

**NORTH CAROLINA DEPARTMENT OF STATE TREASURER
INVESTMENT ADVISORY COMMITTEE
MEETING MINUTES FOR August 25, 2021**

Time and Location: The Investment Advisory Committee ("IAC" or the "Committee") met on Wednesday, August 25, 2021, at 9:00 a.m. via conference call and GoToWebinar.

Members Present: State Treasurer Dale R. Folwell (Chair), Loris Colclough

Members Attending via Webinar: Lentz Brewer, John Aneralla, and Greg Patterson

Not in attendance: Michael Mebane

Staff Present (in person and virtual): Matt Krimm, Rhonda Smith, Brian Jackson, Nick Langley, Gail Kadash, Kathy O'Neill, Fran Lawrence, Bill Golden, Loren de Mey, Laura Rowe, Joe Farley, Casey High, Greg Taylor, Tina Kapoor, Dan Way, Deana Solomon, Troy March, Brian Bolcar, Ty Powers, Brett Hall, Sam Watts, Frank Lester, Debbie Thomas, Chris Ward, Jeff Smith, Chris Morris, Ronald Funderburk, Craig Demko, Anne Roof, Ben Garner, Jason Sass.

Others in Attendance: Adam Rees (pageantmedia.com), Lindsay Saienni (fin-news), Brian Kahley (Franklin Templeton), Charles Ashmun (BlackRock), Julia Dunton (Blackrock), Mitchell King (Blackrock), Angela Scioli, Drew Edwards, Keith Townsend

AGENDA ITEM – OPENING REMARKS

The meeting was called to order at approximately 9:00 a.m. by Treasurer Folwell. Meeting etiquette information, and Webinar/Conference line use was shared by Ben Garner. Mr. Garner confirmed there was a quorum and provided procedures for virtual guidelines.

The Treasurer then commenced the meeting, introducing a Legislative update via Mr. Sam Watts requesting an approval of a Resolution for Board consideration.

Mr. Watts began by giving a background on current legislative issues. Mr. Watts explained how there are efforts within the General Assembly to include provisions in the state budget that would severely limit the State Treasurer's ability to use funds for critical administrative and investment expenses, including payment of fees to investment managers. These provisions would gravely impair the State Treasurer's ability to hire necessary third parties, as allowed by statute, and to properly invest the monies for which the State Treasurer is responsible.

Mr. Colclough requested some technical changes and comments be added to the resolution. The Treasurer stated those changes/comments would be added to the resolution and returned to the Board for signature execution if the Resolution was approved. Mr. Colclough approved the resolution, seconded by Mr. Aneralla, and agreed upon by remainder of the Board.

AGENDA ITEM – APPROVAL OF MINUTES

Mr. Patterson moved, Mr. Aneralla seconded, and there was a member roll call to approve the minutes. The minutes were approved.

AGENDA ITEM – PERFORMANCE UPDATE

The Chair recognized Jeff Smith, Co-CIO and Director of Fixed Income, and Chris Morris, Co-CIO and Chief Risk and Operating Officer, to present the performance update.

Mr. Smith provided an update on the United States economic environment for the second quarter of 2021 and further discussed the current quarter changes. Some highlights included that we had a fifth consecutive quarter of positive returns for the total pension. Additionally, after a historically negative first quarter return in investment grade fixed income due to rising rates, the portfolio was able to bounce back in the second quarter.

Mr. Morris presented an update on Assets Under Management (AUM), as of June 30, 2021. He stated the total AUM was \$171.4B, which is up \$12.4B since the prior quarter and up \$30B since the end of the last fiscal year. Most of the increase is due to appreciation of the N.C. Retirement System and large non-pension deposits into the Cash Management program (STIF).

Mr. Morris reviewed the asset allocation as of June 30, 2021. In this quarter, there were no major changes to over- and underweights. The portfolio is currently 7.7% underweight to growth, largely driven by the underweight in public equity. The portfolio shows overweight to rates and liquidity due to cash mostly and neutral to multi-strategy.

Mr. Morris continued to the Total Net Portfolio Returns vs. Benchmarks slide, discussing the periodic performance from both an absolute and relative perspective across multiple time horizons. The one-year return on an absolute basis is the second highest fiscal year return since 1997. The only other year higher was 1998 at 19.8%. We have exceeded the actuary rate in all timeframes presented with a strong 12-month return.

Mr. Morris discussed the Growth of a Dollar charts, which illustrate how the total pension and alternatives sleeve have performed relative to the long-term policy benchmark over the five- and ten-year periods and since 1997, which is the beginning of the pensions' performance record. Mr. Morris stated there were no big movements, and the total pension outperformed both benchmarks over all time periods. The alternatives outperformed over the 10-year period but were in line with the benchmark over 5 years.

Mr. Morris moved on to the Contribution to Total Plan Return. He discussed the dollar amount each asset class contributed to the earnings of the plan for the prior one-year period. Mr. Morris highlighted that public equity had strong earnings due to portfolio size and positive returns, followed by private equity earning north of 50% for the year relative to their portfolio allocation.

Mr. Morris next walked the committee through the Net of Fees Return Attribution charts, discussing how the portfolio either added or detracted value relative to the benchmark over various horizons. He discussed how the selection effect added value, while the allocation effect detracted value as the portfolio remained underweight to public equities and overweight to cash.

Mr. Morris presented the Net of Fees Risk Metrics slide. This slide shows across all time periods rolling volatility and tracking error down significantly.

Mr. Morris discussed the peer universe comparison slides, which show our percentile rank. In strong markets we are expected to lag our peers, due to less equity exposure as compared to our peers and more fixed income assets. In falling markets we outperform significantly. In reviewing the risks, we are at the lowest risk percentile versus our peers. Standard deviation reflects our conservative nature.

Mr. Morris moved on to the liquidity slides, hitting on the structural liquidity, benefit payments, and cash flows within the alternatives sleeve. The portfolio is currently at 76% Level 1 Liquidity, which is well within minimums for policy guidelines, and we remain cash flow positive. Mr. Morris also reported there have been no changes to benefit payments and it is expected by calendar year-end with pay out of \$2-3B in net benefit payments. This has trended down in recent years, but we do expect it to trend upwards in coming years.

Mr. Smith reported on Asset Class Performance and spoke to the Calendar Year Asset Class Return chart, highlighting growth with the strong 1-year performance in public equity (41.8%), and private equity (58.5%), adding value above all other asset classes.

Mr. Smith next discussed new and incremental investments, particularly one new fund this month in real estate, with a continued down trend of unfunded commitments. Mr. Smith also reported on one real estate redemption.

Mr. Smith moved along to Asset Allocation History with no changes and the Top 20 Investment Managers presentation, noting the 2 internally managed portfolios have been slightly higher due to growth in markets.

Mr. Aneralla asked a question related to increased cash flow from stimulus. Mr. Smith responded it has been challenging as the increase is occurring across the country, but we managed it with discount notes not just repos. It has been more challenging due to vast amount of cash in the marketplace.

AGENDA ITEM – PRIVATE EQUITY ASSET CLASS REVIEW

The Treasurer thanked the CIOs for their reports and introduced Craig Demko, Investment Director of Private Equity.

Mr. Demko and Mr. Brian Bolcar began by reviewing the private equity portfolio starting with statutory allocation. The portfolio is below the 8.75% legislative cap for the combined weight of Private Equity and Multi-Strategy portfolios, at just under 8%. The Private Equity portfolio is slightly above the policy target of 6% at 6.1%. In calendar 2020, there was over \$1.5B of additional allocation into the asset class because of positive performance (valuation increases), despite being cash flow positive during the year. The distributions continued to exceed funding, with 2021 on track to continue this trend.

They went on to discuss portfolio composition, which shows higher allocations to Venture Capital and Growth Equity, but do not have a concern with this as it is a function of performance. The industry allocation is not managed to specific exposures but monitored from a risk and return perspective. The portfolio has higher allocations to Information Technology, Healthcare, Consumer Discretionary, and Industrials. The geographic allocation is primarily North America.

Mr. Demko reported that our portfolio is comprised of 149 funds since inception with \$10.8B of called capital and distributed at \$10.1B, with profits over \$7B. Private equity continues to focus on long term value creation. Mr. Demko also discussed the portfolios cash flows by calendar year, reported that nine out of last ten years having been cashflow positive, receiving more money back than funded. Mr. Demko mentioned two new funds pending approval and one additional recommendation for a co-investment. It was mentioned that Private Equity benefits during market dislocation, and COVID created the biggest dislocation.

Mr. Bolcar next reported on market trends and specifically future opportunities in secondaries and structured transactions, and a continuation of co-investments. The key is to partner with high conviction

managers with primary commitments that will increase NC's opportunity set for more co-investments. Mr. Bolcar mentioned that working these deals across multiple asset classes allows us to benefit from using scale for preferred terms and average down cost basis. The path forward is to drive value through co-investments with key primary commitments.

Mr. Aneralla added that the focus on high value managers over a handful of years is paying off. Mr. Demko confirmed that keeping up with general partners is important to get access to these returns and co-investment opportunities.

The Treasurer asked Mr. Demko to elaborate on fees. Mr. Demko replied that we want a good deal where the relationship can capitalize on co-investment opportunities with no fees. The estimated savings from this approach at the end of the 1Q 2021 was \$54M, a significant amount. It was again highlighted that they will continue to work with other asset classes to reduce fees when able, as this will benefit the entire pension program.

AGENDA ITEM – PUBLIC EQUITY ASSET CLASS REVIEW

The Treasurer introduced Rhonda Smith, Investment Director of Public Equity, and Ms. Smith introduced her team and the team's newest member, Tina Kapoor.

Ms. Smith and the team discussed the portfolio's structure and performance. They began with a report on performance stating after record lows in March 2020, the markets exceeded historic record highs for the period ended June 30th. Energy and tech sectors lead performance with all indices up double digits for the year.

The team continued to provide a performance overview stating that although the hedged subclass had positive performance across all time periods, the under-allocation to hedged equity resulted in the decision to unwind. This portion of the portfolio never grew to meaningful allocation, so the decision to wind it down was made and should be completed by early next year.

With no exits, or fund additions to the remainder of the Public Equity portfolio, the focus has been on structure. Ms. Smith commented that it's been four years since the implementation of the internal equity strategies. Members of the Public Equity team went on to summarize the Russell Index rebalance and June reconstitution events and the impact to the internal strategies. They also indicated the team was able to save transactions costs on 6.6M shares (market value of \$219 million) that were transferred between the Russell 200 and Russell Midcap indices, by completing index transfers between accounts.

Ms. Smith highlighted that the team's 2021-2022 strategic goals were to rebalance total public equity portfolio and grow the internal management.

AGENDA ITEM – PUBLIC COMMENT

Paul Keith Townsend was introduced for public comment. Mr. Townsend, a retired Wake County public school teacher, posed questions surrounding asset allocation and funded status of the pension plan.

Angela Scioli was introduced for public comment. Ms. Scioli, a retired Wake County public school teacher, made comments surrounding the amount of cash in the investment portfolio and questioned whether fee savings was at the cost of better investment deals.

Drew Edwards was introduced for public comment; however, he did not comment.

The Treasurer closed out the public comments and moved to IAC member questions.

AGENDA ITEMS – IAC MEMBER Q&A

IAC members were provided with the opportunity to pose questions to the Treasurer and IMD staff.

Mr. Aneralla inquired about legislation impacts related to power funds and our plan to manage these assets; specifically, would it be similar to our overall management or will new parameters be added?

Treasurer clarified that Mr. Aneralla was referring to Electricities, their decommission, and available funds seeking new investment options via legislation. He stated he does not have an answer at the ready but would revert. The Treasurer strives for attainable and affordable power for North Carolina.

Other members commented on great efforts by IMD as recognized by resources such as AON and CEM. The focus is to protect pensions going forward for rest of their lives whether new or retired.

The Treasurer thanked the committee members for their comments. He continued that the history of plan has been about risk and return, but now more than ever it is about return and keeping the plan funded. He continued to provide historical reference to financial crisis impacts during Treasurer Moore's and Treasurer Cowell's terms that took the plan from 110% funded to where it is today. For every 25% lost, we need to make 33% to be even again. In addition, he commented that the plan was not designed for zero interest rates, early retirements, increased life expectancy, and fewer participants paying into the plan with over 100,000 participants vested and eligible to draw but not yet drawn.

The Treasurer pledged to preserve, strengthen, and sustain this plan for the next generation.

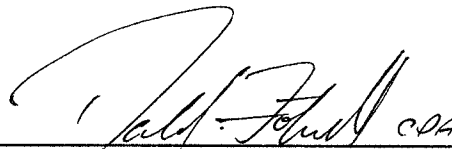
ADJOURNMENT

The Treasurer next thanked Jeff Smith, Christopher Morris, and the Investment Management team and requested that there be a motion to adjourn the meeting.

Before the motion to adjourn, the Treasurer noted the new members of the legal team. Mr. Garner introduced a new IMD legal staff member, Jason Sass, and mentioned other new legal staff members assigned throughout the Department.

Mr. Colclough motioned to adjourn. Mr. Aneralla seconded the motion. Mr. Lentz and Mr. Brewer agreed to adjourn.

The Treasurer officially adjourned the meeting at approximately 11:00 am.



DALE R. FOLWELL, CPA
NORTH CAROLINA STATE TREASURER AND CHAIR