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Executive Director

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October 15, 2012

The Honorable Rick Perry
Governor of Texas
State Capitol, 2S.1
Austin, TX 78701

RE: FY 2012 Annual Investment Performance Report

Dear Governor Perry:

The annual investment performance report of the Teacher Retirement System of Texas (TRS) for the fiscal year ended August 31, 2012, is enclosed for your information.

The TRS Trust Fund earned 7.58% return net of all external manager fees for the fiscal year, led by strong performance in Treasuries and Tactical Credit. The fund grew by \$4.1 billion to \$111.1 billion as of August 31, 2012. TRS trailed its benchmark by 114 basis points during the fiscal year, and placed in the top 17% of its peers for the year ended June 30, 2011.

TRS' Investment Management Division continues to benefit from its innovative Strategic Partner Network. The \$5.6 billion program returned 11.4% during the fiscal year net of management fees. It has produced 9.9% annualized returns over the past three years. Additionally, the program has provided valuable asset allocation research and investment opportunities to our internal investment staff. TRS expanded upon the program during the fiscal year, adding strategic partners focused in Private Equity and Real Assets. The Strategic Partner Network, which began in 2008, has proven to be extremely beneficial and effective for TRS.

The performance of the Trust continues to be aided by actions taken by the legislature and the TRS board. TRS has expanded its Emerging Manager program by significantly increasing its allocation and focus during the year. Additionally, the use of external managers, hedge funds and basic derivatives has allowed TRS to access many of the world's leading investment managers and better performing markets, reduce risk in declining markets, and respond more effectively and efficiently to changing market conditions. They have also enabled the Trust to significantly lower costs and focus its internal resources much more effectively.

TRS will continue to conscientiously and prudently manage the fund for the long term financial interest of the members we serve.

If we can provide you with additional information on the fund's performance, please let us know.

Respectfully,

Brian Guthrie
Executive Director

Enclosure

EXHIBIT A
TEACHER RETIREMENT SYSTEM OF TEXAS
INVESTMENT PERFORMANCE
ANNUALIZED TIME-WEIGHTED TOTAL RETURNS
FOR FISCAL YEARS ENDING AUGUST 31, 2012

	<u>One Year</u>		<u>Three Years</u>		<u>Five Years</u>		<u>Ten Years</u>	
Total Fund (A)	<u>7.58</u>	%	<u>11.21</u>	%	<u>2.74</u>	%	<u>7.42</u>	%
Total Global Equity:	<u>4.22</u>	%	<u>9.45</u>	%	<u>-0.46</u>	%	<u>7.14</u>	%
Public Equity (B)	4.14	%	8.09	%	-1.22	%	6.51	%
Private Equity	4.07	%	16.50	%	4.42	%	15.89	%
Total Stable Value:	<u>14.10</u>		<u>13.30</u>		<u>8.71</u>		<u>7.03</u>	
Fixed Income (C)	18.95	%	16.80	%	12.73	%	8.92	%
Stable Value Hedge Funds	0.50	%	3.35	%	0.12	%	4.85	%
Cash Equivalents	2.04	%	1.45	%	1.45	%	2.25	%
Total TRS Real Return:	<u>9.21</u>	%	<u>11.88</u>	%	<u>3.72</u>	%	<u>(F)</u>	
Inflation Linked Bonds	8.35	%	9.89	%	(E)		(E)	
Real Assets	11.19	%	9.39	%	-3.92	%	(F)	
Commodities	-11.03	%	6.37	%	(E)		(E)	
REITS (D)	20.32	%	23.44	%	(E)		(E)	

Note A: All returns were calculated by the Custodian

Note B: Global Equity Returns include Directional Hedge Funds as of September, 2012

Note C: Does not include Global Inflation Linked Bonds in Real Return Portfolio.

Note D: Dedicated portfolio in addition to Global Equity holdings.

Note E: No performance data is available because these asset classes were established within the last five years.

Note F: No performance data is available because these asset classes were established within the last ten years

EXHIBIT B
TEACHER RETIREMENT SYSTEM OF TEXAS
SUMMARY OF INVESTMENTS AT MARKET VALUE
AUGUST 31, 2012

	Market Value	% of Portfolio	Long-Term Normal		
				Low	High
Public Equity (A)	56,724,131,800	51.1%	50.0%	45.0%	55.0%
Private Equity	13,100,878,204	11.8%	12.0%	7.0%	17.0%
TOTAL GLOBAL EQUITY	69,825,010,004	62.9%	62.0%	55.0%	67.0%
Fixed Income (B)	14,475,441,520	13.0%	13.0%	0.0%	23.0%
Short Term	956,871,370	0.9%	1.0%	0.0%	5.0%
Hedge Funds	3,935,617,648	3.5%	4.0%	0.0%	10.0%
TOTAL STABLE VALUE	19,367,930,538	17.4%	18.0%	13.0%	23.0%
Inflation Linked bonds	5,499,238,301	5.0%	5.0%	0.0%	10.0%
Real Assets	13,030,781,800	11.7%	13.0%	5.0%	20.0%
Commodities	1,154,604,506	1.0%	0.0%	0.0%	5.0%
REITS (C)	2,187,939,551	2.0%	2.0%	0.0%	5.0%
TOTAL REAL RETURN	21,872,564,158	19.7%	20.0%	15.0%	25.0%
TOTAL	111,065,504,700	100.0%	100.0%		

Note A: Global Equity allocation included Directional Hedge Funds with an 8/31/12 Market Value of \$5,584,378,041.

Note B: Does not include Global Inflation Linked Bonds in Real Return Portfolio.

Note C: Dedicated portfolio in addition to Global Equity holdings.

EXHIBIT C
TEACHER RETIREMENT SYSTEM OF TEXAS
LISTING OF COMMISSIONS AND FEES PAID
FOR SALE, PURCHASE OR MANAGEMENT OF SYSTEM ASSETS
FISCAL YEAR ENDED AUGUST 31, 2012

Investment Related Expenses Paid from the Pension Trust Fund:

Management Operating Costs:

Direct Expenses:

Salaries and Other Personnel Costs	\$ 26,653,903
Professional Fees and Services	5,531,470
Consumable Supplies	85,156
Travel	545,399
Building Lease*	1,327,136
Copier Rentals	64,854
Dues, Fees and Staff Development	42,706
Subscriptions and Reference Materials	37,911
Reproduction and Printing Services	14,894
Software Upgrades	284,802
Telecommunication and Data Services	289,465
Furniture and Equipment - Expensed	25,132
Depreciation - Leasehold Improvements	516,031

Total Direct Expenses	\$ 35,418,859
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Indirect Expenses:

Depreciation	\$ 233,094
Executive Management Support	1,358,459
Legal Support	1,511,699
Audit Support	755,984
Human Resources Support	609,223
Fiscal Management Support	1,535,735
Information Technology Support	3,368,077
Staff Services Support	1,579,170
Other Support Services	388,434

Total Indirect Expenses	\$ 11,339,875
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Total Internal Investment Costs	\$ 46,758,734
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External Manager Fees	\$ 111,030,583
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Total Investment Costs **	\$ 157,789,317
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*Includes adjustments for proportional amount of rent abatement and lease allowances in the amount of \$430,470. The sum of this adjustment reduces the amount of Building Lease reported for FY 2012.

** Does not include commissions and fees paid from investment proceeds.

Commissions paid on Equity Transactions	\$ 65,233,002
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Alternative Investments Fees:

Hedge Funds	\$ 106,069,852
Other Absolute Return	\$ 2,102,087
External Public	\$ 24,154,779
Private Equity	\$ 156,688,170
Real Assets	\$ 73,005,225