



NORTH CAROLINA

OFFICE OF THE TREASURER

JANET COWELL, TREASURER

June 30, 2016

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

Re: Use of new investment authority by the State Treasurer through the year ended December 31, 2015

Commission Members:

We are submitting a report under G.S. 147-69.8 on the use of new investment authority by the State Treasurer. The report covers new investment authority granted by the General Assembly since 2009 and includes performance and other investment information through December 31, 2015. We have interpreted "new investment authority" or "broadens the investment authority" in the statute to cover two types of situations: (1) changes in the percentage limits stated by G.S. 147-69.2(b) for particular classes of investments; and (2) changes that allowed the State Treasurer to invest in an investment asset type that was not previously allowed.

Opportunistic Fixed Income Portfolio

The Opportunistic Fixed Income (or Credit Strategies) asset class (G.S. 147-69.2(b)(6c)) was created by the General Assembly in 2009. It included some investments that were previously authorized under other provisions of G.S. 147-69.2. **Table 1** reports the assets and investment performance for the Opportunistic Fixed Income Portfolio from 2009 through 2015.

Table 1: Opportunistic Fixed Income Assets and Investment Performance, 2009-2015

Calendar Year	Beginning Market Value	Additions	Redemptions / Distributions	Net Revenue	End Market Value	Rate of Return	% of Retirement Systems' Assets
2009	342,459	253,015	(39,504)	57,631	613,601	6.72%	0.91%
2010	613,601	2,280,023	(1,584,023)	119,836	1,429,437	15.89%	1.35%
2011	1,429,437	3,532,886	(2,108,886)	(2,608)	2,850,828	2.22%	3.97%
2012	2,850,828	802,584	(825,584)	398,539	3,226,368	13.95%	4.13%
2013	3,226,368	1,107,950	(784,429)	533,564	4,083,452	16.56%	4.73%
2014	4,083,452	1,322,105	(327,997)	135,228	5,212,787	3.40%	5.86%
2015	5,212,787	500,867	(346,093)	(143,958)	5,223,603	-2.61%	6.00%

Note: Dollar amounts are in thousands. All data are as of December 31 of the applicable calendar year.

The value of Opportunistic Fixed Income assets originally was limited to 5% of the total assets of the Retirement Systems, but the limit was raised to 7.5% in 2013. The allocation to Opportunistic Fixed Income assets remained

below the original 5% limit in 2013 despite the increase in the limit to 7.5%; however, the allocation rose above 5% for 2014 and 2015. Therefore, **Table 2** provides information on the Opportunistic Fixed Income funds added by the State Treasurer in 2014 and 2015.

Table 2: New and Additional Commitments to Opportunistic Fixed Income Funds in 2014 and 2015

Calendar Year	Fund	Beginning Commitment	Additional Commitment	Commitment Amount Funded	Redemptions / Distributions	End Market Value	Rate of Return
2014	AG Global Debt Strategy Partners, L.P.	179,915	100,000	279,915	5,399	446,082	10.14%
2014	Brightwood Capital Fund III, L.P.	0	100,000	75,000	5,528	73,435	4.92%
2014	Claren Road Credit Opportunities Partners, L.P.	131,840	100,000	231,840	0	183,784	-13.68%
2014	Marathon Currituck Fund, LP	0	400,000	413,400	0	406,117	-2.48%
2014	MCP Private Capital Fund II	0	82,149	35,766	962	16,654	-14.58%
2014	Monarch Debt Recovery Fund	330,000	50,000	380,000	1,840	450,500	3.49%
2014	PAAMCO - Newport Burgundy	600,000	150,000	950,000	0	1,090,842	4.30%
2015	CVI Credit Value Fund III	0	100,000	25,000	0	25,700	3.80%
2015	Marathon Currituck Fund, LP	400,000	53,000	413,400	0	406,117	-2.48%
2015	PAAMCO - Newport Burgundy	750,000	200,000	950,000	0	1,090,842	4.30%

Note: Dollar amounts are in thousands. All data are as of December 31, 2015. New commitments include commitments to new funds and additional commitments to existing funds. Returns of some funds may reflect higher costs and lower returns in earlier years. For additional commitments, the “Redemptions/Distributions,” “End Market Value,” and “Rate of Return” are reported for the entire commitment, not just the additional commitment. Given the irregular distribution schedule of capital drawdown vehicles, IRR is shown for rate of return as opposed to a time-weighted return.

Inflation Sensitive Portfolio

The Inflation Sensitive asset class (G.S. 147-69.2(b)(9a)) was created by the General Assembly in 2009. It included some investments that were previously authorized under other provisions of G.S. 147-69.2. **Table 3** reports the assets and investment performance in the Inflation Sensitive Portfolio from 2009 through 2015.

Table 3: Inflation Sensitive Assets and Investment Performance, 2009-2015

Calendar Year	Beginning Market Value	Additions	Redemptions / Distributions	Net Revenue	End Market Value	Rate of Return	% of Retirement Systems' Assets
2009	372,650	637,467	(12,660)	(54,520)	942,938	-5.77%	1.41%
2010	429,713	967,940	(344,966)	(126,045)	926,643	-13.21%	1.16%
2011	926,643	6,018,013	(3,519,251)	(222,787)	2,818,605	-5.47%	3.92%
2012	2,818,605	1,468,604	(1,324,729)	27,802	2,990,282	1.06%	3.78%
2013	2,990,282	1,897,550	(1,577,596)	(42,568)	3,267,668	-1.32%	3.78%
2014	3,267,668	1,963,368	(898,696)	(58,713)	4,273,627	-0.65%	4.72%
2015	4,273,627	2,556,440	(1,418,053)	(450,753)	4,961,261	-9.05%	5.70%

Note: Dollar amounts are in thousands. All data are as of December 31 of the applicable calendar year.

The value of Inflation Sensitive assets originally was limited to 5% of the total assets of the Retirements Systems, but the limit was raised to 7.5% in 2013. The allocation to Inflation Sensitive assets remained below the original 5% limit in 2013 and 2014 despite the increase in the limit to 7.5%; however, the allocation rose above 5% in 2015. Therefore, **Table 4** provides information on the Inflation Sensitive funds added by the State Treasurer in 2015.

Table 4: New and Additional Commitments to Inflation Sensitive Funds in 2015

Fund	Beginning Commitment	Additional Commitment	Commitment Amount Funded	Redemptions / Distributions	End Market Value	Rate of Return
BlackRock TIPS Index	0	500,000	500,000	0	496,451	-0.71%
Blackstone SP NCRASMA (Overage)	0	100,000	41,634	0	45,834	14.56%
EnCap Energy Capital Fund X, L.P.	0	123,000	6,208	0	6,997	0.94%
MTP Energy Opportunities Fund II LLC	0	250,000	52,022	1,494	45,237	-10.55%

Note: Dollar amounts are in thousands. All data are as of December 31, 2015. New commitments include commitments to new funds and additional commitments to existing funds. Returns of some funds may reflect higher costs and lower returns in earlier years. For additional commitments, the “Redemptions/Distributions,” “End Market Value,” and “Rate of Return” are reported for the entire commitment, not just the additional commitment. Given the irregular distribution schedule of capital drawdown vehicles, IRR is shown for rate of return as opposed to a time-weighted return.

Alternatives Portfolio

The State Treasurer makes investments in the Alternatives Portfolio, which includes the Private Equity and Multi-Strategy Portfolios, through G.S. 147-69.2(b)(9).

G.S. 147-69.2(b)(9)(ii), added by Session Law 2011-211, allows investments in limited liability entities if their primary purpose is “to engage in any other strategies not expressly authorized by any other subdivision of this subsection.” The State Treasurer today administratively classifies the Multi-Strategy Portfolio under G.S. 147-69.2(b)(9)(ii). According to the Investment Policy Statement, the Multi-Strategy Portfolio includes “externally managed vehicles with the flexibility to invest across markets.” Of the six funds in the Multi-Strategy Portfolio, only one fund post-dates the 2011 session law, and this fund was also within the authority granted by G.S. 147-69.2(b)(8). **Table 5** reports the assets and investment performance of the Multi-Strategy Portfolio.

Table 5: Multi-Strategy Portfolio, 2011-2015

Calendar Year	Beginning Market Value	Additions	Redemptions / Distributions	Net Revenue	End Market Value	Rate of Return	% of Retirement Systems’ Assets
2011	631,761	1,006,668	(353,506)	121,802	1,406,725	6.15%	1.96%
2012	1,406,725	13	(17,236)	205,582	1,595,083	14.70%	2.04%
2013	1,595,083	192	(178,837)	341,481	1,757,919	22.61%	2.04%
2014	1,757,919	129	(160,035)	45,600	1,643,613	2.69%	1.85%
2015	1,643,613	555	(45,792)	14,530	1,612,906	0.85%	1.86%

Note: Dollar amounts are in thousands. All data are as of December 31 of the applicable calendar year. Returns of some funds may reflect higher costs and lower returns in earlier years.

The limit on the value of Alternatives assets as a percentage of the total assets of the Retirement Systems was raised from 5% to 7.5% in 2011 (Session Law 2011-211) and to 8.75% in 2013 (Session Law 2013-398). The allocation to the Alternatives Portfolio rose above 5% in 2011, and has been above or below 5% at various times since 2011. However, the allocation has not exceeded 7.5%. **Table 6** provides information on the Alternatives funds added by the State Treasurer from 2011 through 2015.

Table 6: New and Additional Commitments to Alternatives Funds, 2011-2015

Calendar Year	Fund	Beginning Commitment	Commitment	Commitment Amount Funded	Redemptions / Distributions	End Market Value	Rate of Return
2011	Gladius Aconcagua	0	1,000,000	1,000,000	319,131	1,389,747	14.94%
2011	Harvest Partners VI, L.P.	0	100,000	88,182	45,265	83,369	18.00%
2011	Oaktree European Principal Fund III, L.P.	0	50,000	40,199	0	39,488	6.77%
2011	Tenaya Capital Fund VI	0	75,000	57,655	0	60,007	1.93%
2011	Vista Equity Partners Fund IV, L.P.	0	50,000	40,735	14,422	54,787	20.15%
2011	WLR AGO Co-Inv, L.P.	20,000	1,300	7,162	9,466	0	5.15%
2012	Accel-KKR Capital Partners IV, LP	0	10,000	3,487	0	4,171	8.78%
2012	Carousel Capital Partners IV, L.P.	0	25,000	13,293	804	17,814	18.53%
2012	Halifax Capital Partners III, L.P.	0	30,000	11,277	5,738	14,043	29.96%
2012	Mount Kellett Capital Partners II, LP	0	75,000	67,793	44,001	27,632	1.29%
2012	NEA 14, L.P.	0	45,000	38,925	2,445	49,275	16.02%
2013	Angeleno Investors II, L.P.	30,000	1,700	29,989	7,036	17,453	-5.05%
2013	Apollo Investment Fund VIII, L.P.	0	220,000	58,383	0	63,361	-3.74%
2013	Avista Capital Partners III, L.P.	0	150,000	123,027	0	140,737	7.76%
2013	Catterton Growth Partners II, L.P.	0	75,000	57,951	0	72,672	11.26%
2013	Catterton Partners VII, L.P.	0	100,000	54,226	308	82,991	12.31%
2013	CVC Capital Partners VI, L.P.	0	97,489	28,757	13	25,674	-38.11%
2013	GCM Grosvenor - NC Innovation Fund 2013-1	0	15,000	10,336	1,675	10,281	10.71%
2013	Hg Capital 7	0	98,230	41,920	0	44,057	-5.83%
2013	Levine Leichtman Capital Partners V	0	150,000	98,371	5,389	89,140	5.78%
2013	Marlin Equity IV	0	49,000	20,324	0	19,805	-2.28%
2013	Milestone Partners IV, L.P.	0	50,000	42,719	102	47,496	5.50%
2013	StepStone SYN	30,000	5,000	30,451	2,215	18,616	-6.70%
2013	TCV VIII, L.P.	0	150,000	86,556	0	87,527	1.43%
2013	Warburg Pincus Private Equity XI, L.P.	0	150,000	115,563	13,895	142,342	15.25%
2014	ARCH Venture Fund VIII, L.P.	0	80,000	26,400	0	38,560	-3.83%
2014	Crestview Capital Partners III, L.P.	0	150,000	19,939	0	31,764	-10.85%
2014	Francisco Partners IV, L.P.	0	100,000	29,250	0	27,419	- 8.44%
2014	Landmark Equity Partners XV, L.P.	0	250,000	103,735	32,328	86,905	22.25%
2014	Lexington Middle Market Investors III, L.P.	0	150,000	44,799	11,495	50,210	25.63%
2014	Tenaya Capital Fund VII, L.P.	0	90,000	15,034	0	14,557	- 4.32%
2015	Charterhouse Capital Partners X, L.P.	0	168,735	0	0	0	N/A
2015	GCM Grosvenor - NC Innovation Fund II	0	247,500	11,190	0	12,353	10.27%
2015	MHR Institutional Partners IV, L.P.	0	150,000	20,797	11	19,239	-8.56%
2015	NEA 15 Opportunity Fund, L.P.	0	65,000	4,875	0	11,502	22.17%
2015	NEA 15, L.P.	0	67,500	17,550	0	18,792	-0.93%
2015	Northbound NCRS Fund, L.P.	0	200,000	1,307	0	6,322	0.00%
2015	Warburg Pincus Private Equity XII, L.P.	0	175,000	0	0	1,587	-43.72%

Note: Dollar amounts are in thousands. All data are as of December 31, 2015. New commitments include commitments to new funds and additional commitments to existing funds. Returns of some funds may reflect higher costs and lower returns in earlier years. For 2011, only commitments closed on or after June 23, the effective date of Session Law 2011-211, are included. For additional commitments, the “Redemptions/Distributions,” “End Market Value,” and “Rate of Return” are reported for the entire commitment, not just the additional commitment. Given the irregular distribution schedule of capital drawdown vehicles, IRR is shown for rate of return as opposed to a time-weighted return.

Public Equity Portfolio

The State Treasurer makes investments in the Public Equity (or Global Equity) Portfolio through G.S. 147-69.2(b)(8).

G.S. 147-69.2(b)(8) was amended in 2009 to broaden the public equities in which the State Treasurer could invest directly to include equities represented or publicly announced to be included in the S&P 500 Index. In 2011, this

amendment was removed, and the State Treasurer was authorized to invest directly in equities for the purpose of approximating a market benchmark index. Direct investment requires dedicated internal staff; the first staff positions were granted by the General Assembly for direct public equity investment in 2014. At that time, the State Treasurer began the implementation effort for direct public equity investment. Implementation is in progress, with the first trading expected in the first half of 2017.

Beginning in 2011, investments were permitted in “limited partnerships, limited liability companies, and other limited liability investment vehicles that are not publicly traded and invest primarily in [public equities]” (G.S. 147-69.2(b)(8)(b.)). These investments include the Hedged Equity subcomponent of the Public Equity Portfolio identified in the State Treasurer’s Investment Policy Statement. **Table 7** reports the assets and performance of these funds from 2011 through 2015. Prior to the 2011 addition of G.S. 147-69.2(b)(8)(b.), the State Treasurer invested in hedge funds through the Alternatives and other Portfolios (*e.g.*, Opportunistic Fixed Income), depending on the assets in which the fund invested.

Table 7: Public Equity Limited Liability Vehicle Assets and Investment Performance, 2011-2015

Calendar Year	Beginning Market Value	Additions	Redemptions / Distributions	Net Revenue	End Market Value	Rate of Return	% of Retirement Systems’ Assets
2011	N/A	N/A	N/A	N/A	N/A	N/A	N/A
2012	0	140,000	0	(5,291)	134,709	-3.78%	0.17%
2013	134,709	0	0	13,989	148,698	10.38%	0.17%
2014	148,698	95,670	(191,339)	(1,628)	51,400	1.12%	0.06%
2015	54,152	2,446,791	(112,178)	(55,266)	2,330,747	4.04%	2.69%

Note: Dollar amounts are in thousands. All data are as of December 31 of the applicable calendar year.

The limit on the value of public equity limited liability vehicle assets as a percentage of the total assets of the Retirements Systems was raised from 6.5% to 8.5% in 2013, but the value of this portfolio has yet to exceed 6.5% of total Retirement Systems assets.

Investment Grade Fixed Income Portfolio

The State Treasurer makes investments in the Investment Grade Fixed Income Portfolio through G.S. 147-69.2(b)(1)-(6).

Beginning in 2009, the State Treasurer was allowed to invest in corporate and foreign sovereign/supranational debt and asset-backed securities that were so-called split-rated at the time of purchase. Specifically, assets in G.S. 147-69.2(b)(4) (corporate and foreign sovereign/supranational debt) and G.S. 147-69.2(b)(6) (asset-backed securities) were no longer disqualified because they had a “rating below the four highest by any nationally recognized rating service which rates the particular security.” **Tables 8 and 9** report the performances of corporate and foreign sovereign/supranational debt and asset-backed securities, respectively, since 2009. This was the first year in which split-rated corporate and foreign sovereign/supranational debt and asset-backed securities were added to the Treasurer’s portfolio. These numbers include both split-rate and non-split-rate assets. Calculating the performances specifically of split-rated corporate and foreign sovereign/supranational debt and asset-backed securities since 2009 would require significant resources and would require the calculation of security-level returns in a different manner than the calculation of portfolio-level returns.

Table 8: Assets under 147-69.2(b)(4) (Corporate and Foreign Sovereign/Supranational Debt), 2009-2015

Calendar Year	Beginning Market Value	Additions	Withdrawals	Net Revenue	End Market Value	Rate of Return
2009	9,892,061	724,469	(2,838,962)	1,633,640	9,411,208	18.50%
2010	9,411,208	828,062	(1,730,394)	1,026,869	9,535,745	11.53%

2011	9,535,745	1,406,650	(1,428,678)	987,452	10,501,170	10.21%
2012	10,501,170	1,187,485	(1,948,023)	1,330,458	11,071,091	13.03%
2013	11,071,091	1,100,262	(1,891,647)	(258,822)	10,020,884	-2.38%
2014	10,020,884	715,452	(2,369,947)	1,003,941	9,370,330	10.43%
2015	9,370,330	1,111,689	(1,926,591)	(49,693)	8,552,946	-0.75%

Note: Dollar amounts are in thousands. All data are as of December 31 of the applicable year.

Table 9: Assets under 147-69.2(b)(6) (Asset-Backed Securities), 2009-2015

Calendar Year	Beginning Market Value	Additions	Withdrawals	Net Revenue	End Market Value	Rate of Return
2009	100,695	1,270,000	(92,500)	319,507	1,597,703	39.98%
2010	1,597,703	157,500	(743,000)	227,220	1,239,423	17.51%
2011	1,239,423	180,000	(721,823)	6,779	704,378	0.93%
2012	704,378	0	(330,250)	109,016	483,145	22.55%
2013	483,145	625	(149,888)	31,050	364,932	9.18%
2014	364,932	0	(123,500)	13,378	254,810	4.81%
2015	254,810	0	(257,139)	2,329	0	12.19%

Note: Dollar amounts are in thousands. All data are as of December 31 of the applicable calendar year. Given the irregular distribution schedule of capital drawdown vehicles, IRR is shown for rate of return as opposed to a time-weighted return.

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

Sincerely,



Janet Cowell

Appendix – Clarifications and Technical Corrections

Since 2009, the General Assembly has made several changes to G.S. 147-69.2 that could be viewed as broadening the Treasurer's investment authority but that the State Treasurer has interpreted as technical corrections or clarifications and not new investment authority.

Opportunistic Fixed Income Portfolio

In 2013, the investments for the Opportunistic Fixed Income (or Credit Strategies) Portfolio (G.S. 147-69.2(b)(6c)) was changed from "obligations and other debt securities, including securities convertible into other securities" to "obligations, debt securities, and asset-backed securities, whether considered debt or equity, including obligations and securities convertible into other securities." Prior to the 2013 change, the State Treasurer invested in asset-backed securities as well as both debt and equity securities in the Opportunistic Fixed Income Portfolio under the pre-existing broad language.

Investment Grade Fixed Income Portfolio

In 2009, the phrase "including obligations that are convertible into equity securities" was inserted after the introductory phrase that defined the assets in G.S. 147-69.2(b)(4) as "[o]bligations of any company, other organization or legal entity incorporated or otherwise created within or outside the United States." Prior to the 2009 change, the Investment Grade Fixed Income Portfolio included convertible debt under the language that generally covered obligations of any company. In 2015, the statute was modernized by adding a phrase to expressly authorize repurchase agreements with registered broker-dealers that are subject to SEC regulations and are members in good standing of FINRA, regardless of whether those broker-dealers report to the Federal Reserve Bank of New York.