



2014-15 Investment Management Division Initiatives

September 24, 2014



North Carolina Department of State Treasurer
Investment Management

Learn. Invest. Grow. Prosper.

Investment Projects and Priorities

- Implement transition/capital allocation plan (result of Asset Liability Study), including using the internal Investment Committee in a structured cross-asset class allocation process
- Finalize Annual Work Plans for each asset class
- Support General Counsel's corporate governance initiatives related to evaluating ESG strategies and implementing diversity engagements and divestment policies
- Transition oversight of Ancillary Funds to Chief Operating Officer, including establish a new long-term fixed income product for certain clients and facilitate movement of assets
- Other Investment Initiatives:
 - Evaluate restructuring/exiting Fund of Funds and legacy low-conviction funds/managers
 - Research design and recommendations on Managed Accounts Program
 - Implement initial components of direct Hedged Equity program
 - Research and implement strategic co-investments program(s) and/or secondary program(s)
 - Research and implement Real Estate separate accounts
 - Review Small and Emerging Manager programs across NCRS
 - Procure Public Equity consultant
 - Effect Public Equity investment management agreement restatements
 - Evaluate liquid "Staging Portfolios" for Core Real Estate and Inflation Sensitive



Investment Grade Fixed Income Transition

	Old Target	New Target	Current (As of 9/15/14)
Government (UST & Agency)	40%	27.0%	24.7%
Corporate	35%	31.5%	33.4%
Mortgages	25%	31.5%	30.5%
Core-Cash			0.2%
Total Core Fixed Income	100%	90%	88.8%
Non Core			1.0%
Cash (STIF)		10%	10.2%
Total I.G. Fixed Income		100%	100%



The timing of the transition was favorable, with the cash raise completed at the end of August before 10 yr. rates increased.



NCRS Asset Allocation as of 9/12/14

	Market Value (\$MM)	Actual	Target	Range		Relative %	Relative \$ (MM)
				Minimum	Maximum		
Growth	\$53,109	59.35%	58.0%	37.0%	71.0%	1.35%	\$1,207
Public Equity	39,957	44.65%	42.0%	37.0%	47.0%	2.65%	2,373
Non Core Real Estate	4,320	4.83%	3.0%	0.0%	8.0%	1.83%	1,635
Opportunistic Fixed Income	4,875	5.45%	7.0%	0.0%	7.5%	-1.55%	(\$1,389)
Private Equity	3,958	4.42%	6.0%	0.0%	8.75%	-1.58%	(\$1,412)
Inflation Sensitive & Diversifiers	6,657	7.44%	11.0%	4.0%	16.0%	-3.56%	(\$3,187)
Core Real Estate	2,681	3.00%	5.0%	2.0%	10.0%	-2.00%	(\$1,793)
Inflation Sensitive	3,976	4.44%	6.0%	2.0%	7.5%	-1.56%	(\$1,394)
Multi-Strategy	1,670	1.87%	2.0%	0.0%	4.0%	-0.13%	(\$120)
Rates & Liquidity	28,051	31.35%	29.0%	24.0%	42.0%	2.35%	2,100
Cash	1,014	1.13%	1.0%	0.0%	10.0%	0.13%	119
Investment Grade Fixed Income	27,037	30.21%	28.0%	24.0%	32.0%	2.21%	1,981
Grand Total	\$89,487	100.00%					

	Relative %						
	31-Mar	30-Apr	31-May	30-Jun	31-Jul	31-Aug	Current
Growth	1.44%	1.20%	1.43%	1.74%	1.55%	1.59%	1.35%
Public Equity	3.54%	2.86%	2.96%	3.30%	2.88%	3.17%	2.65%
Non Core Real Estate	1.73%	1.75%	1.82%	1.71%	1.74%	1.64%	1.83%
Opportunistic Fixed Income	-2.06%	-1.74%	-1.75%	-1.71%	-1.56%	-1.64%	-1.55%
Private Equity	-1.77%	-1.68%	-1.60%	-1.56%	-1.52%	-1.59%	-1.58%
Inflation Sensitive & Diversifiers	-4.11%	-4.01%	-3.91%	-3.94%	-3.82%	-3.65%	-3.56%
Core Real Estate	-2.03%	-1.99%	-1.87%	-2.05%	-2.00%	-2.03%	-2.00%
Inflation Sensitive	-2.07%	-2.02%	-2.04%	-1.90%	-1.83%	-1.62%	-1.56%
Multi-Strategy	0.03%	0.03%	-0.15%	-0.15%	-0.16%	-0.18%	-0.13%
Rates & Liquidity	2.64%	2.78%	2.62%	2.34%	2.43%	2.24%	2.35%
Cash	-0.45%	-0.42%	-0.55%	-0.07%	-0.11%	-0.27%	0.13%
Investment Grade Fixed Income	3.08%	3.21%	3.18%	2.41%	2.54%	2.51%	2.21%

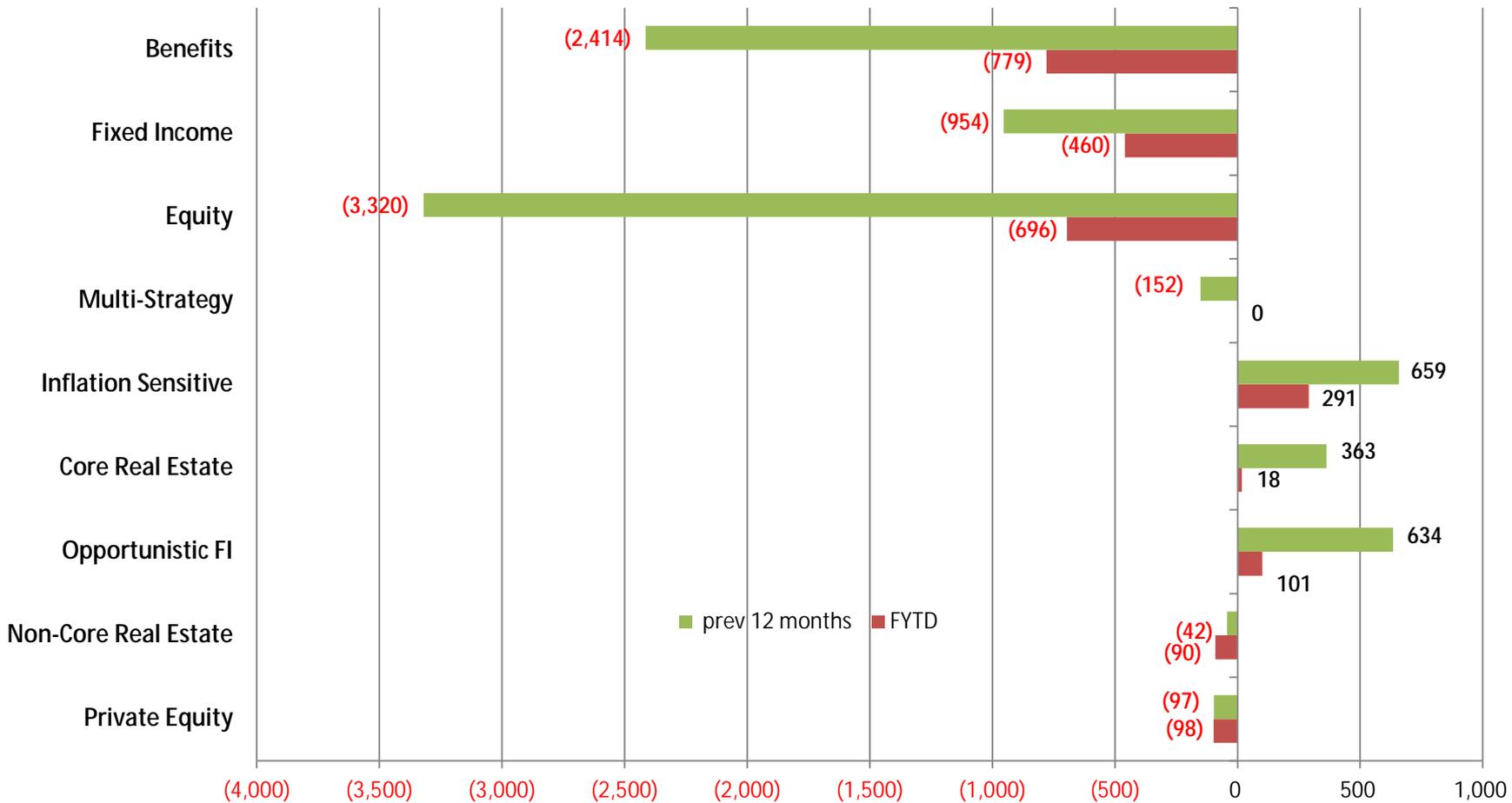


Progress on Pro Forma Tentative Transition Plan

Sources (\$MM)	May 2014 Gap	9/12/14 Gap
<i>Public Equity</i>	\$2,400	\$2,373
<i>Investment Grade Fixed Income</i>	\$3,000	\$1,981
<i>Non-Core Real Estate</i>	\$1,500	\$1,635
Subtotal	\$6,900	\$5,989
Uses (\$MM)	May 2014 Gap	9/12/14 Gap
<i>Private Equity</i>	(\$1,500)	(\$1,412)
<i>Opportunistic Fixed Income</i>	(\$1,500)	(\$1,389)
<i>Core Real Estate</i>	(\$1,750)	(\$1,793)
<i>Inflation Sensitive</i>	(\$1,750)	(\$1,394)
<i>Cash + Multi-Strategy</i>	(\$400) + \$0	\$119 + (\$120)
Subtotal	(\$6,900)	(\$5,989)
Memo Items	May 2014 Gap	9/12/14 Gap
<i>Public Equity Rebalance: Long to Long/Short</i>	(\$2,700)	(\$2,700)
<i>Multi-Strategy Rebalance</i>	(\$1,000)	(\$1,000)



NCRS Net Cash Flows through 9/15/14



Pro Forma Projected Tentative Commitments

Sources (\$MM)	Annualized Commitments	Projected ~2016 Gap
<i>Public Equity</i>	\$0	\$500 - \$1,300
<i>Investment Grade Fixed Income</i>	\$0	(\$1,400) - \$0
<i>Non Core Real Estate</i>	\$300 - \$750	\$1,500 - \$1,700
Subtotal	\$300 - \$750	\$600 - \$2,600
Uses (\$MM)	Annualized Commitments	Projected ~2016 Gap
<i>Private Equity</i>	\$1,200 - \$1,600	(\$1,500) - (\$1,000)
<i>Opportunistic Fixed Income</i>	\$500 - \$1,400	(\$200) - \$200
<i>Core Real Estate</i>	\$700 - \$1,000	(\$1,000) - (\$600)
<i>Inflation Sensitive</i>	\$1,000 - \$2,500	(\$400) - \$800
<i>Cash + Multi-Strategy</i>	\$0 - \$400	\$0
Subtotal	\$3,400 - \$7,000	(\$2,600) - (\$600)
Memo Items	Annualized Commitments	Projected ~2016 Gap
<i>Public Equity Rebalance: Long to Long/Short</i>	\$500 - \$1,500	(\$800) - \$0
<i>Multi-Strategy Rebalance</i>	\$500 - \$1,000	\$0 - \$500



“Staging Portfolio” Concepts

- Hedged Equity (i.e., Equity Long/Short)
 - Managed Account Platform finalists in diligence and design work underway with AF Advisors
 - Rich pipeline of fundamental long/short managers
 - Several Quantitative Market Neutral prospects in diligence
 - Evaluating alternative beta replication proposals (active and passive) to potentially utilize equities, cash, fixed income, and/or derivatives
- Inflation Sensitive Tradeable Portfolio
 - Delegated separate account arrangement
 - TIPS, floating rate investments, Interest-Only CMOs, inflation derivatives, interest rate derivatives, ARM MBS pass-throughs, etc.
 - Equity and mortgage REITS
 - Natural resources debt and equity, etc.
 - Investments whose value is otherwise reasonably expected to outperform other publicly-traded investments in an environment of unanticipated and rising inflation
- Core Real Estate
 - 2 New(er) Open-End funds in advanced diligence
 - REIT-related strategy in diligence



Investment Projects and Priorities

- Implement transition/capital allocation plan (result of Asset Liability Study), including using the internal Investment Committee in a structured cross-asset class allocation process
- Finalize Annual Work Plans for each asset class
- Support General Counsel's corporate governance initiatives related to evaluating ESG strategies and implementing diversity engagements and divestment policies
- Transition oversight of Ancillary Funds to Chief Operating Officer, including establish a new long-term fixed income product for certain clients and facilitate movement of assets
- Other Investment Initiatives:
 - Evaluate restructuring/exiting Fund of Funds and legacy low-conviction funds/managers
 - Research design and recommendations on Managed Accounts Program
 - Implement initial components of direct Hedged Equity program
 - Research and implement strategic co-investments program(s) and/or secondary program(s)
 - Research and implement Real Estate separate accounts
 - Review Small and Emerging Manager programs across NCRS
 - Procure Public Equity consultant
 - Effect Public Equity investment management agreement restatements
 - Evaluate liquid "Staging Portfolios" for Core Real Estate and Inflation Sensitive



Operations and Risk Management Priorities

- Formalize Operating Committee charter and use the Operating Committee to procure a strategic planning/organizational culture consultant
- Implement operating/resource improvements resulting from Investment Fiduciary Governance Commission, short session legislation, and reorganization
 - Effect new Director Director roles and fill Director of Multi-Strategy
 - Fill position vacancies and utilize targeted contractual resources
 - Conduct market-oriented compensation study
 - Support audit readiness preparation with State Auditor and FOD
- Restructure BNY Mellon contract, including new business requirements
- Finalize streamlining and developing new IMD policies/procedures
- Implement total fund risk systems and processes
 - Keep SAS project on timeline with high quality deliverables
 - Revise and enhance performance reporting
 - Build-out detailed risk budget monitoring thresholds and risk standards



Operations and Risk Management Priorities

- Review pool of external legal counsel and support search for new firms, as necessary
- Review pool of transition/stock distribution managers and search for new firms, as necessary
- Institute manager training and career development program for Portfolio Managers and Analysts
- Institute structured third-party review of fees and incentive payments
- Finalize implementation of CRM/Backstop
- Effect relocation



Other DST Initiatives to Support

- General Assembly long-session deliberations
- Reevaluation of Consultant/IMD roles for Supplemental Retirement Plan
- GASB Working Group
- Standardizing DST Board practices

