



## NORTH CAROLINA

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OFFICE OF THE TREASURER

JANET COWELL, TREASURER

November 8, 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 September 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 0.43% 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>9/30/11</u>	<u>3/31/12</u>	<u>9/30/12</u>
3-Mo. T-Bill	0.023%	0.066%	0.094%
6-Mo. T-Bill	0.053%	0.132%	0.129%

The Short-Term Investment Fund produced a one year return of 0.43% for the participants. The investable balances earning income for the General Fund were \$157 million higher than one year earlier based on book value. The investable balances, which earn income for the Highway Funds, were \$58 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:	13.87%	8.25%	8.65%	3.09%

Long Term Investment Fund

	<u>1 Year</u>	<u>2 Year</u>	<u>3 Year</u>	<u>5 Year</u>
LTIF Returns:	8.52%	7.83%	9.03%	9.12%

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 6/30/12	0.72%	1.65%	2.75%
As of 9/30/12	0.63%	1.63%	2.82%

- Long Term assets (based on market value) ended the quarter approximately \$413 million higher than at the end of the prior reporting period.
- The realized earnings for the fiscal year to date are \$352 million.
- Approximately \$319 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:	22.39%	7.85%	8.50%	-0.53%

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

Quarterly Index Returns:	S&P 500	6.35%	DJIA	4.32%
	Russell 3000	6.23%	MSCI EAFE	6.92%

- Assets of the fund (based on market value) ended the quarter approximately \$2.10 billion higher than at the end of the prior reporting period.
- Approximately \$100 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, the Local Government Other Post-Employment Benefits Fund and the Conservation Easement Endowment 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 September 30, 2012, the invested assets were valued at \$77.8 million after returns in the domestic and international accounts of 6.14% and 8.04% 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 September 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 \$16.5 million has been returned; and commitments totaling \$57 million have been made to private equity, of which \$50.8 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 September 30, 2012, the externally invested assets were valued at \$61.5 million after returns in the domestic and international equity accounts of 6.14% and 8.04% 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 that reads "Janet Cowell". The signature is written in black ink and is positioned to the right of the word "Sincerely,".

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**  
**SEPTEMBER 30, 2012**

	*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	35,300,000	-	35,300,000	-	-	35,300,000
Repurchase Agreements	1,540,000,000	-	1,540,000,000	-	-	1,540,000,000
Discount Notes/Bills	-	-	-	-	-	-
U.S. Treasury Bills/ Notes/ Bonds	6,507,338,050	-	6,507,338,050	9,045,160,224	-	15,552,498,274
U.S. Government Agency Notes/ Bonds	4,892,655,578	-	4,892,655,578	1,935,251,504	-	6,827,907,082
GNMA Certificates	-	-	-	7,105,689,986	-	7,105,689,986
Corporate Obligations	5,005,153	-	5,005,153	10,993,937,550	-	10,998,942,703
Other Investments	-	-	-	27,137,590	-	27,137,590
Investments in RMBS and CMBS	-	-	-	421,895,052	-	421,895,052
Investments in Equity Securities	-	-	-	3,883,011	-	3,883,011
Bond proceeds Advisory	-	61,942,648	61,942,648	-	-	61,942,648
Investments in Equity Trusts	-	-	-	34,101,264,442	-	34,101,264,442
Investments in Real Estate Trust Funds & Partnerships	-	-	-	5,902,123,408	-	5,902,123,408
Investments in Alternative Partnerships	-	-	-	3,771,175,737	-	3,771,175,737
Investments in Credit Partnerships	-	-	-	3,114,184,651	-	3,114,184,651
Investments in Inflation Partnerships	-	-	-	1,360,045,188	-	1,360,045,188
Total Investment Securities	\$ 12,980,298,781	\$ 61,942,648	\$ 13,042,241,429	\$ 77,781,748,343	\$ -	\$ 90,823,989,772
Cash in Bank	193,407,802	-	193,407,802	-	-	193,407,802
Deposits in Short-term Investment Fund	-	-	-	358,262,303	(358,262,303)	-
Other Assets, Net of Liabilities	22,760,107	-	22,760,107	257,293,404	-	280,053,511
Total Net Assets	\$ 13,196,466,690	\$ 61,942,648	\$ 13,258,409,338	\$ 78,397,304,050	\$ (358,262,303)	\$ 91,297,451,085
Participant Equity:						
General Fund	\$ 2,096,484,917		\$ 2,096,484,917	\$ -	\$ -	\$ 2,096,484,917
Other Funds Which Earn Interest						
for General Fund	1,475,785,611	61,942,648	1,537,728,259	-	-	1,537,728,259
Highway Fund	617,188,828	-	617,188,828	-	-	617,188,828
Highway Trust Fund	447,089,175	-	447,089,175	-	-	447,089,175
University Trust Funds	2,783,199,463	-	2,783,199,463	-	-	2,783,199,463
Pension Trust Funds	163,281,570	-	163,281,570	77,131,016,794	-	77,294,298,364
Other Independent Trust Funds	4,361,482,847	-	4,361,482,847	1,266,287,256	-	5,627,770,103
Local Political Subdivisions	867,931,568	-	867,931,568	-	-	867,931,568
Licensing Boards	25,760,408	-	25,760,408	-	-	25,760,408
Other Investment Funds	358,262,303	-	358,262,303	-	(358,262,303)	-
Total Participant Equity	\$ 13,196,466,690	\$ 61,942,648	\$ 13,258,409,338	\$ 78,397,304,050	\$ (358,262,303)	\$ 91,297,451,085
Percent of Total	14.45	0.07	14.53	85.86	-0.39	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**  
**SEPTEMBER 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	8,398,330,931						646,829,293	9,045,160,224
U.S. Government Agency Notes/ Bonds	1,489,235,564	64,635,520					381,380,420	1,935,251,504
GNMA Certificates	7,105,689,986							7,105,689,986
Corporate Obligations	10,993,937,550							10,993,937,550
Other Investments		27,137,590						27,137,590
Investments in RMBS and CMBS		421,895,052						421,895,052
Investments in Equity Securities					3,883,011			3,883,011
Bond Proceeds Advisory								-
Investments in Equity Trusts			34,101,264,442					34,101,264,442
Investments in Real Estate Trust Funds & Partnerships				5,902,123,408				5,902,123,408
Investments in Alternative Partnerships					3,771,175,737			3,771,175,737
Investments in Credit Partnerships						3,114,184,651		3,114,184,651
Investments in Inflation Partnerships & Other Invest.							1,360,045,188	1,360,045,188
Total Investment Securities	\$ 27,987,194,031	\$ 513,668,162	\$ 34,101,264,442	\$ 5,902,123,408	\$ 3,775,058,748	\$ 3,114,184,651	\$ 2,388,254,901	\$ 77,781,748,343
Cash in Bank								-
Deposits in Short-term Investment Fund	176,423,112	93,838,312	2,353,249	6,758,602	38,929,747	31,430,955	8,528,326	358,262,303
Other Assets, Net of Liabilities	258,017,485	2,295,833					(3,019,914)	257,293,404
Total Net Assets	\$ 28,421,634,628	\$ 609,802,307	\$ 34,103,617,691	\$ 5,908,882,010	\$ 3,813,988,495	\$ 3,145,615,606	\$ 2,393,763,313	\$ 78,397,304,050
Participant Equity:								
Pension Trust Funds	27,155,347,372	609,802,307	34,103,617,691	5,908,882,010	3,813,988,495	3,145,615,606	2,393,763,313	77,131,016,794
Other Independent Trust Funds	1,266,287,256	-	-	-	-	-	-	1,266,287,256
Total Participant Equity	\$ 28,421,634,628	\$ 609,802,307	\$ 34,103,617,691	\$ 5,908,882,010	\$ 3,813,988,495	\$ 3,145,615,606	\$ 2,393,763,313	\$ 78,397,304,050
Percent of Total	36.25	0.78	43.51	7.54	4.86	4.01	3.05	100.00

**DEPARTMENT OF STATE TREASURER  
ANCILLARY INVESTMENT PROGRAMS  
SEPTEMBER 30, 2012**

	<u>Escheats External Investments</u>	<u>OPEB External Investments</u>	<u>Hospital External Investments</u>	<u>Totals</u>
Net Assets:				
Deposits in Equity Investment Fund	\$ 186,880	61,508,569	77,788,293	\$ 139,483,742
Deposits in Alternative Investment Fund	37,757,803			37,757,803
Total Net Assets	<u>\$ 37,944,683</u>	<u>\$ 61,508,569</u>	<u>\$ 77,788,293</u>	<u>\$ 177,241,545</u>

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

	Cash Management Program			*Trust Funds Investment Program	Memorandum	
	Short-term Investment Fund	Bond Proceeds Fund	Subtotal	Subtotal	Intrafund Eliminations	Total
<b>Revenues:</b>						
<b>Investment Income:</b>						
Investment Earnings	\$ 15,431,918	27,655	\$ 15,459,573	\$ 1,172,786,280	\$ -	\$ 1,188,245,853
Intra-Pool Interest Earnings			-	480,162	(480,162)	-
Income from Security Lending			-	5,060,014	-	5,060,014
Commission Recapture			-	14,071	-	14,071
Other Income			-	419,605	-	419,605
Subtotal	<u>15,431,918</u>	<u>27,655</u>	<u>15,459,573</u>	<u>1,178,760,132</u>	<u>(480,162)</u>	<u>1,193,739,543</u>
Net Unrealized Appreciation/Depreciation				<u>2,197,559,140</u>	-	<u>2,197,559,140</u>
Total Investment Income	<u>15,431,918</u>	<u>27,655</u>	<u>15,459,573</u>	<u>3,376,319,272</u>	<u>(480,162)</u>	<u>3,391,298,683</u>
<b>Expenditures:</b>						
Treasurer's Allocated Cost	(528,994)		(528,994)	(1,120,203)	-	(1,649,197)
Management Fees			0	(23,020,280)	-	(23,020,280)
Dividend Withholding Tax			-	(6,884,751)	-	(6,884,751)
Other Cost	<u>(563,750)</u>	<u>(8,524)</u>	<u>(572,274)</u>	<u>(6,894,805)</u>	<u>-</u>	<u>(7,467,079)</u>
Total Expenditures	<u>(1,092,744)</u>	<u>(8,524)</u>	<u>(1,101,268)</u>	<u>(37,920,039)</u>	<u>-</u>	<u>(39,021,307)</u>
Net Investment Income (Loss)	\$ <u>14,339,174</u>	\$ <u>19,131</u>	\$ <u>14,358,305</u>	\$ <u>3,338,399,233</u>	\$ <u>(480,162)</u>	\$ <u>3,352,277,376</u>
<b>Total Investment Income Allocated:</b>						
General Fund	\$ 2,933,659		2,933,659	\$ -	\$ -	\$ 2,933,659
Highway Fund	746,190		746,190	-	-	746,190
Highway Trust Fund	498,888		498,888	-	-	498,888
University Trust Funds	3,093,084		3,093,084	-	-	3,093,084
Pension Trust Funds	423,257		423,257	3,305,687,744	-	3,306,111,001
Other Independent Trust Funds	5,141,641		5,141,641	32,711,489	-	37,853,130
Local Political Subdivisions	991,414		991,414	-	-	991,414
Licensing Boards	30,879		30,879	-	-	30,879
Other Investment Funds	<u>480,162</u>	<u>19,131</u>	<u>499,293</u>	<u>-</u>	<u>(480,162)</u>	<u>19,131</u>
Total Investment Income Allocated	\$ <u>14,339,174</u>	\$ <u>19,131</u>	\$ <u>14,358,305</u>	\$ <u>3,338,399,233</u>	\$ <u>(480,162)</u>	\$ <u>3,352,277,376</u>

**Cash Return, Fiscal Year-to-Date (Annualized)**      0.4340%      0.060%      0.4320%

\*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 SEPTEMBER 30, 2012**

	Trust Funds Investment Program							Totals
	Long-term	External Fixed Inc.	Equity	Real Estate	Alternative	Credit	Inflation	
	Investment	Investment	Investment	Investment	Investment	Investment	Investment	
	Fund	Fund	Fund	Fund	Fund	Fund	Fund	
<b>Revenues:</b>								
<b>Investment Income:</b>								
Investment Earnings	\$ 352,692,634	23,401,848	604,752,913	23,152,986	66,116,300	40,044,101	62,625,498	\$ 1,172,786,280
Intra-Pool Interest Earnings	178,528	122,702	9,537	43,049	63,620	42,873	19,853	480,162
Income from Security Lending			5,060,014					5,060,014
Commission Recapture			14,071					14,071
Other Income			419,605					419,605
Subtotal	<u>352,871,162</u>	<u>23,524,550</u>	<u>610,256,140</u>	<u>23,196,035</u>	<u>66,179,920</u>	<u>40,086,974</u>	<u>62,645,351</u>	<u>1,178,760,132</u>
Net Unrealized Appreciation/Depreciation	384,313,634	18,948,962	1,607,696,071	71,557,099	(37,200,975)	72,080,580	80,163,769	2,197,559,140
Total Investment Income	<u>737,184,796</u>	<u>42,473,512</u>	<u>2,217,952,211</u>	<u>94,753,134</u>	<u>28,978,945</u>	<u>112,167,554</u>	<u>142,809,120</u>	<u>3,376,319,272</u>
<b>Expenditures:</b>								
Treasurer's Allocated Cost	(414,264)	(10,647)	(475,372)	(85,109)	(55,495)	(45,776)	(33,540)	(1,120,203)
Management Fees		(157,439)	(3,049,117)	(9,617,529)	(4,323,783)	(421,555)	(5,450,857)	(23,020,280)
Dividend Withholding Tax			(6,843,335)	(41,416)				(6,884,751)
Other Cost	(205,193)	(22,248)	(507,338)	(849,627)	(2,435,065)	(692,416)	(2,182,918)	(6,894,805)
Total Expenditures	<u>(619,457)</u>	<u>(190,334)</u>	<u>(10,875,162)</u>	<u>(10,593,681)</u>	<u>(6,814,343)</u>	<u>(1,159,747)</u>	<u>(7,667,315)</u>	<u>(37,920,039)</u>
Net Investment Income (Loss)	\$ <u>736,565,339</u>	\$ <u>42,283,178</u>	\$ <u>2,207,077,049</u>	\$ <u>84,159,453</u>	\$ <u>22,164,602</u>	\$ <u>111,007,807</u>	\$ <u>135,141,805</u>	\$ <u>3,338,399,233</u>
<b>Total Investment Income Allocated:</b>								
General Fund	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Highway Fund	-	-	-	-	-	-	-	-
Highway Trust Fund	-	-	-	-	-	-	-	-
University Trust Funds	-	-	-	-	-	-	-	-
Pension Trust Funds	703,853,850	42,283,178	2,207,077,049	84,159,453	22,164,602	111,007,807	135,141,805	3,305,687,744
Other Independent Trust Funds	32,711,489	-	-	-	-	-	-	32,711,489
Local Political Subdivisions	-	-	-	-	-	-	-	-
Licensing Boards	-	-	-	-	-	-	-	-
Other Investment Funds	-	-	-	-	-	-	-	-
Total Investment Income Allocated	\$ <u>736,565,339</u>	\$ <u>42,283,178</u>	\$ <u>2,207,077,049</u>	\$ <u>84,159,453</u>	\$ <u>22,164,602</u>	\$ <u>111,007,807</u>	\$ <u>135,141,805</u>	\$ <u>3,338,399,233</u>
<b>Total Return, 12, 24, and 36 and 60 months:</b>								
12 months	8.52%	14.87%	22.39%	7.20%	4.66%	8.67%	4.79%	13.87%
24 months	7.83%	8.66%	7.85%	11.75%	9.12%	8.45%	0.10%	8.25%
36 months	9.03%	10.03%	8.50%	5.35%	9.37%	N/A	N/A	8.65%
60 months	9.12%	10.28%	-0.53%	-5.20%	2.21%	N/A	N/A	3.09%