



NORTH CAROLINA

OFFICE OF THE TREASURER

JANET COWELL, TREASURER

August 1, 2012

Joint Legislative Commission
on Governmental Operations
North Carolina General Assembly
Raleigh, North Carolina 27601

Re: Quarterly report on Investment Funds for the period
ended June 30, 2012.

Commission Members:

Pursuant to G.S.147-68, we are providing a report on the investment activities of the State Treasurer. The report outlines investment activities in summary form for:

- The Cash Management Program – responsible for managing the operating funds of the State. The primary participants in this program are the State's General Fund and Highway Funds.
- The Trust Funds Investment Program – responsible for managing assets of the Teachers' and State Employees' Retirement System, the Consolidated Judicial Retirement System, the Firemen's and Rescue Squad Workers' Pension Fund, the Local Governmental Employees' Retirement System, the Legislative Retirement System, and the North Carolina National Guard Pension Fund. Collectively, these systems and funds are referred to as the North Carolina Retirement Systems or the Pension Fund. The Trust Funds Investment Program also includes other participants such as the State Health Plan, the Disability Income Plan, and the State Educational Assistance Authority.
- The Ancillary Investment Programs - as authorized by the General Assembly, responsible for managing assets for the Escheats Fund, Public Hospital Funds and the Local Government Other Post-Employment Benefits Fund.

Cash Management Program

The Cash Management Program, composed mostly of the Short-Term Investment Fund ("STIF"), produced a one year return of 0.64% for the participants. It also includes the Bond Proceeds Fund which is a separate investment account for each state bond issue to comply with Internal Revenue Service regulations on bond arbitrage.

Short Term Investment Fund

<u>Historical T-Bill rates</u>	<u>6/30/11</u>	<u>12/31/11</u>	<u>6/30/12</u>
3-Mo. T-Bill	0.010%	0.010%	0.081%
6-Mo. T-Bill	0.097%	0.056%	0.152%

The Short-Term Investment Fund produced a one year return of 0.65% for the participants. The investable balances earning income for the General Fund were \$80 million lower than one year earlier based on book value. The investable balances, which earn income for the Highway Funds, were \$76 million higher than at the same time last year.

The investments held by the STIF on a particular date may be accruing income at different levels from current short-term interest rates. For example, if the investments were made when interest rates were lower, the earnings would continue to be at the lower rates of return, even though current interest rates may have moved higher. This happens in reverse as well.

The Bond Proceeds Fund is managed by a private investment company under contract with the Department of State Treasurer. The investments are valued at amortized cost, which approximates fair value.

Trust Funds Investment Program

The investment results for the Trust Funds Investment Program (“Trust Funds”) are managed and reported on a cumulative total return basis. Total return includes realized income and the appreciation or depreciation of fair market value. Two funds comprise the vast majority of the Trust Funds assets. They are the Long-Term Investment Fund (“LTIF”) and the Equity Investment Fund (“EIF”).

	<u>1 Year</u>	<u>2 Year</u>	<u>3 Year</u>	<u>5 Year</u>
Total Trust Returns:	2.36%	10.02%	10.67%	2.73%

Long Term Investment Fund

	<u>1 Year</u>	<u>2 Year</u>	<u>3 Year</u>	<u>5 Year</u>
LTIF Returns:	12.12%	8.61%	10.15%	9.28%

The below table provides a trend comparison of the current Treasury yields to the previous quarter.

<u>US Treasury Yields</u>	<u>5 Year UST</u>	<u>10 Year UST</u>	<u>30 Year UST</u>
As of 3/31/12	1.04%	2.21%	3.34%
As of 6/30/12	0.72%	1.65%	2.75%

- Long Term assets (based on market value) ended the quarter approximately \$828 million higher than at the end of the prior reporting period.
- The realized earnings for the fiscal year to date are \$1.7 billion.
- Approximately \$125 million was used to pay benefits or was reallocated to other investment funds this quarter.

Equity Investment Fund

	<u>1 Year</u>	<u>2 Year</u>	<u>3 Year</u>	<u>5 Year</u>
EIF Returns:	-5.98%	10.88%	12.01%	-1.46%

The below table provides second quarter equity market returns as measured by major indices.

Quarterly Index Returns:	S&P 500	-2.75%	DJIA	-2.51%
	Russell 3000	-3.15%	MSCI EAFE	-7.13%

- Assets of the fund (based on market value) ended the quarter approximately \$2.50 billion lower than at the end of the prior reporting period.
- Approximately \$495 million was used to pay benefits or was reallocated to other investment funds this quarter.

Pursuant to Session Law 2009-98 and G.S.147-69.2, the Treasurer is now authorized to invest in credit and inflation-linked strategies. These new classifications are reflected in the attached report.

Ancillary Investment Programs

The Ancillary Investment Programs, as authorized by the General Assembly, are responsible for managing assets for the Escheats Fund, Public Hospital Funds and the Local Government Other Post-Employment Benefits Fund.

Pursuant to G.S. 116-37, deposits are held for the Watauga Medical Center, New Hanover Memorial Hospital, Margaret R. Pardee Hospital, and Columbus Regional Healthcare System, all subject to compliance with G.S. 147-69.2. The assets are allocated as follows: STIF, LTIF and authorized Equity funds. For the quarter ending June 30, 2012, the invested assets were valued at \$73.1 million after returns in the domestic and international accounts of -3.48% and -7.45% respectively.

Pursuant to G.S. 147-69.2(b)(12), up to 20% of the Escheat Fund's assets can be invested in authorized Equity, Real Estate, and Alternative Investments. For the quarter ending June 30, 2012, \$40 million has been invested in equity, of which \$40.8 million has been received in distributions; \$20 million has been invested in real estate, of which \$16.4 million has been returned; and commitments totaling \$57 million have been made to private equity, of which \$49.4 million has been contributed.

Pursuant to G.S. 159-30.1, 147-69.2(a)(17g), and 147-69.2(b4), deposits are held for the Local Government Other Post-Employment Benefits Fund. The assets are allocated as follows: STIF, LTIF, and authorized Equity funds. For the quarter ending June 30, 2012, the externally invested assets were valued at \$52.8 million after returns in the domestic and international equity accounts of -3.48% and -7.45% respectively.

Other Reporting Requirements

Pursuant to Session Law 2007-323 Sec. 13.2.(b), G.S. 147-68(d1), the Treasurer "shall include a specific listing of all investments made with certified green managers and companies and funds that support sustainable practices, including the names of the companies, managers,

and funds, the amount invested, and the State's return on investment." Based on currently available research, there is no validation group or process that certifies green managers for investments, and the statute provides no definition of the term "sustainable practices" that would enable the Treasurer to determine which companies and funds would fall under this provision. Thus, it is not possible to report any relevant data at this time.

Thank you for your attention. Please feel free to contact the Department of State Treasurer if you have any questions.

Sincerely,

A handwritten signature in cursive script, appearing to read "Janet Cowell". The signature is written in black ink and is positioned to the right of the typed name "Janet Cowell".

Janet Cowell

Attachments

cc: Bryan Lewis, Interim Chief Investment Officer
Fran Lawrence, Chief Financial Officer

**DEPARTMENT OF STATE TREASURER
COMBINED STATEMENT OF NET ASSETS AND PARTICIPANT EQUITY - ALL POOLS AND ACCOUNTS
JUNE 30, 2012**

	*Cash Management Program		**Trust Funds Investment Program		All Pools
	Short-term Investment Fund	Bond Proceeds Fund	Subtotal	Intrafund Eliminations	
Net Assets:					
Investment Securities:					
Cash Equivalents	\$ -	\$ -	\$ -	\$ -	\$ -
Certificates of Deposit	35,800,000	-	35,800,000	-	35,800,000
Repurchase Agreements	1,725,000,000	-	1,725,000,000	-	1,725,000,000
Discount Notes/Bills	-	-	-	-	-
U.S. Treasury Bills/ Notes/ Bonds	5,720,709,086	-	5,720,709,086	-	14,591,266,077
U.S. Government Agency Notes/ Bonds	5,065,137,406	-	5,065,137,406	-	6,938,386,454
GNMA Certificates	-	-	-	-	7,015,312,265
Corporate Obligations	30,000,962	-	30,000,962	-	10,796,499,641
Other Investments	-	-	-	-	24,429,776
Investments in RMBS and CMBS	-	-	-	-	528,222,913
Investments in Equity Securities	-	-	-	-	2,928,221
Bond proceeds Advisory	-	67,038,456	67,038,456	-	67,038,456
Investments in Equity Trusts	-	-	-	-	31,988,604,504
Investments in Real Estate Trust Funds & Partnerships	-	-	-	-	5,744,937,541
Investments in Alternative Partnerships	-	-	-	-	3,726,717,467
Investments in Credit Partnerships	-	-	-	-	3,069,976,150
Investments in Inflation Partnerships	-	-	-	-	1,257,892,705
Total Investment Securities	\$ 12,576,647,454	\$ 67,038,456	\$ 12,643,685,910	\$ -	\$ 87,513,012,170
Cash in Bank	179,947,076	-	179,947,076	-	179,947,076
Deposits in Short-term Investment Fund	-	-	-	(544,989,356)	-
Other Assets, Net of Liabilities	29,540,050	-	29,540,050	-	320,156,528
Total Net Assets	\$ 12,786,134,580	\$ 67,038,456	\$ 12,853,173,036	\$ (544,989,356)	\$ 88,013,115,774
Participant Equity:					
General Fund	\$ 1,849,907,824	\$ -	\$ 1,849,907,824	\$ -	\$ 1,849,907,824
Other Funds Which Earn Interest for General Fund	1,317,183,863	67,038,456	1,384,222,319	-	1,384,222,319
Highway Fund	675,922,580	-	675,922,580	-	675,922,580
Highway Trust Fund	435,822,383	-	435,822,383	-	435,822,383
University Trust Funds	2,519,832,210	-	2,519,832,210	-	2,519,832,210
Pension Trust Funds	165,952,347	-	165,952,347	-	74,467,314,051
Other Independent Trust Funds	4,382,943,729	-	4,382,943,729	-	5,620,561,772
Local Political Subdivisions	866,668,808	-	866,668,808	-	866,668,808
Licensing Boards	26,911,480	-	26,911,480	-	26,911,480
Other Investment Funds	544,989,356	-	544,989,356	(544,989,356)	-
Total Participant Equity	\$ 12,786,134,580	\$ 67,038,456	\$ 12,853,173,036	\$ (544,989,356)	\$ 88,013,115,774
Percent of Total	14.53	0.08	14.61	-0.62	100.00

* The Cash Management Program is presented at book value.

**The Trust Funds Investment Program is presented at market value. Trust Funds detail is included on Combining Statement of Net Assets and Participant Equity.

**DEPARTMENT OF STATE TREASURER
COMBINING STATEMENT OF NET ASSETS AND PARTICIPANT EQUITY - TRUST FUNDS INVESTMENT PROGRAM
JUNE 30, 2012**

	Long-term Investment Fund	External Fixed Inc. Investment Fund	Equity Investment Fund	Real Estate Investment Fund	Alternative Investment Fund	Credit Investment Fund	Inflation Investment Fund	Totals
Net Assets:								
Investment Securities:								
Cash and Cash Equivalents								
U.S. Treasury Bills/ Notes/ Bonds	8,298,215,282						\$ 572,341,709	8,870,556,991
U.S. Government Agency Notes/ Bonds	1,473,528,322	37,323,586					362,397,140	1,873,249,048
GNMA Certificates	7,015,312,265							7,015,312,265
Corporate Obligations	10,766,498,679							10,766,498,679
Other Investments		24,429,776						24,429,776
Investments in RMBS and CMBS		528,222,913						528,222,913
Bond Proceeds Advisory					2,928,221			2,928,221
Investments in Equity Trusts			31,988,604,504					31,988,604,504
Investments in Real Estate Trust Funds & Partnerships				5,744,937,541				5,744,937,541
Investments in Alternative Partnerships					3,726,717,467			3,726,717,467
Investments in Credit Partnerships						3,069,976,150		3,069,976,150
Investments in Inflation Partnerships & Other Invest.							1,257,892,705	1,257,892,705
Total Investment Securities	\$ 27,553,554,548	\$ 589,976,275	\$ 31,988,604,504	\$ 5,744,937,541	\$ 3,729,645,688	\$ 3,069,976,150	\$ 2,192,631,554	\$ 74,869,326,260
Cash in Bank								
Deposits in Short-term Investment Fund	163,161,478	171,098,505	7,936,138	29,785,016	102,178,205	44,631,649	26,198,365	544,989,356
Other Assets, Net of Liabilities	292,030,539	3,794,350					(5,208,411)	290,616,478
Total Net Assets	\$ 28,008,746,565	\$ 764,869,130	\$ 31,996,540,642	\$ 5,774,722,557	\$ 3,831,823,893	\$ 3,114,607,799	\$ 2,213,621,508	\$ 75,704,932,094
Participant Equity:								
Pension Trust Funds	26,771,128,522	764,869,130	31,996,540,642	5,774,722,557	3,831,823,893	3,114,607,799	2,213,621,508	74,467,314,051
Other Independent Trust Funds	1,237,618,043							1,237,618,043
Total Participant Equity	\$ 28,008,746,565	\$ 764,869,130	\$ 31,996,540,642	\$ 5,774,722,557	\$ 3,831,823,893	\$ 3,114,607,799	\$ 2,213,621,508	\$ 75,704,932,094
Percent of Total	37.00	1.01	42.27	7.63	5.06	4.11	2.92	100.00

**DEPARTMENT OF STATE TREASURER
ANCILLARY INVESTMENT PROGRAMS**

JUNE 30, 2012

	Escheats External Investments	OPEB External Investments	Hospital External Investments	Totals
Deposits in Equity Investment Fund	\$ 230,407	52,780,410	73,138,513	\$ 126,149,330
Deposits in Real Estate Investment Fund	-			-
Deposits in Alternative Investment Fund	39,478,496			39,478,496
Other Assets, Net of Liabilities	\$ 39,708,903	\$ 52,780,410	\$ 73,138,513	\$ -
Total Net Assets	\$ 39,708,903	\$ 52,780,410	\$ 73,138,513	\$ 165,627,826

Net Assets:

Deposits in Equity Investment Fund
 Deposits in Real Estate Investment Fund
 Deposits in Alternative Investment Fund
 Other Assets, Net of Liabilities
 Total Net Assets

**DEPARTMENT OF STATE TREASURER
COMBINED STATEMENT OF OPERATIONS - ALL POOLS AND ACCOUNTS
FOR THE PERIOD ENDED JUNE 30, 2012**

	Cash Management Program			*Trust Funds		Memorandum	
	Short-term Investment Fund	Bond Proceeds Fund	Subtotal	Investment Program	Intrafund Eliminations	Total	
Revenues:							
Investment Income:							
Investment Earnings	\$ 87,457,115	73,721	\$ 87,530,836	\$ 3,002,614,370	-	\$ 3,090,145,206	
Intra-Pool Interest Earnings	-	-	-	5,946,673	(5,946,673)	-	
Income from Security Lending	-	-	-	19,223,797	-	19,223,797	
Commission Recapture	-	-	-	73,696	-	73,696	
Other Income	-	-	-	2,806,074	-	2,806,074	
Subtotal	87,457,115	73,721	87,530,836	3,030,664,610	(5,946,673)	3,112,248,773	
Net Unrealized Appreciation/Depreciation	87,457,115	73,721	87,530,836	(908,082,163)	-	(908,082,163)	
Total Investment Income	87,457,115	73,721	87,530,836	2,122,582,447	(5,946,673)	2,204,166,610	
Expenditures:							
Treasurer's Allocated Cost	(1,980,413)		(1,980,413)	(4,709,045)	-	(6,689,458)	
Management Fees	(40,821)		(40,821)	(317,796,275)	-	(317,837,096)	
Dividend Withholding Tax	-		-	(27,180,281)	-	(27,180,281)	
Other Cost	(1,719,154)		(1,719,154)	(35,031,599)	-	(36,750,753)	
Total Expenditures	(3,699,567)		(3,740,388)	(384,717,200)	-	(388,457,588)	
Net Investment Income (Loss)	\$ 83,757,548	\$ 32,900	\$ 83,790,448	\$ 1,737,865,247	(5,946,673)	\$ 1,815,709,022	
Total Investment Income Allocated:							
General Fund	\$ 13,663,977		\$ 13,663,977	-	-	\$ 13,663,977	
Highway Fund	4,681,677		4,681,677	-	-	4,681,677	
Highway Trust Fund	2,160,040		2,160,040	-	-	2,160,040	
University Trust Funds	18,536,598		18,536,598	-	-	18,536,598	
Pension Trust Funds	2,665,760		2,665,760	1,603,296,755	-	1,605,962,515	
Other Independent Trust Funds	30,169,312		30,169,312	134,568,492	-	164,737,804	
Local Political Subdivisions	5,742,132		5,742,132	-	-	5,742,132	
Licensing Boards	191,379		191,379	-	-	191,379	
Other Investment Funds	5,946,673	32,900	5,979,573	-	-	5,979,573	
Total Investment Income Allocated	\$ 83,757,548	\$ 32,900	\$ 83,790,448	\$ 1,737,865,247	(5,946,673)	\$ 1,815,709,022	
Cash Return, Fiscal Year-to-Date (Annualized)	0.6460%	0.020%	0.6420%				

*Trust Funds detail is included on the Combining Statement of Operations-Trust Funds Investment Program.

**DEPARTMENT OF STATE TREASURER
COMBINING STATEMENT OF OPERATIONS - TRUST FUNDS INVESTMENT PROGRAM
FOR THE PERIOD ENDED JUNE 30, 2012**

	Trust Funds Investment Program							Totals
	Long-term Investment Fund	External Fixed Inc. Investment Fund	Equity Investment Fund	Real Estate Investment Fund	Alternative Investment Fund	Credit Investment Fund	Inflation Investment Fund	
Revenues:								
Investment Income:								
Investment Earnings	\$ 1,720,038,532	79,141,819	820,585,573	137,310,750	333,620,668	60,782,628	(148,865,620)	\$ 3,002,614,370
Intra-Pool Interest Earnings	1,549,970	3,501,273	21,952	265,577	400,541	126,416	80,944	5,946,673
Income from Security Lending			19,223,797	73,696				19,223,797
Commission Recapture			2,806,074					2,806,074
Other Income			842,711,092	137,576,327	334,021,209	60,909,044	(148,784,676)	3,030,664,610
Subtotal	1,721,588,522	82,643,092	842,711,092	137,576,327	334,021,209	60,909,044	(148,784,676)	3,030,664,610
Net Unrealized Appreciation/Depreciation	1,458,699,528	(39,008,478)	(2,536,895,290)	345,949,001	(70,880,877)	1,897,908	(67,843,955)	(908,082,163)
Total Investment Income	3,180,288,050	43,634,614	(1,694,184,198)	483,525,328	263,140,332	62,806,952	(216,628,631)	2,122,582,447
Expenditures:								
Treasurer's Allocated Cost	(1,783,218)	(59,659)	(1,940,946)	(360,657)	(239,193)	(188,778)	(136,594)	(4,709,045)
Management Fees		(6,998,121)	(117,109,551)	(76,956,073)	(56,773,749)	(27,224,457)	(32,734,324)	(317,796,275)
Dividend Withholding Tax			(26,935,188)	(245,093)				(27,180,281)
Other Cost	(1,102,507)	(1,281,857)	(2,159,045)	(10,214,357)	(11,343,337)	(6,049,895)	(2,880,601)	(35,031,599)
Total Expenditures	(2,885,725)	(8,339,637)	(148,144,730)	(87,776,180)	(68,356,279)	(33,463,130)	(35,751,519)	(384,717,200)
Net Investment Income (Loss)	\$ 3,177,402,325	35,294,977	(1,842,328,928)	395,749,148	194,784,053	29,343,822	(252,380,150)	\$ 1,737,865,247
Total Investment Income Allocated:								
General Fund	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Highway Fund	-	-	-	-	-	-	-	-
Highway Trust Fund	-	-	-	-	-	-	-	-
University Trust Funds	-	-	-	-	-	-	-	-
Pension Trust Funds	3,042,833,833	35,294,977	(1,842,328,928)	395,749,148	194,784,053	29,343,822	(252,380,150)	1,603,296,755
Other Independent Trust Funds	134,568,492	-	-	-	-	-	-	134,568,492
Local Political Subdivisions	-	-	-	-	-	-	-	-
Licensing Boards	-	-	-	-	-	-	-	-
Other Investment Funds	-	-	-	-	-	-	-	-
Total Investment Income Allocated	\$ 3,177,402,325	\$ 35,294,977	\$ (1,842,328,928)	\$ 395,749,148	\$ 194,784,053	\$ 29,343,822	\$ (252,380,150)	\$ 1,737,865,247
Total Return, 12, 24, and 36 and 60 months:								
12 months	12.12%	6.15%	-5.98%	7.88%	5.39%	0.37%	-10.67%	2.36%
24 months	8.61%	7.52%	10.88%	12.90%	9.71%	7.80%	-13.56%	10.02%
36 months	10.15%	10.30%	12.01%	2.00%	10.62%	N/A	N/A	10.67%
60 months	9.28%	9.15%	-1.46%	-4.57%	2.77%	N/A	N/A	2.73%