



NORTH CAROLINA

OFFICE OF THE TREASURER

JANET COWELL, TREASURER

August 24, 2011

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, 2011.

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 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, UNC and 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 fiscal year return of 1.019% 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>6/30/10</u>	<u>12/31/10</u>	<u>6/30/11</u>
3-Mo. T-Bill	0.17%	0.12%	0.01%
6-Mo. T-Bill	0.22%	0.18%	0.10%

The Short-Term Investment Fund produced a fiscal year return of 1.04% for the participants. The investable balances earning income for the General Fund were \$259 million higher than one year earlier based on book value. The investable balances, which earn income for the Highway Funds, were \$100 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:	18.26%	15.08%	4.47%	5.10%

Long Term Investment Fund

	<u>1 Year</u>	<u>2 Year</u>	<u>3 Year</u>	<u>5 Year</u>
LTIF Returns:	5.22%	9.18%	8.66%	8.16%

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 3/31/11	2.28%	3.47%	4.51%
As of 6/30/11	1.76%	3.16%	4.37%

- Long Term assets (based on market value) ended the quarter approximately \$1.13 billion higher than at the end of the prior reporting period.
- The realized earnings for the fiscal year to date are \$1.52 billion.

Equity Investment Fund

	<u>1 Year</u>	<u>2 Year</u>	<u>3 Year</u>	<u>5 Year</u>
EIF Returns:	30.76%	22.26%	3.14%	3.45%

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

Quarterly Index Returns:	S&P 500	0.10%	DJIA	0.77%
	Russell 3000	-0.03%	MSCI EAFE	1.56%

- Assets of the fund (based on market value) ended the quarter approximately \$1.31 billion lower than at the end of the prior reporting period.
- Approximately \$1.45 billion 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, UNC and Public Hospital Funds, and the Local Government Other Post-Employment Benefits Fund.

Pursuant to G.S. 116-37, deposits are held for the University of North Carolina Hospitals at Chapel Hill Trust, 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, 2011, the invested assets were valued at \$419 million after returns in the domestic and international accounts of 1.31% and 1.07% 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, 2011, \$40 million has been invested in equity; \$20 million has been invested in real estate, and commitments totaling \$57 million have been made to private equity, of which, \$45 million has been contributed.

Pursuant to G.S. 147-69.4, deposits are held for the Local Government Other Post-Employment Benefits Fund, 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, 2011, the externally invested assets were valued at \$36.6 million after returns in the domestic and international equity accounts of 1.31% and 1.07% 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

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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.

During the second quarter of 2011, the Department released a report on a survey of the Retirement System's Real Estate Portfolio managers. A copy of the report is attached.

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 blue ink that reads "Janet Cowell". The signature is fluid and cursive, with the first letter of each name being significantly larger and more decorative than the others.

Janet Cowell

Attachments

cc: Shawn Wischmeier, 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, 2011

	*Cash Management Program			**Trust Funds Investment Program		All Pools
	Short-term Investment Fund	Bond Proceeds Fund	Subtotal	Subtotal	Intrafund Eliminations	Total
Net Assets:						
Investment Securities:						
Cash Equivalents	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Certificates of Deposit	37,100,000	-	37,100,000	-	-	37,100,000
Repurchase Agreements	1,074,000,000	-	1,074,000,000	-	-	1,074,000,000
Discount Notes/Bills	-	-	-	-	-	-
U.S. Treasury Bills/ Notes/ Bonds	4,674,699,863	-	4,674,699,863	8,268,329,921	-	12,943,029,784
U.S. Government Agency Notes/ Bonds	7,250,223,882	-	7,250,223,882	2,212,042,684	-	9,462,266,566
GNMA Certificates	-	-	-	7,091,072,932	-	7,091,072,932
Corporate Obligations	364,911,463	-	364,911,463	10,022,673,735	-	10,387,585,198
Other Investments	-	-	-	31,145,494	-	31,145,494
Investments in RMBS and CMBS	-	-	-	682,684,950	-	682,684,950
Investments in Equity Securities	-	-	-	-	-	-
Bond proceeds Advisory	-	87,690,472	87,690,472	-	-	87,690,472
Investments in Equity Trusts	-	-	-	33,903,890,360	-	33,903,890,360
Investments in Real Estate Trust Funds & Partnerships	-	-	-	4,210,108,192	-	4,210,108,192
Investments in Alternative Partnerships	-	-	-	3,590,181,483	-	3,590,181,483
Investments in Credit Partnerships	-	-	-	2,474,758,878	-	2,474,758,878
Investments in Inflation Partnerships	-	-	-	1,445,187,517	-	1,445,187,517
				-	-	-
Total Investment Securities	\$ 13,400,935,208	\$ 87,690,472	\$ 13,488,625,680	\$ 73,932,076,146	\$ -	\$ 87,420,701,826
Cash in Bank	99,125,768	-	99,125,768	-	-	99,125,768
Deposits in Short-term Investment Fund	-	-	-	1,728,562,619	(1,728,562,619)	-
Other Assets, Net of Liabilities	(88,730,113)	-	(88,730,113)	390,874,523	-	302,144,410
Total Net Assets	\$ 13,411,330,863	\$ 87,690,472	\$ 13,499,021,335	\$ 76,051,513,288	\$ (1,728,562,619)	\$ 87,821,972,004
Participant Equity:						
General Fund	\$ 1,849,706,754	\$ -	\$ 1,849,706,754	\$ -	\$ -	\$ 1,849,706,754
Other Funds Which Earn Interest for General Fund	1,397,346,590	-	1,397,346,590	-	-	1,397,346,590
Highway Fund	823,479,292	87,690,472	911,169,764	-	-	911,169,764
Highway Trust Fund	212,766,733	-	212,766,733	-	-	212,766,733
University Trust Funds	2,368,666,570	-	2,368,666,570	-	-	2,368,666,570
Pension Trust Funds	149,528,634	-	149,528,634	74,941,597,298	-	75,091,125,932
Other Independent Trust Funds	4,102,579,343	-	4,102,579,343	1,109,915,990	-	5,212,495,333
Local Political Subdivisions	749,894,260	-	749,894,260	-	-	749,894,260
Licensing Boards	28,800,068	-	28,800,068	-	-	28,800,068
Other Investment Funds	1,728,562,619	-	1,728,562,619	-	(1,728,562,619)	-
Total Participant Equity	\$ 13,411,330,863	\$ 87,690,472	\$ 13,499,021,335	\$ 76,051,513,288	\$ (1,728,562,619)	\$ 87,821,972,004
Percent of Total	15.27	0.10	15.37	86.60	-1.97	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, 2011

	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	7,654,544,021						613,785,900	8,268,329,921
U.S. Government Agency Notes/ Bonds	2,018,996,736	4,105,109					188,940,839	2,212,042,684
GNMA Certificates	7,091,072,932							7,091,072,932
Corporate Obligations	10,022,673,735							10,022,673,735
Other Investments		31,145,494						31,145,494
Investments in RMBS and CMBS		682,684,950						682,684,950
Investments in Equity Securities								-
Bond Proceeds Advisory								-
Investments in Equity Trusts			33,895,110,910		8,779,450			33,903,890,360
Investments in Real Estate Trust Funds & Partnerships				4,210,108,192				4,210,108,192
Investments in Alternative Partnerships					3,590,181,483			3,590,181,483
Investments in Credit Partnerships						2,474,758,878		2,474,758,878
Investments in Inflation Partnerships & Other Inv							1,445,187,517	1,445,187,517
Total Investment Securities	\$ 26,787,287,424	\$ 717,935,553	\$ 33,895,110,910	\$ 4,210,108,192	\$ 3,598,960,933	\$ 2,474,758,878	\$ 2,247,914,256	\$ 73,932,076,146
Cash in Bank								
Deposits in Short-term Investment Fund	111,592,002	1,544,223,350	15,633,660	9,853,198	13,078,907	29,505,099	4,676,403	1,728,562,619
Other Assets, Net of Liabilities	264,786,253	(18,334,749)					144,423,019	390,874,523
Total Net Assets	\$ 27,163,665,679	\$ 2,243,824,154	\$ 33,910,744,570	\$ 4,219,961,390	\$ 3,612,039,840	\$ 2,504,263,977	\$ 2,397,013,678	\$ 76,051,513,288
Participant Equity:								
Pension Trust Funds	26,053,749,689	2,243,824,154	33,910,744,570	4,219,961,390	3,612,039,840	2,504,263,977	2,397,013,678	74,941,597,298
Other Independent Trust Funds	1,109,915,990	-	-	-	-	-	-	1,109,915,990
Total Participant Equity	\$ 27,163,665,679	\$ 2,243,824,154	\$ 33,910,744,570	\$ 4,219,961,390	\$ 3,612,039,840	\$ 2,504,263,977	\$ 2,397,013,678	\$ 76,051,513,288
Percent of Total	35.72	2.95	44.59	5.55	4.75	3.29	3.15	100.00

**DEPARTMENT OF STATE TREASURER
ANCILLARY INVESTMENT PROGRAMS
JUNE 30, 2011**

	<u>Escheats External Investments</u>	<u>OPEB External Investments</u>	<u>Hospital Investment Fund</u>	<u>Totals</u>
Net Assets:				
Deposits in Equity Investment Fund	\$ 16,095,499	36,643,562	419,367,801	\$ 472,106,862
Deposits in Real Estate Investment Fund	15,644,672			15,644,672
Deposits in Alternative Investment Fund	39,955,166			39,955,166
Other Assets, Net of Liabilities	137,030			137,030
Total Net Assets	<u>\$ 71,832,367</u>	<u>\$ 36,643,562</u>	<u>\$ 419,367,801</u>	<u>\$ 527,843,730</u>
 Participant Equity:				
General Fund	\$ -	\$ -	\$ -	\$ -
Other Investment Funds	<u>71,832,367</u>	<u>36,643,562</u>	<u>419,367,801</u>	<u>527,843,730</u>
Total Participant Equity	<u>\$ 71,832,367</u>	<u>\$ 36,643,562</u>	<u>\$ 419,367,801</u>	<u>\$ 527,843,730</u>

**DEPARTMENT OF STATE TREASURER
COMBINED STATEMENT OF OPERATIONS - ALL POOLS AND ACCOUNTS
FOR THE PERIOD ENDED JUNE 30, 2011**

	Cash Management Program			*Trust Funds Investment Program	Memorandum	
	Short-term Investment Fund	Bond Proceeds Fund	Subtotal	Subtotal	Intrafund Eliminations	Total
Revenues:						
Investment Income:						
Investment Earnings	\$ 138,841,673	473,888	\$ 139,315,561	\$ 6,792,755,613	\$ -	\$ 6,932,071,174
Intra-Pool Interest Earnings			-	15,980,290	(15,980,290)	-
Income from Security Lending			-	29,037,060	-	29,037,060
Commission Recapture			-	122,417	-	122,417
Other Income			-	5,613,509	-	5,613,509
Subtotal	<u>138,841,673</u>	<u>473,888</u>	<u>139,315,561</u>	<u>6,843,508,889</u>	<u>(15,980,290)</u>	<u>6,966,844,160</u>
Net Unrealized Appreciation/Depreciation				<u>5,429,975,390</u>	-	<u>5,429,975,390</u>
Total Investment Income	<u>138,841,673</u>	<u>473,888</u>	<u>139,315,561</u>	<u>12,273,484,279</u>	<u>(15,980,290)</u>	<u>12,396,819,550</u>
Expenditures:						
Treasurer's Allocated Cost	(1,906,587)		(1,906,587)	(4,185,554)	-	(6,092,141)
Management Fees		(151,114)	(151,114)	(248,571,684)	-	(248,722,798)
Foreign Income Tax			-	(23,595,194)	-	(23,595,194)
Other Cost	<u>(1,584,090)</u>		<u>(1,584,090)</u>	<u>(33,990,461)</u>	<u>-</u>	<u>(35,574,551)</u>
Total Expenditures	<u>(3,490,677)</u>	<u>(151,114)</u>	<u>(3,641,791)</u>	<u>(310,342,893)</u>	<u>-</u>	<u>(313,984,684)</u>
Net Investment Income (Loss)	\$ <u>135,350,996</u>	\$ <u>322,774</u>	\$ <u>135,673,770</u>	\$ <u>11,963,141,386</u>	\$ <u>(15,980,290)</u>	\$ <u>12,082,834,866</u>
Total Investment Income Allocated:						
General Fund	\$ 31,390,988		31,390,988	\$ -	\$ -	\$ 31,390,988
Highway Fund	7,719,394		7,719,394	-	-	7,719,394
Highway Trust Fund	983,750		983,750	-	-	983,750
University Trust Funds	25,676,825		25,676,825	-	-	25,676,825
Pension Trust Funds	3,815,253		3,815,253	11,963,141,386	-	11,966,956,639
Other Independent Trust Funds	42,498,404		42,498,404	-	-	42,498,404
Local Political Subdivisions	6,971,146		6,971,146	-	-	6,971,146
Licensing Boards	314,946		314,946	-	-	314,946
Other Investment Funds	<u>15,980,290</u>	<u>322,774</u>	<u>16,303,064</u>	<u>-</u>	<u>(15,980,290)</u>	<u>322,774</u>
Total Investment Income Allocated	\$ <u>135,350,996</u>	\$ <u>322,774</u>	\$ <u>135,673,770</u>	\$ <u>11,963,141,386</u>	\$ <u>(15,980,290)</u>	\$ <u>12,082,834,866</u>

Cash Return, Fiscal Year-to-Date (Annualized) 1.040% 0.021% 1.019%

*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, 2011

Trust Funds Investment Program

	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
Revenues:								
Investment Income:								
Investment Earnings	\$ 1,516,844,321	281,496,600	4,573,338,736	168,280,564	170,048,488	77,036,223	5,710,681	\$ 6,792,755,613
Intra-Pool Interest Earnings	2,754,813	11,663,601	92,857	486,684	545,269	343,281	93,785	15,980,290
Income from Security Lending			29,037,060					29,037,060
Commission Recapture			122,417					122,417
Other Income			5,613,509					5,613,509
Subtotal	<u>1,519,599,134</u>	<u>293,160,201</u>	<u>4,608,204,579</u>	<u>168,767,248</u>	<u>170,593,757</u>	<u>77,379,504</u>	<u>5,804,466</u>	<u>6,843,508,889</u>
Net Unrealized Appreciation/Depreciation	(199,001,188)	(92,815,131)	4,828,312,990	476,838,915	376,364,712	148,755,074	(108,479,982)	5,429,975,390
Total Investment Income	<u>1,320,597,946</u>	<u>200,345,070</u>	<u>9,436,517,569</u>	<u>645,606,163</u>	<u>546,958,469</u>	<u>226,134,578</u>	<u>(102,675,516)</u>	<u>12,273,484,279</u>
Expenditures:								
Treasurer's Allocated Cost	(1,487,943)	(136,187)	(1,915,657)	(224,566)	(191,870)	(129,476)	(99,855)	(4,185,554)
Management Fees		(34,699,573)	(94,811,112)	(38,540,249)	(57,635,688)	(6,417,144)	(16,467,918)	(248,571,684)
Foreign Income Tax			(23,595,194)					(23,595,194)
Other Cost	<u>(823,251)</u>	<u>(579,300)</u>	<u>(1,978,646)</u>	<u>(6,403,508)</u>	<u>(11,991,813)</u>	<u>(8,722,520)</u>	<u>(3,491,423)</u>	<u>(33,990,461)</u>
Total Expenditures	<u>(2,311,194)</u>	<u>(35,415,060)</u>	<u>(122,300,609)</u>	<u>(45,168,323)</u>	<u>(69,819,371)</u>	<u>(15,269,140)</u>	<u>(20,059,196)</u>	<u>(310,342,893)</u>
Net Investment Income (Loss)	\$ <u>1,318,286,752</u>	\$ <u>164,930,010</u>	\$ <u>9,314,216,960</u>	\$ <u>600,437,840</u>	\$ <u>477,139,098</u>	\$ <u>210,865,438</u>	\$ <u>(122,734,712)</u>	\$ <u>11,963,141,386</u>
Total Investment Income Allocated:								
General Fund	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	-
Highway Fund	-	-	-	-	-	-	-	-
Highway Trust Fund	-	-	-	-	-	-	-	-
University Trust Funds	-	-	-	-	-	-	-	-
Pension Trust Funds	1,264,121,247	164,930,010	9,314,216,960	600,437,840	477,139,098	210,865,438	(122,734,712)	11,908,975,881
Other Independent Trust Funds	54,165,505	-	-	-	-	-	-	54,165,505
Local Political Subdivisions	-	-	-	-	-	-	-	-
Licensing Boards	-	-	-	-	-	-	-	-
Other Investment Funds	-	-	-	-	-	-	-	-
Total Investment Income Allocated	\$ <u>1,318,286,752</u>	\$ <u>164,930,010</u>	\$ <u>9,314,216,960</u>	\$ <u>600,437,840</u>	\$ <u>477,139,098</u>	\$ <u>210,865,438</u>	\$ <u>(122,734,712)</u>	\$ <u>11,963,141,386</u>

Total Return, 12, 24, and 36 and 60 months:

12 months	5.22%	8.91%	30.76%	18.16%	14.20%	15.79%	-16.35%	18.26%
24 months	9.18%	12.43%	22.26%	-0.81%	13.33%	N/A	N/A	15.08%
36 months	8.66%	12.08%	3.14%	-12.30%	0.36%	N/A	N/A	4.47%
60 months	8.16%	N/A	3.45%	-3.20%	4.37%	N/A	N/A	5.10%