

INVESTMENT SECTION



HMEPS

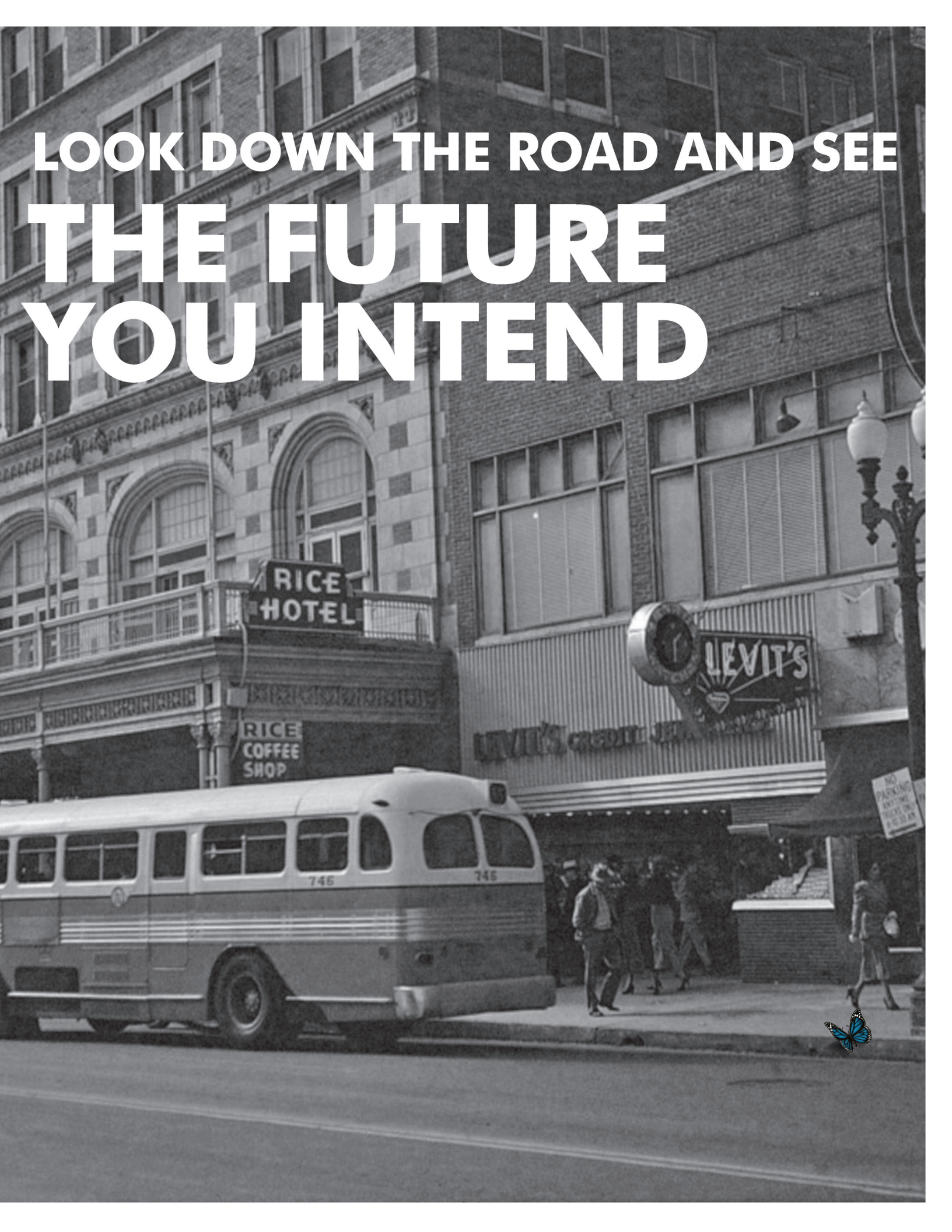
HOUSTON MUNICIPAL EMPLOYEES PENSION SYSTEM



Rice Hotel on Main Street, 1955



LOOK DOWN THE ROAD AND SEE
**THE FUTURE
YOU INTEND**



DISCUSSION OF INVESTMENT POLICIES AND ACTIVITIES

The Board of Trustees (“Board”) of the Houston Municipal Employees Pension System (“System”) has adopted an Investment Policy Statement (“IPS”) as a framework for the investment of the System’s assets. The authority to amend the IPS rests solely with the Board. The following provides an outline of the IPS.

PURPOSE

The IPS assists the Board in its role as fiduciary for the System’s investments by: a) specifying the Board’s expectations, objectives and guidelines for the System, b) clarifying the responsibilities of the Board, the staff, the consultants and vendors, c) setting forth an investment structure for managing the portfolio, d) encouraging effective communications, and e) establishing criteria to select, remove, monitor and evaluate performance of money managers and vendors on a regular basis.

INVESTMENT OBJECTIVES

The investment objective of the total portfolio is to produce an annualized investment return over the long term that exceeds the actuarial return rate assumption for the System. This will help the Board to achieve its overall objective of providing adequate retirement benefits to the members of the System.

The performance of the System’s investments is compared with a policy portfolio comprised of market indices, which are consistent with the overall investment policy. The policy portfolio reflects a passive implementation of the investment policy. Effective October 1, 2017, the Board approved an updated asset allocation for the System’s investments, along with an updated policy portfolio. During the first quarter of the fiscal year, the System operated under the previous policy portfolio.

Comparisons of total fund performance are also made with a universe of public pension funds implementing generally comparable investment policies. The public pension fund universe used for comparative purposes is the Wilshire TUCS Master Trusts – Public Universe.

ASSET ALLOCATION

The System’s investment allocation provides an efficient allocation of assets that is designed to achieve overall portfolio risk and return objectives. The Board periodically undertakes strategic studies to address the appropriateness of asset classes to be considered for inclusion in the asset allocation, and to define the targeted percentage to each asset class to achieve the desired level of diversification.

The System’s updated asset allocation became effective October 1, 2017. The current target and actual allocations are included in Table 2.

DIVERSIFICATION

The System invests in seven major asset classes (Global Equities, Fixed Income, Real Estate, Private Credit, Private Equity, Inflation-Linked, and Absolute Return) and engages the services of numerous professional investment managers (including in both public markets and private partnerships) with demonstrated skills and expertise in managing portfolios within each asset class as a method to maximize overall fund diversification. The managers retained are expected to utilize varied investment approaches that, when combined, will exhibit characteristics that are similar to the asset class proxy utilized in the strategic asset allocation plan. As of June 30, 2018, the System had investments with 84 investment managers, several of which manage multiple mandates. Cash inflows and outflows are directed within the targeted asset class to the various managers so that actual characteristics of the portfolio will be consistent with the strategic plan. No investment manager is permitted to have more than 20% of the fair value of the System’s assets.

REBALANCING

The IPS requires a periodic adjustment, or rebalancing, of assets be made to ensure conformance with policy target levels. Such rebalancing is necessary to reflect sizable cash flows and performance imbalances among the various asset classes that may occur over time. During fiscal year 2018, Staff directed the rebalancing of assets within the asset allocation targets in response to market dynamics and the System’s liquidity needs.

INVESTMENT MANAGER GUIDELINES – PUBLIC MARKETS

Investment managers are subject to guidelines and objectives incorporated in the investment management agreements entered into by the Board and the respective investment managers. Investment managers are expected to perform their fiduciary duties as prudent people skilled in such matters and, further, are expected to comply with all applicable State and Federal statutes governing the investment of retirement funds. Within the context of the guidelines, investment managers have full discretion with respect to the purchase and sale of individual securities and portfolio weightings. Portfolios are to be managed in a manner similar to other portfolios within an organization with similar guidelines and performance objectives.

The Board requires that all investment managers seek best execution for all trades ordered on behalf of the System.

MANAGER EVALUATION

Managers of portfolios are evaluated quarterly against predetermined benchmarks such as an appropriate market index or a comparable peer group. All public market managers are required to provide written reports to HMEPS of their activities and performance. In addition, System personnel and professional consultants engaged by the Board monitor managers' performance, material changes in the managers' organization and conformity with their guidelines and objectives.

Managers who do not meet expectations will be placed on probation (for public market managers) or watchlist (for private market managers). Staff and the consultant will increase monitoring of these managers, evaluating factors such as changes in the assets in the portfolio, changes in investment style, peer universe ranking and others.

INVESTMENT PERFORMANCE EVALUATION

The Board reviews System investment performance on a periodic basis to evaluate conformity to the goals and objectives established in the strategic plan. The Board recognizes that financial markets from time to time may not support attainment of those goals and objectives. During such times, progress toward conformity is evaluated by comparing the System's performance to the policy portfolio and to the Wilshire TUCS Master Trusts – Public Universe. Investment results are calculated using a time-weighted rate of return based on the market rate of return.

PROXY VOTING

The Board authorizes each investment manager to vote all proxies relating to shares of securities under management. Each manager is expected to promptly vote all proxies and related actions in a manner consistent with the long-term interests of the System and its participants and beneficiaries. Each investment manager is required to keep detailed records of all voting of proxies and related actions and to comply with all related regulatory obligations. The System's management staff periodically reviews each investment manager's policies and actions in respect to proxy voting.

Investment Results*LONG-TERM RESULTS*

The 10-year period ended June 30, 2018 encompassed the 2008 financial crisis and has produced volatile returns, both for the markets as a whole, and also for the System. The System generated double digit positive returns in five of the past ten fiscal years, and outperformed its peer group in seven of those ten years. Due to the diversification of assets, the System's 5-year annualized return is 8.6%. The 10-year return stands at 7.0%.

As shown in the investment results (Table 2), HMEPS' total fund performance compares favorably to the median public fund, as represented by the Wilshire TUCS Master Trusts – Public Universe.

DISCUSSION OF INVESTMENT POLICIES AND ACTIVITIES

FISCAL YEAR 2018 RESULTS

For the fiscal year ended June 30, 2018, the System returned 9.3%. This rate of return exceeded both the System's policy benchmark return of 8.3%, and the return of the median fund in the Wilshire TUCS Master Trusts – Public Universe of 8.5%.

The Investment Section was written by Chief Investment Officer Gregory Brunt, CFA, Sr. Financial Analyst Brad Bangen, and Financial Analyst Jumana Aumir, CFA.

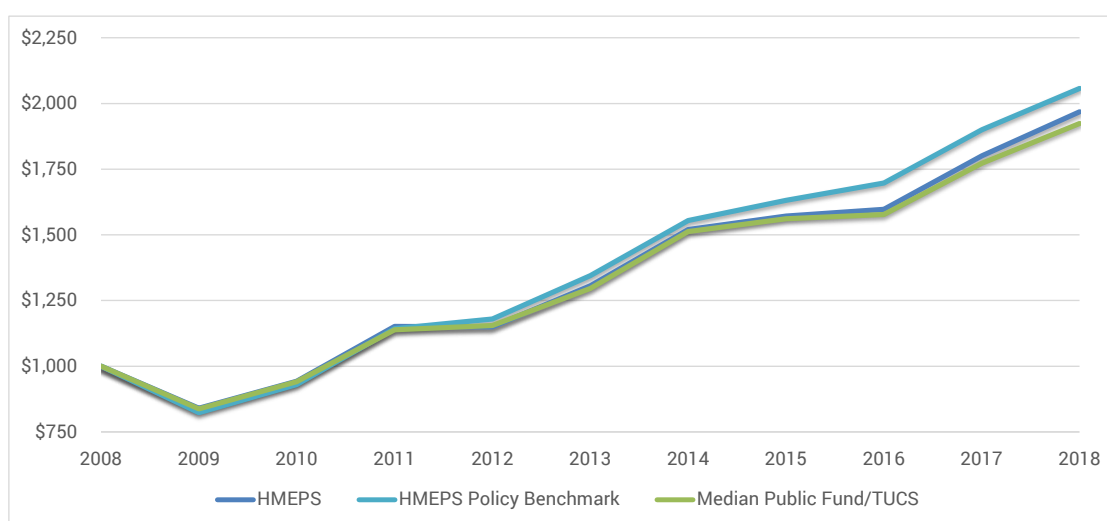
Schedule of Asset Allocation

Table 1

Asset Class	Allocation		Investment Performance			
	Target	Actual	1 Yr.	3 Yrs.	5 Yrs.	10 Yrs.
Total Global Equity	32.5%	33.0%	9.8%	8.4%	9.7%	n/a
<i>Global Equity Policy</i> ¹			10.2	8.4	9.5	n/a
Global Fixed Income	10.0	13.7	1.5	4.2	4.5	6.1
<i>Barclays Aggregate Index</i>			-0.4	1.7	2.3	3.7
<i>Merrill Lynch High Yield Master II Index</i>			2.5	5.5	5.5	8.0
Private Credit	5.0	0.5	n/a	n/a	n/a	n/a
<i>CSFB Leveraged Loan Index</i>			n/a	n/a	n/a	n/a
Private Equity	17.0	20.7	17.2	13.3	12.9	9.6
<i>S&P 500 Index + 3%</i> ²			17.4	14.9	16.4	13.2
Real Estate ³	12.5	10.3	9.9	10.6	10.4	1.4
<i>NCREIF Property Index</i>			7.2	8.3	9.8	6.2
Inflation-Linked	15.0	14.4	5.8	0.2	2.3	n/a
<i>CPI + 4%</i> ⁴			6.9	5.8	5.5	n/a
Absolute Return	8.0	5.7	4.7	1.4	2.8	n/a
<i>LIBOR + 4%</i> ⁵			5.8	5.1	4.8	n/a
Cash	-	1.6	0.9	0.6	1.8	1.8
Total Portfolio	100.0	100.0	9.3	7.8	8.6	7.0
<i>Policy Benchmark</i>			8.3	8.0	8.9	7.5
<i>Median of Wilshire Public Fund Universe/TUCS</i>			8.6	7.3	8.4	7.0

Illustration of Growth of \$1000

Table 2



1. The Global Equity Policy: 3Q13 -Present: 75% MSCI All-Country World IMI (Net), 25% MSCI All-Country World Minimum Volatility Index (Net).
2. Beginning October 1, 2008, Private Equity is separate from Absolute Return. Prior returns were combined in the Private Equity composite.
3. Beginning October 1, 2008, Real Estate is separate from Inflation-Linked. Prior returns were combined in the Real Estate composite.
4. Inflation Linked Assets Custom Benchmark: 2Q11-Present: CPI + 4% annually; Prior to 2Q11: CPI + 5% annually.
5. Absolute Return Benchmark: 2Q11 - Present: Libor 3-Month Yield + 4% annually; Prior to 2Q11: Libor 3-Month Yield + 5% annually.

Schedule of Top Investments

Schedule Of Top Public Equity Investments As Of June 30, 2018*

Name of Investment	Fair Value of Investment	Percent of Portfolio
BlackRock ACWI ex-US Index	\$ 224,735,728	7.5%
BlackRock MSCI ACWI MIC Index	219,145,233	7.3%
State Street Global Advisors REIT Index	103,919,199	3.5%
BlackRock Equity Index Fund A	34,637,132	1.2%
State Street Global Advisors Global Natural Resources	33,258,269	1.1%
Blackrock MSCI Emerging Markets Free Fund	32,611,100	1.1%
State Street Global Advisors Bloomberg Roll Select	27,004,623	0.9%
Williams Partners	9,976,454	0.3%
MPLX	9,144,160	0.3%
Plains All American Pipeline	7,944,104	0.3%

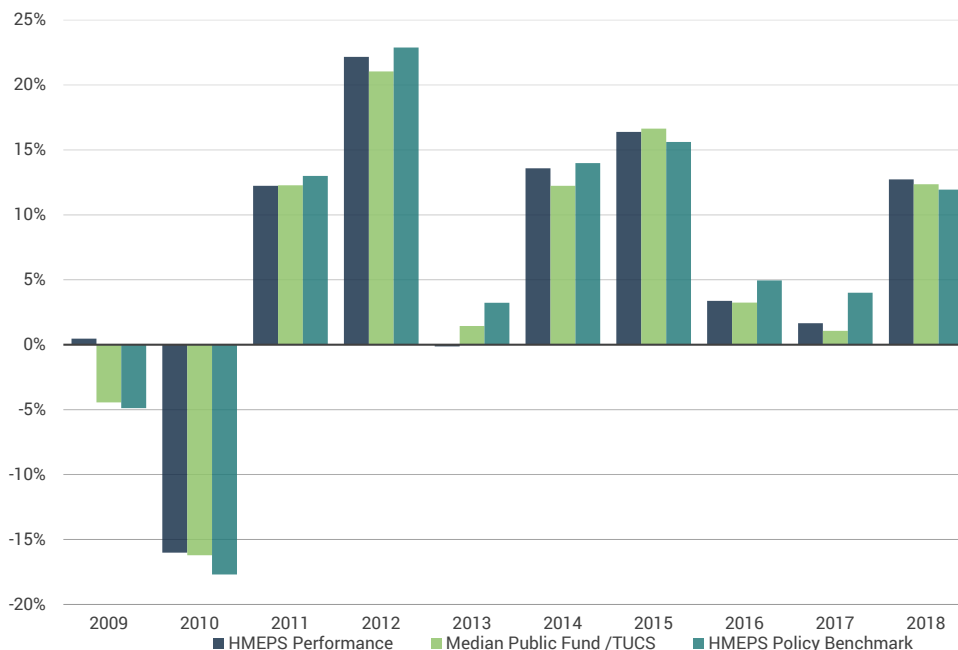
Schedule Of Top Debt Investments As Of June 30, 2018*

BlackRock U.S. Debt Index (Barclays Aggregate)	\$ 74,377,792	2.9%
GMO Emerging Country Debt	18,889,412	0.7%
Alliance Bernstein Emerging Market	17,445,170	0.7%
US Treasury N/B 11/15/18	8,073,463	0.3%
US Treasury N/B 11/1/18	4,032,828	0.2%
US Treasury N/B 8/46 2.25	2,674,181	0.1%
US Treasury N/B 11/23 2.75	2,374,074	0.1%
Star Metals 14 2LSR	2,342,100	0.1%
US Renal Care Inc Loan	2,282,850	0.1%
US Treasury N/B 5/22 1.75	2,264,121	0.1%

* A complete list of the System's holdings is available at the System's office by appointment.

Performance By Fiscal Year

Last Ten Years



Comparison of Investment Returns - Years Ended June 30

(Calculated based on a time-weighted rate of return based on the market rate of return)

Period ending 06-30	HMEPS Total Fund	HMEPS Policy Portfolio	Median of Wilshire Public Fund Universe/ TUCS	HMEPS Global Equity	MSCI ACWI IMI	MSCI ACWI Min Vol	HMEPS Fixed Income	Barclays Capital Aggregate Bond Index	Merrill Lynch High Yield Master II Index	HMEPS Private Equity	S&P 500 Index	HMEPS Real Estate	NCREIF Property Index	HMEPS Inflation-Linked	Consumer Price Index	HMEPS Absolute Return	LIBOR
2009	-16.02%	-17.55%	-19.19%	n/a	n/a	n/a	0.36%	6.06%	-3.53%	-20.93%	-26.22%	-40.37%	-19.57%	n/a	n/a	n/a	n/a
2010	12.24%	13.00%	14.71%	n/a	n/a	n/a	17.00%	9.50%	27.53%	16.82%	14.43%	-9.52%	-1.48%	21.52%	1.05%	23.39%	0.34%
2011	22.17%	22.89%	21.19%	n/a	n/a	n/a	9.33%	3.90%	15.40%	22.54%	30.68%	10.92%	16.73%	39.72%	3.56%	13.94%	0.33%
2012	-0.14%	3.23%	1.25%	n/a	n/a	n/a	6.31%	7.48%	6.51%	11.00%	5.44%	3.78%	12.00%	-21.96%	1.66%	-0.86%	0.46%
2013	13.58%	13.99%	12.27%	n/a	n/a	n/a	5.99%	-0.69%	9.57%	7.85%	20.59%	12.80%	10.73%	14.52%	1.75%	10.87%	0.31%
2014	16.39%	15.61%	16.83%	21.92%	20.92%	13.84%	9.22%	4.37%	11.80%	14.31%	24.61%	9.11%	11.21%	22.33%	2.07%	7.28%	0.24%
2015	3.38%	4.96%	3.38%	2.22%	0.81%	6.59%	1.13%	1.86%	-0.55%	10.36%	7.42%	10.88%	12.96%	-9.14%	0.12%	2.65%	0.25%
2016	1.65%	4.02%	1.07%	-0.31%	-3.87%	11.55%	3.33%	6.00%	1.71%	7.05%	3.99%	12.95%	10.64%	-12.18%	1.01%	-6.92%	19.00%
2017	12.73%	11.95%	12.41%	16.34%	19.01%	6.05%	7.80%	-0.31%	12.75%	16.02%	17.90%	9.15%	6.98%	8.24%	1.63%	7.13%	1.02%
2018	9.33%	8.29%	8.45%	9.81%	11.14%	7.33%	1.50%	-0.40%	2.49%	17.22%	14.38%	9.87%	7.20%	5.78%	2.87%	4.65%	1.36%
3 Yrs.	7.80%	8.04%	7.25%	8.40%	8.34%	8.28%	4.18%	1.72%	5.53%	13.34%	11.93%	10.64%	8.26%	0.18%	1.83%	1.43%	0.68%
5 Yrs.	8.55%	8.88%	8.42%	9.68%	9.59%	9.03%	4.65%	2.27%	5.50%	12.93%	13.42%	10.38%	9.77%	2.25%	1.54%	2.82%	0.42%
10 Yrs.	7.01%	7.46%	6.98%	n/a	6.14%	7.70%	6.09%	3.72%	8.03%	9.55%	10.17%	1.39%	6.22%	n/a	n/a	n/a	n/a

Schedule of Fees and Commissions Paid

In Fiscal Year 2018

Broker Name	Number of Shares	Commissions (\$)	Cents/Share
B. Riley & Co., LLC	76,650	3,066	4.00
Barclays Capital	733,564	14,482	1.97
BNP Paribas Securities Services	210,316	2,274	1.08
BTIG, LLC	57,550	2,211	3.84
Canaccord Genuity Corp.	184,786	4,263	2.31
Capital Institutional Svcs Inc Equities	6,360,900	14,209	0.22
Citigroup Global Markets Inc.	888,971	19,152	2.15
Cjs Securities Inc	65,475	2,619	4.00
Cowen And Company, LLC	437,547	12,976	2.97
Craig - Hallum	66,700	2,668	4.00
Credit Suisse Securities	316,804	9,245	2.92
Davidson D.A. + Company Inc.	71,650	2,866	4.00
Deutsche Bank Securities Inc	546,538	6,595	1.21
Goldman Sachs + Co	727,405	12,610	1.73
Guzman And Company	146,139	2,783	1.90
HSBC Bank PLC	335,490	2,276	0.68
Instinet LLC	242,424	5,186	2.14
J P Morgan Securities Inc	1,322,838	12,007	0.91
Jefferies + Company Inc	965,704	8,620	0.89
Macquarie Bank Limited	310,800	2,705	0.87
Maxim Group	259,546	6,660	2.57
Merrill Lynch And Co Inc	569,948	11,731	2.06
Morgan Stanley Co Incorporated	724,179	18,981	2.62
National Financial Services Corp.	495,104	9,927	2.00
Piper Jaffray	60,925	2,352	3.86
Raymond James And Associates	170,798	3,416	2.00
RBC Capital Markets	262,363	4,846	1.85
Robert W. Baird Co. Incorporate	139,121	5,076	3.65
Rosenblatt Securities LLC	121,450	3,038	2.50
Roth Capital Partners LLC	68,700	2,748	4.00
Sanford C. Bernstein Ltd	403,319	9,321	2.31
Sg Americas Securities LLC	123,170	3,530	2.87
Sidoti + Company LLC	70,175	2,807	4.00
Societe Generale	320,234	3,267	1.02
Stifel Nicolaus + Co Inc	150,953	5,831	3.86
UBS Securities LLC	1,386,719	26,463	1.91
Weeden + Co.	174,715	4,175	2.39
Wells Fargo Securities, LLC	591,583	37,490	6.34
Others	2,755,086	30,189	1.10
Total	22,916,339	334,661	

Schedule of Fees and Commissions Paid cont.

In Fiscal Year 2018

Public Market Investments	Market Value	Fees	Basis Points
Global Equity	\$ 988,271	\$ 2,724	28
Fixed Income	408,458	1,259	31
Inflation Linked	430,427	1,024	24
Other Public Market	103,919	297	29
Non-Public Market	1,028,720	75	1
Grand Total	<u>\$ 2,959,795</u>	<u>\$ 5,382</u>	
Custodian Bank			
State Street Bank & Trust Company		370	
Consultant Services			
Wilshire Associates, Inc.		284	
Cliffwater LLC		550	
Legal Services		53	
Other Investment Expenses		<u>1,027</u>	
Total Investment Expenses		<u>\$ 7,667</u>	

Note: Dollar amount in \$000