

# *North Carolina Supplemental Retirement Plans*

## STATEMENT OF INVESTMENT POLICY

~~JUNE~~ SEPTEMBER 2013

Rev 1.7

### **Inflation Sensitive Fund**

The Inflation Sensitive Fund was established to provide participants of the Plan with an actively managed option focused on providing exposure to various asset classes which show a correlation or sensitivity to inflation over various market environments.

#### **Investment Objective**

This fund seeks to provide participants with protection from rising inflation by investing in several asset classes that are expected to be positively correlated to the Consumer Price Index (“CPI”), especially during period when the CPI is increasing. Since the Consumer Price Index is not an investible index the strategy will not keep up with inflation in all markets and may expose investors to negative returns. Based on the belief that no single asset class provides the highest correlation with CPI during all market conditions, the management team will allocate assets among several asset classes based on their evaluation of market conditions including expected sources of inflation. The asset classes in which the fund will invest includes but is not limited to TIPS and other inflation-sensitive bonds, emerging market currencies, real estate investment trusts, commodities, and gold.

#### **Investment Management**

One manager has been selected for the management of this fund. The manager selected is responsible for the asset allocation of the fund across multiple asset class as well as the management decisions within the underlying asset classes. A table of the current investment managers for this Option, their target allocations and the allocation range for each manager is shown in Appendix B. This strategy may utilize sophisticated investment techniques, including the use of derivatives and forward settling security transactions to adjust the portfolio’s positioning.

#### ***Acceptable Investments***

Bonds, including Treasury Inflation-Protected Securities (TIPS), commodities, currencies, real estate and gold. In addition, tail risk hedging strategies that are intended to limit the impact of periodic market declines that may affect inflation-related assets are permitted, including the use of options.

#### ***Quality***

The minimum average quality of the bonds in the portfolio will be A-.

#### ***Diversification***

The fund should be well diversified across multiple inflation sensitive asset classes with the following maximum weights:

Commodities:	40%
Equity Securities and REITs:	15%
Gold:	25%

#### ***Cash Reserves***

Although the portfolio is expected to generally be fully

### Global Equity Fund

The Global Equity Fund was established to provide participants of the Plan with an active equity investment option that invests in stocks of companies without any geographic limitation. The option will invest in both US and non-U.S. equity markets. The manager is expected to seek to outperform the broad global equity market through stock selection as well as sector and country/region selection

#### Investment Objective

The primary objective of the Option is to outperform global equity markets over the long term on a risk adjusted basis through a diversified portfolio of global equity securities.

#### Investment Management

The Board recognizes that no investment manager is able to provide consistently superior returns in all time periods. Therefore, the Board has determined that multiple investment managers will be retained to manage portions of the Option's assets. This will provide diversification for the Option by investment organization. A table of the current sub-advisors for this Option, their target allocations and the allocation range for each manager is shown in Appendix B.

#### *Acceptable Investments*

US and Non-U.S. equity securities, meaning common stock or stock equivalents of non-U.S. companies (ADRs, issues convertible into common stock, etc.) traded on U.S. and/or foreign exchanges.

#### *Capitalization*

The portfolio should be invested primarily in large cap companies. For the purposes of this policy, large cap companies will be deemed to include companies in the MSCI AC World Index. This index includes the largest 80% of companies in each country market cap.

#### *Country/Region Diversification*

The maximum allocation to any one country is 60%, regardless of index weight to that country. The allocation to any one country should not exceed 200% of that country's weight in the MSCI AC World Index, with the exception of countries whose allocation in the index is less than 5%, for which countries the maximum allocation will be 10%. The allocation to countries not included in the benchmark, including frontier markets countries, is limited to 10%.

#### *Hedging*

The Option's assets may be hedged to U.S. Dollars to protect against currency fluctuations at the manager(s) discretion.

#### *Cash Reserves*

Cash may be used opportunistically. Cash reserves will be limited to cash equivalent instruments of maturities less than one year carrying a credit rating of at least A1/P1 or a commingled money market fund offered by the custodian

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- (b) Peer Group Universe Comparison: Investment Managers will be informed of the peer group universe against which their performance will be compared. Investment Managers are expected to place above the median of their assigned peer group over rolling three and five year periods.
- (c) In assessing an Investment Manager's performance relative to the assigned benchmark and peer group universe, the Board will consider risk adjusted performance as well as absolute and relative returns.

### 5) Asset Restrictions/Exclusions

The Board requires that all Investment Managers comply with the following limitations and restrictions on their investment activities and holdings:

- (a) Restrictions:
  - (i) Securities issued by, or obligations of, the Investment Manager or any Affiliate shall not be held in the account of any Investment Manager;
  - (ii) Except where explicitly permitted, all accounts shall be free of leverage and Investment Managers shall not engage in short sales or margin purchases; ~~except where explicitly permitted. All accounts shall be free of leverage;~~
  - (iii) Restricted securities are prohibited with the following exception: Securities acquired under rule 144A of the Securities Act of 1933 may be purchased with the stipulation that these securities shall not exceed 15% of the Investment Manager's account valued at market prices.
- (b) Derivative securities are prohibited except where specifically permitted in each mandate. Specific mandates may be permitted to make use of derivatives consistent with the overall investment guidelines and objectives of that mandate. Where derivative securities are permitted, they may not be used to establish a leveraged account without explicit permission from the Board. The Board is responsible for any required compliance with Rule 4.5 under the Commodity Exchange Act on behalf of the account.
- (c) Investments in commercial paper or other similar securities intended as cash equivalents shall be made only if such paper is rated at least A1/P1 by Standard and Poor's, Moodys or Fitch respectively and has a maturity of less than one year or a commingled money market fund offered by the custodian bank is used which meets these standards. Commercial paper rated below A1/P1 by any of the three rating agencies is not permitted.
- (d) Investment Managers may utilize exchange traded funds ("ETF's") representing their primary assigned benchmark in lieu of cash. Any ETF holdings will be considered part of the manager's allocation to cash and be subject to the cash allocation limits.

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### **D. Trade Execution**

Investment Managers shall effect all purchases and sales of securities for the account(s) managed for the State of North Carolina in a manner consistent with the principals of best execution, taking into account net price (including commissions), execution capability and other services which the broker or dealer may provide. In this regard, the Investment Manager may effect transactions which cause the account to pay a commission or price in excess of a commission or price which another broker or dealer would have charged, provided, however, that the Investment Manager shall have first determined that such commission or cost is reasonable in relation to the value of the brokerage, research, performance measurement service and other services performed by that broker for the account(s).

Investment Managers are prohibited from purchasing securities from affiliates of the Manager in an initial offering, unless granted permission by the Board.

### **E. Proxy Voting**

All proxies shall be voted by the Department of State Treasurer in accord with the proxy policy approved by the Board.

### **F. Reporting**

- 1) Each Investment Manager is required to submit a written report to the Board and/or its designees of any personnel changes that might impact the management of the Plan's assets. This report should be submitted as soon as the change is known or could be expected.
- 2) Each Investment Manager is directed to perform monthly reconciliations of their account holdings and values with the Plan's custodian. The Investment Manager is directed to provide a written report to the Board and/or their designees of any significant unresolved discrepancies.
- 3) Each Investment Manager is directed to provide, within 30 days of the end of each calendar quarter, a written report to the Board and/or its designees detailing any derivative security holding and their potential impact on the portfolio given a worst case scenario.
- 4) Each Investment Manager is required to submit to the Board and/or its designees annually a written report detailing the firm's soft dollar activity. This report should be submitted within 30 days of the end of each calendar year. The report should list the types of services the firm buys, from whom the services are purchased, total soft dollars generated by the firm, and the percentage of the firm's total soft dollars that are generated by the Plan's portfolio..
- 5) Each Investment Manager should reconcile the performance of its portfolio with the calculations of the custodian on a quarterly basis. Any material discrepancies should be reported to the Board or its designee.

Guideline Exceptions Granted by the Board

<u>Manager</u>	<u>Date</u>	<u>Guideline</u>	<u>Explanation</u>
<u>PIMCO – Inflation Strategy</u>	<u>Sept 2013</u>	<u>Prohibition against leverage</u>	<u>PIMCO utilized forward settling bond purchases in order to adjust their yield curve positioning. PIMCO will remain with the overall duration guidelines of the fund.</u>

### IPS Revision History

Version	Approved	Summary of Changes
1.4	Dec 2011	<ul style="list-style-type: none"> <li>Change Stable Value guidelines to refer to “manager” generically and not Galliard specifically</li> </ul>
1.5	June 2012	<ul style="list-style-type: none"> <li>Change consultant reporting to quarterly</li> <li>Change global equity from “Opportunistic” to just Global Equity Fund, updated guidelines to traditional long equity</li> <li>Add Max 10% security limit to all equity funds</li> <li>Add new managers and update fund target allocations: <ul style="list-style-type: none"> <li>Neuberger, Robeco, Wedge, Arrowstreet</li> </ul> </li> </ul>
1.6	<del>Proposed</del> June 2013	<ul style="list-style-type: none"> <li>Move Global Equity country max limit to 60% from 50% ( Approved Nov 2012)</li> <li>Add Inflation Fund</li> <li>Add revision history</li> </ul>
<u>1.7</u>	<u>Proposed September 2013</u>	<ul style="list-style-type: none"> <li><u>Clarify language around use of leverage in general; leverage prohibited except where permission granted by the Board.</u></li> <li><u>Add prohibition against purchasing initial offerings from affiliated entities of the investment manager</u></li> <li><u>Add Exceptions Granted table</u></li> <li><u>Modify global equity fund guidelines to allow smaller cap companies and frontier market countries</u></li> </ul>