Investment Section

for Fiscal Year ending June 30, 2013

REPORT ON INVESTMENT ACTIVITY

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

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December 1, 2013

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

The KTRS investment program produced a total return of 14.1% in the twelve-month period ended June 30, 2013. This exceeded the policy benchmark return of 12.9% and ranked in the top 10% of returns of a universe of 62 pension funds with over $1 billion in assets. The outperformance was attributed to successful application of the program's strategic asset allocation policy and the strong relative performance of individual asset classes.

A relatively high weighting to equities, at 63.2% of assets as of June 30, drove the strong performance. The system's domestic equities returned 22.7% versus 21.1% for the S&P 1500 Index. The system's international equities returned 14.7% versus 14.1% for the MSCI All Country World (ex-U.S) Index. Gains were harvested from the equity allocation over the course of the fiscal year as rising prices pushed total market value near the top of the asset class's strategic range.

Fixed income returns were less attractive during the fiscal year, particularly at the end of the period as interest rates rose. The system's fixed income portfolio was resilient during the fiscal year, returning 0.7%, vs. the -0.6% return of Barclay's Government Credit Index, thanks to less interest rate risk exposure and greater exposure to corporate bonds, which outperformed government bonds. A reduced overall exposure to the asset class also helped overall returns as well. The program's allocation to fixed income declined from 31.1% of total assets as of June 30, 2010 to 21.3% as of June 30, 2013.

The program's alternative investments, which include real estate, private equity, and alternative credit strategies, also performed well over the fiscal year. Collectively, the strategies represented 13.1% of the total assets as of June 30. These growing allocations have absorbed the majority of the assets removed from fixed income in recent years.

Markets were heavily influenced by an unconventional Federal Reserve policy over the past fiscal year that kept interest rates at artificially low levels since the financial crisis of 2008. Near the end of the period, almost five years after the peak of the crisis, official talk of a foreseeable reduction in monetary stimulus sent interest rates upward and halted the equity markets' upward surge. The markets view an imminent reduction and eventual end to monetary stimulus with trepidation in light of a stronger financial system but soft economic growth.

Over the trailing five-year period, KTRS' investment returns rank in the top 7% of the pension fund universe cited earlier. We believe consistently strong relative returns in recent years have been the result of a successful implementation of a sound philosophy rooted in fundamental value and a "best practices" culture. This philosophy and process has led the investment program to respond well to changing investment opportunities and risks since the financial crisis.

As always, we are grateful to be a part of this process. We sincerely thank the Board of Trustees, Investment Committee, and investment staff for their continued confidence.

Respectfully,

Patrick J. Kelly

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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, 2013, and June 30, 2012, as well as the target and strategic range for each asset class for fiscal year 2013.

Retirement Annuity Trust

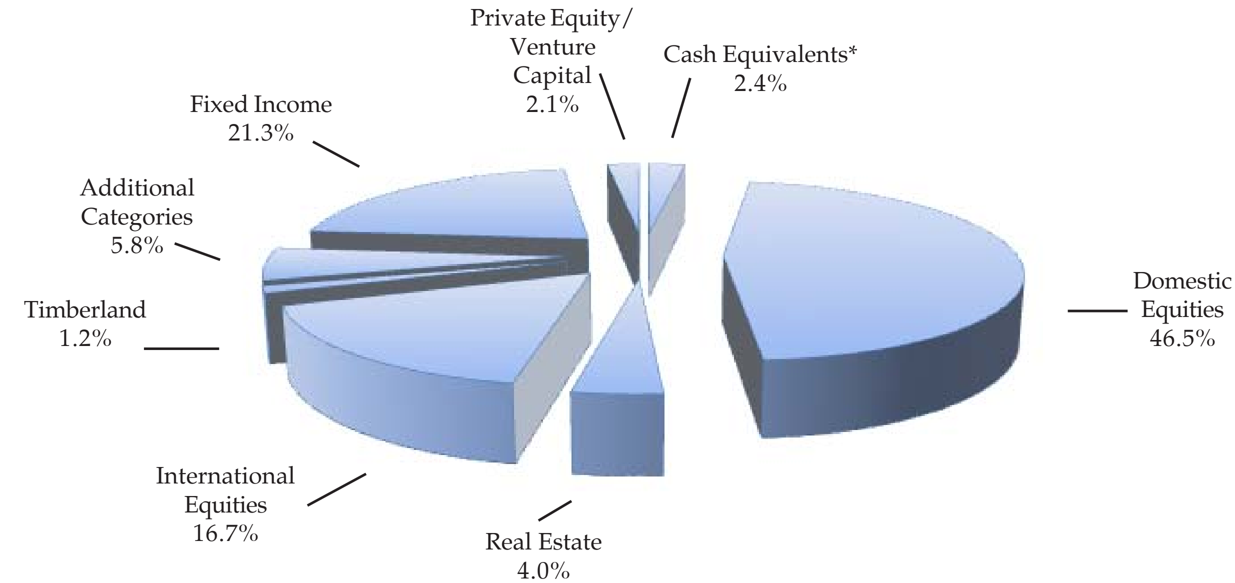
	June 30, 2013*	%	June 30, 2012	%
Cash Equivalents**	$ 386,683,234	2.4	$ 431,810,127	2.9
Fixed Income	3,434,080,377	21.3	3,391,777,780	23.0
Domestic Equities	7,511,572,763	46.5	7,044,415,411	47.5
International Equities	2,698,774,335	16.7	2,309,883,058	15.6
Real Estate	642,611,173	4.0	586,800,767	4.0
Private Equity	343,259,092	2.1	265,833,651	1.8
Timberland	197,480,029	1.2	185,432,686	1.2
Additional Categories	935,376,476	5.8	587,848,810	4.0
Totals	**$ 16,149,837,479**	**100.0**	**$ 14,803,802,290**	**100.0**

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

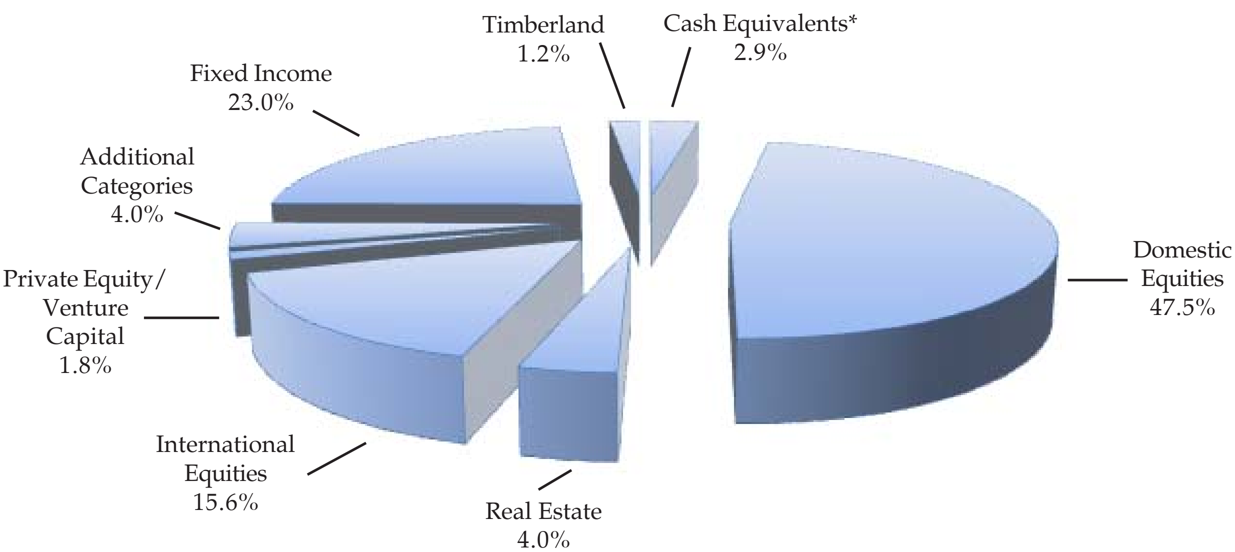
** Reflects only cash balances not allocated to other asset classes. Uninvested cash balances allocated to various asset classes are represented in the respective asset classes.

Distribution of Investments
Retirement Annuity Trust**
Fair Values

June 30, 2013



June 30, 2012



* 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)	6/30/2013 (Mkt)**
Cash		1 - 3%	2.0%	**2.4%**
Fixed Income		18 - 24	21.0	**21.3**
Government/Agency/Other	Unlimited			10.3
Corporate	35%			11.0
Equity	65%	58 - 65	62.0	**63.2**
Domestic Large Cap		35 - 45	40.0	39.5
Domestic Mid Cap		1 - 5	3.0	4.3
Domestic Small Cap		1 - 3	2.0	2.7
International***	30%	14 - 20	17.0	16.7
Real Estate	10%	2 - 6	4.0	**4.0**
Alternative Investments*	10%	2 - 8	5.0	**3.3**
Additional Categories	15%	3 - 9	6.0	**5.8**
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 6/30/13, 18.9% 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 14.1%, exceeding the policy benchmark return of 12.9%. Domestic equities returned 22.7% versus 21.1% for the Standard & Poor's 1500 Index, while international equities returned 14.7% versus 14.1% for the MSCI All Country World (Ex-US) Index. Fixed income investments outperformed, returning 0.7% versus -0.6% 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, 2013. 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.

	1 Yr(2)	3 Yr(2)	5 Yr(2)	10 Yr(2)	20 Yr(2)
Total Fund					
KTRS	14.1	12.4	6.6	6.4	7.3
Policy Index (1)	12.9	12.1	6.0	-	-
Equities					
Domestic Equities	22.7	18.7	7.4	7.7	9.1
S & P Blended Index (3)	21.1	18.6	7.3	7.5	8.7
International Equities (5)	14.7	9.9	1.6	-	-
MSCI AC World (Ex US)	14.1	8.5	-0.3	-	-
Total Equities	20.5	16.4	6.1	7.2	8.8
Fixed Income					
Total Fixed Income	0.7	5.0	6.7	5.2	6.3
Barclays Govt/Credit Index	-0.6	3.9	5.3	4.4	5.9
Real Estate					
Non-Core Real Estate	30.1	-	-	-	-
NCREIF Index	10.7	-	-	-	-
Core Real Estate	9.7	14.9	-2.6	-	-
NCREIF ODCE	12.0	14.9	-0.2	-	-
Triple Net Lease Real Estate	8.3	7.9	8.4	8.9	9.0
CPI plus 2%	3.8	4.4	3.4	4.5	4.4
Alternative Investments					
Private Equity (4)	8.7	14.0	10.4	-	-
Timberland	7.7	5.8	3.8	-	-
NCREIF Timberland Index	9.4	3.6	2.1	-	-
Cash					
Cash (Unallocated)	0.1	0.1	0.3	2.1	3.4
90 Day Treasury Bill	0.1	0.1	0.3	1.7	3.0
Additional Categories					
High Yield					
High Yield Bond Fund	8.8	10.6	-	-	-
B of A Merrill Lynch High Yield Master II	9.6	10.4	-	-	-
Alternative Credit					
Special Situations Fund	11.4	-	-	-	-
KTRS Credit Fund	21.8	-	-	-	-
B of A Merrill Lynch High Yield Master II	9.6	10.4	-	-	-

(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) 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.
(5) As of June 30, 2013, 18.9% of Total International Equities was invested in emerging markets.

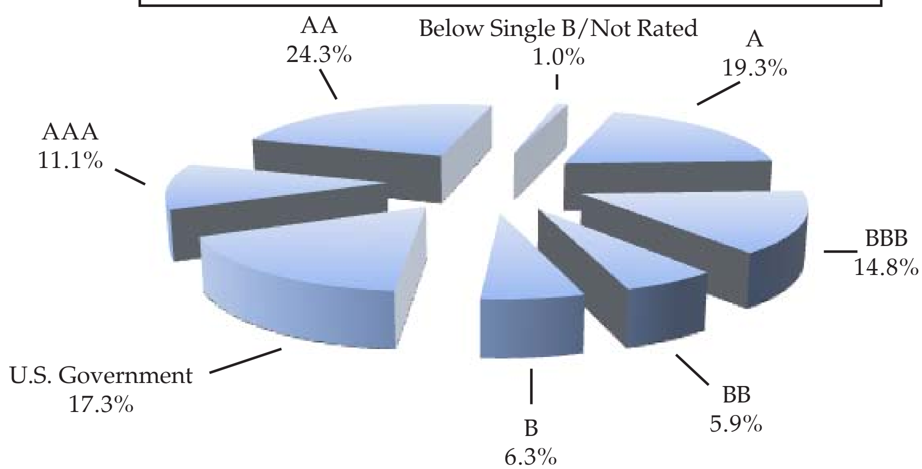
FIXED INCOME INVESTMENTS

As of June 30, 2013, the retirement annuity trust fund had approximately $3.43 billion, 21.3% 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, 2013.

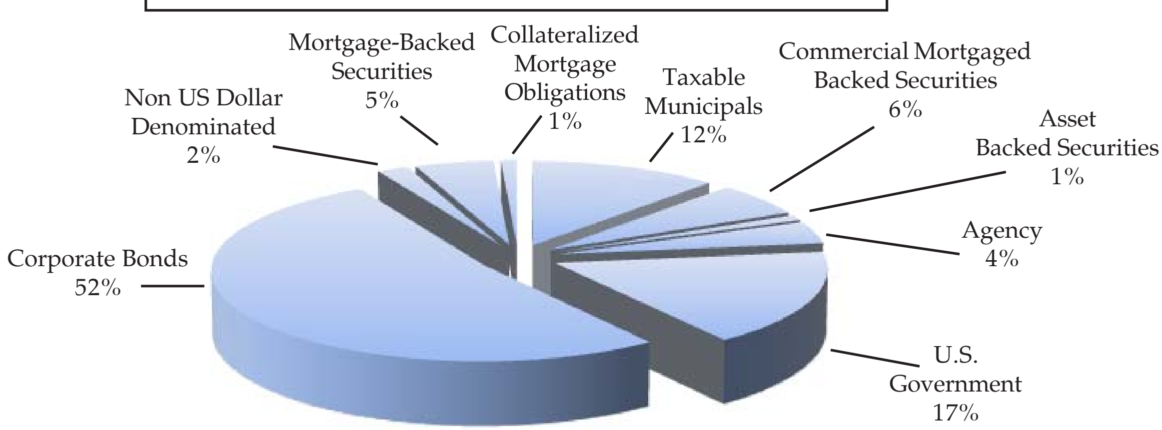
In addition, the retirement annuity trust fund had $935.38 million, 5.8% of total assets, in other debt related investments under a regulatory provision which allows for up to 15% of assets in "additional categories of investments" approved by the Board of Trustees. Investments under this authorization 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 QUALITY DISTRIBUTION



FIXED INCOME SECTOR DISTRIBUTION



FIXED INCOME MARKET OVERVIEW

Interest rates on U.S. Treasury bonds tended to drift higher over most of the fiscal year, spiking upward sharply in May and June, 2013 on expectations of an imminent reduction of the Federal Reserve's quantitative easing program. Prices generally declined, with the Barclays U.S. Government / Credit Index returning -0.6% for the fiscal year. The retirement annuity trust fund's investment grade bonds were more resilient, returning 0.7%. The outperformance was driven by less duration (interest rate risk) than the benchmark and an overweighting to corporate bonds, which substantially outperformed government bonds.

Prices of long-term bonds dropped more than those with shorter maturities as long term rates rose more than short term rates. The spread between the 30 year and 2 year Treasury widened to 314 basis points after starting the year at 240 basis points. Due to a narrowing of risk premiums, corporate bonds outperformed U.S. Treasuries of similar duration. The Barclays U.S. Government index declined by 1.5% over the year, and the Barclays Corporate Investment Grade Index produced a positive 1.4% return over the same time period. High Yield bonds performed very well returning 9.6% for the year as measured by the B of A Merrill Lynch High Yield Master II Index.

Gross Domestic Product (GDP) grew 1.6% for the fiscal year ended June 30, 2013. Inflation, as measured by the GDP price deflator rose 1.5% for the fiscal year. The economy added an average of 180,000 jobs per month according to the Bureau of Labor Statistics' non-farm payrolls report. Normally, these rates of increase would be considered a good environment for fixed income securities, but, given the low level of real interest rates to begin the fiscal year, the slow growth environment was already priced into the market. As has been the case since the economic recovery began in 2009, the performance of domestic fixed income markets was driven more by the influence of the Federal Reserve than by the traditional economic fundamentals of growth and inflation.

In June of 2012, the Federal Reserve announced it would extend its bond purchase program, commonly referred to as Operation Twist, through the end of calendar year 2012 by adding an additional $267 billion in long term bond purchases. When this program was completed in December of 2012, the Fed implemented another asset purchase program, pledging to purchase U.S. Treasury securities at an initial pace of $45 billion per month for an indefinite time period. This latest asset purchase program is unique as there was no definitive date targeted by the Federal Reserve for ending the Treasury purchases. In addition, the Fed indicated it would continue its existing program to purchase $40 billion per month in mortgage backed securities.

In its December 12, 2012 press release, the Fed outlined its rationale and expectations for the new asset purchase program. The Fed's statement indicated that it was concerned that "without sufficient policy accommodation, economic growth might not be strong enough to generate sustained improvement in labor market conditions", and that "these actions should maintain downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative".

Given the near term concerns outlined above, the Fed's asset purchase program was somewhat successful. The economy grew, albeit at a subdued pace, and continued to add jobs. Mortgage interest rates remained near historical lows while the median existing home sale price increased 18.8% from December 2012 to June 2013. The S & P 500 Index returned 15.3% from the Fed statement in December 2012 to the end of May 2013.

In May 2013 the Fed surprised the markets by suggesting that it may start to "taper" its program of purchasing Treasuries and mortgage backed securities. The market adjusted to this new guidance by pushing interest rates sharply higher, causing a substantial selloff in investment grade fixed income as the fiscal year came to a close.

Despite the recent increase in interest rates, the Fed's policy of keeping both short and longer term interest rates low has been supportive to many areas of the economy. However, low rates have left investment grade bond prices higher than they would otherwise be. Currently, 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, 2013 the retirement annuity trust fund's public equity investments had a fair value of $10.21 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 $7.51 billion as of June 30, representing 46.5% of total assets. This is a $467 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, 2013 was $2.7 billion, representing 16.7% of total assets, up from 15.6% 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 24 developed countries and 21 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 2013. The upward trend was fairly consistent, with hiccups only in the fall of 2012 and the early summer of 2013. Returns of domestic stocks as measured by the S&P 1500 and Russell 2000 were 21.13% and 24.21%, respectively. Within the S&P 1500, small and mid-cap stocks were up 25.18%, while the large-cap S&P 500 was up 20.60%. Non-U.S. stocks also performed very well on the year, but with higher volatility and a steeper pullback at the end of the year. The Morgan Stanley Capital International (MSCI) World (ex-U.S.) Index returned 17.62%. The MSCI Emerging Markets Index was up only 3.23%.

The domestic markets were propelled by rising payrolls and declining unemployment in the first half of the year. In September the FOMC announced its plan to purchase $40 billion per month of agency mortgage backed securities in addition to $45 billion of U.S. Treasury securities. While this kept key interest rates low, markets dipped on lower consumer confidence due to negative expectations for the economy. Financial stocks were the biggest winners in the first half, posting a 13.28% gain in the first six months. Internationally there was a similar story as the European Central Bank and the Bank of Japan also initiated quantitative easing programs in September. This news, however, was much better received internationally as the MSCI EAFE and ACWI ex US posted much stronger returns in the first half. European markets, which had been in turmoil due to the ongoing Eurozone crisis, were stabilized by the ECB's bond purchase program. Asia also experienced a favorable reaction to QE, led by Japan, whose stocks rose 5.3% in December alone.

The second half of the fiscal year continued an upward trend, as stocks rallied on better employment data and continued signs of strength in the manufacturing sector. Consumer confidence also made progress. Manufacturing was primarily led by a jump in the housing market. Increasing employment numbers coupled with low borrowing costs were the main drivers of the housing market. Stocks did see a slight pullback at the end of the fourth quarter of the fiscal year. In May, the Fed announced it may begin to "taper" its quantitative easing program later in the calendar year. Interest rates immediately spiked and money began to flow modestly away from equities. Internationally, emerging markets lagged due to China's slowing growth. Europe and Japan, however, continued to post gains on the heels of their respective central banks' QE programs.

Politically, the Presidential election dominated the headlines during the first half of the fiscal year. Concern over the growing national debt and national healthcare tempered investors' enthusiasm. Fortunately, the strong labor market and the rising manufacturing numbers were able to increase consumer confidence overall. Internationally, the ongoing European debt crisis and the slowdown in China dampened consumer confidence, but strong returns were still realized, driven by Europe and Japan.

In summary, we experienced a very strong equity market for the fiscal year. Small and mid cap domestics were 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 year, markets are wary going forward of any potential reduction or elimination of that stimulus.

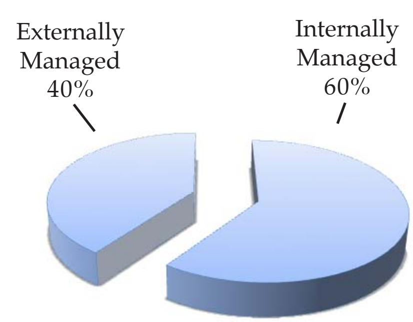
REAL ESTATE

The retirement annuity trust fund's real estate investments had a fair value of $642.6 million as of June 30, 2013, representing 4.0% 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 six 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 four real estate limited partnerships: Carlyle Realty Partners VI, Blackstone Real Estate Partners VII, Rockwood Capital Real Estate Fund IX, and TA Realty Associates Fund X. Going forward, investment staff will continue to opportunistically add to the annuity trust fund's real estate investments.

Real Estate Investments
$642.6 Million Fair Value
As of June 30, 2013



REAL ESTATE OVERVIEW

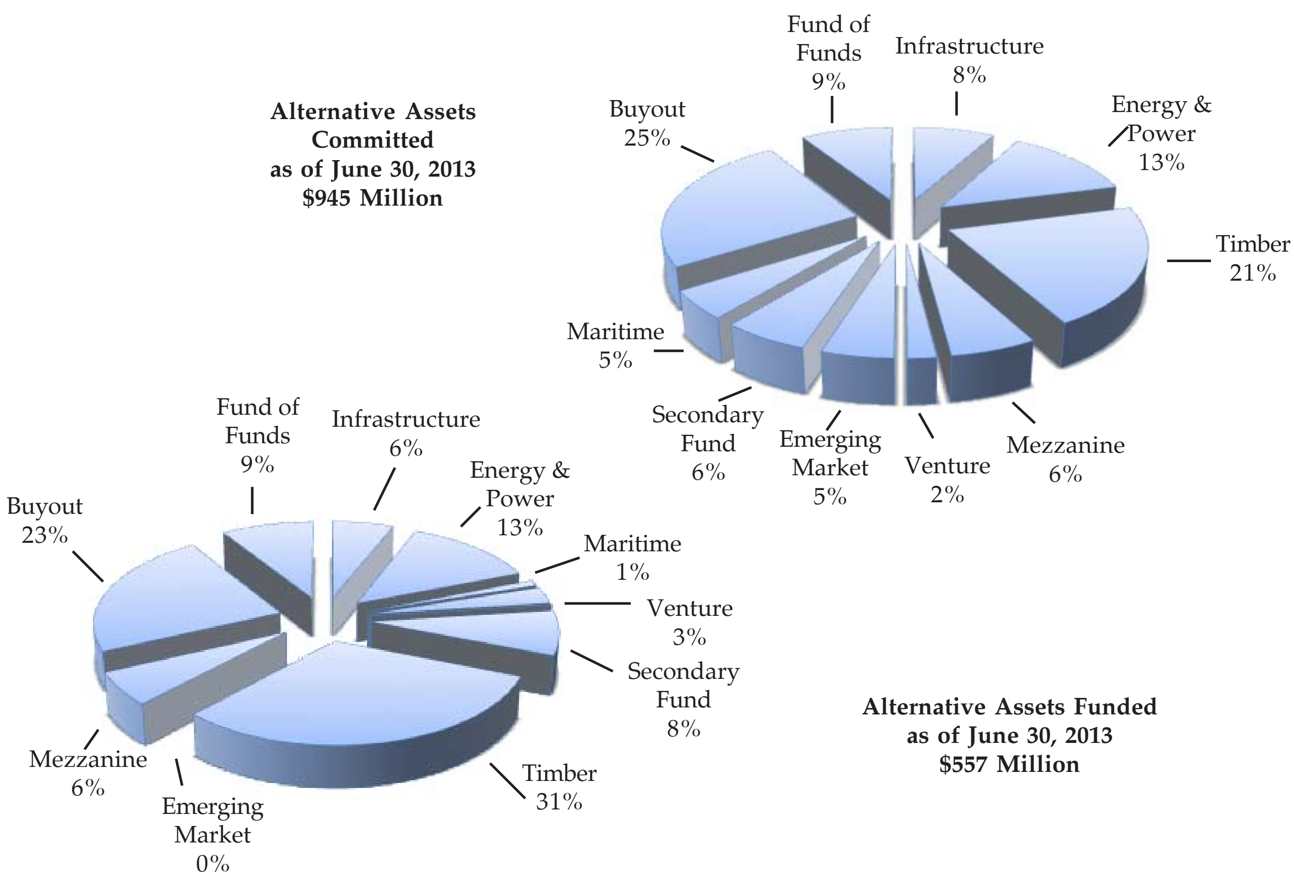
Investor demand for commercial real estate was quite strong during the fiscal year. Demand for core properties was especially robust with top-tier properties located in gateway markets commanding prices that are back to 2007 levels. Property values in secondary markets also got a boost as investors moved up the risk spectrum to capture more yield and financing became more readily available. Investor appetite for real estate investments should remain strong over the next year due to the sector's solid income yields and improving fundamentals.

According to Real Capital Analytics, $145.3 billion of properties traded in 2013 through June, an improvement of 24% from the same period in 2012. With construction completions at 50-year lows, there has been a lack of new supply in most sectors of the commercial real estate market. This lack of supply in conjunction with a moderately improving economy should provide a favorable environment for higher rents and lower vacancy rates. Property rents are expected to grow by 1% to 4% on average over the next year.

A growing area of opportunity for investors is in the real estate debt markets. An estimated $374 billion in commercial and multi-family mortgages will mature in 2013 while another $1.3 trillion in loans are expected to mature from 2014 to 2017. As borrowers look to refinance, this should provide non-traditional lenders of capital an opportunity to provide financing at attractive levels.

ALTERNATIVE ASSETS

As of June 30, 2013, the retirement annuity trust fund had committed $945 million to alternative investments and had funded $557 million of those commitments. The percentage of the retirement annuity trust fund's portfolio in alternative assets was 3.3%. 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 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 rebound from the effects of the financial crisis. Investors, especially on the institutional side, continue to increase their allocation to alternative investments, including private equity. However, fundraising continues to remain challenging for all but the top tier funds, with many funds extending their initial fundraising term. A strong equity market and low interest rates has allowed many private equity funds to exit their portfolio companies either through the IPO market or sales to strategic buyers. A strong IPO market remains the linchpin of the rebound in private equity.

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, 2013 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 owns 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

The improving U.S. housing market, continued demand from China, and the reduced supply of Canadian timber, have begun to have a positive impact on the U.S. timber market. Despite the usual pricing dips associated with late spring and summer, market fundamentals have continued to support a sustained recovery. During the second quarter of 2013, there was a flurry of announcements regarding increases in production capacity and new investments of capital by U.S. lumber and plywood facilities. 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 saw timber and ply logs are improving. In the U.S. South, prices for all products continued to strengthen. Normal weather patterns persisted throughout the winter, with rain events providing regional upticks in pulpwood stumpage as facilities liquidated stored on-site inventories.

RETIREMENT ANNUITY TRUST
PORTFOLIOS
FAIR VALUES *
June 30, 2013

Internally Managed

Cash Equivalents	
Cash Collections Fund (Unallocated)	$ 386,683,234
Fixed Income	
Intermediate Bond Fund	795,899,998
Broad Market Bond Fund	649,467,257
Long Term Bond Fund	520,333,595
Internal Bond Fund	326,217,515
Life Insurance Trust	88,623,343
Tax Shelter Fund	391,095
Equity	
S & P 500 Stock Index Fund (Large Cap)	2,633,692,407
S & P 400 Stock Index Fund (Mid Cap)	395,801,667
S & P 600 Stock Index Fund (Small Cap)	274,394,764
Real Estate	
Internally Managed Fund	387,422,184
Subtotal	$ 6,458,927,059

Externally Managed

Fixed Income	
Galliard Capital Management	529,404,800
Ft. Washington Broad Market	523,742,773
Domestic Equity	
Todd Asset Management (Large Cap Core)	1,247,098,155
UBS (Large Cap Value)	1,009,186,556
GE Asset Management (Large Cap Growth)	609,224,099
Wellington (Large Cap Core)	588,175,698
Wellington (Mid Cap Core)	293,729,796
Wellington (Small Cap Core)	161,246,606
Todd Asset Management Opportunity Fund	160,371,755
UBS (130/30)	138,651,261
International Equity	
Todd Asset Management International	764,861,378
Baillie Gifford EAFE Alpha	627,629,002
UBS All Country World ex US	495,487,967
Baring All Country World ex US	459,890,115
Blackrock All Country World ex US IMI	350,905,874

continued ...

RETIREMENT ANNUITY TRUST PORTFOLIOS continued ...
JUNE 30, 2013

Real Estate	
Prudential PRISA Fund	196,179,640
Blackstone Partners VII, LP	27,825,130
Carlyle Realty Partners VI	21,155,651
The Realty Associates Fund X	10,028,567
Rockwood Capital Real Estate Fund IX	1
Alternative Investments	
Molpus Woodlands Group Lake Superior Timberlands LLC	97,835,024
Molpus Seven States LLC	74,912,053
KKR & Co European Fund III	56,543,955
Riverstone/Carlyle E & P Fund IV	42,056,249
Alinda Infrastructure Fund II	31,537,771
Ft. Washington Fund VI	27,641,971
Hancock Bluegrass LLC - Oregon	24,732,952
KKR & Co Fund 2006	18,873,820
NGP Natural Resources X, LP	18,765,153
Landmark Equity Partners Fund XIV	18,606,867
Lexington Capital Partners Fund VII	18,437,263
Chrysalis Venture Fund III	17,184,268
Ft. Washington Fund V	13,615,257
Oaktree Mezzanine Fund III	13,248,259
Hellman & Friedman Fund VII	12,494,953
Stepstone Pioneer Capital Fund III, LP	10,676,201
Oaktree European Principal Fund III	10,157,366
Audax Mezzanine Fund III	9,871,455
Riverstone E & P Fund V	8,201,917
CapitalSouth Partners Fund III	4,533,801
J. P. Morgan Maritime Fund	3,243,342
Audax Private Equity Fund IV, LP	3,214,644
APAX VIII, LP	2,738,899
Actis Global Fund IV	1,607,674
Alinda Core I	8,007
Additional Categories	
Fort Washington High Yield Bond Fund	305,843,652
Shenkman Capital Management	232,452,630
Marathon KTRS/Credit Fund LP	174,213,019
Avenue Special Situations Fund VI	109,931,579
Rogge Global International Fixed Income	91,778,981
Highbridge Principal Strategies III	11,312,685
Oaktree Opportunities IX, LP	4,984,001
Marathon Legacy Securities PPIP	4,826,734
AG GECC PPIF, LP	33,194
Subtotal	**$ 9,690,910,420**
Total Assets	**$ 16,149,837,479**

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

Investment Summary
Fair Value – Retirement Annuity Trust*
June 30, 2013

Type of Investment	Fair Value 07/01/12	Acquisitions	Appreciation (Depreciation)	Sales Redemptions, Maturities & Paydowns	Fair Value 06/30/13
Cash Equivalents	$ 624,793,000	$ 3,665,519,800	$ -	$ 3,489,334,500	$ 800,978,300
Fixed Income	3,295,533,000	3,410,462,600	(111,041,000)	3,414,968,300	3,179,986,300
Equities	9,259,302,400	2,674,158,900	1,677,527,300	3,508,435,800	10,102,552,800
Real Estate	586,800,800	49,233,000	13,870,400	7,292,900	642,611,300
Alternative	451,266,300	110,612,900	17,538,500	38,678,600	540,739,100
Additional Categories	586,106,700	594,661,200	1,063,800	298,862,000	882,969,700
TOTAL	**$ 14,803,802,200**	**$ 10,504,648,400**	**$ 1,598,959,000**	**$ 10,757,572,100**	**$ 16,149,837,500**

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

Contracted Investment Management Expenses
Fiscal Year 2012-13
(in thousands of dollars)

Investment Counselor Fees	Assets Under Management	Expense	Basis Points (1)
Equity Manager(s)	$ 6,906,458	$ 12,109	
Fixed Income Manager(s)	1,053,148	448	
Real Estate	255,189	3,957	
Additional Categories	935,376	4,122	
Alternative Investments (2)	540,739	10,959	
Total	$ 9,690,910	$ 31,595	32.6
Other Investment Services			
Custodian Fees (3)	$ 16,150,347	$ 333	0.2
Consultant Fees		359	0.2
Legal & Research		156	0.1
Subscriptions/Services		700	0.4
Total	$ 16,150,347	$ 1,548	1.0
Grand Total		$ 33,143	**20.5**

(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.

Ten Largest Stock Holdings Ranked (1) (2)
by Fair Value
June 30, 2013

Rank	Description	Fair Value	Percentage of Equities
1	Apple Inc	140,776,477	1.752
2	JP Morgan Chase	115,322,289	1.435
3	Exxon Mobil Corp	113,519,444	1.413
4	Philip Morris Inc	100,467,939	1.250
5	Wells Fargo & Co	98,465,556	1.226
6	Google Inc CL A	95,260,436	1.186
7	Citigroup Inc	90,207,681	1.123
8	Microsoft Corp	84,672,939	1.054
9	Chevron Corp	77,297,676	0.962
10	Qualcomm Inc	72,744,506	0.905

Top Ten Fixed Income Holdings (2)
by Fair Value
June 30, 2013

Rank	Description	Maturity	Coupon	Par Value	Fair Value	Percent of Fixed Income
1	U S Treasury	4/30/2017	0.880	55,000,000	54,725,000	1.500
2	U S Treasury	5/31/2015	0.250	50,000,000	49,912,000	1.364
3	U S Treasury	5/15/2016	0.250	49,950,000	49,419,531	1.362
4	U S Treasury	4/30/2018	0.630	50,290,000	48,600,759	1.372
5	U S Treasury	5/15/2023	1.750	49,415,000	46,280,112	1.348
6	U S Treasury Bonds	8/15/2023	6.250	31,900,000	42,805,972	0.870
7	U S Treasury	1/15/2023	0.130	32,475,000	31,724,558	0.886
8	U S Treasury Bonds	8/15/2029	6.130	22,000,000	30,603,980	0.600
9	FNMA	7/01/2043	3.000	26,650,000	26,037,850	0.727
10	U S Treasury	3/31/2017	1.000	23,180,000	23,201,789	0.632

(1) Includes only actively managed separate accounts.
(2) Detailed information concerning these values along with book values and cost values of all KTRS investments is available upon request.

Transaction Commissions Fiscal Year 2012-13

COMPANIES	SHARES TRADED	COMMISSIONS	COMMISSION PER SHARE	% OF TOTAL
Academy Securities, Inc.	18,410	$ 720.90	$ 0.04	0.03 %
Allen & Co	1,400	1,411.20	1.01	0.05
Avondale Partners, LLC	25,655	939.51	0.04	0.03
B. Riley & Co. LLC	1,510	60.40	0.04	0.00
Barclays	1,475,278	50,318.74	0.03	1.79
Barclays Capital, London	1,200	12.00	0.01	0.00
Bay Crest Partners, LLC	4,010	160.40	0.04	0.01
BB & T Capital Markets	1,500	1,140.00	0.76	0.04
Blair, William & Co	44,383	1,696.48	0.04	0.06
BMO Capital Markets	17,100	684.00	0.04	0.02
BNP Paribas Securities Bond	36,410	1,456.40	0.04	0.05
BNY ConvergEX Group	6,053,748	110,036.70	0.02	3.92
Brean Murray, Carret & Co., LLC	10,380	415.20	0.04	0.01
BTIG	82,100	3,129.60	0.04	0.11
Burke & Quick Partners LLC	3,620	144.80	0.04	0.01
Cabrera Capital	20,320	802.45	0.04	0.03
Canaccord Genuity, Inc.	35,105	1,388.41	0.04	0.05
Cantor Fitzgerald & Co	35,490	1,547.55	0.04	0.06
CIBC Worldmarket	20,100	804.00	0.04	0.03
Citigroup Global	363,070	22,564.78	0.06	0.80
Cowen & Co	274,085	12,707.38	0.05	0.45
Credit Agricole Securities	27,470	997.94	0.04	0.04
Credit Research & Trading LLC	132,610	3,692.50	0.03	0.13
Credit Suisse Sec. LLC	3,161,651	118,937.19	0.04	4.23
Crowell Weedon & Co	98,185	3,927.40	0.04	0.14
CSI US Institutional (Calyon)	244,030	9,712.30	0.04	0.35
Cuttone & Co Inc	12,300	485.00	0.04	0.02
D A Davidson & Co	23,270	911.70	0.04	0.03
Dahlman Rose & Co LLC	14,930	597.20	0.04	0.02
Deutsche Bank	1,217,738	52,018.98	0.04	1.85
Dowling & Partners	3,860	154.40	0.04	0.01
Drexel Hamilton LLC	5,690	199.15	0.04	0.01
Evercore Group LLC	4,938	194.52	0.04	0.01
Fidelity Capital Markets	4,600	184.00	0.04	0.01
Fig Partners, LLC	28,840	1,153.60	0.04	0.04
First Kentucky Securities Corp	1,334,140	40,024.20	0.03	1.42
Freidman Billings	130,065	6,542.75	0.05	0.23
Goldman Sachs	3,030,494	116,895.54	0.04	4.16
Green Street Advisors	30,650	1,226.00	0.04	0.04
Imperial Capital	4,942	197.68	0.04	0.01
Instinet	26,420	264.20	0.01	0.01
Investment Tech Grp Transition	23,741,366	230,536.44	0.01	8.21
Investment Technology Grp	23,942,525	345,076.51	0.01	12.28
ISI Group	3,333,962	96,959.83	0.03	3.45
J.J.B. Hilliard, W.L. Lyons	3,094,796	92,843.88	0.03	3.30
Janney Montgomery Scott Inc	173,170	5,212.30	0.03	0.19
Jefferies & Co.	576,622	12,096.68	0.02	0.43
JMP Securities	7,400	296.00	0.04	0.01
Jones & Associates	87,910	3,545.40	0.04	0.13
JP Morgan & Chase	643,306	42,235.41	0.07	1.50
Keefe Bruyette & Woods	46,880	1,875.20	0.04	0.07
Keybanc Capital	53,390	2,084.00	0.04	0.07
King, CL, & Associates, Inc.	49,970	1,998.80	0.04	0.07
Knight Equity Markets	41,250	1,057.40	0.03	0.04
Lazard Freres & Co.	3,847,179	115,722.70	0.03	4.12
Leerink Swann & Co.	82,830	3,334.45	0.04	0.12
Lexington Investment Co.	611,500	18,345.00	0.03	0.65
Liquidnet Inc	18,385,361	170,743.57	0.01	6.08
Liquidnet Inc - Transition	5,753,200	43,149.00	0.01	1.54

Transaction Commissions continued . . .

COMPANIES	SHARES TRADED	COMMISSIONS	COMMISSION PER SHARE	% OF TOTAL
Longbow Securities LLC	62,770	2,510.80	0.04	0.09
Loop Capital Markets, LLC	9,270	168.60	0.02	0.01
MacQuarie Securities Inc Total	36,890	1,475.60	0.04	0.05
Merrill Lynch	5,481,270	121,746.59	0.02	4.33
Merrill Lynch, Pierce, Fenner	81,310	3,072.95	0.04	0.11
Miller Tabak & Co. LLC	22,530	901.20	0.04	0.03
Mizuho Securities, USA	79,390	2,986.35	0.04	0.11
MKM Partners	26,860	1,074.40	0.04	0.04
Morgan Keegan	2,566,520	76,995.60	0.03	2.74
Morgan Stanley	709,638	26,190.99	0.04	0.93
Morgan Stanley Smith Barney-Huntington	2,306,600	69,198.00	0.03	2.46
Morgan Stanley Smith Barney-Louisville	2,436,910	73,107.30	0.03	2.60
Morgan Stanley Smith Barney-Northern KY	2,907,190	87,215.70	0.03	3.10
Needham	19,680	787.20	0.04	0.03
Nomura Securities Intrntl Inc	4,000	160.00	0.04	0.01
OTA Limited Partners	11,890	475.60	0.04	0.02
Pacific Crest Securities	44,185	1,767.40	0.04	0.06
Pershing LLC	25,190	1,007.60	0.04	0.04
Piper Jaffray	82,198	3,249.08	0.04	0.12
Pulse Trading	8,420	84.20	0.01	0.00
R W Baird	359,855	12,428.37	0.03	0.44
Raymond James & Assoc	5,392,070	179,638.36	0.03	6.39
RBC Capital Markets	394,016	15,767.59	0.04	0.56
Rosenblatt Securities LLC	13,590	168.90	0.01	0.01
Ross Sinclaire & Assoc	720,200	21,606.00	0.03	0.77
Sandler O'Neill	31,080	1,087.80	0.04	0.04
Sanford C Bernstein	581,468	7,968.53	0.01	0.28
Scotia Capital, USA	9,200	368.00	0.04	0.01
SG AMERICAS SECURITIES	30,000	1,350.00	0.05	0.05
Sidoti & Company LLC	25,400	991.60	0.04	0.04
Simmons & Co	18,970	758.80	0.04	0.03
State Street Global	50,150	1,515.00	0.03	0.05
Stephens Inc.	21,545	855.80	0.04	0.03
Sterne, Agee & Leach	118,890	4,370.85	0.04	0.16
Stifel, Nicolaus & Co	2,072,190	67,386.59	0.03	2.40
Stifel, Nicolaus & Co-Louisville	690,440	20,713.20	0.03	0.74
Suntrust Robinson	41,130	4,039.30	0.10	0.14
Susquehanna Brokerage	118,730	4,732.70	0.04	0.17
Telsey Advisory Group LLC	106,133	4,056.36	0.04	0.14
The Benchmark Company LLC	10,580	450.00	0.04	0.02
UBS/Paine Webber Securities	763,396	15,683.36	0.02	0.56
UBS/Paine Webber-Louisville	2,539,990	76,199.70	0.03	2.71
Wedbush Morgan Securities	9,840	393.60	0.04	0.01
Weeden & Co	3,949,505	118,655.18	0.03	4.22
Wells Fargo Securities, LLC	181,012	16,011.22	0.09	0.57
Williams Capital Group	7,070	282.80	0.04	0.01
Zacks & Company	600	24.00	0.04	0.00
TOTAL	**137,714,075**	**$ 2,809,248.49**	**$ 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 2012-13, the retirement annuity trust fund bought small capitalization IPOs that generated $239,941 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 $2,809,248. 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. On occasion, investment companies direct third party research to active clients. The primary research provideres were: Bloomberg, Interactive Data, Segal Rogers Casey, ISS, QED Financial Systems, and Thomson Financial.

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 $1.5 billion in benefits are distributed to members and annuitants living in Kentucky annually. Approximately $318 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

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

Additional Categories Investment Managers
AG GECC PPIF GP, LLC
Avenue Capital Group
Marathon Asset Management
Ft. Washington Investment Advisors
Oaktree Capital Management
Shenkman Capital Management, Inc
Rogge Global Partners
Highbridge Principal Strategies, LLC

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, 2013, the health insurance trust fund had approximately $447.2 million in total assets. This included $39.5 million in cash and $76.9 million in short-term high quality bonds for liquidity purposes. This trust fund also had $59.2 million in high yield bonds, $243.0 million in a global stock index fund, $1.3 million in private equity investments, $26.2 million in bank loans, and $1.1 million in an alternative credit fund.

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 fair value as of June 30, 2013 and June 30, 2012.

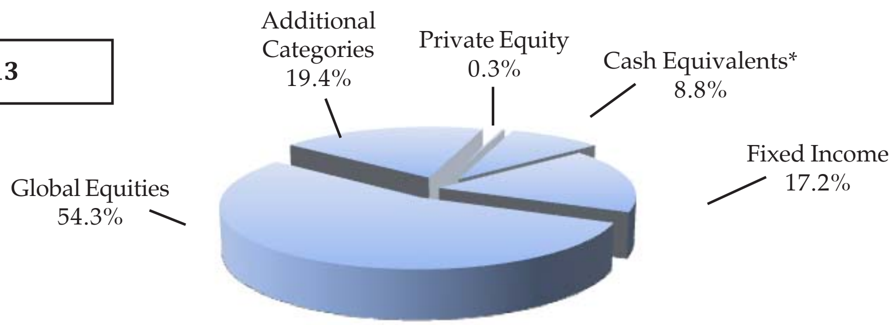
Health Insurance Trust

	June 30, 2013	%	June 30, 2012	%
Cash Equivalents *	$ 39,455,381	8.8	$ 22,265,278	6.8
Fixed Income	76,930,328	17.2	164,189,966	50.1
Global Equities	243,022,751	54.3	140,740,861	42.9
Additional Categories	86,551,982	19.4	-0-	0.0
Private Equity	1,255,715	0.3	748,103	0.2
Totals	**$ 447,216,157**	**100.0**	**$ 327,944,208**	**100.0**

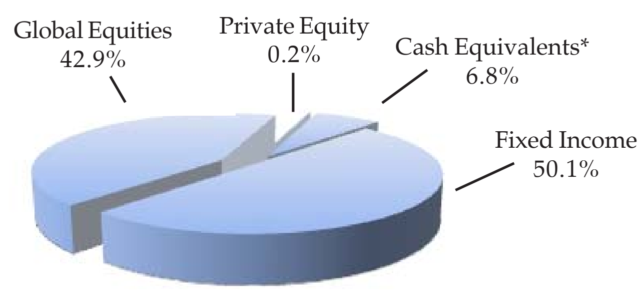
* Reflects only cash balances not allocated to other asset classes. Uninvested cash balances allocated to various asset classes are represented in the respective asset classes.

Distribution of Investments Health Insurance Trust Fair Values

June 30, 2013



June 30, 2012



** 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.*

HEALTH INSURANCE TRUST

PORTFOLIO RETURNS

For the fiscal year, the health insurance trust fund's portfolio returned 10.1%. The fund's global equities returned 17.6% versus 17.1% for the MSCI All country World IMI Index. A short-term bond fund held for liquidity purposes returned 0.1%. A high yield bond fund returned 8.8% versus 9.6% 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.

	1 Yr. (1)	3 Yr. (1)	5 Yr. (1)	10 Yr. (1)	20 Yr. (1)
Total Fund					
KTRS Health Insurance Trust	10.1	-	-	-	-
Equities					
Global Equities	17.6	-	-	-	-
MSCI AC World IMI	17.1	-	-	-	-
Fixed Income					
Internal Bond Fund	0.1	-	-	-	-
90 Day Treasury Bill	0.1	-	-	-	-
Alternative Investments					
Private Equity (2)	40.1	-	-	-	-
Additional Categories					
High Yield Bond Fund	8.8	-	-	-	-
B of A Merrill Lynch High Yield Master II	9.6	-	-	-	-
Shenkman Capital Management	-	-	-	-	-
Highbridge Principal Strategies III	-	-	-		-
S & P LSTA Leverage Loan Index	-	-	-	-	-
Cash					
Cash (Unallocated)	0.1	-	-	-	-
90 Day Treasury Bill	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.*

HEALTH INSURANCE TRUST
PORTFOLIOS
FAIR VALUES *
June 30, 2013

Internally Managed

Cash Equivalents	
Cash Collections Fund	$ 39,455,381
Fixed Income	
Internal Bond Fund	76,930,328
Subtotal	116,385,709

Externally Managed

Global Equities	
BlackRock Fund B	243,022,751
Alternative Investments	
Ft. Washington Fund VII	1,096,647
Actis Global Fund IV	157,467
Alinda Core Fund I	1,601
Additional Categories	
Ft. Washington High Yield Bond Fund	59,184,982
Shenkman Capital Management	26,235,731
Highbridge Principal Strategies III	1,131,269
Subtotal	**330,830,448**
Total Assets	**$ 447,216,157**

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

Investment Summary
Fair Value – Medical Insurance Trust
June 30, 2013

Type of Investment	Fair Value 07/1/2012	Acquisitions	Appreciation (Depreciation)	Sales Redemptions, Maturities & Paydowns	Fair Value 06/30/13
Cash Equivalents	$ 46,051,900	$ 566,757,800	$ -	$ 558,087,300	$ 54,722,400
Fixed Income	87,375,500	71,955,100	(533,300)	94,069,100	64,728,200
Real Estate	-	-	-	-	-
Equities	140,740,900	77,004,700	25,277,200	-	243,022,800
Alternative	748,100	1,126,500	69,600	688,500	1,255,700
Additional Categories	53,027,900	61,167,900	617,900	31,326,600	83,487,100
TOTAL	$ 327,944,200	$ 778,012,000	$ 25,431,400	$ 684,171,400	$ 447,216,200

Health Insurance Trust Fund
Contracted Investment
Management Expenses
Fiscal Year 2012-13
(in thousands of dollars)

Investment Counselor Fees	Assets Under Management	Expense	Basis Points [1]
Equity Manager(s)	$ 243,023	$ 112	
Fixed Income Manager(s)	0	0	
Additional Categories	86,552	152	
Alternative Investments [2]	1,256	284	
Total	$ 330,831	$ 548	16.6
Other Investment Services			
Custodian Fees	447,216	$ 7	0.2
Consultant Fees		0	0.0
Legal & Research		0	0.0
Subscriptions/Services		1	0.0
Total	$ 447,216	$ 8	0.2
Grand Total		$ 556	**12.4**

(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."

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

Global Equity Manager
BlackRock Institutional Trust Company

Alternative Investment Managers
Ft. Washington Private Equity Investors
Actis LLP
Alinda Capital Partners, LLC

Attorney
Ice Miller LLP