



2015-16 Investment Management Division Initiatives (IAC Meeting Supplement)

July 28, 2016



North Carolina Department of State Treasurer
Investment Management

Learn. Invest. Grow. Prosper.

Good Progress on Major Initiatives

1. Research and develop ESG policies and strategies
2. Transition oversight of Ancillary Funds, including establish a new long-term fixed income product for certain clients and facilitate movement of assets
3. Evaluate restructuring/exiting Fund of Funds and legacy low-conviction funds/managers
4. Implement Managed Accounts Program and initial components of direct Hedged Equity program
5. Develop internal equity index fund implementation plan
6. Update asset-liability study and support review of the NCRS discount rate/investment return assumption
7. Institute 360 degree feedback for senior management and career development program for team leaders, portfolio managers, and analysts
8. Implement BNY Mellon Private Investment Asset Service processes
9. New IMD role with unbundled Supplemental Retirement Plan
10. Implement Venture Capital Multiplier Fund



IAC Consultation on Policies

1. On at least a biennial basis, IPS shall be presented to the IAC for consultation. NCGS § 147-69.10(a)
2. Industry standard portfolio guidelines for internally managed portfolios with periodic consultation by the IAC. NCGS § 147-69.2(e)
3. DST shall consult with the IAC and adopt policies on the following topics:
 - Investment Management Division Code of Ethics
 - DST employees with investment responsibility to be provided with training on duties and responsibilities to the funds
 - Gifts to DST with investment responsibility
 - Imposing limitations on external investment managers' use of placement agents and other persons that appear before DST
 - Conflict checks in the investment due diligence, negotiations, and contracting process. NCGS § 147-69.11
4. TSERS and LGERS Boards of Trustees asked staff to study potential consensus legislative proposals or supplemental policies addressing future State Treasurers' commercial corporate board service

**Note: DST already has policies or procedures on these topics. This process will give IAC members the opportunity to review and suggest improvements to these policies and procedures. Treasurer is required to adopt policies on these topics by January 31, 2017.*



IAC Consultation on Policies

1. September IAC 2016 meeting

- Draft ESG policy
- Draft ethics, training, gifts, conflicts, et. al. policies
- Proposals related to future Treasurers' corporate board service, reflecting consultation with Board of Trustee members in August

2. November 2016 IAC meeting

- Draft IPS
- Draft internal portfolio guidelines



Review of Governance, Operations, and Investment Practices

1. At least once every four years, the State Treasurer shall engage a commercial independent expert firm to evaluate the governance, operations, and investment practices of the State Treasurer in order to develop recommendations for improvement
2. The State Treasurer must consult with the Investment Advisory Committee to develop the scope of the evaluation
3. The report of the independent expert firm shall be provided to the Joint Legislative Commission on Governmental Operations, the House of Representatives Appropriations Committee, the Senate Appropriations/Base Budget Committee, and the Fiscal Research Division within 30 days of receipt



Goals

1. Adopt national best practices for governance, operations, investment practices, and other programmatic practices at peer organizations with similar program objectives and legal and regulatory requirements
2. Enhance the ability to produce cost-efficient long-term growth of trust assets with reasonable risk of not achieving investment objectives
3. Enhance programs' cost-effectiveness, fiscal control, compliance, and risk environments
4. Enhance transparency for beneficiaries and stakeholders regarding program performance, funding, and budgeting
5. Enhance accountability of the governing fiduciary or governing board, as applicable
6. Maintain a high-performing organization with access to necessary, qualified, and prudent internal resources and the ability to contract as necessary and prudent with qualified external business partners
7. Identify any amendments to current law needed to achieve these goals



Scope: Governance

1. The powers, duties, and required approvals related to the investment and other programs exercised by the “Fiduciaries” (the State Treasurer, Boards of Trustees, and/or the Department of State Treasurer, as applicable), and by the General Assembly, Office of State Budget and Management, the Office of State Controller, and the Office of State Human Resources
2. The laws and other constraints upon use of the trust funds and appropriations under the North Carolina Constitution, statutes, and common law and/or the federal Constitution, statutes, common law, and regulations
3. The current sole investment trustee and investment advisory committee model versus an “enhanced investment advisory committee model”, an investment board of trustees or other models



Scope: Operations

1. Fiduciary independence, including federal and state laws, regulations, and practice that are applicable to personnel, procurement, and funding and budget decisions, including but not limited to authority for:
 - Position creation, personnel hiring/termination, and establishing and administering personnel compensation
 - Information technology procurement
 - Charging/apportioning Department expenditures directly to the trust funds as a continuous receipt-supported program while not requiring a General Fund appropriation or reimbursement
 - Determining the most cost-effective and transparent method to record Department expenditures for financial statement and budget reporting
 - Utilizing internal budget transfers to pay for core services within the Department (i.e., IT, HR, accounting, internal audit, etc.)
2. External investment and program oversight, reporting, and monitoring, including but not limited to the sufficiency of:
 - The Department's expert reviews and audits of the investment programs' cost-effectiveness, fiscal control, compliance, and risk environments
 - Transparency and reporting of program performance, funding, and budgeting to beneficiaries, the General Assembly, Office of State Budget and Management, and Office of State Controller



Scope: Investment Practices

1. Macro drivers of investment performance and cost-effectiveness, including but not limited to:
 - Asset allocation
 - Investment performance (net of investment fees)
 - Asset class structure
 - Fees and other costs
 - The use of traditional and various alternative investment strategies and vehicles
 - Foreign currency exposure management
 - The use of internal and external investment strategies and/or middle- and back-office support
 - The use of consultants

2. Policies, procedures, and processes, including but not limited to the sufficiency of:
 - Due diligence and investment manager selection
 - Portfolio and manager monitoring
 - Investment reporting against benchmarks, peers, and universes
 - Risk management and compliance
 - Internal staff, organization, and governance



Tentative Next Steps

1. Receive IAC feedback on Scope
2. DST utilize both an investment consultant and external legal counsel that would work jointly to develop draft work product and the final deliverables
3. Investment consultant and external legal counsel directly receive input on focus areas of interest from individual IAC members
4. Investment consultant and external legal counsel provide a briefing on work-in-progress at the September 2016 and November 2016 IAC meetings
5. DST, investment consultant, and external legal counsel provide final report to General Assembly and Governor's Office in December 2016





Fiscal June 2016 Performance Update (IAC Meeting Supplement)

July 28, 2016



North Carolina Department of State Treasurer
Investment Management

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NCRS Asset Allocation

As of June 30, 2016

	Market Value (\$000)	%	Target	Range		Relative %	Relative \$ (\$000)
				Minimum	Maximum		
Growth	\$50,797,799	58.01%	58.0%	37.0%	71.0%	0.01%	\$7,151
Public Equity	37,256,098	42.54%	42.0%	37.0%	47.0%	0.54%	476,663
Non Core Real Estate	3,906,419	4.46%	3.0%	0.0%	8.0%	1.46%	1,279,317
Opportunistic Fixed Income	5,259,505	6.01%	7.0%	0.0%	7.5%	-0.99%	(870,401)
Private Equity	4,375,777	5.00%	6.0%	0.0%	8.8%	-1.00%	(878,428)
Inflation Sensitive & Diversifiers	9,639,160	11.01%	11.0%	4.0%	16.0%	0.01%	6,451
Core Real Estate	4,446,703	5.08%	5.0%	2.0%	10.0%	0.08%	68,199
Inflation Sensitive	5,192,457	5.93%	6.0%	2.0%	7.5%	-0.07%	(61,748)
Multi-Strategy	1,617,323	1.85%	2.0%	0.0%	4.0%	-0.15%	(134,078)
Rates & Liquidity	25,515,800	29.14%	29.0%	24.0%	42.0%	0.14%	120,476
Cash	854,436	0.98%	1.0%	0.0%	10.0%	-0.02%	(21,265)
Investment Grade Fixed Income	24,661,364	28.16%	28.0%	24.0%	32.0%	0.16%	141,741
Grand Total	\$87,570,083	100.00%					



NCRS Unaudited Asset Allocation

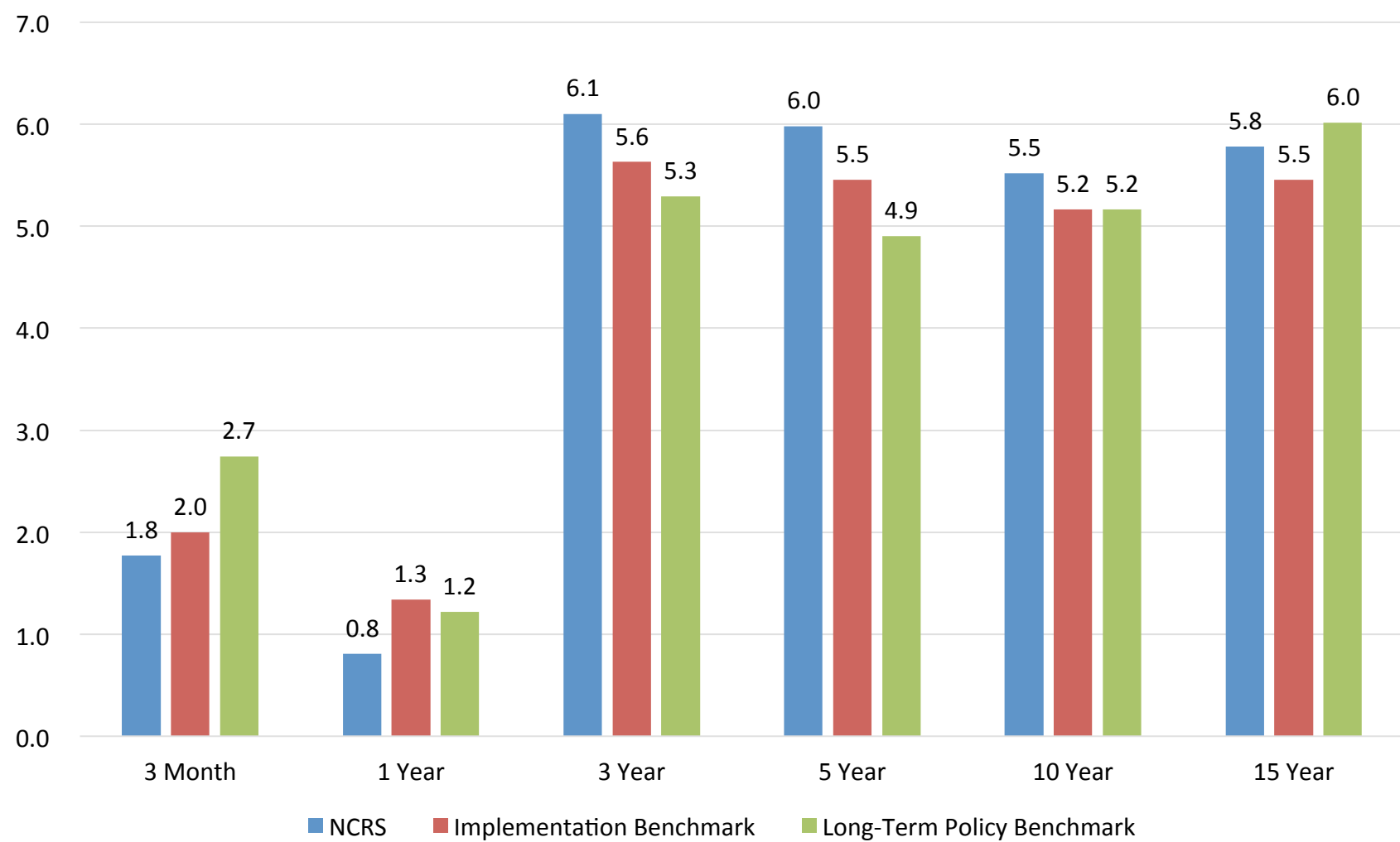
As of July 26, 2016

	Market Value (\$000)	%	Target	Range		Relative %	Relative \$ (\$000)
				Minimum	Maximum		
Growth	\$51,838,504	58.47%	58.0%	37.0%	71.0%	0.47%	\$417,216
Public Equity	38,491,352	43.42%	42.0%	37.0%	47.0%	1.42%	1,255,247
Non Core Real Estate	3,866,215	4.36%	3.0%	0.0%	8.0%	1.36%	1,206,493
Opportunistic Fixed Income	5,105,790	5.76%	7.0%	0.0%	7.5%	-1.24%	(1,100,228)
Private Equity	4,375,147	4.93%	6.0%	0.0%	8.8%	-1.07%	(944,296)
Inflation Sensitive & Diversifiers	9,481,568	10.69%	11.0%	4.0%	16.0%	-0.31%	(270,745)
Core Real Estate	4,306,470	4.86%	5.0%	2.0%	10.0%	-0.14%	(126,400)
Inflation Sensitive	5,175,098	5.84%	6.0%	2.0%	7.5%	-0.16%	(144,345)
Multi-Strategy	1,617,323	1.82%	2.0%	0.0%	4.0%	-0.18%	(155,824)
Rates & Liquidity	25,719,998	29.01%	29.0%	24.0%	42.0%	0.01%	9,354
Cash	978,720	1.10%	1.0%	0.0%	10.0%	0.10%	92,147
Investment Grade Fixed Income	24,741,277	27.91%	28.0%	24.0%	32.0%	-0.09%	(82,793)
Grand Total	\$88,657,393	100.00%					



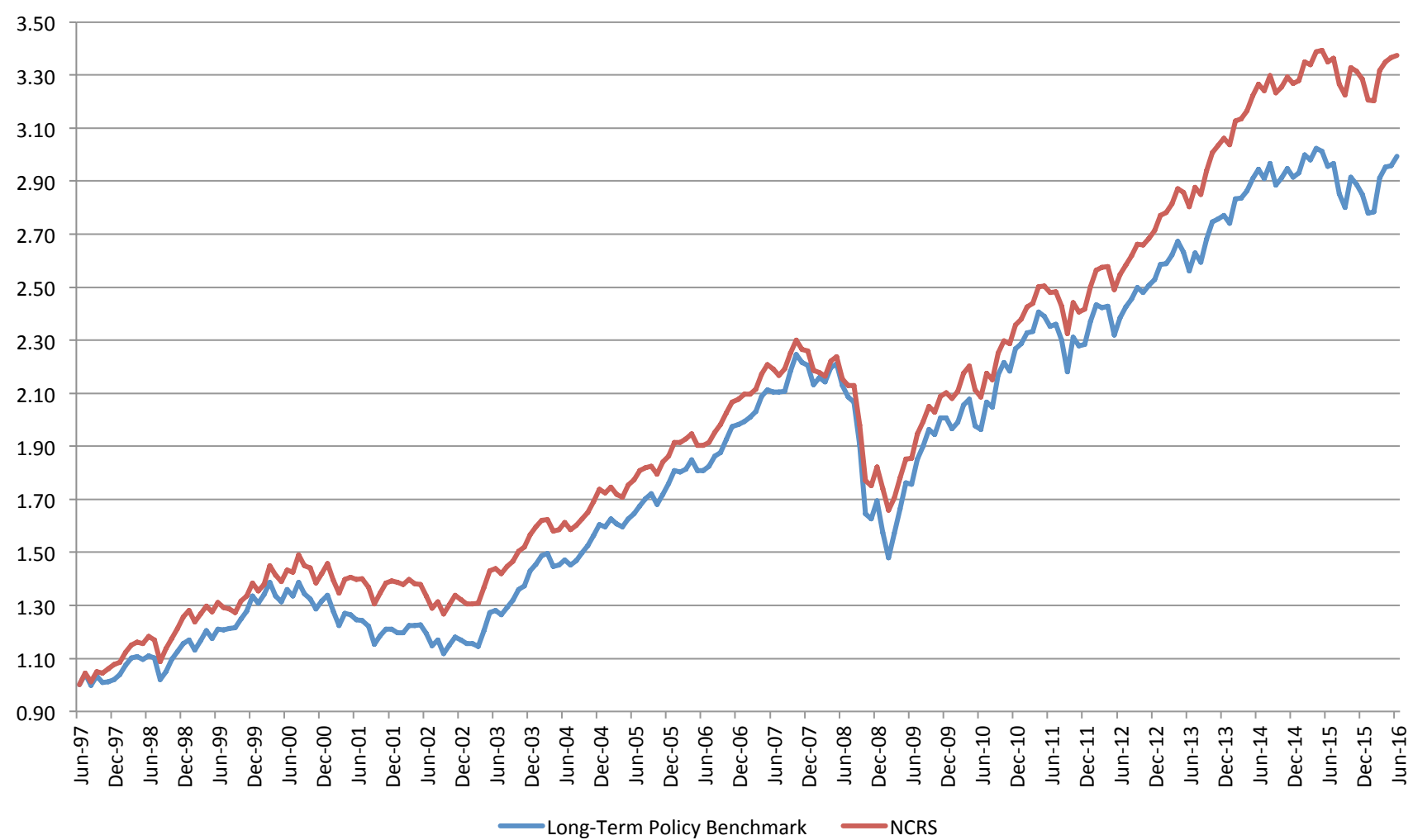
NCRS Total Net Portfolio Return vs. Benchmarks

As of June 30, 2016



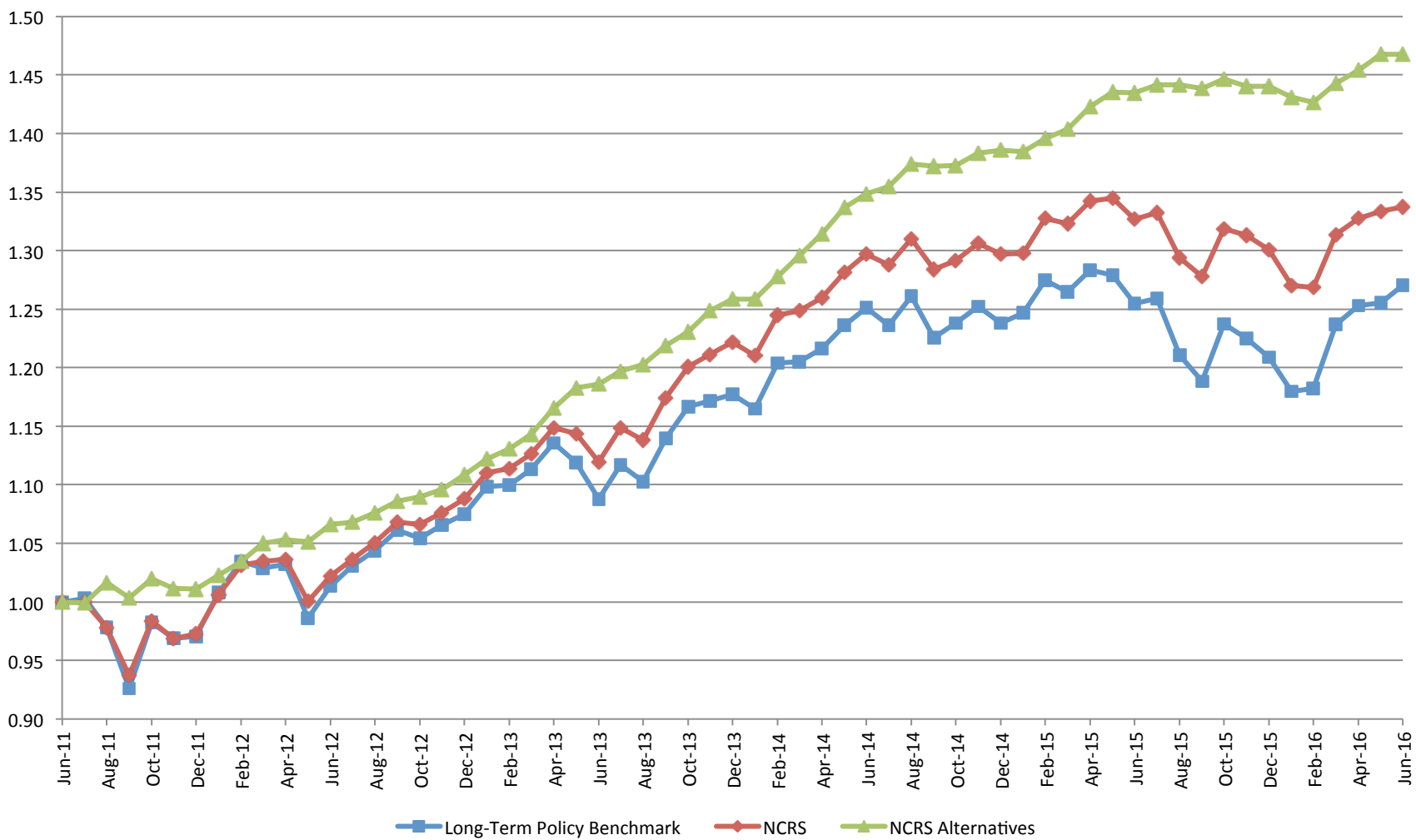
Growth of a Dollar

As of June 30, 2016



Growth of a Dollar

5 Years Ending June 30, 2016



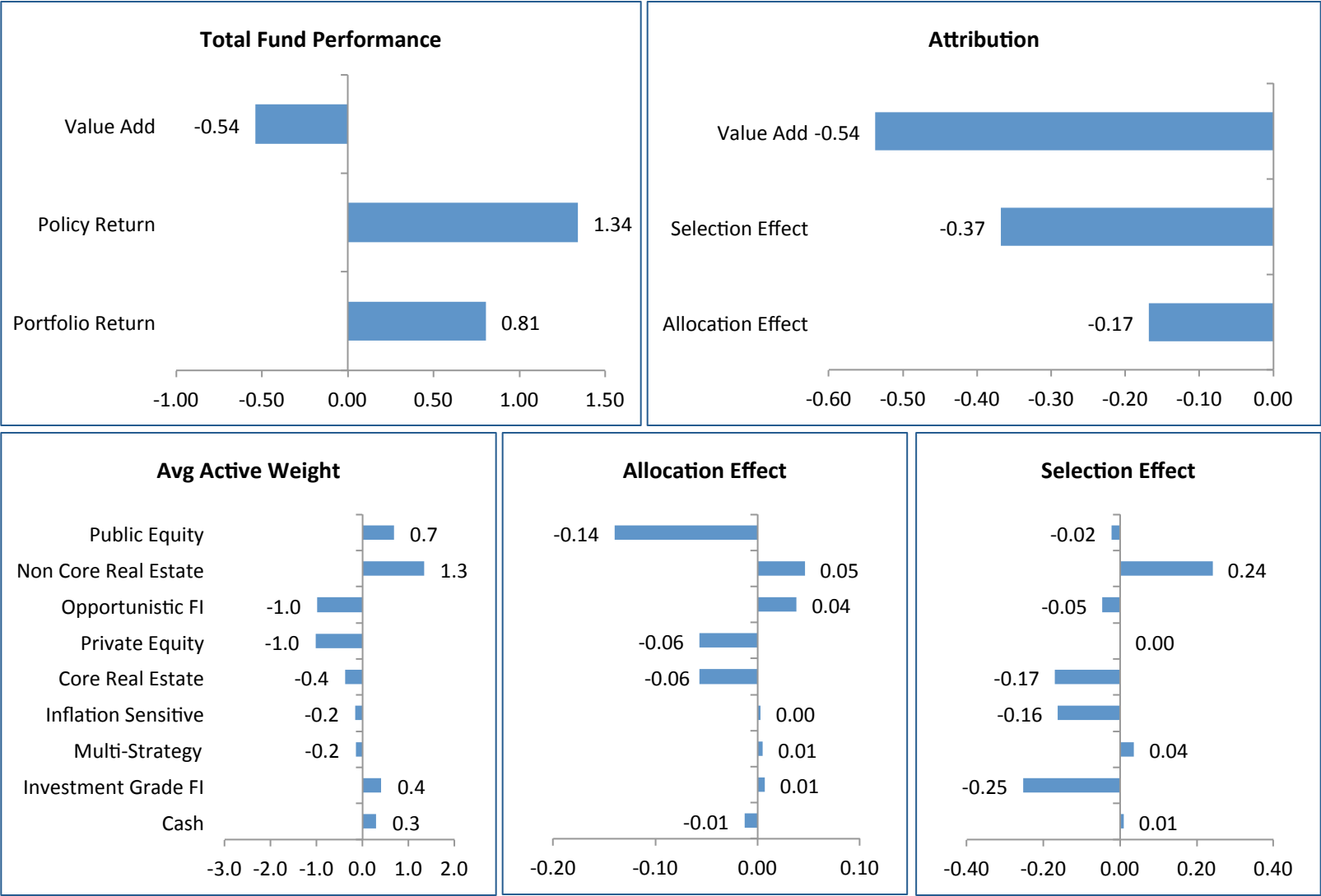
Note: NCRS Alternatives includes the following: Core Real Estate, Inflation Sensitive - Private Natural Resources, Inflation Sensitive – Real Assets and Other, Multi-Strategy Investments, Non Core Real Estate, Opportunistic Fixed Income, Private Equity, Equity Hedge Strategies and the Blackstone Granite Fund (Class B).



NCRS Net Return Attribution

Total Fund Performance vs. Implementation Benchmark

1 Year Ending June 30, 2016



NCRS Net Return Attribution

Total Fund Performance vs. Implementation Benchmark

5 Years Ending June 30, 2016



NCRS Gross of Fees Return and Risk
 BNY Mellon Universe: Public Funds > \$1B
 As of June 30, 2016

<u>Returns</u>	<u>3 Years</u>	<u>5 Years</u>	<u>10 Years</u>	<u>15 Year</u>
25th percentile	7.19	7.08	6.06	6.46
Median	6.72	6.51	5.78	6.18
75th percentile	5.81	5.86	5.28	5.78
NCRS	6.75	6.56	6.00	6.12
Percentile Rank (1 st percentile = highest performance)	47	45	29	61
<u>Risk</u>	<u>3 Years</u>	<u>5 Years</u>	<u>10 Years</u>	<u>15 Year</u>
25th percentile	7.32	7.92	10.43	9.91
Median	6.15	7.23	9.81	9.46
75th percentile	5.42	6.31	9.04	8.53
NCRS	5.42	6.16	8.18	7.77
Percentile Rank (99 th percentile = lowest risk)	75	78	90	94

BNY Mellon data presented are based on currently available information at time of publication and may be revised subsequently.



New and Incremental Investment Commitments

Since April 2016 IAC Meeting

<u>Fund Name</u>	<u>Firm Name</u>	<u>Commitment</u>	<u>Closing Date</u>
<u>Public Equity</u>			
BlackRock EAFE LC Growth	BlackRock	\$672,230,334	06/01/16
Old North State Hedged Equity MEN	Menta Capital	\$200,000,000	07/01/16
<u>Private Equity</u>			
ARCH Venture Fund IX	ARCH Venture Partners	\$60,000,000	04/26/16
Thoma Bravo XII	Thoma Bravo	\$150,000,000	05/11/16
TCV IX	Technology Crossover Ventures	\$150,000,000	07/13/16
<u>Non-Core Real Estate</u>			
Harrison Street HSREP VI	Harrison Street	\$150,000,000	07/26/16
<u>Core Real Estate</u>			
Rockpoint Growth & Income II	Rockpoint	\$200,000,000	07/18/16
<u>Opportunistic Fixed Income</u>			
Centerbridge Special Credit Partners III	Centerbridge	\$150,000,000	07/26/16
<u>Inflation Sensitive</u>			
DL Blue Diamond Fund	Doubleline Capital	\$300,000,000	05/31/16
GSO Energy SMA	GSO	\$150,000,000	07/21/16
<u>Multi Strategy</u>			
None	--	--	--



NCRS Asset Class Net Performance

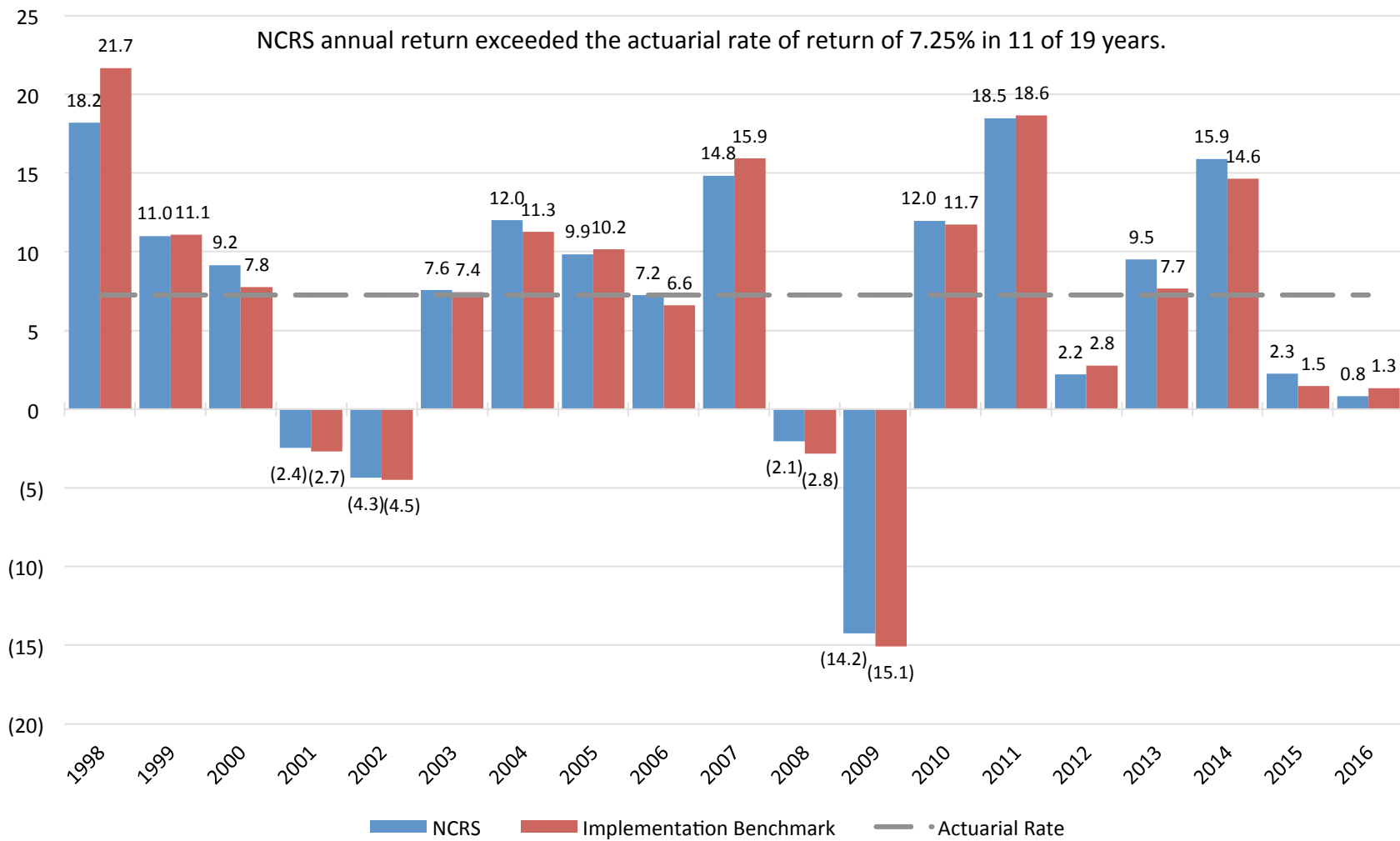
As of June 30, 2016

	Market Value (\$MM)	1 Year	3 Years	5 Years	10 Years	15 Years
Growth	\$50,798	(2.14)	7.28	6.77	4.65	4.95
Benchmark ¹		(2.30)	6.19	5.74	4.24	4.47
Public Equity	\$37,256	(3.89)	6.65	6.21	4.59	4.90
Benchmark ²		(3.84)	6.14	5.43	4.11	4.22
Private Equity	\$4,376	4.32	10.58	8.79	7.23	4.16
Benchmark ³		4.33	9.66	9.30	9.22	9.26
Non-Core Real Estate	\$3,906	12.39	15.73	13.56	3.76	5.09
Benchmark ⁴		6.48	9.66	9.52	2.84	6.69
Opportunistic Fixed Income	\$5,260	(4.40)	2.40	4.83	5.81	-
Benchmark ⁵		(3.59)	0.42	0.46	0.18	-
Rates & Liquidity	\$25,516	6.97	4.97	5.09	6.61	6.47
Benchmark ⁶		7.88	5.42	5.33	6.38	6.25
IG Fixed Income	\$24,661	7.25	5.10	5.17	6.65	6.50
Benchmark ⁷		8.17	5.54	5.40	6.41	6.27
Cash	\$854	0.84	0.59	-	-	-
Benchmark ⁸		0.15	0.07	0.06	-	-
Inflation Sensitive & Diversifiers	\$9,639	0.24	2.00	1.38	0.88	3.37
Benchmark ⁹		3.72	4.27	3.17	0.71	3.76
Inflation Sensitive	\$5,192	(5.75)	(2.67)	(3.60)	(0.98)	2.48
Benchmark ¹⁰		(3.13)	(1.71)	(3.05)	2.08	-
Core Real Estate	\$4,447	8.53	8.64	9.25	4.63	5.92
Benchmark ¹¹		12.37	11.89	11.57	5.39	6.94
Multi-Strategy	\$1,617	(1.46)	5.92	8.53	4.98	-
Benchmark ¹²		(3.35)	4.73	6.60	5.69	-



NCRS Net of Fees Annual Performance vs. Implementation Benchmark

For Fiscal Years Ending June 30



NOTES:

All data presented are based on currently available information at time of publication and may be revised subsequently.

1. The Growth Benchmark is a blend of the Public Equity Benchmark, Private Equity Benchmark, Non-Core Real Estate Benchmark, & Opportunistic FI Benchmark at policy weights.
2. The Public Equity Benchmark is the dynamically weighted combination of the MSCI ACWI IMI Net (Long-Only) and a beta adjusted MSCI ACWI IMI Net (Hedged Equity).
3. The Private Equity Benchmark is comprised of the following Burgiss Group Private iQ indices: 50% Buyout, 20% Venture Capital, and 30% Special Situations and Distressed Securities.
4. The Non-Core Real Estate Benchmark is comprised of the following Burgiss Group Private iQ indices: 80% U.S. Non-Core Real Estate (Opportunistic and Value-Added) and 20% Non-U.S. Non-Core Real Estate (Opportunistic and Value-Added).
5. The Opportunistic Fixed Income Benchmark is comprised of 50% HFRX Distressed Securities Index, 20% HFRX Relative Value Index, 15% Credit Suisse Leveraged Loan Index, and 15% BOAML High Yield Index*.
6. The Rates & Liquidity Benchmark is a blend of the IG Fixed Income Benchmark and the Cash Benchmark at policy weights.
7. The IG Fixed Income Benchmark is comprised 10% iMoneyNet First Tier Institutional Money Market Funds Net Index and 90% custom BOAML Core Investment Grade Index*. The custom BOAML core index comprised of the following weightings: 30% BOAML 5+ Years Governments, 35% BOAML 5+ Years Investment Grade Corporates, and 35% BOAML Mortgage Master.
8. The Cash Benchmark is the iMoneyNet First Tier Institutional Money Market Funds Net Index.
9. The Inflation Sensitive & Diversifiers Benchmark is a blend of the Inflation Sensitive Benchmark and the Core Real Estate Benchmark at policy weights.
10. The Inflation Sensitive Benchmark is the dynamically weighted combination of the Bank of America Merrill Lynch 1-3 Years U.S. Inflation-Linked Treasury Index (TIPS)*, the Bloomberg Commodities Index (Commodities), and a combination of the benchmarks of investments classified within Private Natural Resources or Other Real Assets and Diversifiers.
11. The Core Real Estate Benchmark is comprised of 80% NCREIF ODCE Net and 20% FTSE EPRA NAREiT Global Index.
12. The Multi-Strategy Benchmark is comprised of a dynamically weighted combination of the HFRX ED: Multi-Strategy Index, net of fees, and the market value weighted benchmarks for any other total fund strategies within the Portfolio.





Thank You!

Together we can build and maintain a fiscally strong and prosperous North Carolina.

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