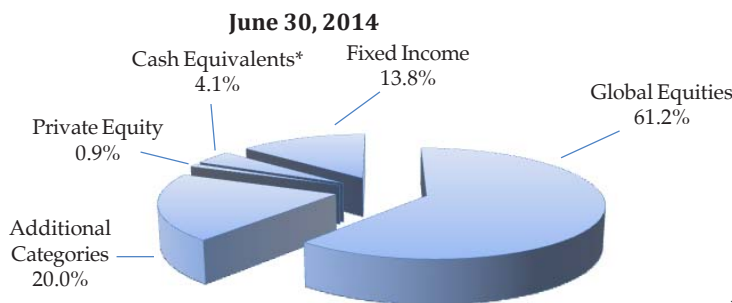
As of June 30, 2014, the health insurance trust fund had approximately \$491.9 million in total assets. This included \$20.1 million in cash and \$67.6 million in short-term high quality bonds for liquidity purposes. This trust fund also had \$65.4 million in high yield bonds, \$300.9 million in a global stock index fund, \$4.3 million in private equity investments, \$28.2 million in bank loans, and \$5.4 million in alternative credit funds.

Asset allocation will be adjusted annually by the Investment Committee to reflect changing liquidity needs and actuarial funding status. Due to upcoming contribution rate increases enacted in statute, liquidity needs are expected to decline in coming years while funding status improves. The information below shows the health insurance trust fund's asset allocation by market value as of June 30, 2014 and June 30, 2013.

Health Insurance Trust				
	June 30, 2014	%	June 30, 2013	%
Cash Equivalents*	\$ 20,149,704	4.1	\$ 39,455,381	8.8
Fixed Income	67,647,915	13.8	76,930,328	17.2
Global Equities	300,857,011	61.2	243,022,751	54.3
Additional Categories	99,027,356	20.0	86,551,982	19.4
Private Equity	4,251,239	0.9	1,255,715	0.3
TOTALS	\$ 491,933,225	100.0	\$ 447,216,157	100.0

* Reflects only cash balances not allocated to other asset classes. Uninvested cash balances allocated to various asset classes are represented in the respective asset classes.

Distribution of Investments Health Insurance Trust Fair Values



* Reflects only cash balances not allocated to other asset classes. Uninvested cash balances allocated to various asset classes are represented in the respective asset classes.

INVESTMENT SECTION

HEALTH INSURANCE TRUST

PORTFOLIO RETURNS

For the fiscal year, the health insurance trust fund's portfolio returned 15.5%. The fund's global equities returned 23.8% versus 23.4% for the MSCI All Country World IMI Index. A short-term bond fund held for liquidity purposes returned 0.8%. A high yield bond fund returned 11.0% versus 11.8% for its benchmark.

Due to a necessary focus on liquidity needs early in the fund's existence and rapidly evolving asset allocation as its funding mechanism is implemented, no policy benchmark has yet been established. Returns were generated by the Segal Rogers Casey performance reporting system using a time-weighted rate of return calculation based upon the modified Dietz methodology.

	<u>1 Yr⁽¹⁾</u>	<u>3 Yr⁽¹⁾</u>	<u>5 Yr⁽¹⁾</u>	<u>10 Yr⁽¹⁾</u>	<u>20 Yr⁽¹⁾</u>
Total Fund					
KTRS Health Insurance Trust	15.5	7.9	-	-	-
Equities					
Global Equities	23.8	10.8	-	-	-
MSCIAC World IMI	23.4	10.4	-	-	-
Fixed Income					
Internal Bond Fund	0.8	0.6	-	-	-
90 Day Treasury Bill	0.0	0.1	-	-	-
Alternative Investments					
Private Equity ⁽²⁾	17.6	-	-	-	-
Additional Categories					
High Yield					
High Yield Bond Fund	11.0	9.3	-	-	-
B of A Merrill Lynch High Yield Master II	11.8	9.3	-	-	-
Alternative Credit					
Shenkman Capital Management	7.3	-	-	-	-
Highbridge Principal Strategies	8.6	-	-	-	-
Marathon European Credit Opportunities	-	-	-	-	-
S & P LSTA Leverage Loan Index	5.6	-	-	-	-
Cash					
Cash(Unallocated)	0.1	0.1	-	-	-
90 Day Treasury Bill	0.0	0.1	-	-	-

(1) Annualized.

(2) For a period of five years private equity will be benchmarked against their own returns. The primary reason for this is that these investments have a minimum investment horizon of ten years and there is no market benchmark that would be expected to track these types of assets in their early years. Beginning five years after the commitment date, investments in this class shall be benchmarked versus the S & P 500 plus 3%, which is the System's long-term expected return for this asset class.

SCHEDULE OF INVESTMENT RETURNS - HEALTH INSURANCE TRUST

2014	Annual Rate of Return Net of Investment Expense	15.38%
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HEALTH INSURANCE TRUST
PORTFOLIOS
FAIR VALUES *
 June 30, 2014

Internally Managed

Cash Equivalents	
Cash Collections Fund (Unallocated)	\$ 20,149,704
Fixed Income	
Internal Bond Fund	67,647,915
Subtotal	\$ 87,797,619

Externally Managed

Global Equities	
BlackRock Fund B	300,857,011
Alternative Investments	
Ft. Washington Fund VII	2,238,277
Actis Global Fund IV	1,095,879
Landmark Equity XV	750,961
Ft. Washington Fund VIII	166,122
Additional Categories	
Fort Washington High Yield Bond Fund	65,430,375
Shenkman Capital Management	28,175,936
Highbridge Principal Strategies III	3,172,278
Marathon European Credit Opp Fund II	2,248,767
Subtotal	\$ 404,135,606
TOTAL ASSETS	\$ 491,933,225

* Detailed information concerning these fair values of all KTRS investments is available upon request.

Investment Summary
Fair Value – Medical Insurance Trust
 June 30, 2014

Type of Investment	Fair Value 06/30/13	Acquisitions	Appreciation (Depreciation)	Sales Redemptions, Maturities & Paydowns	Fair Value 06/30/14
Cash Equivalents	\$ 54,722,400	\$ 253,265,800	\$ -	\$ 236,854,600	\$ 71,133,600
Fixed Income	64,728,200	34,163,400	(175,800)	77,481,200	21,234,600
Equities	243,022,800	-	57,905,000	70,800	300,857,000
Alternative	1,255,700	3,069,000	479,600	553,100	4,251,200
Additional Categories	83,487,100	60,737,000	3,091,200	52,858,500	94,456,800
TOTAL	\$ 447,216,200	\$ 351,235,200	\$ 61,300,000	\$ 367,818,200	\$ 491,933,200

INVESTMENT SECTION

**Health Insurance Trust Fund
Contracted Investment
Management Expenses
Fiscal Year 2013-14
(in thousands)**

<u>Investment Counselor Fees</u>	<u>Assets Under Management</u>	<u>Expense</u>	<u>Basis Points ⁽¹⁾</u>
Equity Manager(s)	\$ 300,857	\$ 159	
Fixed Income Manager(s)			
Real Estate		12	
Additional Categories	99,027	271	
Alternative Investments ⁽²⁾	4,251	209	
TOTAL	\$ 404,135	\$ 651	16.1
Other Investment Services			
Custodian Fees	491,933	\$ 10	0.2
Consultant Fees			0.0
Legal & Research			0.0
Other Administrative and Operational		50	1.0
TOTAL	\$ 491,933	\$ 60	1.2
GRAND TOTAL		\$ 711	14.5

1 - One basis point is one hundredth of one percent or the equivalent of .0001.

2 - Accrual of fees payable as of June 30, 2014

3 - Private equity fees are either withheld from the Fund operations or paid by direct disbursement, depending on contract terms.

**Schedule of Contracted and Administrative Investment Expenses
Health Insurance Trust Fund
June 30, 2014**

INVESTMENT COUNSELOR FEES

EQUITY MANAGERS

BlackRock	158,797
Total Equity Managers	\$ 158,797

REAL ESTATE

Carlyle VII	11,507
Total Real Estate	\$ 11,507

ADDITIONAL CATEGORIES

Highbridge Principal Strategies Fund III,L.P.	27,859
Fort Washington Investmetns High Yield	124,836
Marathon European Credit Fund II	9,110
Shenkman Capital	109,593
Total Additional Category Managers	\$ 271,398

ALTERNATIVE INVESTMENTS

Actis Global Fund IV, L.P.	50,000
Alinda Core Fund III, L.P.	37,073
Fort Washington Fund VII, L.P.	37,500
Fort Washington Fund VIII, L.P.	13,747
Landmark Fund XV ,L.P.	70,719
Total Alternative Managers	\$ 209,039

ADMINISTRATIVE AND OPERATIONAL EXPENSES

CUSTODIAN

The Bank of New York Mellon	10,392
Total Custodian	\$ 10,392

LEGAL & RESEARCH

Ice Miller	-
Total Legal & Research	\$ -

OTHER

Other Administrative and Operational (includes Personnel, Subscription services, etc...)	49,950
Total Other	\$ 49,950

TOTAL INVESTMENT EXPENSES	\$ 711,083
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HEALTH INSURANCE TRUST PROFESSIONAL SERVICE PROVIDERS

Investment Consultant

Hewitt EnnisKnupp, Inc.

Investment Custodian

The Bank of New York Mellon

Additional Categories Managers

Ft. Washington Investment Advisors
Shenkman Capital Management, Inc
Highbridge Principal Strategies, LLC
Marathon Asset Management

Global Equity Manager

BlackRock Institutional Trust Company

Alternative Investment Managers

Ft. Washington Private Equity Investors
Actis LLP
Landmark Partners

Attorney

Ice Miller LLP

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