Investment Section

for Fiscal Year ending June 30, 2012

REPORT ON INVESTMENT ACTIVITY

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

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December 3, 2012

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

Investment returns were lackluster in the twelve-month period ended June 30, 2012, reflecting a subpar U.S. economic recovery, the ongoing Eurozone debt crisis, and slowing economic growth in emerging markets. The retirement annuity trust fund's total return for the fiscal year was 2.4%. While less than a banner year in an absolute sense, this return ranked in the top 26% of returns of our universe of pension funds with over $1 billion in assets.

Over the past fiscal year, U.S. inflation-adjusted gross domestic product grew by 2.1% while the unemployment rate fell from 9.1% to a still-high 8.2%. Risk aversion caused by a growth slowdown in the U.S. and an intensification of the Eurozone crisis led risky assets to plunge in the late summer and early fall of 2011 while safe haven assets such as U.S. Treasury bonds rallied. Growth picked up and fear abated, causing risky assets to generally rebound from fall, 2011, to spring, 2012. By late spring, a slowdown in growth in the U.S. and China was apparent and no resolution to the Eurozone crisis was in sight. Equities and other risky assets retreated once again.

Equities, which represented 63.1% of assets as of June 30, 2012, had a particularly difficult fiscal year. Domestic equities returned 2.8% versus 4.6% for the S&P 1500 Index. Most active equity managers underperformed in an environment characterized by enormous outperformance of defensive industries. International equities were battered, with the MSCI All Country World (ex-U.S.) Index declining by 14.2%. The retirement system's international equities were relatively resilient, declining by 12.1%. Investment grade fixed income returned 9.6% versus 8.8% for the Barclays Government/Credit Index.

Real estate investments generally performed well, as the commercial real estate market continued to recover. The retirement system's private equity program, still in its early stages, showed promising results. Other non-traditional strategies, such as alternative credit and timberland, were mixed in a volatile year.

The retirement system's investment performance has been strong in recent years relative to its peers as a multi-year program of improving the diversification of its asset allocation has been implemented. In a rapidly evolving global economic and financial climate, the investment program has responded well to both emerging opportunities and risks.

The philosophy which guides the investment program is grounded in fundamental economic value and, above all, safely funding its long-term obligations to its members. A robust process and uncompromising commitment to best practices has led to successful implementation and strong risk control. We believe continued commitment to this philosophy and process will help ensure long-term success in meeting the retirement system's goals.

We are grateful to be a part of this process. As always, we would like to thank the Board of Trustees, Investment Committee, and investment staff for their 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 annuity trust fund's asset allocation by market value as of June 30, 2012, and June 30, 2011, as well as the target and strategic range for each asset class for fiscal year 2012.

Retirement Annuity Trust*

	June 30, 2012	%	June 30, 2011	%
Cash Equivalents**	$ 431,810,127	2.9	$ 352,707,345	2.4
Fixed Income ***4	3,391,777,780	23.0	3,856,183,434	25.6
Domestic Equities	7,044,415,411	47.5	7,356,796,262	48.4
International Equities	2,309,883,058	15.6	2,294,036,935	15.1
Real Estate	586,800,767	4.0	480,447,237	3.1
Private Equity	265,833,651	1.8	189,131,441	1.2
Timberland	185,432,686	1.2	180,318,434	1.2
Additional Categories	587,848,810	4.0	457,628,442	3.0
Totals	**$ 14,803,802,290**	**100.00**	**$ 15,167,249,530**	**100.0**

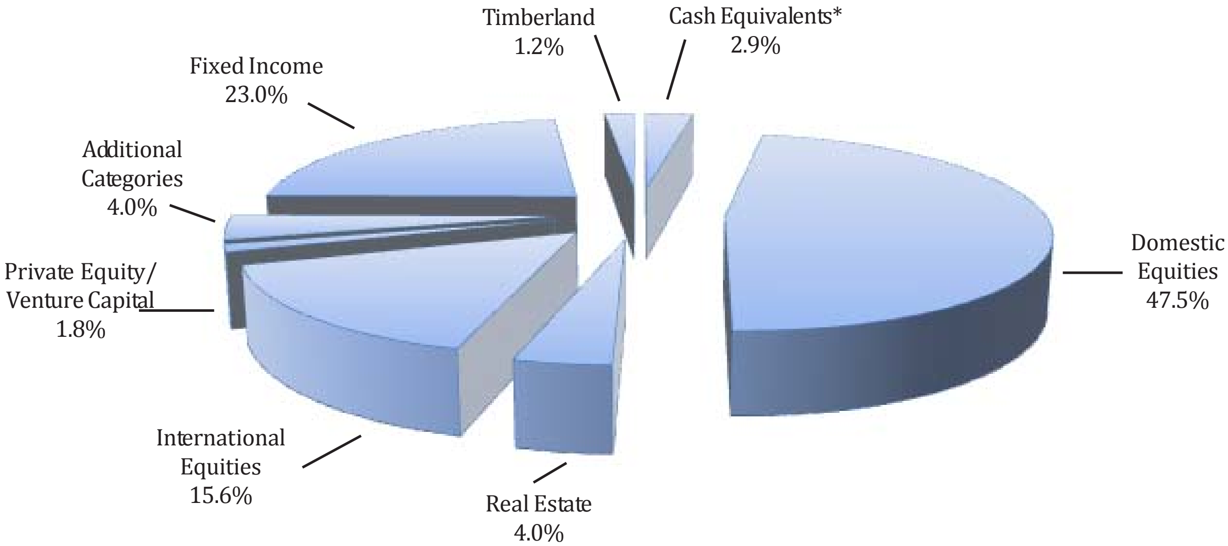
* Includes Life Insurance Trust values of $90,867,361 Tax Shelter Annuity value of $405,136, and 401(h) value of $11,606,479.

** 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.

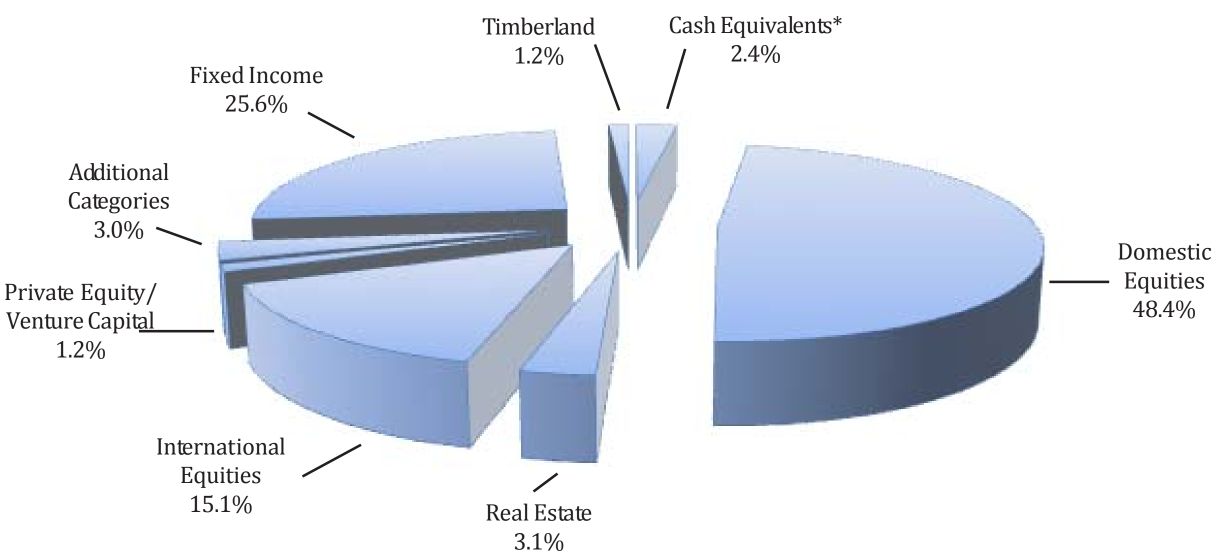
*** Excludes purchased interest of $797,403 as of June 30, 2012, and $779,260 as of June 30, 2011.

Distribution of Investments
Retirement Annuity Trust**
Market Values

June 30, 2012



June 30, 2011



* 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)	6/30/2012 (Mkt)**
Cash		1 - 3%	2.0%	2.9%
Fixed Income		21 - 27	24.0	23.0
Government/Agency/Other	Unlimited			10.7
Corporate	35%			12.3
Equity	65%	58 - 65	62.0	63.1
Domestic Large Cap		35 - 45	40.0	40.3
Domestic Mid Cap		1 - 5	3.0	4.5
Domestic Small Cap		1 - 3	2.0	2.7
International* **	30%	14 - 20	17.0	15.6
Real Estate	10%	2 - 6	4.0	4.0
Alternative Investments*	10%	2 - 6	4.0	3.0
Additional Categories	15%	2 - 6	4.0	4.0
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 6/30/12, 20.3% 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 2.4%, versus a 3.1% return for the benchmark Policy Index. Domestic equities returned 2.8% versus 4.6% for the Standard & Poor's 1500 Index, while international equities returned -12.1% versus -14.2% for the MSCI All Country World (Ex-US) Index. Fixed income investments outperformed, returning 9.6% versus 8.8% for the Barclays Government/Credit Index. Investments in real estate, private equity, high yield bonds, and alternative credit contribute a modest, but growing, portion of total return due to increasing exposure to these asset classes.

The table below details historical performance for the retirement annuity trust fund and its component asset classes for the period ended June 30, 2012. 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	2.4	12.1	2.6	5.5	7.2
Policy Index (1)	3.1	12.1	-	-	-
Equities					
Domestic Equities	2.8	16.1	0.4	5.4	8.7
S & P Blended Index (3)	4.6	16.8	0.5	5.4	8.4
International Equities	-12.1	9.2	-3.5	-	-
MSCI AC World (Ex US)	-14.2	7.4	-4.2	-	-
Total Equities	-1.0	14.4	-0.4	5.1	8.5
Fixed Income					
Total Fixed Income	9.6	8.7	8.1	6.4	7.0
Barclays Govt/Credit Index	8.8	7.3	6.9	5.8	6.6
Real Estate					
Non-Core Real Estate	4.8	-	-	-	-
NCREIF Index	12.0	-	-	-	-
Core Real Estate	14.7	4.7	-	-	-
NCREIF ODCE	12.4	8.4	-	-	-
Triple Net Lease Real Estate	8.2	8.1	8.3	9.0	9.1
CPI plus 2%	3.7	4.1	4.0	4.5	4.5
Alternative Investments					
Private Equity (4)	9.7	16.8	9.3	-	-
Timberland	3.0	1.7	-	-	-
NCREIF Timberland Index	1.1	-0.7	-	-	-
Cash					
Cash (Unallocated)	0.1	0.2	1.1	2.2	3.6
90 Day Treasury Bill	0.0	0.1	1.0	1.8	3.1
Additional Categories					
High Yield Bond Fund	7.6	-	-	-	-
Public-Private Investments	1.7	-	-	-	-
Special Situations Fund	-7.8	-	-	-	-
KTRS Credit Fund	1.4	-	-	-	-
B of A Merrill Lynch High Yield Master II	6.5	-	-	-	-

(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.

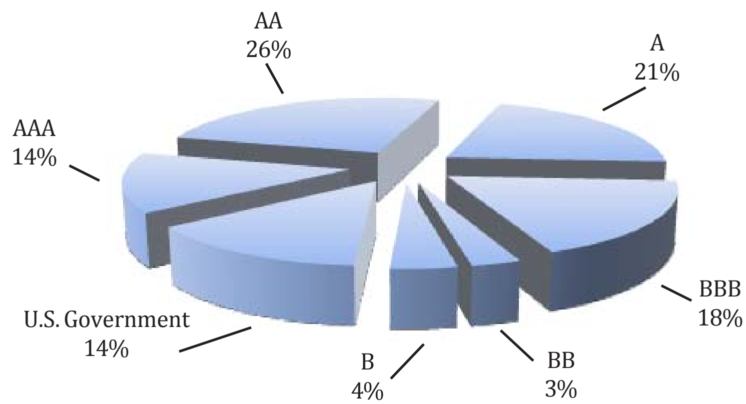
(4) For a period of five years private equity will be benchmarked against their own returns. The primary reason for this is that these investments have a minimum investment horizon of ten years and there is no market benchmark that would be expected to track these types of assets in their early years. 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.

FIXED INCOME INVESTMENTS

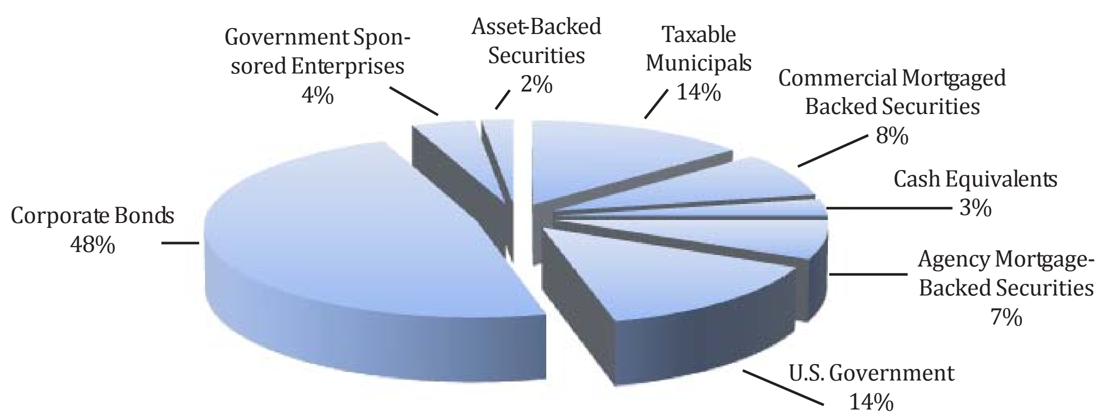
As of June 30, 2012, the retirement annuity trust fund had approximately $3.39 billion, 23% of total assets, in investment grade fixed income assets. In addition, the retirement annuity trust fund had $587.85 million, 4% of total assets, in other debt related investments approved under a regulatory provision 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, investments with two managers participating in U.S. Treasury's Public-Private Investment Program (PPIP), and two alternative credit funds.

Excluding the other debt-related investments discussed above, the retirement annuity trust fund's fixed income investments maintained the average investment grade rating required by administrative regulation as of June 30, 2012. The credit quality distribution, including the high yield portfolio, is illustrated below. Also illustrated below is the distribution of fixed income assets by sector, again including the high yield portfolio.

FIXED INCOME QUALITY DISTRIBUTION



FIXED INCOME SECTOR DISTRIBUTION



FIXED INCOME MARKET OVERVIEW

U.S. bond markets performed remarkably well over the fiscal year with all major fixed income market sectors posting positive returns. High quality long-term bonds performed the best as the rally in the fixed income markets was driven by continuing uncertainties in Europe, domestic fiscal gridlock, and the continued application of easy monetary policies by the Federal Reserve. Despite a slow start, the economy showed definite signs of strength as GDP grew 2.1%, up from 1.9% the previous year, and the unemployment rate dropped to 8.2% from 9.1% a year earlier. Inflation was mixed with the headline CPI measure dropping from 3.6% to 1.7% year over year. The CPI "core" measure, which excludes food and energy prices, increased from 1.6% in the year ending June 2011 to 2.2% by June 30, 2012.

The fiscal year began amid turmoil as Eurozone finance ministers struggled to put together a package of supports to keep Greece from defaulting on its sovereign debts. Domestically, the U.S. Government had reached its debt limit in May of 2011 and was embroiled in a stalemate between the Obama administration and the Republican House over raising the debt ceiling. A $600 billion program of bond purchases by the Federal Reserve had just concluded in June and the economy was slowing. Indeed, U.S. GDP grew at only 1.6% year-over-year in the quarter ending September 2011. The debt of the U.S. Treasury was ultimately downgraded to AA+ from AAA by Standard and Poor's over the handling of the debt ceiling fiasco.

Despite the eventual resolution of these issues, confidence in risky assets dropped sharply; equity and lower quality corporate bond markets were roiled in the first quarter of the fiscal year. The flight out of risky assets caused a sharp rally in U.S. Treasuries, driving the yield on 30 year Treasuries under 2.75% by early October, down from 4.4% in July.

In addition to the crisis of confidence, the rally in high grade bonds was also aided by the announcement of additional policy action by the Federal Reserve. At the September 2011 Federal Open Market Committee meeting, the Federal Reserve announced that it would begin a $400 billion bond purchase program that would extend until June 2012. This program, commonly referred to as "operation twist", was an attempt to bring down long term interest rates by buying U.S. Treasuries with maturities of 6 to 30 years. The purchases would be financed by sales of Treasuries with less than 3 year maturities.

The Fed's policy was very effective not only in lowering long term interest rates, but also in keeping them low throughout the year, as the yield on 30 year Treasuries ended the fiscal year at 2.75%. The low Treasury rates held down mortgage rates, giving a much needed boost to the real estate market. The average 30 year fixed mortgage rate dropped from 4.51% to 3.66% during the course of operation twist.

As the fiscal year progressed, the low long term Treasury rates provided a boost to other markets as investors accepted additional risk in search of higher yield. Investment grade corporate bonds returned 9.71% for the year while high yield bonds rebounded from lows early in the year to return 6.51%. Agency mortgage-backed securities returned 4.97%. U.S. Treasuries returned 8.32% overall. The retirement annuity trust fund's total fixed income return was 9.6%, outpacing the Barclays Government/Credit index, which returned 8.78% for the year ended June 30, 2012.

In June of 2012, the Federal Reserve announced it would extend its current bond purchase program, operation twist, through the end of calendar year 2012 by adding an additional $267 billion in long term bond purchases. The Fed's policy of keeping both short and longer term interest rates low has been supportive to some areas of the economy. However, low rates have left investment grade bond prices higher than they would otherwise be. The result is an asset class with unfavorable risk and reward characteristics. The retirement system continues to adjust the structure of its fixed income portfolio to control risk and maintain required liquidity. An important part of this work is an increasing exposure to nontraditional debt-related investments, which offer both diversification and better risk / reward potential.

EQUITY INVESTMENTS

As of June 30, 2012, the retirement annuity trust fund's public equity investments had a market value of $9.35 billion, representing 63.1% of total assets. Strong equity returns over the last six months of the fiscal year prompted some 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 market value of $7.04 billion as of June 30, representing 47.5% of total assets. 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, S&P 400, and S&P 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 market value of the international equity holdings as of June 30, 2012 was $2.31 billion, representing 15.6% of total assets. 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 23 developed countries and 21 emerging market countries. Four external asset managers manage the retirement annuity trust fund's international equities. During the fiscal year international equities increased slightly as a percent of total assets. The retirement annuity trust fund plans to continue increasing the international equity exposure during the coming fiscal year.

EQUITY MARKET OVERVIEW

For the fiscal year 2012, stocks were flat to slightly down overall, but experienced high volatility throughout the year. Returns of domestic stocks as measured by the S&P 1500 and Russell 2000 were up 4.63% and down 2.08%, respectively. Domestic large caps fared relatively well on the year, as the Dow Jones advanced 6.63% and the S&P 500 was up 5.45%. The Morgan Stanley Capital International (MSCI) World Index was down 4.41% for the year, brought down by foreign markets. The MSCI EAFE, which measures the foreign developed markets, fell 13.38%, while the MSCI Emerging Markets Index was down 15.66%.

Following two strong years, fiscal year 2012 was a tale of two halves. Momentum died early in the fiscal year as stocks plummeted in late July and continued the downward trend for the better part of the first and second quarters. Volatility was extremely high with the market reaching its lows in October and beginning its recovery in December.

The domestic markets were generally led down by many market uncertainties, both domestic and abroad. Locally, negative investor sentiment was driven by the sluggish labor market and the U.S. government's debt ceiling crisis. Although Congress ultimately reached a compromise, employment and confidence remained weak. Most of the decline was led by the energy and financial sectors. International uncertainty centered on the European debt crisis. This crisis came to the forefront in the first quarter as Greece teetered on defaulting on its sovereign debts. European and International Monetary Fund officials engineered a debt restructuring that kept Greece in the euro. The crisis was, however, ominously spreading to Spain and Italy. The associated austerity measures and political turmoil generated tremendous volatility in the markets.

The second half of the fiscal year was a completely different story, as stocks generally rallied, particularly in the third quarter. This rally was led by strong corporate earnings, despite the uncertain macroeconomic outlook. When calendar year-end earnings were all reported, 61% of the companies in the S&P 500 had exceeded expected earnings with an average 3.9% earnings surprise to the upside. The strong earnings were led by Apple Corp (AAPL) who successfully rolled out their iPad2 and iPhone4S. Also aiding the second half resurgence was the Fed's decision to keep interest rates low and the European Central Bank's aggressive rate cuts. The housing market benefitted from the continued promise by the Fed to maintain low borrowing rates. The housing and real estate market, as measured by the MSCI US REIT Index, advanced 14.88% in the second half and was up 39.23% from its 52 week low on October 3, 2011. Labor markets also improved on the back of the strong corporate earnings as unemployment fell from 9.07 on September 30, 2011 to 8.17 as of the end of the fiscal year. Stocks, however, did see a slight pullback at the end of the fourth quarter of the fiscal year, as concerns re-emerged about a growth slowdown in the U.S.

Domestically, the Presidential campaign dominated the headlines. Concern over the growing national debt and national healthcare kept investors from buying into the recovery. Internationally, the European debt crisis and an interest rate fixing scandal dampened confidence. China also experienced a pullback in equity markets as investors found better opportunities in other emerging markets.

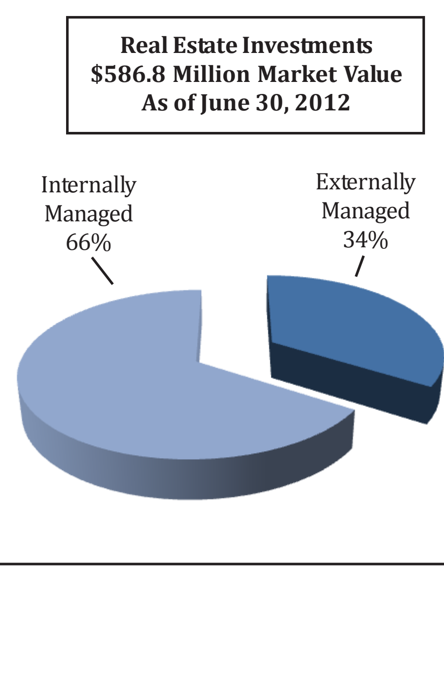
In summary, despite tremendous volatility manifested in a plummeting first quarter and a soaring third quarter, we ended the year fairly flat. Generally, defensive industries and countries performed relatively well while those perceived as riskier performed poorly. Large cap U.S. stocks did well while small cap stocks were down slightly. European and emerging markets stocks suffered significant declines. Financial markets are expected to remain volatile at least through the national elections in November, 2012.

REAL ESTATE

The retirement annuity trust fund's real estate investments had a market value of $586.8 million as of June 30, 2012, 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 four 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 two real estate limited partnerships: Carlyle Realty Partners VI, L.P., and Blackstone Real Estate Partners VII, L.P. Carlyle Realty Partners VI is an opportunistic real estate fund targeting distressed properties where fundamentals such as supply, demand, and location indicate that the property can be successfully turned around. This fund focuses on the major markets on the East and West Coasts and across all property types. Blackstone Real Estate Partners VII is an opportunistic real estate fund whose goal is to create core real estate by buying distressed and/or undermanaged assets at below market prices, executing a strategy to fix the issues and sell to institutional or strategic buyers or the public markets at higher values. Blackstone prefers to acquire high quality, income-producing assets in favor of engaging in development activities.



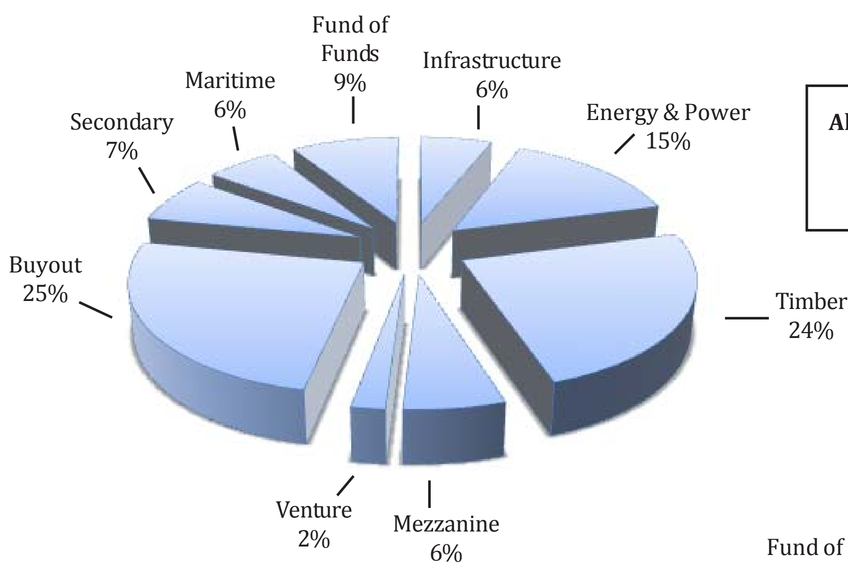
REAL ESTATE OVERVIEW

The commercial real estate market experienced a second consecutive year of moderate recovery during the fiscal year. Demand remained strong for trophy properties located in gateway markets, while improving lending conditions helped support growing transaction volume in the broader market as well. Property yields continue to provide an attractive option to investors in a low interest rate environment with government bond yields near record lows. New construction activity in most sectors of the market remained constrained with the notable exception of multifamily construction.

Over the upcoming year, demand for apartments should remain strong due to favorable demographics and declining homeownership rates. The lack of new supply in the office, retail, and industrial sectors should promote a gradual recovery in overall rent and vacancies. It is estimated that up to $2 trillion in commercial mortgage debt will need to be refinanced over the next five years. These impending debt maturities will force owners who are unable to retire or refinance maturing debt to bring high quality assets to market. This will provide an opportunity for investors with ready capital to acquire commercial real estate properties at attractive prices.

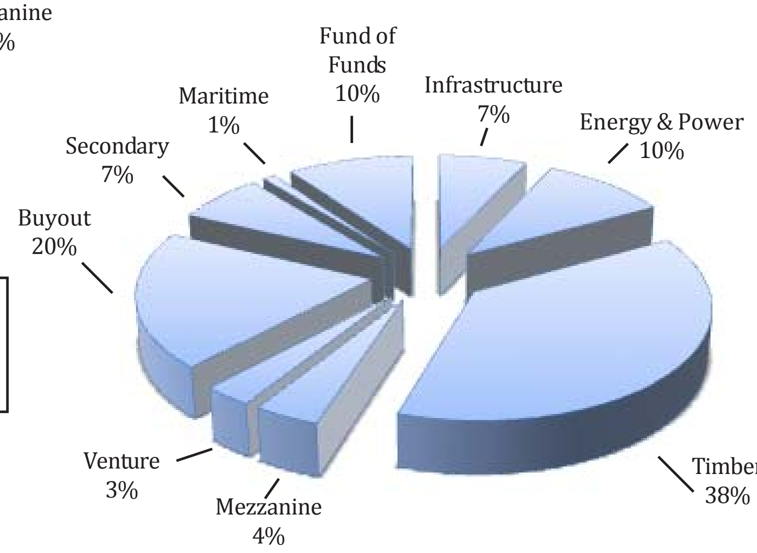
ALTERNATIVE ASSETS

As of June 30, 2012, the retirement annuity trust fund had committed $850 million to alternative investments and had funded $449 million of those commitments. The percentage of the retirement annuity trust fund's portfolio in alternative assets was 3.0%. The retirement annuity trust fund's current alternative asset portfolio consists of private equity investments and timberland.



Alternative Assets Committed as of June 30, 2012 $850 Million

Alternative Assets Funded as of June 30, 2012 $449 Million



PRIVATE EQUITY

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

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

PRIVATE EQUITY MARKET OVERVIEW

The private equity markets continue to 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, continued uncertainty in the financial markets along with the record number of funds coming into the market over the next twelve months means that fund raising will remain challenging for all but the top tier funds. A strong IPO market remains the linchpin of the rebound in private equity as many funds that are in the harvesting period have not been able to dispose of the underlying portfolio companies in the time frame they had anticipated. As the IPO market begins to open back up this trend should reverse itself, and funds will begin to harvest their underlying portfolio companies at an accelerated pace.

As limited partners have become more selective in the funds in which they invest we continue to see a bifurcation in the private equity market 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, 2012 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 stagnation in the general economy and the poor housing market continued to negatively affect the global timber markets over the past fiscal year. However, many economists are expressing a guarded optimism that the domestic housing market is finally beginning a sustained turnaround, with the supply of homes moving downward and housing starts beginning to show some signs of life. Forecasts project timber demand, primarily softwood lumber and hardwoods, used in housing construction, improving over the next several years as the housing market continues its recovery. A return of a strong, stable domestic housing market will be crucial to a reemergence of strong timber markets across the timber-growing regions of the U.S. Currently the export timber markets are a mixed bag, with Vietnam heating up while China is cooling and Europe is mixed, due to its economic issues. However, both the international and domestic sectors are displaying a continued interest in biomass as a renewable energy source. As full-scale biomass facilities continue to come online in the next several years, pulpwood demand could pick up in specific target markets.

RETIREMENT ANNUITY TRUST
PORTFOLIOS
MARKET VALUES **
June 30, 2012

Internally Managed	
Cash Equivalents	
Cash Collections Fund (Unallocated)	$ 431,810,127
Fixed Income*	
Broad Market Bond Fund	750,385,239
Long Term Bond Fund	598,106,329
Intermediate Bond Fund	549,189,016
Internal Bond Fund	201,888,109
Life Insurance Trust	90,866,589
Tax Shelter Fund	405,136
Equity	
S & P 500 Stock Index Fund (Large Cap)	2,564,993,470
S & P 400 Stock Index Fund (Mid Cap)	379,525,980
S & P 600 Stock Index Fund (Small Cap)	254,716,531
Real Estate	
Internally Managed Fund	387,922,191
Subtotal	6,209,808,717
Externally Managed	
Fixed Income	
Galliard Capital Management	625,593,033
Ft. Washington Broad Market	575,344,329
Domestic Equity	
Todd - Veredus (Large Cap Core)	1,149,720,807
UBS (Large Cap Value)	810,731,375
GE Asset Management (Large Cap Growth)	689,778,128
Wellington (Large Cap Core)	531,381,716
Wellington (Mid Cap Core)	280,311,563
Wellington (Small Cap Core)	145,277,634
Todd - Veredus Opportunity Fund	128,992,509
UBS (130/30)	108,985,699
International Equity	
Todd - Veredus International	692,815,522
UBS All Country World ex US	676,201,690
Baillie Gifford EAFE Alpha	540,343,180
Baring All Country World ex US	400,522,666

continued ...

RETIREMENT ANNUITY TRUST PORTFOLIOS continued ...
JUNE 30, 2012

Real Estate	
Prudential PRISA Fund	178,863,056
Blackstone Partners VII, LP	10,677,256
Carlyle Realty Partners VI	9,338,263
Alternative Investments	
Molpus Woodlands Group Lake Superior Timberlands LLC	90,793,322
Molpus Seven States LLC	72,658,059
Riverstone/Carlyle E & P Fund IV	45,047,180
KKR & Co European Fund III	37,466,724
Alinda Infrastructure Fund II	30,561,419
Ft. Washington Fund VI	25,022,073
Hancock Bluegrass LLC - Oregon	21,981,305
KKR & Co Fund 2006	20,495,041
Chrysalis Venture Fund III	18,654,648
Lexington Capital Partners Fund VII	14,097,411
Landmark Equity Partners Fund XIV	13,821,365
Ft. Washington Fund V	12,975,169
Hellman & Friedman Fund VII	9,619,080
Stepstone Pioneer Capital Fund III, LP	9,396,601
Oaktree Mezzanine Fund III	9,276,709
Oaktree European Principal Fund III	7,561,954
Audax Mezzanine Fund III	4,578,412
NGP Natural Resources X, LP	3,262,969
CapitalSouth Partners Fund III	3,115,049
J. P. Morgan Maritime Fund	881,847
Additional Categories	
Fort Washington High Yield Bond Fund	274,645,691
Marathon KTRS/Credit Fund LP	100,513,682
Avenue Special Situations Fund VI	91,332,362
Marathon Legacy Securities PPIP	69,805,272
AG GECC PPIF, LP	51,551,803
Subtotal	8,593,993,573
Total Assets	$ 14,803,802,290

* *Excludes purchased interest of $797,403 as of June 30, 2012.*
** *Detailed information concerning these market values of all KTRS investments is available upon request.*

Investment Summary
Fair Market Value – Retirement Annuity Trust*
June 30, 2012

Type of Investment	Fair Value 07/01/11	Acquisitions	Appreciation (Depreciation)	Sales Redemptions, Maturities & Paydowns	Fair Value 06/30/12
Cash Equivalents	$ 640,018,300	$ 3,663,036,500	$ -	$ 3,678,261,800	$ 624,793,000
Fixed Income**	3,882,958,300	2,610,743,300	182,636,200	3,108,112,800	3,568,225,000
Equities	9,588,077,100	3,171,547,400	(249,922,900)	3,249,390,000	9,260,311,600
Real Estate	480,447,200	103,402,100	11,274,300	8,322,900	586,800,700
Alternative	576,527,800	219,172,600	(9,829,200)	21,401,800	764,469,400
TOTAL	$ 15,168,028,700	$ 9,767,901,900	$ (65,841,600)	$ 10,065,489,300	$ 14,804,599,700

* Includes Life Insurance Trust Values and Tax Shelter Annuity.
** Includes Purchased Interest.

Contracted Investment Management Expenses
Fiscal Year 2011-12
(in thousands of dollars)

Investment Counselor Fees	Assets Under Management	Expense	Basis Points (1)
Equity Manager(s)	$ 6,155,062	$ 11,316	
Fixed Income Manager	1,475,583	1,039	
Real Estate	198,879	2,223	
Alternative Investments (2)	764,469	11,977	
Total	$ 8,593,993	$ 26,555	30.9
Other Investment Services			
Custodian Fees	$ 14,805,138	$ 305	0.2
Consultant Fees		359	0.2
Legal & Research		124	0.1
Subscriptions/Services		746	0.5
Total		$ 1,534	1.0
Grand Total		$ 28,089	**19.0**

(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.

Ten Largest Stock Holdings Ranked [1] [2]
by Market Value
June 30, 2012

Rank	Description	Market Value	Percentage of Equities
1	Apple Inc	231,970,640	3.078
2	Exxon Mobil Corp	119,695,145	1.588
3	Philip Morris Inc	95,036,611	1.261
4	Microsoft Corp	93,227,338	1.237
5	Pepsico Inc	86,087,480	1.142
6	Qualcomm Inc	81,809,009	1.085
7	Chevron Corp	78,823,587	1.046
8	Wells Fargo & Co	74,800,832	0.992
9	Oracle Corp	72,683,236	0.964
10	International Business Machines	71,949,970	0.954

Top Ten Fixed Income Holdings [2]
by Market Value
June 30, 2012

Rank	Description	Maturity	Coupon	Par Value	Market Value	Percent of Fixed Income
1	U S Treasury Bonds	8/15/2023	6.250	31,900,000	46,334,750	1.298
2	U S Treasury TIPs	4/15/2014	1.250	39,515,000	44,344,111	1.243
3	U S Treasury	5/15/2022	1.750	39,270,000	39,589,265	1.109
4	U S Treasury	2/15/2022	2.000	36,670,000	37,904,679	1.062
5	U S Treasury Bonds	8/15/2029	6.130	22,000,000	33,986,480	0.952
6	Treasury Inflation Index	2/15/2042	0.750	30,000,000	32,037,420	0.898
7	U S Treasury	4/30/2017	0.880	29,800,000	30,025,884	0.841
8	U S Treasury	3/31/2017	1.000	28,180,000	28,567,475	0.800
9	U S Treasury Bonds	11/15/2026	6.500	16,000,000	24,664,960	0.691
10	U S Treasury Bonds	2/15/2020	8.500	14,980,000	22,961,494	0.643

(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 2011-12

COMPANIES	SHARES TRADED	COMMISSIONS	COMMISSION PER SHARE	% OF TOTAL
Allen & Co	1,400	$ 764	$ 0.5460	0.03 %
Assent LLC	3,815	153	0.0400	0.01
Avondale Partners, LLC	48,460	1,938	0.0400	0.08
Barclays	1,882,919	69,378	0.0368	2.71
Bass / Baypoint Trading	8,030	321	0.0400	0.01
BB & T Capital Markets	21,905	876	0.0400	0.03
Blair, William & Co	91,195	3,648	0.0400	0.14
BMO Capital Markets	39,025	1,561	0.0400	0.06
BNP Paribas Securities Bond	46,860	1,874	0.0400	0.07
BNY ConvergEX Group	3,123,502	65,901	0.0211	2.58
Boenning & Scattergood	7,770	311	0.0400	0.01
Brean Murray, Carret & Co., LLC	50,995	2,040	0.0400	0.08
Broadpoint Capital	8,866	582	0.0656	0.02
BTIG	174,970	5,073	0.0290	0.20
Burke & Quick Partners LLC	9,025	361	0.0400	0.01
Cabrera Capital	21,805	590	0.0271	0.02
Canaccord Genuity, Inc.	89,876	3,595	0.0400	0.14
Cantor Fitzgerald & Co	38,826	1,265	0.0326	0.05
CIBC Oppenheimer Worldmarket	98,140	3,952	0.0403	0.15
Citigroup Global	247,000	9,503	0.0385	0.37
Collins Stewart LLC	56,680	2,267	0.0400	0.09
Cowen & Co	367,515	13,231	0.0360	0.52
Credit Suisse Sec. LLC	3,524,206	88,051	0.0250	3.44
Crowell Weedon & Co	68,105	2,724	0.0400	0.11
CSI US Institutional (Calyon)	90,972	3,639	0.0400	0.14
Cuttone & Co Inc 3	19,270	434	0.0225	0.02
D A Davidson & Co	9,600	384	0.0400	0.02
Dahlman Rose & Co LLC	26,300	1,052	0.0400	0.04
Davenport & Company LLC	6,800	272	0.0400	0.01
Deutsche Bank	627,405	21,622	0.0345	0.84
Dowling & Partners	60,285	2,411	0.0400	0.09
Fidelity Capital Markets	1,980	59	0.0300	0.00
First Kentucky Securities Corp	1,656,895	49,707	0.0300	1.94
Freidman Billings	136,135	5,529	0.0406	0.22
Gleacher & Company Securities	1,500	60	0.0400	0.00
Goldman Sachs	2,858,273	94,979	0.0332	3.71
Green Street Advisors	41,355	1,654	0.0400	0.06
Heflin & Co	20,325	813	0.0400	0.03
HSBC	4,400	176	0.0400	0.01
Instinet	2,700	108	0.0400	0.00
Investment Tech Group Transition	17,228,270	159,122	0.0092	6.22
Investment Technology Group	22,935,980	337,885	0.0147	13.20
ISI Group	2,589,165	73,717	0.0285	2.88
J.J.B. Hilliard, W.L. Lyons	2,823,420	84,703	0.0300	3.31
Janney Montgomery Scott Inc	157,725	6,097	0.0387	0.24
Jefferies & Co.	514,239	18,942	0.0368	0.74
JMP Securities	18,420	737	0.0400	0.03
Jones & Associates	7,724	309	0.0400	0.01
JP Morgan & Chase	951,563	55,076	0.0579	2.15
Keefe Bruyette & Woods	90,635	11,412	0.1259	0.45
Keybanc Capital	114,805	10,582	0.0922	0.41
King, CL, & Associates, Inc.	8,090	324	0.0400	0.01
Knight Equity Markets	71,399	2,635	0.0369	0.10
Lazard Freres & Co.	2,713,805	81,775	0.0301	3.20
Leerink Swann & Co.	98,675	30,666	0.3108	1.20
Lexington Investment Co.	1,130,475	33,914	0.0300	1.33
Liquidnet Inc	10,382,594	107,285	0.0103	4.19
Longbow Securities LLC	21,135	845	0.0400	0.03
Loop Capital Markets, LLC	11,820	309	0.0261	0.01

Transaction Commissions continued . . .

COMPANIES	SHARES TRADED	COMMISSIONS	COMMISSION PER SHARE	% OF TOTAL
MacQuarie Securities Inc	100,545	4,053	0.0403	0.16
Merrill Lynch	3,538,209	120,064	0.0339	4.69
Merrill Lynch, Pierce, Fenner	67,915	2,717	0.0400	0.11
Miller Tabak & Co. LLC	146,005	5,840	0.0400	0.23
Mischler Financial Group Inc	4,500	180	0.0400	0.01
Mizuho Securities, USA	7,900	316	0.0400	0.01
MKM Partners	41,945	1,678	0.0400	0.07
Morgan Keegan	2,151,500	64,545	0.0300	2.52
Morgan Stanley Smith Barney-Huntington	2,176,090	65,283	0.0300	2.55
Morgan Stanley Smith Barney-Louisville	2,184,750	65,543	0.0300	2.56
Morgan Stanley Smith Barney-Northern KY	2,931,559	87,947	0.0300	3.44
Morgan Stanley	1,335,761	33,226	0.0249	1.30
Needham	3,900	156	0.0400	0.01
Nomura Securities Intrntl Inc	181,260	6,247	0.0345	0.24
Pacific Crest Securities	20,755	1,632	0.0786	0.06
Pershing LLC	47,250	1,790	0.0379	0.07
Pipeline Trading	20,455	205	0.0100	0.01
Piper Jaffray	109,980	4,399	0.0400	0.17
Pulse Trading	37,830	559	0.0148	0.02
R W Baird	460,136	19,064	0.0414	0.75
Raymond James & Assoc	4,991,335	154,456	0.0309	6.04
RBC Capital Markets	540,215	21,301	0.0394	0.83
Rosenblatt Securities LLC	1,500	60	0.0400	0.00
Ross Sinclaire & Assoc	1,116,600	33,498	0.0300	1.31
Sandler O'Neill	10,450	468	0.0448	0.02
Sanford C Bernstein	633,536	13,484	0.0213	0.53
SG AMERICAS SECURITIES	12,620	505	0.0400	0.02
Sidoti & Company LLC	8,380	335	0.0400	0.01
Simmons & Co	31,120	1,245	0.0400	0.05
SJ Levinson & Sons LLC	7,400	296	0.0400	0.01
State Street Global	21,400	642	0.0300	0.03
Stephens Inc.	74,550	2,982	0.0400	0.12
Sterne, Agee & Leach	134,925	5,397	0.0400	0.21
Stifel, Nicolaus & Co	1,934,149	93,922	0.0486	3.67
Stifel, Nicolaus & Co-Louisville	1,103,085	33,093	0.0300	1.29
Suntrust Robinson	15,661	626	0.0400	0.02
Susquehanna Brokerage	55,980	2,239	0.0400	0.09
Telsey Advisory Group LLC	153,865	5,837	0.0379	0.23
The Benchmark Company LLC	3,950	158	0.0400	0.01
UBS/Paine Webber Securities	760,251	16,949	0.0223	0.66
UBS/Paine Webber-Louisville	2,687,140	80,614	0.0300	3.15
Wedbush Morgan Securities	15,010	600	0.0400	0.02
Weeden & Co	3,588,160	107,853	0.0301	4.21
Wells Fargo Securities, LLC	410,185	12,213	0.0298	0.48
Williams Capital Group	5,830	233	0.0400	0.01
WJB Capital Group Inc	129,500	5,180	0.0400	0.20
TOTAL	**111,480,066**	**$ 2,558,823**	**$ 0.0230**	**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 2011-12, the retirement annuity trust fund bought small capitalization IPOs that generated $240,230 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 $2,558,823. 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 retirement system received third party research credit through BNY ConvergEx during this fiscal year. The primary research providers were: Bloomberg, Interactive Data, Segal Rogers Casey, ISS, QED Financial Systems, and Thomson Financial; however, KTRS began the process of paying for research directly to vendors instead of through third party research agreements.

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 ever mindful of its significance to the Commonwealth's economy. For the fiscal year ended June 30, 2012, approximately $1.5 billion in benefits were distributed to members living in Kentucky. Approximately $331 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-Veredus Asset Management LLC
UBS Global Asset Management
Wellington Management Company
GE Asset Management

International Equity Managers
Todd-Veredus Asset Management LLC
UBS Global Asset Management
Baring Asset Management, Inc.
Baillie Gifford

Real Estate Managers
Prudential Real Estate Investors
Carlyle Realty Partners
Blackstone Real Estate Partners

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
Marathon Legacy Securities GP, LLC
AG GECC PPIF GP, LLC
Avenue Capital Group
Hellman & Friedman Capital Partners
Natural Gas Partners
Marathon Asset Management

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, 2012, the health insurance trust fund had approximately $327.9 million in total assets. This included $22.3 million in cash and $110.9 million in short-term high quality bonds for liquidity purposes. This trust fund also had $53.3 million in high yield bonds, $140.7 million in a global stock index fund, and $748,000 in private equity investments.

Asset allocation will be adjusted annually by the Investment Committee to reflect changing liquidity needs and actuarial funding status. Due to upcoming contribution rate increases enacted in statute, liquidity needs are expected to decline in coming years while funding status improves. The information below shows the health insurance trust fund's asset allocation by market value as of June 30, 2012 and June 30, 2011.

Health Insurance Trust

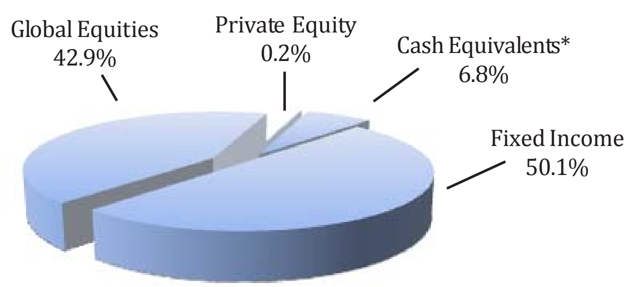
	June 30, 2012	%	June 30, 2011	%
Cash Equivalents *	$ 22,265,278	6.8	$ 63,546,353	16.8
Fixed Income **	164,189,966	50.1	164,924,873	43.5
Global Equities	140,740,861	42.9	150,698,032	39.7
Private Equity	748,103	0.2	-0-	0.0
Totals	**$ 327,944,208**	**100.0**	**$ 379,169,258**	**100.0**

* 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.

** Excludes purchased interest of $34,806 as of June 30, 2012, and $221,418 as of June 30, 2011. Also excludes 401(h) value of $11,606,479.

Distribution of Investments Health Insurance Trust Market Values

June 30, 2012



June 30, 2011

** 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 -1.1%, largely the net result of exposure to global equities offset by the stability of short-term bonds. The fund's global equities returned -6.6% versus -6.9% for the MSCI All country World IMI Index. A short-term bond fund held for liquidity purposes returned 0.8%. A high yield bond fund returned 8.1% versus 6.5% 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	-1.1	-	-	-	-
Equities					
Global Equities	-6.6	-	-	-	-
MSCI AC World IMI	-6.9	-	-	-	-
Fixed Income					
High Yield Bond Fund	8.1	-	-	-	-
B of A MerrillLynch High Yield Master II	6.5	-	-	-	-
Internal Bond Fund	0.8	-	-	-	-
90 Day Treasury Bill	0.0	-	-	-	-
Alternative Investments					
Private Equity (2)	-	-	-	-	-
Cash					
Cash (Unallocated)	0.1	-	-	-	-
90 Day Treasury Bill	0.0	-	-	-	-

(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
MARKET VALUES **
June 30, 2012

Cash Equivalents	
Cash Collections Fund	$ 22,265,278
Fixed Income*	
Internal Bond Fund	110,899,830
Subtotal	133,165,108
Fixed Income*	
Ft. Washington High Yield Bond Fund	53,290,136
Global Equities	
BlackRock Fund B	140,740,861
Alternative Investments	
Ft. Washington Fund VII	748,103
Subtotal	194,779,100
Total Assets	$ 327,944,208

* *Excludes purchased interest of $34,806 as of June 30, 2012.*

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

Investment Summary
Fair Market Value – Medical Insurance Trust
June 30, 2012

Type of Investment	Fair Value 06/30/11	Acquisitions	Appreciation (Depreciation)	Sales Redemptions, Maturities & Paydowns	Fair Value 06/30/12
Cash Equivalents	$ 92,109,500	$ 479,798,400	$ -	$ 525,856,000	$ 46,051,900
Fixed Income *	136,110,900	136,294,900	112,600	132,352,600	140,165,800
Equities	151,170,200	-	(9,925,000)	232,000	141,013,200
Real Estate	-	-	-	-	-
Alternative	-	750,000	19,100	21,000	748,100
TOTAL	$ 379,390,600	$ 616,843,300	$ (9,793,300)	$ 658,461,600	$ 327,979,000

* Includes Purchased Interest.

Health Insurance Trust Fund
Contracted Investment
Management Expenses
Fiscal Year 2011-12
(in thousands of dollars)

Investment Counselor Fees	Assets Under Management	Expense	Basis Points [1]
Equity Manager(s)	$ 140,741	$ 89	
Fixed Income Manager	53,325	107	
Real Estate	-	-	
Alternative Investments [2]	748	75	
Total	$ 194,814	$ 271	13.9
Other Investment Services			
Custodian Fees	$ 327,979	$ 5	0.2
Consultant Fees		-	0.0
Legal & Research		6	0.2
Subscriptions/Services		-	0.0
Total		$ 11	0.3
Grand Total		$ 282	**8.6**

(1) – One basis point is one hundredth of one percent or the equivalent of .0001.
(2) – Private equity fees are either withheld from the Fund operations or paid by direct" disbursement, depending on contract terms."

HEALTH INSURANCE TRUST PROFESSIONAL SERVICE PROVIDERS

Investment Consultants
Hewitt EnnisKnupp, Inc.

Investment Custodian
The Bank of New York Mellon

Fixed Income Manager
Ft. Washington Investment Advisors

Global Equity Manager
BlackRock Institutional Trust Company

Alternative Investment Manager
Ft. Washington Private Equity Investors

Attorney
Ice Miller LLP