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

MINUTES OF MEETING
June 23, 2011

Time and Location: The Investment Advisory Committee ("IAC") met on Thursday, June 23, 2011 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 Medlin (Vice-Chair)(by teleconference); Donald Tarkenton; Dr. Harold Martin (by teleconference); Courtney Tuttle (by teleconference); and Neal Triplett.

Staff: The following staff members were present: Shawn Wischmeier, Bryan Lewis, Michael Ruetz, Jeff Smith, Craig Demko, Greg Beuris, Rhonda Smith, Chris Morris, Casey High, Rodney Overcash, Susan Carter, Norman Schiszler, Ron Ottavio, Heather Strickland, and Jay Chaudhuri.

Other Present: John Brocklebank (SAS), Prashant Pai (SAS), Paula Joshi (SAS), Heather Cox (SAS), Michael Forno (SAS), Nancy Williams (Hewitt Ennis Knupp), and Anthony Greco (Rep. Dale Folwell).

CALL TO ORDER

The meet was called to order at approximately 10:00 a.m. Treasurer Cowell reminded all IAC members of the Code of Ethics.

AGENDA ITEM – APPROVAL OF MINUTES

Chair Cowell asked for any discussion, comments, or corrections concerning the minutes of the February 16, 2011 meetings. Mr. Medlin offered two corrections that are reflected in the revised draft minutes of February 16. Mr. Medlin motioned approval for the revised minutes. Mr. Triplett seconded the motion. The IAC unanimously approved the minutes.

AGENDA ITEM – OLD BUSINESS / FOLLOW-UP ITEMS

Investment Bill: Shawn Wischmeier, Chief Investment Officer, provided an update on the investment bill (House Bill 318). He noted that the investment bill allows for hedging within the public equities portfolio and increases the cap on alternatives to 7.5 percent. The bill has passed both the House and the Senate and now awaits the Governor's approval.

Follow-up: Bryan Lewis, Chief Administrative Officer, provided a follow up from the February 16 meeting regarding the fund's investment managers and the respective legislative constraints for each asset class / strategy. As of April 30, Mr. Lewis said the real estate portfolio had approximately 50 managers across 80 investments. The real estate portfolio has a statutory limitation of no more than10 percent of plan assets with investment portfolio asset allocation target of 8 percent.

Mr. Medlin asked staff' assessment as to whether the individual investment managers in each asset class were excellent, good, or underperforming. Mr. Wischmeier indicated that staff will provide a more in-depth overview of how funds were performing at a future IAC meeting.

Mr. Lewis then discussed the credit and inflation strategy buckets. He stated that each strategy has a 5 percent cap. Currently, the credit portfolio consists of approximately 9 managers across 14 investments and the inflation portfolio consists of 8 managers across 14 different investments.

Mr. Lewis discussed the private equity class. In private equity, there are approximately 50 managers with 85 investment funds. Mr. Wischmeier said that the private equity portfolio is below the original statutory cap of five percent and well below the new statutory cap of 7.5 percent. If these managers were to call their outstanding commitments, the portfolio would remain below the new proposed limit.

Staff: Mr. Lewis said staff planned to interview three finalists to fill a portfolio manager position.

IAC Member Courtney Tuttle joined the meeting via teleconference at 10:44 a.m.

AGENDA – PORTFOLIO UPDATE

Mr. Wischmeier provided an update on the portfolio. As of April 30, 2011, the Pension Fund held approximately $90 billion in assets under management. The one-year portfolio return net of fees and expenses was 13.08 percent, which is below the North Carolina Retirement Systems' ("NCRS") benchmark of 14.42 percent. The three-year return net of fees and expenses was 3.59 percent compared to the NCRS benchmark of 3.62 percent.

Global Equity: The global equity portfolio was a big contributor to the Pension Fund's absolute return. The global equity portfolio has transitioned $8 billion in order to reduce a structural overweight bias towards the United States. In addition, this restructuring strategy employs more passive index funds.

Fixed Income: The fixed income portfolio had a good performance against the benchmark which reflects taking advantage of steepness in the front end of the yield curve.

Private Equity: The private equity portfolio accounts for 4.5 percent of the total portfolio, which is below its 5 percent statutory cap. Staff sold $850 million worth of fund commitments at an attractive price in the secondary market due to a large demand. Mr. Wischmeier said they will provide a full plan about how they intend to implement the increased legislative cap provided by the new investment bill in the September meeting.

Real Estate: The real estate portfolio still remains volatile given the economic recovery; however, it achieved a 15 percent return year-to-date. Staff is focused on distressed sellers and multi-family housing. A new commitment was made to a Brazilian real estate fund. Mr. Triplett stated that multi-family housing is an appropriate focus for the real estate portfolio. Susan Carter, Director of Real Estate, said that approximately 20 percent of the portfolio will be allocated in this area.

Credit: The credit portfolio has made new commitments of $300 million each to the Brigade LCS Fund and the Monarch Debt Recovery Fund. A commitment to Citadel Residential Mortgage Opportunity Fund was terminated due to the departure of a key person.

Inflation: The inflation portfolio has invested in excess of $1 billion in commodity futures since inception. Mr. Medlin inquired as to the type of commodities in which the Pension Fund has invested. Mr. Wischmeier said these commodities were diversified benchmarked against the Dow Jones UBS benchmark

Mr. Medlin inquired about limits that are placed on new investments. Mr. Wischmeier responded that within the public equity portfolio no individual active investment product exceeds 10 percent. On the private equity side, we do not allocate anymore than 10 percent of the allocation to one investment.

AGENDA – PORTFOLIO BENCHMARK

Mr. Wischmeier said it is staff's intent to review the portfolio benchmark on an annual basis. The purpose for such a benchmark is two-fold: (1) to represent a broad asset class and reflect a portfolio construction methodology; and (2) to measure relative performance. Mr. Wischmeier said that in some cases, staff would be moving from a static to dynamic benchmark given the transition taking place within the Pension Fund. Dynamic benchmarks allow for better assessment of relative performance during periods of high transition in various portions of the portfolio. He then reviewed the proposed benchmarks for the Pension Fund and each asset class / strategy.

Mr. Triplett inquired about how long it would take from the proposed transition benchmark to the proposed long-term benchmark. Mr. Wischmeier stated that in general, the fund should be to all long-term targets and associated benchmarks in the next one to two years.

Mr. Triplett then inquired as whether liquidity was considered as part of the benchmark reporting. Ms. Tuttle asked about how our benchmarks compare against other public pension plans. A discussion then followed.

AGENDA – PORTFOLIO RISK DISCUSSION

Treasurer Cowell opened the discussion by stating the desire to implement a risk system within the Investment Management Division. She said that it was important to understand risk through information and data available in the Pension Fund. As part of the Department of State Treasurer's ("DST") effort to manage risk, Treasurer Cowell, Mr. Wischmeier, and Mr. Ruetz, Director of Risk Management, recently visited Canadian pension funds that have devoted significant resources and created systems to manage risk.

Mr. Ruetz discussed the risk system evaluation process staff undertook in selecting a risk system provider. As part of the evaluation process, Mr. Wischmeier and Mr. Ruetz met with several institutional investors, including some large public plans, to understand the risk systems they were utilizing. Mr. Ruetz explained that it was important for staff to have a risk system that was flexible enough to cover all asset classes and highly customizable to address the unique characteristics of the Plan. Based on the evaluation process, SAS was selected as the preferred risk system vendor.

Mr. Prashant Pai, Head of Risk Consulting, and Dr. John Brocklebank, Vice-President, of SAS Institute, provided an overview of their risk system and dashboard. A brief discussion then followed.

The meeting was adjourned for lunch at approximately noon.

AGENDA ITEM – CIO/IAC EVALUATION (CLOSED SESSION)

The meeting reconvened at 12:45 p.m.

The IAC went into closed session for matters regarding the Chief Investment Officer's evaluation and how his evaluation relates to IAC's function. Because this information will become part of Mr. Wischmeier's personnel record and evaluation, the General Counsel advised that it is considered confidential information under the state personnel law of North Carolina General Statute section 126-24. Mr. Tarkenton made a motion to close session. Mr. Medlin seconded the motion. The motion was approved.

AGENDA – PUBLIC COMMENTS

There were no public comments.

AGENDA – OTHER BUSINESS / COMMITTEE COMMENTS

Mr. Wischmeier expressed his satisfaction as Chief Investment Officer and welcomed the diversity and expertise of the IAC. He stated the importance of having a healthy dialogue between IMD staff and the IAC. Mr. Wischmeier also noted that the degree and level of input from IAC members has to be appropriately matched to the number and length of meetings.

Mr. Medlin inquired about reviewing the selection and monitoring of investment managers. Mr. Wischmeier responded that it becomes very difficult to discuss approximately 135 managers with 250 investment funds given the limited number of meetings. Treasurer Cowell and Mr. Wischmeier suggested that it may be more appropriate to find a way to present summary level metrics about the investment managers. In addition, Mr. Wischmeier said that IMD staff is in the process of establishing an informal investment committee. He stated that he would present the diligence process on investment managers used by IMD's investment committee at an upcoming IAC meeting.

ADJOURNMENT

The meeting was adjourned at 2 p.m.

APPROVED BY: Janet Cowell

JANET COWELL
STATE TREASURER AND CHAIR