

February 7, 2013

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

Re: Quarterly report on Investment Funds for the period
ended December 31, 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 0.44% 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>12/31/11</u>	<u>6/30/12</u>	<u>12/31/12</u>
3-Mo. T-Bill	0.010%	0.081%	0.043%
6-Mo. T-Bill	0.056%	0.152%	0.114%

The Short-Term Investment Fund produced a one year return of 0.44% for the participants. The investable balances earning income for the General Fund were \$264 million higher than one year earlier based on book value. The investable balances, which earn income for the Highway Funds, were \$49 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:	11.77%	6.91%	8.44%	3.40%

Long Term Investment Fund

	<u>1 Year</u>	<u>2 Year</u>	<u>3 Year</u>	<u>5 Year</u>
LTIF Returns:	7.08%	9.34%	9.32%	8.42%

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 9/30/12	0.63%	1.63%	2.82%
As of 12/31/12	0.72%	1.76%	2.95%

- Long Term assets (based on market value) ended the quarter approximately \$104 million lower than at the end of the prior reporting period.
- The realized earnings for the fiscal year to date are \$705 million.
- Approximately \$216 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:	17.59%	4.58%	8.02%	0.52%

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

Quarterly Index Returns:	S&P 500	-0.38%	DJIA	-2.48%
	Russell 3000	0.25%	MSCI EAFE	6.57%

- Assets of the fund (based on market value) ended the quarter approximately \$764 million higher than at the end of the prior reporting period.
- Approximately \$385 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 December 31, 2012, the invested assets were valued at \$77.8 million after returns in the domestic and international accounts of 0.71% and 6.05% 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 December 31, 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 \$50.7 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 December 31, 2012, the externally invested assets were valued at \$65.2 million after returns in the domestic and international equity accounts of 0.71% and 6.05% 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,

Janet Cowell

Attachments

cc: Kevin SigRist, Chief Investment Officer
Fran Lawrence, Chief Financial Officer

DEPARTMENT OF STATE TREASURER
COMBINED STATEMENT OF NET ASSETS AND PARTICIPANT EQUITY - ALL POOLS AND ACCOUNTS
DECEMBER 31, 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	20,200,000	-	20,200,000	-	-	20,200,000
Repurchase Agreements	2,250,000,000	-	2,250,000,000	-	-	2,250,000,000
Discount Notes/Bills	-	-	-	-	-	-
U.S. Treasury Bills/ Notes/ Bonds	5,605,306,190	-	5,605,306,190	9,001,294,873	-	14,606,601,063
U.S. Government Agency Notes/ Bonds	4,725,891,683	-	4,725,891,683	1,901,407,888	-	6,627,299,571
GNMA Certificates	-	-	-	6,942,661,254	-	6,942,661,254
Corporate Obligations	5,004,079	-	5,004,079	10,976,298,455	-	10,981,302,534
Other Investments	-	-	-	66,195,608	-	66,195,608
Investments in RMBS and CMBS	-	-	-	357,490,021	-	357,490,021
Investments in Equity Securities	-	-	-	4,516,864	-	4,516,864
Bond proceeds Advisory	-	58,151,353	58,151,353	-	-	58,151,353
Investments in Equity Trusts	-	-	-	34,864,710,677	-	34,864,710,677
Investments in Real Estate Trust Funds & Partnerships	-	-	-	6,078,832,087	-	6,078,832,087
Investments in Alternative Partnerships	-	-	-	3,718,923,762	-	3,718,923,762
Investments in Credit Partnerships	-	-	-	3,190,848,370	-	3,190,848,370
Investments in Inflation Partnerships	-	-	-	1,330,859,039	-	1,330,859,039
Total Investment Securities	\$ 12,606,401,952	\$ 58,151,353	\$ 12,664,553,305	\$ 78,434,038,898	\$ -	\$ 91,098,592,203
Cash in Bank	184,704,865	-	184,704,865	-	-	184,704,865
Deposits in Short-term Investment Fund	-	-	-	665,460,211	(665,460,211)	-
Other Assets, Net of Liabilities	18,514,327	-	18,514,327	275,642,226	-	294,156,553
Total Net Assets	\$ 12,809,621,144	\$ 58,151,353	\$ 12,867,772,497	\$ 79,375,141,335	\$ (665,460,211)	\$ 91,577,453,621
Participant Equity:						
General Fund	\$ 1,822,790,158		\$ 1,822,790,158	\$ -	\$ -	\$ 1,822,790,158
Other Funds Which Earn Interest				-	-	-
for General Fund	1,224,718,714	58,151,353	1,282,870,067	-	-	1,282,870,067
Highway Fund	458,203,431	-	458,203,431	-	-	458,203,431
Highway Trust Fund	463,610,894	-	463,610,894	-	-	463,610,894
University Trust Funds	2,534,746,473	-	2,534,746,473	-	-	2,534,746,473
Pension Trust Funds	138,574,002	-	138,574,002	78,114,186,246	-	78,252,760,248
Other Independent Trust Funds	4,612,253,718	-	4,612,253,718	1,260,955,089	-	5,873,208,807
Local Political Subdivisions	863,452,260	-	863,452,260	-	-	863,452,260
Licensing Boards	25,811,283	-	25,811,283	-	-	25,811,283
Other Investment Funds	665,460,211	-	665,460,211	-	(665,460,211)	-
Total Participant Equity	\$ 12,809,621,144	\$ 58,151,353	\$ 12,867,772,497	\$ 79,375,141,335	\$ (665,460,211)	\$ 91,577,453,621
Percent of Total	14.00	0.06	14.06	86.67	-0.73	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
DECEMBER 31, 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	8,355,077,090						646,217,783	9,001,294,873
U.S. Government Agency Notes/ Bonds	1,474,188,580	57,558,838					369,660,470	1,901,407,888
GNMA Certificates	6,942,661,254							6,942,661,254
Corporate Obligations	10,976,298,455							10,976,298,455
Other Investments		66,195,608						66,195,608
Investments in RMBS and CMBS		357,490,021						357,490,021
Investments in Equity Securities					4,516,864			4,516,864
Bond Proceeds Advisory								-
Investments in Equity Trusts			34,864,710,677					34,864,710,677
Investments in Real Estate Trust Funds & Partnerships				6,078,832,087				6,078,832,087
Investments in Alternative Partnerships					3,718,923,762			3,718,923,762
Investments in Credit Partnerships						3,190,848,370		3,190,848,370
Investments in Inflation Partnerships & Other Invest.							1,330,859,039	1,330,859,039
Total Investment Securities	\$ 27,748,225,379	\$ 481,244,467	\$ 34,864,710,677	\$ 6,078,832,087	\$ 3,723,440,626	\$ 3,190,848,370	\$ 2,346,737,292	\$ 78,434,038,898
Cash in Bank								-
Deposits in Short-term Investment Fund	293,388,582	143,588,106	2,743,719	62,545,591	92,684,514	35,519,206	34,990,493	665,460,211
Other Assets, Net of Liabilities	275,708,495	1,900,177					(1,966,446)	275,642,226
Total Net Assets	\$ 28,317,322,456	\$ 626,732,750	\$ 34,867,454,396	\$ 6,141,377,678	\$ 3,816,125,140	\$ 3,226,367,576	\$ 2,379,761,339	\$ 79,375,141,335
Participant Equity:								
Pension Trust Funds	27,056,367,367	626,732,750	34,867,454,396	6,141,377,678	3,816,125,140	3,226,367,576	2,379,761,339	78,114,186,246
Other Independent Trust Funds	1,260,955,089	-	-	-	-	-	-	1,260,955,089
Total Participant Equity	\$ 28,317,322,456	\$ 626,732,750	\$ 34,867,454,396	\$ 6,141,377,678	\$ 3,816,125,140	\$ 3,226,367,576	\$ 2,379,761,339	\$ 79,375,141,335
Percent of Total	35.68	0.79	43.92	7.74	4.81	4.06	3.00	100.00

**DEPARTMENT OF STATE TREASURER
ANCILLARY INVESTMENT PROGRAMS
DECEMBER 31, 2012**

	Escheats External Investments	OPEB External Investments	Hospital External Investments	Totals
Net Assets:				
Deposits in Equity Investment Fund	\$ 21,930	65,216,236	77,792,717	\$ 143,030,883
Deposits in Alternative Investment Fund	38,519,984			38,519,984
Total Net Assets	<u>\$ 38,541,914</u>	<u>\$ 65,216,236</u>	<u>\$ 77,792,717</u>	<u>\$ 181,550,867</u>

DEPARTMENT OF STATE TREASURER
COMBINED STATEMENT OF OPERATIONS - ALL POOLS AND ACCOUNTS
FOR THE PERIOD ENDED DECEMBER 31, 2012

	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	\$ 31,188,534	58,523	\$ 31,247,057	\$ 2,020,668,597	\$ -	\$ 2,051,915,654
Intra-Pool Interest Earnings			-	1,086,671	(1,086,671)	-
Income from Security Lending			-	9,042,256	-	9,042,256
Commission Recapture			-	27,732	-	27,732
Other Income			-	1,529,542	-	1,529,542
Subtotal	31,188,534	58,523	31,247,057	2,032,354,798	(1,086,671)	2,062,515,184
Net Unrealized Appreciation/Depreciation				2,854,843,821	-	2,854,843,821
Total Investment Income	31,188,534	58,523	31,247,057	4,887,198,619	(1,086,671)	4,917,359,005
Expenditures:						
Treasurer's Allocated Cost	(786,517)		(786,517)	(2,267,530)	-	(3,054,047)
Management Fees		(16,614)	(16,614)	(58,784,784)	-	(58,801,398)
Dividend Withholding Tax			-	(10,129,077)	-	(10,129,077)
Other Cost	(1,148,591)		(1,148,591)	(19,271,041)	-	(20,419,632)
Total Expenditures	(1,935,108)	(16,614)	(1,951,722)	(90,452,432)	-	(92,404,154)
Net Investment Income (Loss)	\$ 29,253,426	\$ 41,909	\$ 29,295,335	\$ 4,796,746,187	\$ (1,086,671)	\$ 4,824,954,851
Total Investment Income Allocated:						
General Fund	\$ 6,533,460		6,533,460	\$ -	\$ -	\$ 6,533,460
Highway Fund	1,311,388		1,311,388	-	-	1,311,388
Highway Trust Fund	1,025,520		1,025,520	-	-	1,025,520
University Trust Funds	6,165,114		6,165,114	-	-	6,165,114
Pension Trust Funds	810,375		810,375	4,758,627,196	-	4,759,437,571
Other Independent Trust Funds	10,311,158		10,311,158	38,118,991	-	48,430,149
Local Political Subdivisions	1,949,120		1,949,120	-	-	1,949,120
Licensing Boards	60,620		60,620	-	-	60,620
Other Investment Funds	1,086,671	41,909	1,128,580	-	(1,086,671)	41,909
Total Investment Income Allocated	\$ 29,253,426	\$ 41,909	\$ 29,295,335	\$ 4,796,746,187	\$ (1,086,671)	\$ 4,824,954,851

Cash Return, Fiscal Year-to-Date (Annualized) 0.4450% 0.040% 0.4430%

* 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 DECEMBER 31, 2012

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	\$ 706,261,067	42,269,515	827,732,184	86,219,020	196,413,373	99,091,870	62,681,568	\$ 2,020,668,597
Intra-Pool Interest Earnings	454,972	248,927	12,030	99,401	151,290	82,166	37,885	1,086,671
Income from Security Lending			9,042,256					9,042,256
Commission Recapture			27,732					27,732
Other Income			1,529,542					1,529,542
Subtotal	706,716,039	42,518,442	838,343,744	86,318,421	196,564,663	99,174,036	62,719,453	2,032,354,798
Net Unrealized Appreciation/Depreciation	153,802,483	17,516,854	2,553,178,220	139,381,736	(133,455,619)	121,029,142	3,391,005	2,854,843,821
Total Investment Income	860,518,522	60,035,296	3,391,521,964	225,700,157	63,109,044	220,203,178	66,110,458	4,887,198,619
Expenditures:								
Treasurer's Allocated Cost	(831,341)	(19,657)	(972,680)	(172,183)	(111,607)	(91,999)	(68,063)	(2,267,530)
Management Fees		(304,714)	(22,987,902)	(16,370,332)	(11,037,038)	(1,143,550)	(6,941,248)	(58,784,784)
Dividend Withholding Tax			(10,066,377)	(62,329)	(371)			(10,129,077)
Other Cost	(704,344)	(497,305)	(1,301,250)	(2,440,192)	(7,658,781)	(2,207,852)	(4,461,317)	(19,271,041)
Total Expenditures	(1,535,685)	(821,676)	(35,328,209)	(19,045,036)	(18,807,797)	(3,443,401)	(11,470,628)	(90,452,432)
Net Investment Income (Loss)	\$ 858,982,837	\$ 59,213,620	\$ 3,356,193,755	\$ 206,655,121	\$ 44,301,247	\$ 216,759,777	\$ 54,639,830	\$ 4,796,746,187
Total Investment Income Allocated:								
General Fund	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	-
Highway Fund	-	-	-	-	-	-	-	-
Highway Trust Fund	-	-	-	-	-	-	-	-
University Trust Funds	-	-	-	-	-	-	-	-
Pension Trust Funds	820,863,846	59,213,620	3,356,193,755	206,655,121	44,301,247	216,759,777	54,639,830	4,758,627,196
Other Independent Trust Funds	38,118,991	-	-	-	-	-	-	38,118,991
Local Political Subdivisions	-	-	-	-	-	-	-	-
Licensing Boards	-	-	-	-	-	-	-	-
Other Investment Funds	-	-	-	-	-	-	-	-
Total Investment Income Allocated	\$ 858,982,837	\$ 59,213,620	\$ 3,356,193,755	\$ 206,655,121	\$ 44,301,247	\$ 216,759,777	\$ 54,639,830	\$ 4,796,746,187
Total Return, 12, 24, and 36 and 60 months:								
12 months	7.08%	16.62%	17.59%	8.88%	5.51%	13.95%	1.00%	11.77%
24 months	9.34%	8.47%	4.58%	10.55%	8.64%	7.93%	-2.33%	6.91%
36 months	9.32%	9.90%	8.02%	7.02%	7.73%	10.52%	-8.24%	8.44%
60 months	8.42%	10.74%	0.52%	-5.03%	1.92%	N/A	N/A	3.40%