NORTH CAROLINA DEPARTMENT OF STATE TREASURER
INVESTMENT MANAGEMENT DIVISION
INVESTMENT ADVISORY COMMITTEE

MINUTES OF MEETING
March 5, 2015

Time and Location: The Investment Advisory Committee ("IAC") met on Thursday, March 5, 2015, in the Dawson Conference Room of the Albemarle Building, 325 North Salisbury Street, Raleigh, North Carolina.

Members Present: The following members were present: State Treasurer Janet Cowell (Chair), John Aneralla, David Hartzell, Steve Jones, Mike Mebane, Neal Triplett (Vice-Chair) (by teleconference), and Courtney Tuttle.

Members Absent: None

Staff: The following staff members were present: Lynda Boulay, Brad Bullock, Tarik Dalton, Ana-Laura Diaz, Ronald Funderburk II, Alison Garcia, Kathy Hahn, Brett Hall, Beth Harrison, Kathy Kornak, Troy March, Neal Motaparthy, Michael Nichols, Tinh Phan, Norman Schiszler, Kevin SigRist, Jeff Smith, Rhonda M. Smith, Tony Solari, Edgar Starnes, Blake Thomas, Zhexing Zhang.

Others in Attendance: Jim Baker, Olga Cagrillo, Kristen Doyle, Gaynor Fries, Michael McCormick, Liz Smith and Mark White.

AGENDA ITEM – OPENING REMARKS

The meeting was called to order at approximately 10:00 a.m. The Chair, Treasurer Cowell, announced Mr. Triplett was attending by teleconference.

The Chair asked the Members present to declare any conflicts of interest and, there being nothing declared, the meeting commenced.

AGENDA ITEM – APPROVAL OF MINUTES

The Chair asked for approval of the minutes of both the December 10, 2014 and February 18, 2015 meetings. Mr. Aneralla moved to approve the minutes and Ms. Tuttle seconded. Both sets of minutes were approved as written.

AGENDA ITEM – CIO UPDATE

The Chair then recognized Mr. SigRist, Chief Investment Officer, to provide an update on the performance of the investments for the North Carolina Retirement Systems ("NCRS"), as well as a legislative update.

- ***LEGISLATIVE UPDATE***

Mr. SigRist introduced Tony Solari, Director, to the meeting to share updates on the Legislature. Mr. Solari introduced a new addition to his team, Edgar Starnes and reported that he was thrilled to have him on board. Mr. Starnes thanked Mr. Solari for the opportunity and commented that it was a privilege to serve the North Carolina Department of State Treasurer ("NCDST").

Mr. Solari reported that the area of tax incentives for business is currently the main focus of the legislature. After discussions with the leadership of the General Assembly, it appeared unlikely there would be broad support for a change in the governance structure of the pension investments. Mr. Solari reported, with that in mind, they were not currently preparing to bring any major investments legislation forward in this session.

The Chair reported that the NCDST had thanked the legislature for the resources granted in last year's session, particularly relative to staffing. The Chair noted that Mr. SigRist and Mercer, NCDST's compensation consultant, had done great work and have managed the staffing review task well. Calendar year investment earnings of 6.2% were announced the previous day.

Mr. SigRist mentioned that one item for discussion in the legislative session would be investments for the Escheat Fund. The Chair stated that, as of 2006, the state's budget began drawing from the Escheat Fund's corpus as well as investment earnings, and as a result the Escheat Fund is now in the $400 million range. NCDST has requested that the draws of principal from the Escheat Fund be stopped, making the Escheat Fund's balance more predictable and allowing greater investment of the Fund in higher-return sectors.

❖ ***NCRS PERFORMANCE REVIEW***

Performance Review – Mr. SigRist presented a performance review to the IAC. He noted that the US economy was growing at around 3% and job growth has been good. Wealth from the stock market and consumer confidence is high, but home sales are tepid. Commodity price impacts are being seen. We are seeing slow growth overseas (other than in the UK and Germany which are strong) and this is a problem for exports. Overall, there is good momentum and the US economy is strong.

As at December 31, 2014, NCRS's assets under management were around $90 billion. Mr. SigRist gave an overview of the NCRS asset allocation. Relative to the Investment Policy Statement targets, NCRS was overweight in Non-Core Real Estate and Public Equity. Staff are working on a Public Equity managed account provider, targeting funding managers in that program by the middle of the year. Mr. SigRist noted that there were rebalancing issues to consider and a lot of activity and liquidity was generated. It had been a fairly tough year for absolute returns.

It was noted that Private Equity was up 14% for the calendar year, Non-Core Real Estate was up 19%, and Core Real Estate was up 10%.

Mr. Aneralla asked about Public Equity's distribution between domestic and international holdings. Mr. SigRist responded that it was fairly evenly split at around 51%/49% domestic equity managers to non-US equity managers, including a non-US portfolio and two global equity managers who have done extremely well this past year. Public Equity was up 4% for the calendar year. Global outperformed through that period, with Domestic lagging the benchmark. Most Public Equity managers still have very strong performance over time, but the environment was challenging. Ms. Smith added that some managers had struggled during the time period and, while some managers had started to drift into China with stocks like Ali Baba, they had struggled too.

Mr. SigRist stated that the Non-Core Real Estate benchmark was a clean benchmark so was a good comparison. Opportunistic Fixed Income was not strong this past year, but performance has been good compared to benchmark. Investment Grade Fixed Income was conservative on duration, with a 8.5% return for the calendar year. Inflation Sensitive met the benchmark and added a little. Within the

Core Real Estate portfolio, private core managers had been conservative. Mr. Mebane asked if we were still on track with the plan to revamp that area and Mr. SigRist confirmed that we were. We would like to be able to do more in some separate accounts, but that will take time.

Comparison to BNY Mellon Universe – Mr. SigRist stated that, over the last 15 years, we were around 11 basis points lower in returns vs the median and that we make that up through our lower costs structure. We are lower-risk than the median and our risk numbers remain very low. Mr. SigRist provided a graph plotting NCRS's Sharpe Ratio compared to other public funds greater than $1 billion in assets. Mr. Jones asked if we could identify the profile of the organizations at the extreme points on the graph and Mr. SigRist replied that that information is not available.

New and Incremental Investment Commitments – Mr. SigRist outlined to the IAC the changes that have taken place since the December IAC meeting, commenting that the information had changed even since the outline was produced. Francisco Partners IV was a tech-oriented investment. Landmark Equity Partners XV was invested across asset classes to get exposure in Private Equity and Inflation Sensitive. NorthRock Fund was investments in multi-family real estate. Blackstone NC Property Partners was a new open-ended fund accompanying Blackstone Property Partners, a new commitment shown in the December meeting's IAC materials. Mr. SigRist noted that Brightwood Capital Fund was a smaller, newer firm.

Mr. Mebane commented that Mr. SigRist had previously expressed concern about NCRS not being selected for deals and asked whether we are seeing traction in relationships with Blackstone and other funds. Mr. SigRist confirmed that they were. Landmark would be a 2-3 year relationship and Blackstone is the largest private market manager by far. Mr. SigRist confirmed that they do not only look at fees, but are also concerned about finding the right manager for the relationship.

AGENDA ITEM – IAC CHARTER/CODE OF ETHICS

Mr. SigRist commented that the subject of the IAC Code of Ethics and IAC Charter had been raised at a previous meeting and that the IAC had requested redlined documents showing the changes made over time. Mr. Aneralla moved to approve the amended IAC Code of Ethics and the IAC Charter, Mr. Mebane seconded, and both documents were unanimously approved without changes.

AGENDA ITEM – INVESTMENT BENCHMARKING DISCUSSION

Mr. SigRist reported that the IAC's self-assessment and feedback had suggested it may be helpful to have consultants to help think through benchmarks and their appropriateness and to explain how we are choosing them over time. He introduced Kristen Doyle and Michael McCormick of Aon Hewitt.

Ms. Doyle explained that benchmarking is a very important part of evaluating investment portfolios and they typically recommend that clients undertake a comprehensive benchmark review every 2-3 years. Individual asset liabilities might require a separate benchmark review. Ms. Doyle noted the following.

Purposes and Types of Benchmarks – Benchmarks are used to measure the performance of the Total Fund, asset classes, and individual managers over various time periods to determine the effectiveness of an investment program. The benchmarking that is selected depends on the particular asset class and the portfolio of funds being evaluated.

Properties of a Valid Benchmark – A good benchmark has broad coverage, is investable, is transparent, and is appropriate. Peer benchmarks often do not fulfill all aspects of an appropriate benchmark.

Benchmarking Principles – Aon Hewitt's belief is that benchmarks for any asset class should include all the investment opportunities in that particular market and be constructed without bias. Mr. Hartzell asked, in terms of private markets, which organizations benchmark as close to best as possible. Ms. Doyle replied that the peer universe is the best to use for private equity in terms of similarity, even though the depth of the universe and the timing are challenges. This one is still the best over the short term. Over longer periods, they recommend using public benchmarks.

Total Fund Benchmarking – Mr. McCormick stated that the best total fund policy benchmark should be a passive representation of the broad asset classes included in the asset allocation policy. Asset transition timelines and weights should be determined in advance and any changes to the asset class benchmarks should flow through to the total fund policy benchmark. Additional tools to consider would be absolute return target, real return target and opportunity cost benchmarks.

Trends in Benchmarking – Trends to be noted are (i) the transitioning to broader investment mandates - there is movement in the industry to global exposure; (ii) in private equity, the move to a lower risk premium; and, (iii) in private real estate, the use of the NCREIF ODCI for better representation.

Private Market Benchmarking – Mr. Hartzell asked about the range of premiums across funds for private equity and Ms. Doyle replied that they average 300 basis points. They see more variation on the real estate side which can range from 50-250 basis points, depending on strategy. Mr. McCormick added that this was an area where you need to have knowledgeable people to make sure the risk premium is what it should be. It becomes more complicated in real estate and hedge funds.

Mr. Hartzell commented that he was familiar with Burgiss and NCREIF (National Council of Real Estate Investment Fiduciaries) but not familiar with the HFR (Hedge Fund Research) suite. Ms. Doyle offered that HFR has a suite of indices they are based on and is the best available peer index. They are available only monthly, but they rely on information from hedge fund managers and make sure there is a usable database. Mr. Hartzell asked if it was audited or whether it self-reported and Ms. Doyle agreed to follow up on that and get back to the IAC.

Mr. Jones raised the issue that, if the weighting of 750 funds was being taken into account, it may be only 75 funds they we should be looking at. Mr. SigRist commented that there were trade-offs. Mr. McCormick added that, if we look at the distribution between the best and worst managers, it is very close – around 1%. However, the range is a lot wider in private real estate, where there are so many poorer products and it is easier to measure success.

Mr. Triplett asked whether we have looked at public markets for hedge funds, such as the replication indexes. Mr. McCormick responded that they do not use replication indexes. If you look at longer periods of time, they are better; there are significant trading errors in short-term time periods. Ms. Tuttle asked if they could explain the rationale for why premiums have come down in private equity. Mr. McCormick responded that (i) there is a belief they were set too high to begin with; and (ii) part of the lower expected return is the expected growth of the economy. Ms. Tuttle commented that a lot of private equity is anticipating lower returns now, with more money chasing the same deals. Mr. Jones added that the difference is not reflective of less risk, but rather if everyone has a similar experience.

NCRS Total Fund Benchmarks - Mr. McCormick showed the IAC two benchmarks NCRS is currently using – the Implementation Benchmark and the Long-Term Policy Benchmark. He stated that the general view is that the benchmarks are defined explicitly and are a weighted average of underlying asset class policy benchmarks, following best practice and peer practice.

Mr. Jones suggested some follow-up work for the IAC. If we look back over 10 years, benchmarks have changed many times, which means they make it less easy to determine how the portfolio is performing and hold individuals accountable for results. It might be useful to show how often they have changed and find out whether that is typical or has the effects that he suspects it has. Mr. Jones asked whether there was a way to accurately look back over 10 years, or whether we are unable to measure performance accurately due to the adjustments and allowances for changes in benchmarks. Ms. Doyle responded that he had raised a great point, but changing benchmarks is not uncommon when asset classes are added or if a class matures. A long term benchmark can be useful as it does not change.

Mr. Hartzell added in response that there are always better benchmarks out there, so he expected it would have to change over time. He asked what was the best practice that Aon Hewitt have seen across all of their clients and how NCRS could adapt to make it our practice. Mr. Mebane asked whether Aon could recommend new benchmarks to use. Mr. SigRist added that he was hopeful we can get a recommendation from the IAC to set benchmarks over a period of time. Non-Core Real Estate has a clean benchmark going forward to remove disparities. Mr. Hartzell commented that NCREIF was always used as the standard benchmark for certain funds, as other benchmarks were not available at the time.

Mr. Jones asked whether we wanted try to get a benchmark to mimic what we were doing, or what we are going to do. He also asked whether the benchmark was asset- specific or risk-specific (showing returns on a risk adjusted basis) and how does that compare to other benchmarks or organizations that have similar risk profiles? Mr. Jones also suggested, for example, a private equity benchmark that has some historical data with similar return and risk profiles.

Mr. Hartzell commented that we have looked at an asset liability management study, a compensation study, and now a peer group review. He asked whether there was a way to standardize a peer group, as we are comparing ourselves in different capacities. Mr. SigRist responded that certain peer groups are standard. Ms. Doyle added that there was significant overlap when we looked at that. CEM and Mercer are considerate to funds willing to provide them with data. Mellon does not have the flexibility because lack of transparency is an issue. Ms. Doyle added that best practice is setting asset allocation. Ms. Doyle confirmed they will do a deep dive into peer benchmarks and come back in May with a comparison to the top 20 public pension funds.

Long-Term Asset Allocation – Research indicates that the asset allocation decision explains over 90% of an investor's return over time. Mr. Jones asked what Aon Hewitt's conviction was on this point. Ms. Doyle responded that they were very committed to that and long-term asset allocation and believe strongly that you can add returns if you have smart people at the table who are good. Mr. SigRist commented that we agree that asset allocation is going to drive the results for the long term. They are spending a lot of time talking about the asset allocation study.

Mr. Jones asked who is good at picking the right asset allocation and whether you expect to be good at picking it ahead of time. He asked whether there was a set of data that shows who has proven good at asset allocation, based on the return of investment. Mr. McCormick offered that GMO is thought to be really great at this, although they almost went out of business after the tech bubble burst. Ms. Doyle commented that return-seeking vs risk-reducing is also something to consider. Long-term returns have exceeded benchmark and are an area to be confident in.

The Evolution of Institutional Investors' Asset Allocation – Mr. McCormick presented visual showing changes over time in asset classes and levels of risk. The introduction of riskier assets has increased returns. There was a proliferation of asset classes in the last 20-25 years and a huge evolution over the last 40 years driven by higher expectations of returns.

NCRS Asset Allocation Relative to Peers – Ms. Doyle showed information comparing CEM data to BNY Mellon, noting that it was difficult to compare Fixed Income, depending on risk, and that a lot of peers have taken a long time to get into private markets. Ms. Tuttle asked for Aon Hewitt's view on global asset allocation and whether it made sense for NCRS to be as high on its global allocation. Mr. McCormick responded that there was a 10% difference (over equity) once the dollar exposure was hedged out, but there may be some diversification benefits. Mr. SigRist discussed the issue in terms of thinking about hedging cash flows. Managers have the ability to hedge, but NCRS is generally going to be perpetual. Ms. Tuttle added that there were fundamental differences in growth across different parts of the world.

Policy Allocation Changes - Ms. Doyle showed changes taking place and Mr. Jones noted that we are moving out of US equity by 3-7%. Ms. Doyle responded that the decisions were made after a very robust review.

NCRS Asset Allocation Results – Looking at the slide comparing risk to return, Mr. McCormick stated that the NCRS has slightly lower returns than its peers over the trailing three-year period, but at a significantly lower risk.

Mr. SigRist asked what Aon Hewitt would plan to discuss at the next meeting. Mr. Jones suggested that they write up and circulate what questions they intend to address for review. Mr. Mebane asked Mr. SigRist what he would like to get out of this exercise; Mr. SigRist responded that he would like information on historical benchmarks and on how we know if asset allocation is truly working and is successful.

The Chair thanked Ms. Doyle and Mr. McCormick for their presentation and adjourned the meeting for lunch. The IAC then reconvened at 12:45 p.m.

AGENDA ITEM – ENERGY INVESTMENT DISCUSSION

Mr. SigRist introduced an NCRS energy review, which had been scheduled as a result of a suggestion by Ms. Tuttle to drill down into opportunities and risks in the energy sector. He introduced Mark White of Albourne who would talk about what they are seeing in the energy space.

Mr. White stated he had been working with Mr. Funderburk and Ms. Hahn from NCDST. He would give an overview of Albourne, hedge fund consultants with a dedicated team to real assets and the energy space, and would explain past and present situations in energy.

Why is Oil at $50 and not $150? Mr. White explained that the simple answer includes marginal price, price curves, displacement, substitution, and politics. He added that price curves are a terrible predictor of where oil will be in the future. Oil is priced at the next barrel of oil, which seems counterintuitive and is very different from most markets. So, in theory, a barrel could be produced for $3, but if the next barrel will be $100, you would sell that $3 barrel for $100.

Global Reserves – Mr. White showed a visual overview of oil reserves by geographic area from 1999 – 2014. He noted that the Middle East has been consistent, but that the other areas have seen the greatest change with 2011 being a huge jump for Central & South America. North America saw a bump in 2003 with the Tar Sands of Canada and in 2012 the USA saw Shale coming into the market. Mr. White noted that Mexico has a very poor energy policy and no longer appears as a player in the energy market. He also added that the USA is the top energy producer globally and is now the swing producer due to what is known as "technology oil". Technology oil moves very quickly, with the US being able to develop a reserve in around 8 weeks. As a comparison, it would take Brazil 4-5 years to develop a reserve.

Supply and Demand – Looking at the chart from 1999 – 2014, Mr. White stated that the supply and demand of oil has been fairly tight until recently, when supply started to exceed demand. Supply has grown at an average of 3.4% since 1999, while demand has only grown at an average pace of 1.32%. Looking at quarterly supply and demand over the last 2 years, the tipping point was July 28, 2014 when oil closed at $105.68. By July 31, 2014, oil closed at $98.23, which was the start of the decline to the current low set on January 28, 2015. There was a change in the US response, with shale exploration in response to high oil prices, and supply now exceeds demand.

Ms. Tuttle asked why the demand dropped so much at the beginning of 2014. Mr. White responded that strategic reserves are 4 trillion barrels of oil and that the US has 2 trillion barrels largely owned by the government and corporations. There is a huge amount in naval reserves in California, in Oklahoma and in salt caverns throughout the USA.

The Chair asked how long it would take to use up the 2 trillion barrels and Mr. White noted that 92 million barrels a day are used globally and it was estimated that China has 2 years' worth of oil reserves. Mr. Jones asked how long the USA can run on its reserves and Mr. White replied that with its accessible reserves, the USA could run for 6-9 months –with the less accessible reserves, maybe 2 years.

Supply and Demand Displacement – Mr. White noted that demand had been constant and the USA has grown supply by 52% since 1999, with increases since 2009 averaging 8.2%. Analysts predict the ability to grow at this rate for another 10 years. China was thought to absorb any excess in the supply, but the US supply still outstrips China's demand for oil by 1.5 million barrels a day.

The Shape of the Recovery – Mr. White presented an outline of the production cost in dollars per barrel of various countries, with a "Social Breakeven" figure, which is an estimate of the revenue needed to fund social programs in nations dependent on oil revenue. Mr. White noted that most countries have used their revenue to fund social programs. Mr. Mebane commented on Saudi Arabia's figures where, even though it costs $3 to produce a barrel of oil, the breakeven point is actually $106 due to free healthcare, free education, etc.

North America as a Swing Producer – Mr. White outlined a visual showing the crude oil cost curve in Canada and USA. He discussed oil sands projects, describing it as essentially mining for oil. One needs to build a $25 billion processing plant to get the oil, so the cost is up front. With shale, for comparison, you drill first and then process the oil.

Mr. Hartzell sked what happens to research and development costs and Mr. White responded that the cost of producing shale oil has gone down considerably and that, other than Texas, most oil is in areas people don't generally want to live in. So, you pay higher salaries because of those considerations – for example $150K salary is average in the Tar Sands, although salaries have been reduced in some areas. The introduction of more technology, and the use of fracking has increased productivity and the USA should be able to increase by 8% annually due to improved efficiencies.

Deployment is Path Dependent – Mr. White showed an outline of Letter Indicators for paths of recovery and spoke briefly about each option. U indicated the "beta" path, based on spike and demand. The beta path has no skillset involved – you buy the asset and ride it out. W indicated the "alpha" path, where there is drilling in response to make it go back up. The alpha path involves active hedging and trading tactically. L indicated the "tactical" path, which predicts $50 oil is here for a long time and is one you have to watch. Mr. White noted that from a NC perspective, the type of recovery will make Mr. Funderburk or Ms. Hahn consider a different strategy. Mr. White shared that in his opinion, we are leaning to a recovery somewhere between L and W, but not at $50/barrel.

Mr. White noted that there has been a lot of research in alternative energy – bio-diesel is at $105/barrel, down from $200/barrel a couple of years ago. Shale reserves been explored over the last 5 years and the US will take over from China at some point in the future.

Mr. Mebane asked if there was any default on the horizon and Mr. White went on to say that there is an energy dislocation report, but that you have to understand the R&D and technology behind it. In the energy space, the value of what is in the ground is very technical. It involves drilling and estimating and is a science – a lot of people coming in don't have the technical expertise to analyze the asset. We may see defaults in the next cycle.

Mr. SigRist commented on the Private Equity and energy allocation and asked if this was a good opportunity to put some money to work quickly. They have been viewing it fairly continuously and have capacity with some of the managers to move into the market if it makes sense. Mr. Hartzell commented that the energy space has an impact well beyond these portfolios and asked what our exposure was and what do these three systems mean to us? Mr. SigRist responded that we are underweight in energy and Global Equities. We are a little overweight in Fixed Income. In Private Equity, there are going to be some managers that will struggle in this tough environment.

Mr. Mebane thanked Mr. White for giving us a warning to pick our managers wisely. Ms. Vitols commented that we work with energy specialists and that it may be a good opportunity to allocate more money to managers that we have a significant relationship with. In 2016, most managers will be protected with hedges. Mr. Funderburk added that it might be more of a large cap opportunity and that they would be evaluating managers during this period.

Mr. Jones asked what a $10/barrel of oil was worth at the pump. Mr. White responded that 40% of a barrel of oil goes to gas, 20-30% to diesel and then other chemicals/products from the remainder. Mr. White noted that some pensions in the USA only started their oil allocation in 2014, so the NC approach has paid off really well. He noted that the drop in oil can have good implications too, as it provides advantages in other parts of the portfolio and can improve diversification.

In closing, Mr. Funderburk thanked Mr. White for his time and asked if the IAC had any further questions. The Chair added her thanks also.

AGENDA ITEM – FIXED INCOME

Mr. SigRist introduced Mr. Jeff Smith to speak to the IAC on the area of Investment Grade Fixed Income. Mr. Smith introduced his team – Brett Hall, Mike Nichols, Brad Bullock and Beth Harrison and proceeded to take the IAC through an overview of the asset class.

Investment Grade Fixed Income Profile – Mr. Smith showed the allocation as of December 31, 2014. There was an almost 90/10 split in the allocation – Core to Cash. The returns in Fixed Income were 8.8% on the 1-Year period, although there had been a volatile start to the year.

Short-Term Portfolio Rate History – Mr. Smith noted that $14.9 billion of assets were under management as of December 31, 2014. The balance sheet shows the supply issue that we experience on a quarter-end basis. The Feds had adjusted the amount of collateral available to the markets. NC STIF is 51 basis points, which was well above the Mellon rate of 9 basis points at the end of December 2014.

Intermediate and Long Treasury Yields Decline in 2014 – Mr. Smith commented on the steep decline in 2014 as a result of the Ukraine/Russia crisis, turmoil in the Middle East and the Ebola crisis.

Fixed Income Credit Markets – Looking at a10-Year spread history, Mr. Smith commented that we had material spread widening since July 2014, with Energy being the biggest mover.

Corporate Relative Value and LTIP Allocation by Sector – Mr. Smith presented two visual charts to the IAC and commented that it was a broad portfolio. They undertake sector reviews every 6-8 weeks to go over macro factors, as well as the credit opinion relevant to the portfolio. Looking at the Composite Rating for last year – the Energy and Banking sectors will show greatest differences. Mr. Smith also highlighted the Portfolio Weighting against the Index Benchmark Weighting and commented that the Banking sector experienced the most spread tightening, where we have overweight exposure.

Investment Grade Fixed Income Discussion Items – Mr. Smith welcomed input from the IAC on the following:

- Comfort level with short relative duration position
- Limited conviction on timing/pacing of rate increases
- Hidden illiquidity in investment grade credit
- Potential opportunity from future illiquidity
- Name/sector specific M&A risks

FOMC Projections – Mr. Smith showed Federal Reserve projections, but commented that the estimates don't mesh with the pace of policy firming. Modest rate increases are expected in the near term.

Market Growth vs Liquidity – Mr. Smith noted that the outstanding US corporate debt has almost doubled in the last 10 years, but the daily corporate trading volume has remained steady. Liquidity is to be defined by cost (the bid/offer spreads). They are thinking about the opportunities that market stress could present to us – this is not a near term issue, but for long term investors. Mr. Smith added that things are changing very fast. Mr. Nichols noted that M&A activity has increased over the last year. Mr. Smith noted that NCRS recently engaged with Covenant Review, a team of attorneys who will do a deep dive to look into the background of companies.

Mr. Aneralla commented that buying and trading bonds is much more difficult right now and praised the Fixed Income team on a great job working through what has been going on in the last 2 years. Mr. Smith responded there were no negative repos but a lot of people in cash. Regulations changes will have a great impact in a market with less order and more stress.

Mr. Mebane commented that rates can stay down a long time (for example, what has been seen in Japan in the past) and he is not sure that will change any time soon. February was the worst month for Treasuries over the last 2-3 years, the trading range was stuck at 180-250, and actions show a lot of foreign investments in Treasuries. Mr. Mebane asked if there were profits on Treasuries and Mr. Smith responded that we have been working on narrowing that gap and getting out of long bonds. We have seen some illiquidity issues and very slow responses.

Fixed Income Expectations – Mr. Smith commented that expectations are for rates to rise modestly during 2015 and that near term inflationary pressures will remain modest. Return expectations over the next five years remain in the 2-4% range.

Mr. Smith asked if the IAC had any further questions or thoughts they would like to share. Mr. SigRist added that the Inflation Sensitive team will do a presentation at one of the upcoming IAC meetings. The Chair thanked Mr. Smith and the team for their input to the meeting.

AGENDA ITEM – OPPORTUNISTIC CREDIT STRATEGIES

Due to time constraints, it was agreed to postpone the discussion in the Opportunistic Credit Strategies area until the next IAC meeting in May.

AGENDA ITEM – PUBLIC COMMENT[1]

The Chair announced that there was a comment from the public to hear and invited Mr. Jim Baker of Unite Here (a union of hospitality employees) to speak. Mr. Baker wanted to bring to the IAC's attention an issue with UBS Realty, which is an investment manager for NCRS. Mr. Baker stated that on January 22, 2015, workers at the DoubleTree Downtown Los Angeles organized a one-day strike to protest over complaints that employees filed with the California Labor Commissioner's Office alleging they had missed rest breaks. On January 23, 2015, an unfair labor practice charge was filed with the National Labor Relations Board alleging that hotel management had taken action that interfered with workers' rest breaks.

Mr. Baker stated that he had attempted to reach out to UBS, particularly Matt Lynch, with no response over the past few months. He stated they have reached out to establish a dialogue with several partners and, while a number of managers have responded positively and sought to establish a dialogue, UBS Realty had not. Due to the business NCRS does with UBS Realty, Mr. Baker stated that NCDST should be concerned about this.

[1] As a clarification, the DoubleTree hotel discussed in the public comment is not held within any of the NCRS or NCDST investment portfolios. NCRS invests with investment managers that are UBS affiliates in other investment funds.

Mr. Baker then introduced one of the housekeepers at the DoubleTree Downtown Los Angeles, Olga Cagrillo, who had worked there for 7 years, to present a statement to the IAC. Ms. Cagrillo noted that she had a heavy workload, being expected to clean 15 rooms and that she had often worked through rest breaks, giving her no time to do anything. She requested the DoubleTree Downtown Los Angeles to reinstate rest breaks to its employees. The Chair thanked Mr. Baker and Ms. Cagrillo for their time in attending the meeting.

There were no further public comments.

ADJOURNMENT

It was noted that the next IAC meeting was scheduled for May 20th, 2015. Mr. Anarella motioned to close the meeting and Mr. Mebane seconded. The meeting was adjourned at approximately 2:45 p.m.

APPROVED BY: Janet Cowell

JANET COWELL
STATE TREASURER AND CHAIR