



Chicago Teachers' Pension Fund

## Executive Summary

**June 30, 2011**

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**Public School Teachers' Pension and Retirement Fund of Chicago  
Performance Evaluation Executive Summary  
Second Quarter 2011**

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**General Market & Economic Conditions**

The U.S. economy sputtered in the 2nd quarter causing investors to shun equities in favor of fixed income securities. Headlines on two topics of great importance to Main Street, unemployment and housing, were largely negative during the quarter. Job growth remained anemic and the jobs report in early June showed a reversal of the recent declines in the unemployment rate. Joblessness crept slightly higher to 9.1%; and while jobs are still being created, the very slow pace of growth is below that which is necessary to absorb new entrants to the labor force. In addition, the residential housing market, debate over the federal debt limit and future inflation continued to concern market participants

Contrary to the seemingly ominous news on Main Street and in political capitals around the world, Corporate America appears to be reasonably stable. Corporate profits are at the all-time high levels of 2007 and margins remain elevated as the severe cost cutting of 2008-2009 has not been wholly reversed through new hiring and capital expenditures. Contrary to the debt crises at the sovereign level, many corporations have taken advantage of historically low rates to access debt markets at very favorable terms. Issuance of 100-year bonds made headlines as did several "Web 2.0" IPOs such as LinkedIn, Groupon and potentially Facebook.

**Second Quarter 2011: Market Performance**

Within the U.S. equity markets, results were mixed as the late-June rally brought most indices back to roughly flat for the quarter. The S&P 500 rose 10 bps while the Russell 3000 fell fractionally. Growth outperformed value across capitalizations, with the disparity largest in midcap companies (R1G: +0.8% vs. R1V: -0.5%, RMG: +1.6% vs. RMV: -0.7%, R2G: -0.6% vs. R2V: 2.7%). From a capitalization perspective, midcap slightly eclipsed large cap while smaller stocks trailed notably and microcaps lost more than 3% (Russell 2000: -1.6%, Russell Midcap: +0.4%, Russell 1000: +0.1%). Looking at results from the S&P 500 quality indices, high quality enjoyed a wide premium over lower quality (S&P LQ: -2.4%, S&P HQ: +3.3%). Despite the recent outperformance of high quality issues, low quality still enjoys a 5% advantage over the past 12 months. Within the GICS classification of the S&P 500, falling oil prices dragged Energy stocks down by 5% and weakness in the banking industry pulled Financial stocks down by more than 6%. Defensive sectors such as Health Care, Consumer Staples, and Utilities were the best performers among the S&P sectors with mid-single digit gains.

Developed foreign equity markets performed slightly better than their US counterparts while emerging market equities trailed (EAFE: +1.6%, EM: -1.0%). Despite the 11th hour parliamentary votes that paved the way for Greece to receive another round of bailout funding, its equity market was the worst performing country in the EAFE index (MSCI Greece: -16.5%) while New Zealand (+11.3%) was the strongest performer in the index. Like U.S. equities, international style indices were tilted toward growth, and foreign small caps trailed their larger siblings (EAFE Growth: +2.1%, Value: +1.0%, Small Cap: +0.8%). Emerging markets struggled with the market volatility and rising inflation fears and could not keep up with developed markets. South American markets of Peru and Chile bookended the country performance in the emerging world (MSCI Peru: -15.2%, MSCI Chile: +8.8%).

To round out equity performance, securitized real estate performed better than most broad equity markets for the quarter due to strong returns in April and May. The NAREIT Equity Index rose 2.9% in the quarter.

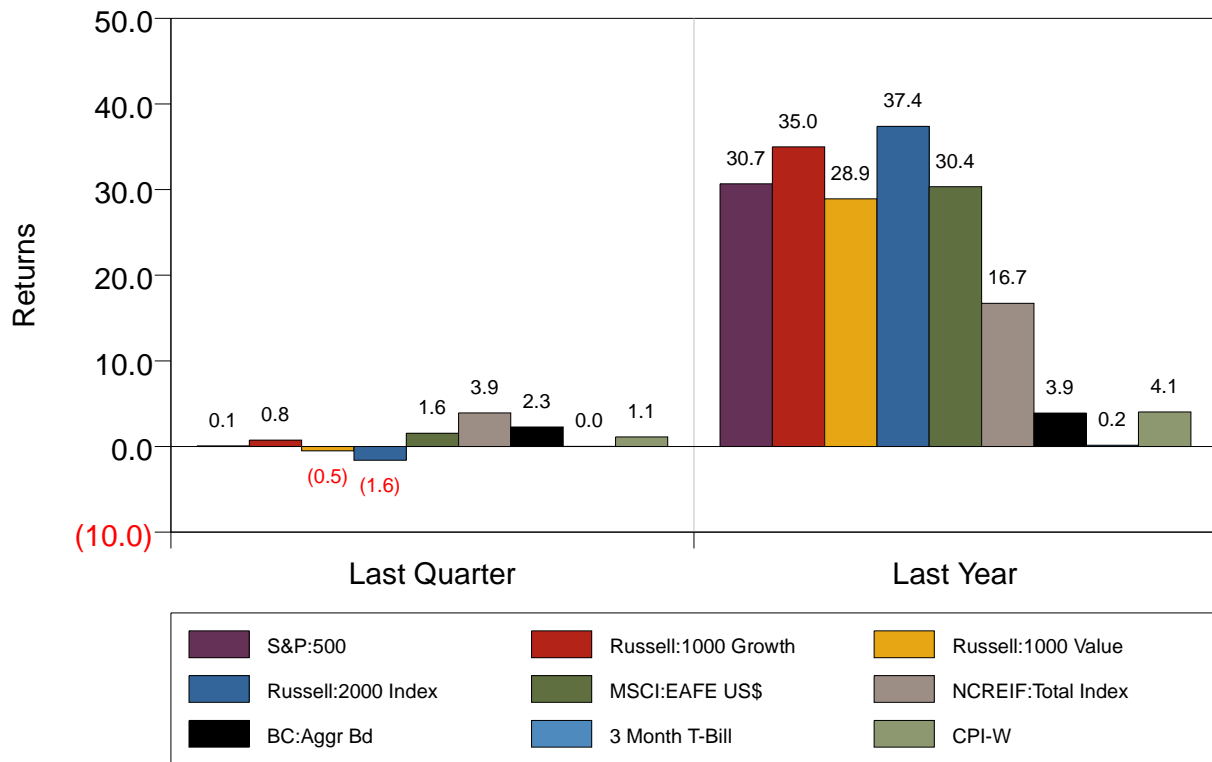
The 2nd quarter saw a sharp drop in interest rates in spite of a reversal in the last few days of the quarter. After opening in April at around 3.5%, the 10-year US Treasury yield fell to as low as

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2.88% before closing around 3.15%. As a result of the drop in rates, the BC Aggregate (+2.3%) index rose and long-dated government-related paper posted the strongest gains. The US dollar weakened versus developed world currencies pushing foreign sovereign fixed income results ahead in local terms versus hedged results (Citi Non-US WGBI Hedged: +1.3%, Unhedged: +3.7%). Further down the credit quality spectrum, high yield bonds (BC HY Cash Pay: +1.0%) trailed investment grade issues as risk aversion resurfaced. However, emerging market debt continued to perform well on the back of relatively strong growth expectation indicators (JPM EMBI+: +4.3%). Municipal bonds were relatively strong performers (BC Muni Index +3.9%) as supply remained muted and investors were attracted to the sector's attractive valuations amid less negative headline news.

The global rally in equity markets is now over two years old and based on classic valuation measures, equities appear reasonably valued on an historical basis. The S&P is trading at about 13.5x forward earnings; well below the 15-year average of 17x. Despite strong results across asset classes since the beginning of 2009, the global economic environment remains cloudy. Government deficits threaten to strain growth and recession-fighting monetary and fiscal policy may well spur inflation. Acknowledging these risks, Callan continues to recommend prudent asset allocation and risk assessment based on future capital needs for both plan sponsors and individual investors. Due diligence reviews and an adherence to a well-developed investment policy remain the most prudent long-term course for investors.

**Returns  
Quarter Ending June 30, 2011**



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**Total Fund Commentary**

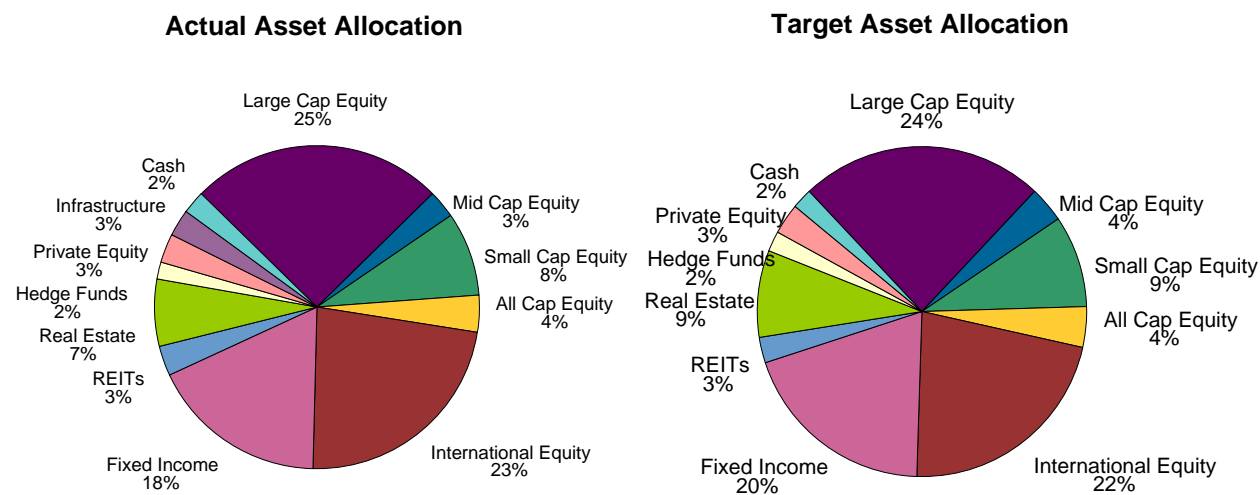
The Total Fund returned 4.41% net of fees, during the quarter, outperforming the Total Fund Benchmark by 23 basis points and ranking in the 9<sup>th</sup> percentile of Large Public Funds. Over the trailing one-year period, the Fund outperformed the benchmark and ranked well above the peer group median. The long term results, (3- and 5-year periods), of Fund performance are below the Total Fund Benchmark. Over the past quarter, most segments of the Fund performed well, with the exception, of the international equity and REIT segments.

The Fund's domestic equity composite outpaced the Russell 3000 Index and ranked well above the universe median during the quarter. The Fund's international equity composite underperformed the benchmark and ranked in the fourth quartile. The fixed income composite outperformed the Barclays Capital Aggregate Index but ranked below the universe median. The hedge fund composite outperformed the benchmark and ranked well above the universe median during the quarter. Over the trailing five-years, the domestic equity composite underperformed the benchmark but ranked above the universe median. The international equity composite underperformed its benchmark over the trailing five-year period and ranked above the universe median. The fixed income composite was ahead of its benchmark and ranked just below the universe median.

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**Asset Allocation**

The Fund was valued at \$10.3 billion at the end of the second quarter, representing a net increase in assets of \$226.1 million since the end of the first quarter 2010. The Fund generated \$164.9 million in investment earnings while \$97.1 million was withdrawn for benefit payments.



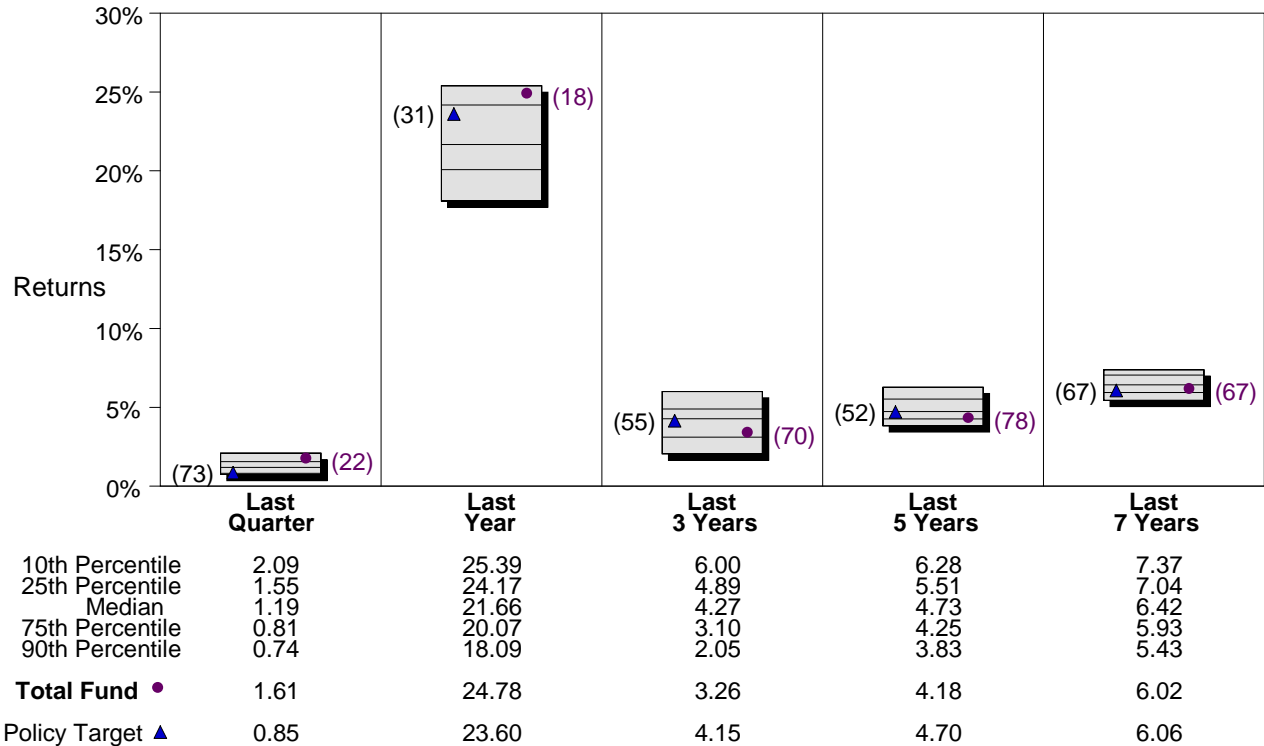
Asset Class	\$Millions Actual	Percent Actual	Percent Target	Percent Difference	\$Millions Difference
Large Cap Equity	2,605	25.3%	24.0%	1.3%	136
Mid Cap Equity	288	2.8%	3.5%	(0.7%)	(72)
Small Cap Equity	859	8.4%	9.0%	(0.6%)	(66)
All Cap Equity	379	3.7%	4.0%	(0.3%)	(32)
International Equity	2,356	22.9%	22.0%	0.9%	94
Fixed Income	1,815	17.7%	19.5%	(1.8%)	(190)
REITs	304	3.0%	2.5%	0.5%	47
Real Estate	691	6.7%	8.5%	(1.8%)	(183)
Hedge Funds	178	1.7%	2.0%	(0.3%)	(28)
Private Equity	295	2.9%	3.0%	(0.1%)	(14)
Infrastructure	280	2.7%	0.0%	2.7%	280
Cash	233	2.3%	2.0%	0.3%	27
<b>Total</b>	<b>10,284</b>	<b>100.0%</b>	<b>100.0%</b>		

The revised asset allocation was adopted on February 17, 2011. Callan and Staff will continue to adjust the target asset allocation as assets are transferred. The target asset allocation that was adopted is: U.S. Equity 31.25%, International Equity 31.25%, Fixed Income 19.5%, REITs 2.5%, Real Estate 6.5%, Infrastructure 2.0%, Hedge Funds 2.0%, Private Equity 3.0% and Cash 2.0%.

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**Total Fund Performance vs. Target**

**CAI Public Fund - Large (>1B)**

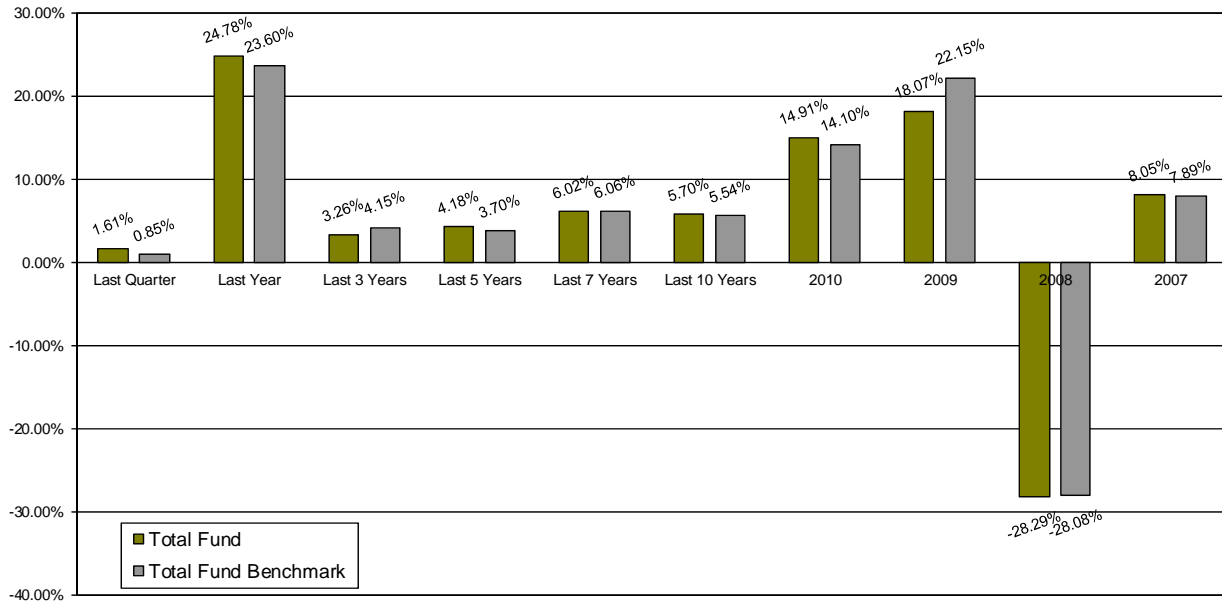


In the second quarter of 2011, the Fund outperformed the Policy Target by 76 basis points and ranked in the 22nd percentile of Public Fund peers. The international equity segment contributed the most to total fund returns. Of the seven international equity mandates in the CTPF portfolio, all but one, Earnest Partners, outperformed their respective benchmarks. Ariel and DFA were the notable detractors from performance in the second quarter as both trailed the Russell 2000 Index.

Performance over the trailing one-year has been favorable. The Fund returned 24.78%, outperforming the Policy Target by 118 basis points and ranking in the 18th percentile of peers. The outperformance of the Fund over the past year was result of good relative performance from all segments of the Fund. All composites outperformed their passive targets with the exception of the REIT composite, which trailed the NCREIF Index by 48 basis points gross of fees.

Performance over the three year period trailed the Policy Target by 89 basis points and five year performance lagged the benchmark by 52 basis points.

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Note: Performance is shown gross of fees

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**Manager Performance**

Table I presents returns for the public market domestic equity, fixed income and real estate managers and composites in the Chicago Teacher Pension Fund relative to their appropriate benchmarks.

**Table I:**

CTPF Investment Options	Total Returns as of 6/30/2011			
FUND	2nd Qtr	1 Yr	3 Yr	5 Yr
<b>Fixed Income</b>				
<b>Northern Trust Gov/ Credit Index Fund</b>	<b>2.31</b>	<b>3.69</b>	<b>6.22</b>	<b>6.50</b>
Barclays Gov/Credit Index	2.32	3.68	6.17	6.35
Variance	-0.01	0.01	0.05	0.15
Peer Ranking – CAI Core Bond	23	95	89	72
<b>Garcia Hamilton</b>	<b>1.85</b>	<b>-</b>	<b>-</b>	<b>-</b>
Barclays Aggregate Index	2.29	-	-	-
Variance	-0.44	-	-	-
Peer Ranking – CAI Core Bond	97	-	-	-
<b>LM Capital</b>	<b>2.57</b>	<b>4.16</b>	<b>7.36</b>	<b>7.10</b>
Barclays Aggregate Index	2.29	3.90	6.46	6.52
Variance	0.28	0.26	0.90	0.58
Peer Ranking - CAI Core Bond	3	79	53	42
<b>Pugh Capital Management</b>	<b>2.51</b>	<b>-</b>	<b>-</b>	<b>-</b>
Barclays Aggregate Index	2.29	-	-	-
Variance	0.22	-	-	-
Peer Ranking - CAI Core Bond	5	-	-	-
<b>Taplin, Canida &amp; Habacht</b>	<b>2.19</b>	<b>5.22</b>	<b>6.14</b>	<b>5.45</b>
Barclays Aggregate Index	2.29	3.90	6.46	6.52
Variance	-0.10	1.32	-0.32	-1.07
Peer Ranking - CAI Core Bond	51	34	89	92
<b>Western Asset Management</b>	<b>1.83</b>	<b>8.39</b>	<b>9.18</b>	<b>6.85</b>
Barclays Aggregate Index	2.29	3.90	6.46	6.52
Variance	-0.46	4.49	2.72	0.33
Peer Ranking - CAI Core Plus Bond	86	16	31	61

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**Table I:**

<b>FUND</b>	<b>Total Returns as of 6/30/2011</b>			
	<b>2nd Qtr</b>	<b>1 Yr</b>	<b>3 Yr</b>	<b>5 Yr</b>
<b>CTPF Investment Options</b>				
<b>Large Cap Equity</b>				
<b>Northern Trust S&amp;P 500 Index Fund</b>	<b>0.11</b>	<b>30.92</b>	<b>3.43</b>	<b>2.97</b>
S&P 500 Index	0.10	30.69	3.34	2.94
Variance	0.01	0.23	0.09	0.03
Peer Ranking – CAI Large Cap	47	59	52	61
<b>Rhumblin Russell 1000 Index Fund</b>	<b>0.17</b>	<b>31.97</b>	<b>3.80</b>	<b>-</b>
Russell 1000 Index	0.12	31.93	3.68	-
Variance	0.05	0.04	0.12	-
Peer Ranking – CAI Large Cap	45	49	45	-
<b>New Amsterdam</b>	<b>0.72</b>	<b>35.56</b>	<b>3.41</b>	<b>2.49</b>
Russell 1000 Index	0.12	31.93	3.68	3.30
Variance	0.60	3.63	-0.27	-0.81
Peer Ranking - CAI Large Cap Core	32	10	55	89
<b>Piedmont Investment Advisors</b>	<b>0.12</b>	<b>27.82</b>	<b>1.33</b>	<b>-</b>
Russell 1000 Index	0.12	31.93	3.68	-
Variance	0.00	-4.11	-2.35	-
Peer Ranking - CAI Large Cap Core	58	85	92	
<b>Waddell &amp; Reed</b>	<b>0.56</b>	<b>37.76</b>	<b>5.41</b>	<b>5.74</b>
Russell 1000 Index	0.12	31.93	3.68	3.30
Variance	0.44	5.83	1.73	2.44
Peer Ranking - CAI Large Cap Core	36	2	9	6
<b>Holland Capital</b>	<b>1.79</b>	<b>33.75</b>	<b>7.10</b>	<b>6.59</b>
Russell 1000 Growth Index	0.76	35.01	5.01	5.33
Variance	1.03	-1.26	2.09	1.26
Peer Ranking - CAI Large Cap Growth	18	56	9	21
<b>Rhumblin Russell 1000 Growth Index Fund</b>	<b>0.80</b>	<b>34.85</b>	<b>5.00</b>	<b>-</b>
Russell 1000 Growth Index	0.76	35.01	5.01	-
Variance	0.04	-0.16	-0.01	-
Peer Ranking - CAI Large Cap Growth	41	47	39	-
<b>Zevenbergen Capital Management</b>	<b>-2.42</b>	<b>41.27</b>	<b>10.75</b>	<b>9.68</b>
Russell 3000 Growth Index	0.64	35.68	5.28	5.36
Variance	-3.06	5.59	5.47	4.32
Peer Ranking - CAI All Cap	65	30	24	29
<b>Harris Investment Management</b>	<b>0.15</b>	<b>33.25</b>	<b>0.74</b>	<b>2.19</b>
Russell 1000 Value Index	-0.50	28.94	2.28	1.15
Variance	0.65	4.31	-1.54	1.04
Peer Ranking - CAI Large Cap Value	31	14	89	44
<b>Lombardia Capital Partners</b>	<b>-0.40</b>	<b>27.30</b>	<b>1.89</b>	<b>2.81</b>
Russell 1000 Value Index	-0.50	28.94	2.28	1.15
Variance	0.10	-1.64	-0.39	1.66
Peer Ranking - CAI Large Cap Value	44	88	72	26

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FUND	Total Returns as of 6/30/2011			
	2nd Qtr	1 Yr	3 Yr	5 Yr
<b>CTPF Investment Options</b>				
<b>Mid Cap Equity</b>				
<b>Northern Trust Mid Cap Index Fund</b>	<b>-0.72</b>	<b>39.44</b>	<b>7.87</b>	<b>6.69</b>
S&P 400 Index	-0.73	39.38	7.82	6.60
Variance	0.01	0.06	0.05	0.09
Peer Ranking – CAI Mid Cap	68	46	36	44
<b>Credo Mid Cap Growth</b>	<b>0.93</b>	<b>44.32</b>	-	-
Russell MidCap Growth Index	1.61	43.25	-	-
Variance	-0.68	1.07	-	-
Peer Ranking – CAI Mid Cap Growth	39	40	-	-
<b>Channing</b>	<b>-0.78</b>	<b>35.95</b>	-	-
Russell MidCap Value Index	-0.69	34.28	-	-
Variance	-0.09	1.67	-	-
Peer Ranking – CAI Mid Cap Value	65	42	-	-
<b>Small Cap Equity</b>				
<b>Northern Trust Small Cap</b>	<b>-0.86</b>	<b>39.35</b>	<b>9.14</b>	<b>4.84</b>
Russell 2000 Index	-1.61	37.41	7.77	4.08
Variance	0.75	1.94	1.37	0.76
Peer Ranking - CAI Small Cap	60	59	51	58
<b>Rhumblin Small Cap Index Fund</b>	<b>-1.57</b>	<b>37.15</b>	<b>7.86</b>	-
Russell 2000 Index	-1.61	37.41	7.77	-
Variance	0.04	-0.26	0.09	-
Peer Ranking - CAI Small Cap	73	68	64	-
<b>Rhumblin Small Growth Index Fund</b>	<b>-0.62</b>	<b>43.05</b>	-	-
Russell 2000 Growth Index	-0.59	43.50	-	-
Variance	-0.03	-0.45	-	-
Peer Ranking - CAI Small Cap Growth	68	68	-	-
<b>Ariel Small Value</b>	<b>-4.35</b>	<b>39.98</b>	<b>14.40</b>	<b>6.59</b>
Russell 2000 Value Index	-2.65	31.35	7.09	2.24
Variance	-1.70	8.63	7.31	4.35
Peer Ranking - CAI Small Cap Value	94	14	10	28
<b>Dimensional Fund Advisors</b>	<b>-3.40</b>	<b>40.72</b>	<b>11.38</b>	<b>3.98</b>
Russell 2000 Value Index	-2.65	31.35	7.09	2.24
Variance	-0.75	9.37	4.29	1.74
Peer Ranking - CAI Small Cap Value	88	12	40	60
<b>Attucks</b>	<b>0.73</b>	<b>34.65</b>	<b>4.31</b>	<b>4.42</b>
Russell 3000 Index	-0.03	32.37	4.00	3.35
Variance	0.76	2.28	0.31	1.07
Peer Ranking – CAI All Cap Broad	18	29	50	45
<b>Progress</b>	<b>0.52</b>	<b>34.34</b>	<b>4.54</b>	<b>4.33</b>
Russell 3000 Index	-0.03	32.37	4.00	3.35
Variance	0.55	1.97	0.54	0.98
Peer Ranking – CAI All Cap Broad	21	30	44	46

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<b>International Equity</b>				
<b>EARNEST Partners</b>	<b>-0.20</b>	<b>37.24</b>	<b>7.82</b>	<b>-</b>
MSCI ACWI ex-US Index	0.61	30.27	0.11	-
Variance	-0.81	6.97	7.71	-
Peer Ranking - CAI Non-US Equity	90	4	1	-
<b>Lazard</b>	<b>3.28</b>	<b>29.79</b>	<b>2.31</b>	<b>4.51</b>
MSCI ACWI ex-US Index	0.61	30.27	0.11	4.14
Variance	2.67	-0.48	2.20	0.37
Peer Ranking - CAI Non-US Equity	9	69	23	23
<b>MFS</b>	<b>4.15</b>	<b>33.24</b>	<b>4.26</b>	<b>5.86</b>
MSCI ACWI ex-US Index	0.61	30.27	0.11	4.14
Variance	3.54	2.97	4.15	1.72
Peer Ranking - CAI Non-US Equity	2	29	8	12
<b>Morgan Stanley</b>	<b>2.59</b>	<b>27.93</b>	<b>0.63</b>	<b>3.63</b>
MSCI EAFE Index	1.56	30.36	-1.77	1.48
Variance	1.03	-2.43	2.40	2.15
Peer Ranking - CAI Non-US Equity	21	82	40	38
<b>Leading Edge</b>	<b>0.99</b>	<b>27.72</b>	<b>-</b>	<b>-</b>
MSCI ACWI ex-US Index	0.61	30.27	-	-
Variance	0.38	-2.55	-	-
Peer Ranking - CAI Non-US Equity	80	83	-	-
<b>William Blair Growth</b>	<b>2.43</b>	<b>28.08</b>	<b>-</b>	<b>-</b>
MSCI ACWI ex-US IMI Growth Index	0.77	31.27	-	-
Variance	1.66	-3.19	-	-
Peer Ranking - CAI Core Growth Int'l Equity	61	90	-	-
<b>William Blair International Small Cap</b>	<b>2.85</b>	<b>37.38</b>	<b>3.56</b>	<b>-</b>
MSCI World Cap ex-US Index	-0.16	37.05	3.71	-
Variance	3.01	0.33	-0.15	-
Peer Ranking - CAI Int'l Small Cap Equity	30	68	42	-
<b>Infrastructure</b>				
<b>Infrastructure Composite</b>	<b>3.08</b>	<b>11.11</b>	<b>-</b>	<b>-</b>
8% Annualized Return	2.00	8.00	-	-
Variance	1.08	3.11	-	-

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**Table 1:**

<b>FUND</b>	<b>Total Returns as of 6/30/2011</b>			
	<b>2nd Qtr</b>	<b>1 Yr</b>	<b>3 Yr</b>	<b>5 Yr</b>
<b>CTPF Investment Options</b>				
<b>Hedge Funds</b>				
<b>K2 Advisors</b>	<b>-1.48</b>	<b>6.71</b>	-	-
T-Bill + 5%	1.29	5.16	-	-
Variance	-2.77	1.55	-	-
Peer Ranking - HFRI FOF: Diversified Group	57	44	-	-
<b>Mesirow Absolute Return</b>	<b>-0.41</b>	<b>5.88</b>	-	-
T-Bill + 5%	1.29	5.16	-	-
Variance	-1.70	0.72	-	-
Peer Ranking - HFRI FOF: Diversified Group	24	49	-	-
<b>Pluscios</b>	<b>-0.04</b>	-	-	-
T-Bill + 5%	1.29	-	-	-
Variance	-1.33	-	-	-
Peer Ranking - HFRI FOF: Diversified Group	16	-	-	-
<b>REITs</b>				
<b>REITs Composite</b>	<b>3.04</b>	<b>32.65</b>	<b>4.62</b>	<b>2.24</b>
NAREIT Equity Index	2.87	33.13	5.70	1.72
Variance	0.17	-0.48	-1.08	0.52
<b>Real Estate</b>				
<b>Real Estate Composite</b>	<b>4.63</b>	<b>17.38</b>	<b>-10.68</b>	<b>-1.60</b>
NCREIF Total Index	3.94	16.73	-2.57	3.44
Variance	0.69	0.65	-8.11	-5.04
<b>Private Equity</b>				
<b>Private Equity Composite</b>	<b>8.30</b>	<b>21.52</b>	<b>1.83</b>	<b>9.05</b>

Note: Hedge Fund returns are typically reported on a 30-45 day lag. Infrastructure and Private Equity returns are on a one quarter lag.

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**Domestic Equity**

- In the second quarter, New Amsterdam Partners and Waddell & Reed, two of the Fund's three large cap core managers, outperformed the Russell 1000 Index and ranked in the top half of Callan's Large Cap Core Peer Group. Piedmont matched the Russell 1000 Index and ranked in the 58<sup>th</sup> percentile of large cap core peers. New Amsterdam's performance can be attributed to their stock selection in the consumer discretionary sector. Waddell and Reed's overweight to the consumer discretionary sector, combined with an overweight allocation to the sector positively impacted performance. Piedmont's exhibited favorable security selection but sector allocation detracted from performance.
- Holland, the only active large cap growth manager in the plan, outperformed the Russell 1000 Growth Index by 103 basis points. Holland ranked in the 18<sup>th</sup> percentile of large growth peers for the quarter. Holland's performance can be attributed to their stock selection in energy and consumer staples sectors. Over longer time periods, Holland has outperformed the benchmark and peers consistently.
- Zevenbergen, the Fund's all cap growth manager, underperformed the Russell 3000 Growth Index and ranked below the median of the Callan All Cap Growth Peer Group in the second quarter. Zevenbergen's stock selection in the financials, energy and information technology sectors was primarily responsible for their underperformance in the second quarter. Intermediate and long term performance relative to the passive benchmark and peers remains favorable.
- Large Cap Value managers Harris and Lombardia both outperformed the Russell 1000 Value Index for the quarter and ranked in the top half of the Large Cap Value peer group. Harris' outperformance can be attributed to stock selection in consumer discretionary as well as, an overweight and stock selection in health care. Lombardia's performance can be attributed to their stock selection in consumer discretionary and consumer staples. In July, Harris's name was officially changed to BMO Global Asset Management reflecting BMO's purchase of Harris Bank. This name change has no impact on the large cap value team or investment process.
- In the mid-cap segment, Credo underperformed the Russell Mid-cap Growth Index by 68 basis points, yet ranked in the 39<sup>th</sup> percentile of peers. Security selection in the financial and industrials detracted from performance, as did unfavorable sector weightings. Credo has very little deviation from the benchmark sector weightings, but those modest deviations were detrimental to performance in the second quarter. Callan does not anticipate sector deviations to have a significant impact on the performance of the fund.
- Channing lagged both the benchmark and the peer group median in the second quarter. Channing underperformed due to stock selection in the financials and industrials sectors.
- The Northern Trust Small Cap Fund outperformed the Russell 2000 Index by 75 basis points in the second quarter and ranked in the 60<sup>th</sup> percentile of peers. Based on the newly approved Domestic Equity structure, the Northern Trust Small Cap Fund will be a source of funds to help increase the allocation to international equity.
- In small cap value equity space, Ariel and DFA underperformed the Russell 2000 Value Index and the peer group median during the second quarter. Ariel's underperformance can be attributed to security selection in consumer discretionary, financials and industrials

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sectors. DFA's stock selection and sector concentrations across several sectors hurt their performance.

- In the MWDBE manager of managers programs, Attucks and Progress outperformed the Russell 3000 Index and ranked above the universe median in the second quarter. Stock selection was responsible for the outperformance of both portfolios in the second quarter.

### **International Equity**

- In the international equity segment Lazard, MFS, Leading Edge and Morgan Stanley all outperformed their respective benchmarks and peer group median. William Blair Growth outperformed its benchmark but ranked below the peer group median. William Blair Small Cap outperformed their benchmark and their peer group median. EARNEST Partners underperformed their benchmark and the universe median.
- EARNEST Partners underperformance can be attributed to their security selection. Performance over all other time periods remains favorable relative to the benchmark and peers.
- Lazard's outperformance was due to a combination of their country and security selection. Performance over the trailing three- and five- year periods is above the benchmark and in the top quartile of the peer group.
- MFS outperformed as a result of their country and security selection. MFS was terminated for failing to meet brokerage requirements.
- Morgan Stanley outperformed the MSCI EAFE Index due to their security selection. Performance over the trailing three- and five-year periods is above the benchmark and in the top half of peers.
- William Blair International Growth outperformed its benchmark primarily due to their security selection.
- William Blair International Small Cap's outperformance was primarily due to their security selection. Performance over the trailing three-years has trailed the benchmark by 15 basis points and ranked in the 42<sup>nd</sup> percentile of peers.
- International MWBDE manager-of-managers Leading Edge outperformed the benchmark but ranked below the universe median during the second quarter. Outperformance was due to country selection of the sub-advisors.

### **Fixed Income**

- Taplin, Canida & Habacht underperformed the benchmark by 10 basis points in the 51<sup>st</sup> percentile of the peer group in the second quarter.
- Western Asset's performance was below benchmark and ranked below the median of their peer group in the second quarter.

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- MWDBE core domestic fixed income managers LM and Pugh Capital Management outperformed the BC Aggregate Bond Index and ranked above the median of their peer group. Garcia Hamilton underperformed the BC Aggregate Bond Index and ranked in the 97<sup>th</sup> percentile of their peer group.

**Hedge Funds**

- K2 Advisors had a market value of \$75.4 million at the end of the second quarter, representing 0.7% of the Total Fund. K2 gained -1.48% during the second quarter and 6.71% over the one year period. Performance over all time periods since inceptions (1.5 years) has been near the median of peers.
- Mesirow ended the quarter with a market value of \$76.0 million, representing 0.7% of the Total Fund. Mesirow returned -0.41% during the quarter and 5.88% over the one year period. Over both time periods, Mesirow ranked in the top half of Hedge Fund of Fund peers.
- Pluscios ended the quarter with a market value of \$26.7 million representing 0.3% of the Total fund. Pluscios returned -0.04% in the second quarter.

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**Notes & Observations**

- Callan and CTPF Staff are currently developing a transition plan to implement the recently approved asset allocation, domestic equity structure and international equity structure. Recent economic uncertainty and market volatility has created an inopportune time to transition assets as significant price fluctuations and unpredictable trading patterns and volumes could potentially impact the transactions costs associated with moving assets. Callan and staff will continue to monitor the markets and select an appropriate time to transition assets.
- As a result of the recently approved domestic equity and international equity structures, Callan and staff will be conducting a search to identify two new managers: an international small cap value manager and an emerging markets equity manager. Assets for the mandates will come from a reduction of domestic equity assets.
- The recent US debt debate and subsequent US Debt downgrade has led to a significant market decline and spike in volatility to start the third quarter. While the timing of this downgrade was a surprise, S&P has been telegraphing this event since the fall of 2010. The downgrade, combined with concern over the slowing of US economic growth, has led to renewed concern of a double-dip recession. It is Callan's expected case forecast that we will continue on a path of modest economic expansion over the coming years. We expect interest rates to ultimately rise, although the date at which the increases begin may be pushed out by the recent reported weakness in GDP. Stocks are certainly cheaper after the past month's decline, and we continue to expect unspectacular but solid single-digit returns going forward. We do not believe underlying fundamentals in the fixed income market have changed, despite the ratings change for Treasuries. As a result, we do not believe long-term investors should be deviating from their long term strategic targets. The downgrade has not resulted in a breach of CTPF's fixed income manager guidelines, so no current action is required by the Board. We continue to monitor the situation closely.