



Population:

6,786



LAMPASAS



The county seat of Lampasas County, located 69 miles northwest of Austin on Highway 183, nestles at the edge of the Hill Country. Lampasas is known as a hunting and fishing destination but is still principally a farming and ranching community, just as it was in 1948. The city endured natural disasters in its past, including fires and floods, but was well established by the 1940s, with city utilities and water, a recognized hospital, and the establishment of Fort Hood near the outskirts of town at the onset of World War II. Lampasas participates in the Texas Main Street Project and has restored its downtown limestone buildings to their former glory. Recent restorations of old structures, including the county courthouse, have revealed architectural marvels all over this rapidly growing city.

Top: residents gather on the square; middle left: windows of City Hall reflect downtown buildings; middle right: the former Gibson's store, shown here in 1968, was turned into police headquarters; bottom: restored historic buildings on Third Street, downtown Lampasas.



A small city 18 miles east of Waco in eastern McLennan County on State Highway 164, Mart remains a traditional, agricultural community founded on wheat and cotton. The population of Mart declined after the Missouri Pacific railroad abandoned its tracks through the town. One of the hidden secrets of Mart is that its post office building features a beautiful mural depicting the arrival of Neil McLennan and family in an ox-drawn covered wagon. In modern-day Mart, new storefronts pop up next to old, established ones, but the feeling of country living remains the same.



MART

Population: 2,273

Top: Downtown building reclaimed as a Texas Historic site looks just as it did in the 1940s; middle right: Mart FFA Ag parade, turning from Texas Avenue onto Pearl Street, 1948; middle left: a main street grocery store; bottom: Main Street in Mart today.



REPORT ON INVESTMENT ACTIVITY



TEXAS MUNICIPAL RETIREMENT SYSTEM

Providing retirement security for Texas municipal employees

April 29, 2005

To The Board of Trustees and Participants of the
Texas Municipal Retirement System

Ladies and Gentlemen:

The objective of the TMRS investment program is to produce consistent income that will allow annual interest credits according to statutory requirements and the TMRS plan design. TMRS achieves this by investing in quality bonds with long maturities with an emphasis on protection from the likelihood of a bond being retired prematurely. As a result, the investment program objectives focus on income rates of return rather than total rates of return that are impacted by volatile valuations in a changing interest rate environment. Depending on the interest rate environment, the TMRS investment portfolio's total rate of return can fluctuate significantly, while the income rate of return is relatively stable. The TMRS focus on income return and its consistent strategy of holding quality long-term bonds has contributed to TMRS' ability to grant for the year 2004 an interest credit of 7.0%. This was above the general market environment and above the statutory target rate of 5%. In addition, TMRS paid one "extra check" to annuitants in 2004, and ended the year with an interest reserve in excess of 2.0% of invested assets.

The year 2004 was characterized by challenges in finding high quality investments at relatively attractive yields. Upgrades were few and far between and the staff's focus was on continuing improvement of the overall quality of the portfolio as well as capturing significant realized gains during the year due to the low interest rate environment. TMRS' economic advisors, A. Gary Shilling and Co., Inc. and Hillswick Asset Management, L.L.C., continue to project an environment of lower long-term interest rates even though we have seen interim short-term rate increases during the second half of 2004. Lower rates mean higher bond prices and zero coupon securities, which are a significant part of the current TMRS investment strategy, perform particularly well in a declining interest rate environment. During 2004, yields ranged from a low of 4.77% to a high of 5.35%. Volatility in yields (i.e. prices) provided opportunities to enhance the portfolio's income through realized gains.

The TMRS portfolio performance was calculated by Holbein Associates and State Street Analytics, a division of State Street Corporation. TMRS makes every effort to compute and present accurate investment return information in accordance with the Global Investment Standards of the CFA Institute, formerly known as the Association for Investment Management and Research (AIMR). Comparisons were made to other pension plans in the State Street Universe (SSU), without regard for the investment objectives of the individual plans in the universe. The State Street Universe is a proprietary comparative universe service developed by State Street Corporation, representing more than \$1 trillion in assets and containing over 5,000 portfolios. Additional comparisons are made to a relevant nationally recognized bond index, the Lehman Government/Credit Long Bond Index (LG/C Long).

The performance measurement reveals that the TMRS income rate of return, a measure that is appropriate for the investment program objectives, remains consistent and was 7.3% over the past ten years. It ranked in the top 1% of SSU's Total Fund income returns whose Median Total Fund return was 2.9%. TMRS also exceeded the LG/C Long income return of 7.0%. For the past ten years the total rate of return was 10.5% versus the 9.9% return of the SSU's Median Public Fund, which represents ownership of all classes of security investments. In addition, TMRS also exceeded the LG/C Long total return of 9.7%. The portfolio's high relative total rate of return is a result of the portfolio's long-term maturity structure and higher concentration in zero coupon securities. The investment results were achieved within the investment policies established by the TMRS Board of Trustees.

Respectfully submitted,



Preston G. Craig
Director of Investments

OUTLINE OF INVESTMENT POLICIES

Because the plan design depends on a relatively consistent level of credited interest across all plan years, and because compound interest credited annually at the highest feasible rate best assures the highest amount of accumulated deposits of the member at retirement, TMRS' goals are best achieved by an income-producing portfolio management strategy, rather than a total return strategy that may result in credits below the 5% statutory minimum target level.

As such, neither market value declines nor rises of its fixed-income portfolio is of material significance to the System's investment objectives. Periods of rising interest rates, which, by definition, will result in erosion of bond market values, should be regarded as opportunities to increase the yield on the total portfolio, and fixed income market volatility should be regarded as an opportunity to realize gains.

INVESTMENT OBJECTIVES

The basic objectives of investment and reinvestment of system assets are:

1. To assure preservation of (and return of) principal.
2. To earn income sufficient to:
 - a) Allow annual interest credit on the reserve funds at the minimum statutory rate;
 - b) Pay annual administrative costs of the System; and
 - c) Allow annual interest credit on the member and municipality accumulation accounts at the minimum statutory rate.
3. To consistently earn additional income, if feasible, for the following purposes:
 - a) Maintain and continue an "interest reserve" to better ensure continued credits at the statutory minimum target rate during low yielding market periods;
 - b) Pay a distributive benefit to annuitants on December 31st of each year; and
 - c) Credit additional annual interest to the individual accounts of members and to the accumulation accounts of municipalities.

GENERAL INVESTMENT POLICIES

1. Funds of the System shall be invested, without distinction as to source, only in securities as that term is defined in the TMRS Act and as authorized by the TMRS Board of Trustees' investment policies. Board policy limits on amounts of any security or class of securities shall be observed.

2. Investments shall be made with the degree of judgment and care, under the circumstances prevailing at the time of the investment, that persons of ordinary prudence, discretion and intelligence exercise in the management of their own affairs, not in speculation but when making a permanent disposition of their funds, considering the probable income from the disposition and probable safety of their capital.

SUMMARY OF INVESTMENTS

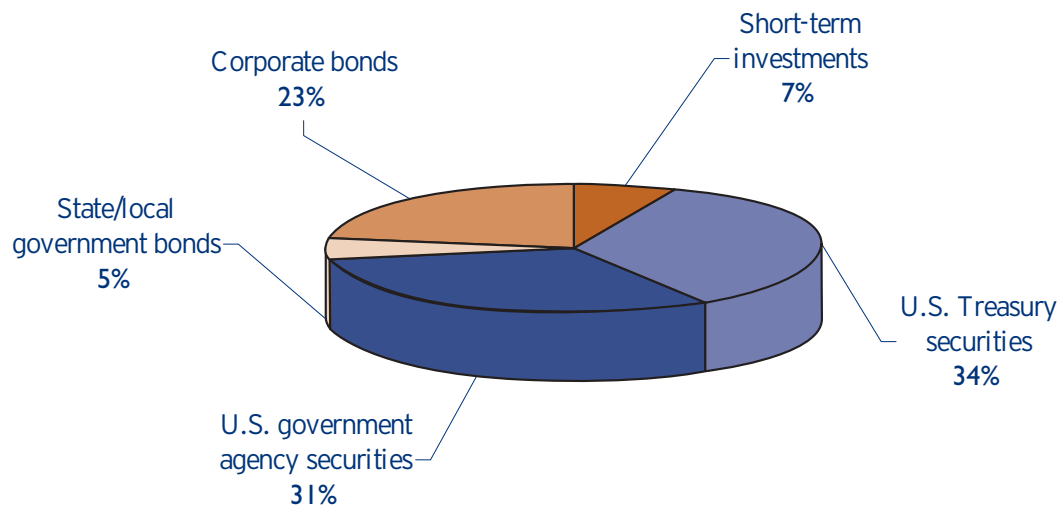
AS OF DECEMBER 31, 2004

	FAIR VALUE	PERCENT OF TOTAL FAIR VALUE	YIELD TO MATURITY
Short-term investments	\$ 782,541,537	6.6%	*1.37%
Investments:			
U.S. Treasury securities	4,101,185,258	34.5	5.02
U.S. government agency securities	3,678,232,636	30.9	5.42
State/local government bonds	618,096,198	5.2	5.37
Corporate bonds	2,718,887,371	22.8	5.70
Total investments	<u>11,116,401,463</u>	<u>93.4</u>	<u>5.34</u>
TOTAL	\$11,898,943,000	100.0%	5.08%

* Average income yield for the year.

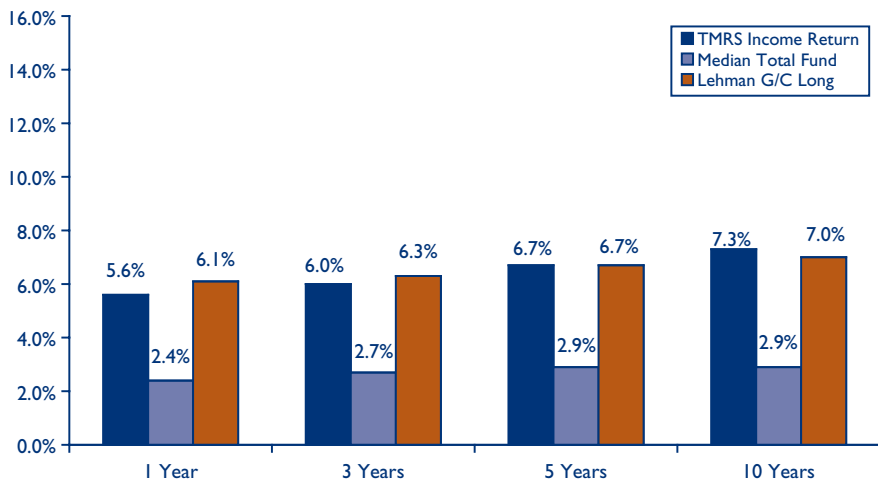
Note: The summary above includes assets of both the Fiduciary and Proprietary Funds.

ASSET ALLOCATION



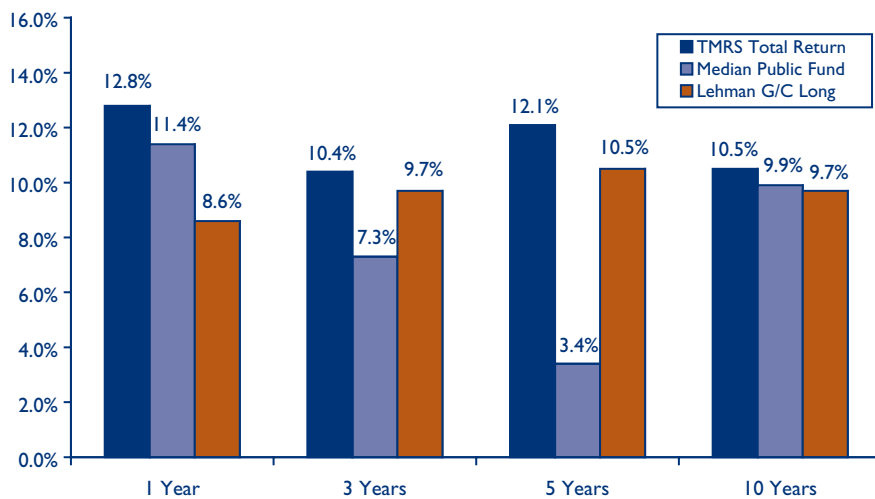
2004 INVESTMENT RESULTS

TMRS INCOME RATE OF RETURN



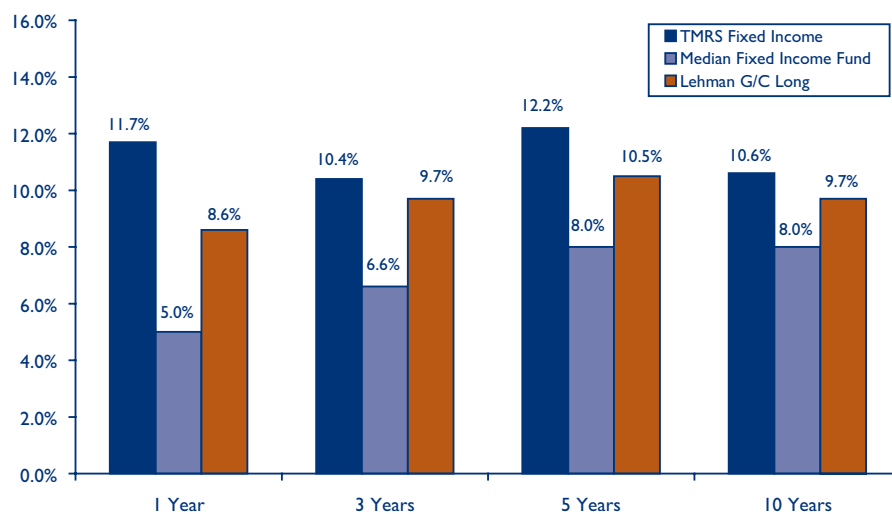
This graph compares the annual income of TMRS on a current yield and time weighted basis with the Median Total Fund Income of the universe measured and the Lehman Brothers Government/Credit Long Bond Index. This income stream is an important part of guaranteeing retirement annuities. Quality income and preservation of capital are the main TMRS investment objectives.

TMRS TOTAL FUND RATE OF RETURN



This graph compares TMRS' total rate of return, which includes income and appreciation of assets (realized and unrealized gains) to the Median Public Fund of all public funds measured, which may or may not be diversified funds, and the Lehman Brothers Government/Credit Long Bond Index.

TMRS BONDS ONLY - TOTAL RATE OF RETURN



This graph compares TMRS' fixed income total rate of return with the Median of the Bonds Only Universe and the Lehman Brothers Government/Credit Long Bond Index. The TMRS policy, with its long-term nature, emphasizes income rate of return in lieu of market performance.

BOND PORTFOLIO CHARACTERISTICS

	TMRS DECEMBER 31, 2004	LB G/C LONG DECEMBER 31, 2004
Total number of securities	152	860
Current coupon	3.60%	7.01
Yield to maturity	5.34%	5.27
Adjusted duration (years)	16.8	11.0
Average quality	AAA	AA2/AA3

This table displays the statistical characteristics of the TMRS bond portfolio as of December 31, 2004, in comparison with a relevant market index, the Lehman Brothers Government/Credit Long Bond Index.

SUMMARY OF INVESTMENT OPERATIONS

FOR YEARS ENDED DECEMBER 31, 2004 and 2003

	2004	2003
INVESTMENT INCOME :		
Interest earned on short-term investments	\$ 4,520,429	\$ 6,792,325
Interest earned on U.S. Treasury securities	210,232,257	144,416,225
Interest earned on U.S. government agencies	218,570,542	243,451,350
Interest earned on state/local government bonds	26,895,306	-
Interest earned on corporate bonds	146,675,006	185,145,252
Gains on sale of bonds	87,988,926	137,198,851
Net securities lending income*	4,309,533	2,886,526
Other	(614)	17,520
TOTAL INVESTMENT INCOME	\$ 699,191,385	\$ 719,908,049

INVESTMENT INCOME ALLOCATION :

Employee savings fund	\$ 202,697,518	\$ 216,329,492
Municipal accumulation fund	307,389,534	331,107,075
Current service annuity reserve fund	157,106,806	138,063,096
Supplemental disability benefits fund	60,875	64,297
Supplemental death benefits fund	937,040	887,138
Endowment:		
Distributive benefits	30,043,422	40,368,985
Interest reserve	956,190	(6,912,034)
TOTAL DISTRIBUTION TO FUNDS	\$ 699,191,385	\$ 719,908,049

* For purposes of this schedule, securities lending income is presented net of related fees of \$66,649,478 and \$23,670,324 for 2004 and 2003, respectively.

Note: This schedule represents the allocation of interest income, as defined by the TMRS Act, to the various funds. A description of each fund can be found in Note 1-D. This schedule does not include unrealized appreciation/depreciation in the fair value of fixed income securities.

LARGEST HOLDINGS (BY FAIR VALUE)

AS OF DECEMBER 31, 2004

PAR	DESCRIPTION	FAIR VALUE
\$ 1,666,000,000	U.S. Treasury - 5 1/2%, due 8-15-2028, Rating AAA	\$ 1,803,111,800
3,225,000,000	Resolution Funding - Zero bonds, due 1-15-2030, Rating AAA	885,585,000
609,952,500	Illinois State Taxable Pension Bonds - 5.1%, due 6-1-2033, Rating AA	585,920,372
1,750,000,000	U.S. Treasury Principal Strips - due 2-15-2027, Rating AAA	568,400,000
1,985,000,000	Resolution Funding - Zero bonds, due 4-15-2030, Rating AAA	538,133,500
410,630,000	Tennessee Valley Authority - 7 1/8%, due 5-1-2030, Rating AAA	510,782,657
1,150,000,000	U.S. Treasury Principal Strips - due 8-15-2026, Rating AAA	383,065,000
1,150,000,000	U.S. Treasury Principal Strips - due 8-15-2027, Rating AAA	364,090,000
755,000,000	Resolution Funding - Zero bonds, due 10-15-2020, Rating AAA	336,277,000
975,000,000	U.S. Treasury Principal Strips - due 11-15-2026, Rating AAA	320,677,500

Note: Space and cost restrictions make it impractical to print a detailed listing of the investment portfolio in this report; however, a portfolio listing is available and will be mailed upon request.

SCHEDULE OF INVESTMENT FEES YEAR ENDED DECEMBER 31, 2004

PERSONNEL SERVICES:	
Staff salaries	\$ 419,890
Payroll taxes	23,408
Retirement contributions	49,547
Insurance	25,148
TOTAL PERSONNEL SERVICES	517,993
PROFESSIONAL SERVICES:	
Consulting fees	86,500
TOTAL PROFESSIONAL SERVICES	86,500
COMMUNICATION:	
Printing	69
Travel	21,719
TOTAL COMMUNICATION	21,788
MISCELLANEOUS:	
Dues, subscriptions and training	115,190
Miscellaneous administrative expenses	1,519
TOTAL MISCELLANEOUS	116,709
TOTAL INVESTMENT EXPENSES	\$ 742,990

Note: All investment fees incurred during 2004 are related to the System's internally-managed portfolio of fixed income securities.