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INVESTMENT MANAGEMENT

To: North Carolina Supplemental Retirement Board of Trustees

From: Kris Byrd, Portfolio Manager

Date: February 22, 2024

Subject: Discussion / Action: 401k and 457b Plans: TCW Watch List Recommendation

Recommendation

When assessing managers for potential inclusion on the watchlist, three critical criteria are considered: consistent underperformance relative to benchmarks and peers, substantial shifts in investment philosophy, and significant organizational changes. These elements enable an evaluation of whether an investment strategy necessitates increased scrutiny due to potential risks to its success.

Staff and Callan recommend adding the TCW Core Plus Fixed Income strategy to the watchlist. This recommendation is based on the notable changes in the overall leadership of the firm and specifically in the management of the Core Plus Fixed Income strategy.

The team remains deep and experienced, and we generally support the recent announcements as a part of a transition to a new generation of leadership. The process and philosophy remains unchanged and has served investors well over longer periods. With the retirement of the key architects of the strategy, it is important to monitor the management team, specifically whether they will adhere to the same discipline or whether this may be a different strategy than NCSRP originally retained.

Portfolio Positioning

TCW manages 50% of the NCSRP Active Fixed Income Fund. The TCW Core Plus Fixed Income strategy is a relative return-oriented strategy that seeks to outperform the broad market primarily through security selection and sector rotation. The team embraces a fundamental, value-oriented research process to build portfolios. Duration is generally +/- one year, relative to the benchmark. The Fund can invest up to 20% in below investment grade securities and non-dollar securities have not historically been a part of the opportunity set, but more recently the Fund has included modest amounts in US dollar-denominated emerging markets debt.

People

TCW has undergone significant leadership transitions in recent years, anchored by a comprehensive succession plan aimed at ensuring continuity and fostering internal talent development. The retirement of the Chief Investment Officer at the end of 2021 marked the beginning of this transitional phase, leading to the elevation of new Co-CIOs from within. Amid this transition, TCW appointed a new President and CEO at the end of 2022 with a focus on ensuring continuity, expanding opportunities, and executing strategic succession planning.

In 2023, TCW made several announcements regarding its structure of the fixed income team. They announced more retirements, including a Co-CIO by end of 2024, and another key leader at the end



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of 2023. These planned exits, aligning with TCW's succession strategy, led to the promotions of two Generalist Portfolio Managers and four Senior Portfolio Managers. Through all these changes, TCW has maintained a strong strategy for handling transitions, talent development, and ensuring ongoing growth and stability.

Philosophy/Process

TCW's core philosophy is based upon several key beliefs:

1. Mean Reversion – Fixed income markets tend to revert to their mean, suggesting that prices will eventually align with their fundamental values after deviations.
2. Price Influence – Prices can deviate from their fundamental levels due to technical factors unrelated to underlying value.
3. Exploiting Inefficiencies: Through disciplined research, these market inefficiencies can be capitalized on to achieve superior returns.

Through this philosophy, TCW is able to employ a value-oriented approach aimed at outperforming the broader fixed income market.

The investment process for constructing the portfolio integrates macroeconomic themes, bottom-up fundamental research, and robust quantitative analysis in the following stages:

1. Sector Rotation: As value investors, TCW typically overweights sectors that it believes will provide the highest risk-adjusted returns. Given its view that sector returns are mean reverting, overweights will often be in sectors that have recently underperformed.
2. Security Selection: Security selection is driven by individual sector specialist teams. Management interviews and covenant analysis are required for almost all corporate issues purchased by the team. Mortgage-backed and asset-backed securities are rigorously modeled by a proprietary system that allows for full transparency into collateral, including loan-level data on non-agency mortgage backed securities. The internal system allows for multiple scenario analyses so that their team can calculate a worst-case scenario price for any security prior to purchase. Purchases and sales are discussed by the entire specialist portfolio management team prior to execution.
3. Yield Curve Control: Yield curve management is utilized as a potential alpha driver. The primary decision points include Fed policy and inflation outlooks, along with market expectations when compared to forward curves. Moderate interest rate positions may be taken in anticipation of shifts in the shape of the overall yield curve.
4. Duration Management: The firm's long-term economic outlook is the primary driver of its duration decision. Primary duration decision factors include monetary policy (such as inflation and Fed funds rate levels), fiscal policy (such as deficit/surplus conditions and budgetary initiatives) and



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financial market conditions (such as credit spreads, yield curve shape and corporate profitability). Duration is constrained to +/- 1 year relative to the benchmark.

Performance

Fourth quarter performance was solid with the Fund's long duration stance being a key contributor. This is notable as duration positioning is expected to be a modest contributor to performance, and duration management has been more pronounced over the last few quarters. A modest allocation to high yield and an overweight in RMBS also added to results.

Full year results outpaced the benchmark in spite of underperformance in Q2 and Q3. Results were helped by the long duration (1Q and 4Q) as well as security selection in corporates, RMBS, non-agency mortgages and non-agency CMBS.

Three-year performance trails the benchmark and ranks in the bottom quartile of the peer group. The team has not strayed from its process/philosophy, but its views have not played out. We are monitoring performance. The Fund's ten-year performance remains in line with the benchmark and median peer.

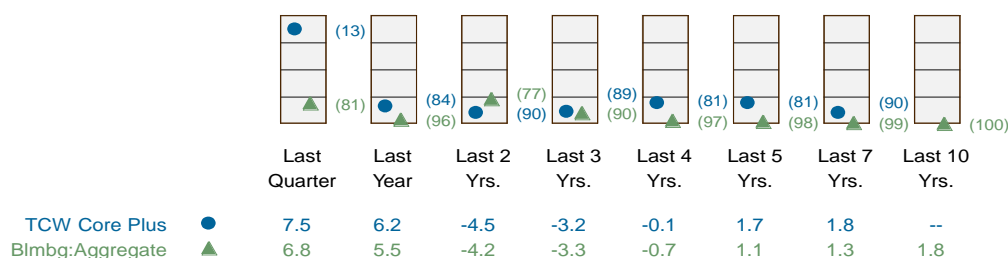


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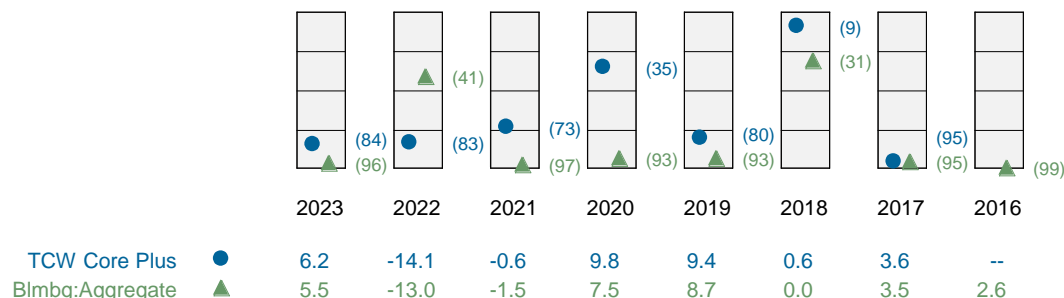
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Performance as of 12/31/23

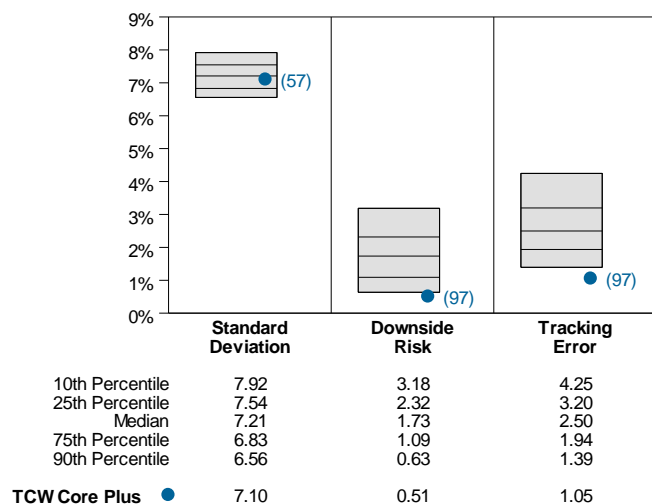
Returns vs. Callan Core Plus FI



Calendar Year Returns



Risk Statistics Rankings vs Bloomberg Aggregate Rankings Against Callan Core Plus Fixed Income (Gross) Five Years Ended December 31, 2023



Callan Core Plus Fixed Income (Gross) Annualized Five Year Risk vs Return

