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North Carolina Supplemental Retirement Plans

Neuberger Berman Large Cap Disciplined Growth Retention Review

February 2014

MARSH & McLENNAN COMPANIES

Summary and Observations

- Neuberger Berman was hired to provide a lower beta / higher quality portfolio to the large cap growth fund
  - Performance is expected to be better in down markets than up markets
- Neuberger Berman has a strong long term track record but performance has been disappointing over last four years
  - Primary issue was mistakes in 2011
  - Team structure changes exacerbated mistakes
- Very tenured PM team (+20 Years together) and a long track record indicates more skill than luck
- Mercer Assessment:
  - 2011 was likely an anomaly
  - 2012 and 2013 performance consistent with expectations
  - 2014 likely to be a “normal” year, with fundamentals driving results
  - **We recommend retaining Neuberger**, with action to be taken if they do not outperform in a normal or down year

Evaluating Managers on Watch List Process

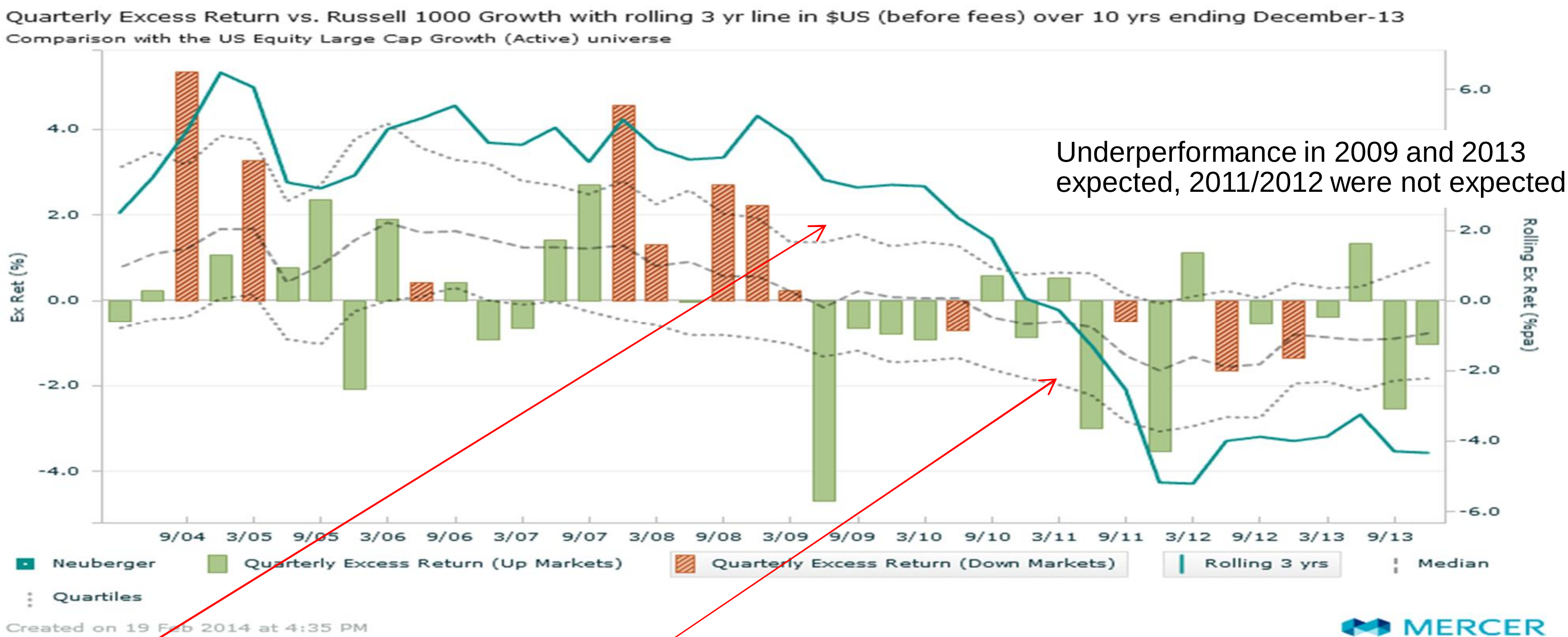
- Objective: Evaluate confidence in manager’s ability to succeed in the future
- Watch List Manager Retention Evaluation
  - What is the manager’s process and philosophy
  - When should it be effective and when should it struggle
  - Is recent performance consistent with expected pattern of performance
  - Can the team execute the strategy successfully
    - Is past performance indicative of ability or luck
  - Can the strategy succeed in the future
    - Stable Team
    - Process and Philosophy expected to work
    - Process and Philosophy can be implemented by manager

Neuberger Berman
Philosophy and Process

- Growth oriented strategy seeking accelerating earnings growth driven by an identified catalyst
- Valuation discipline enhanced by requirement for attractive free cash flow yield
- Companies must have strong and conservative balances sheets, with ample liquidity to finance growth
- Experienced management teams with proven ability to execute

- This philosophy should produce a portfolio that will
  – perform well in most market environments
  – will excel in down markets
  – struggle in exuberant markets

Neuberger Berman
Performance Overview



2009 **2011** **2012/2013**

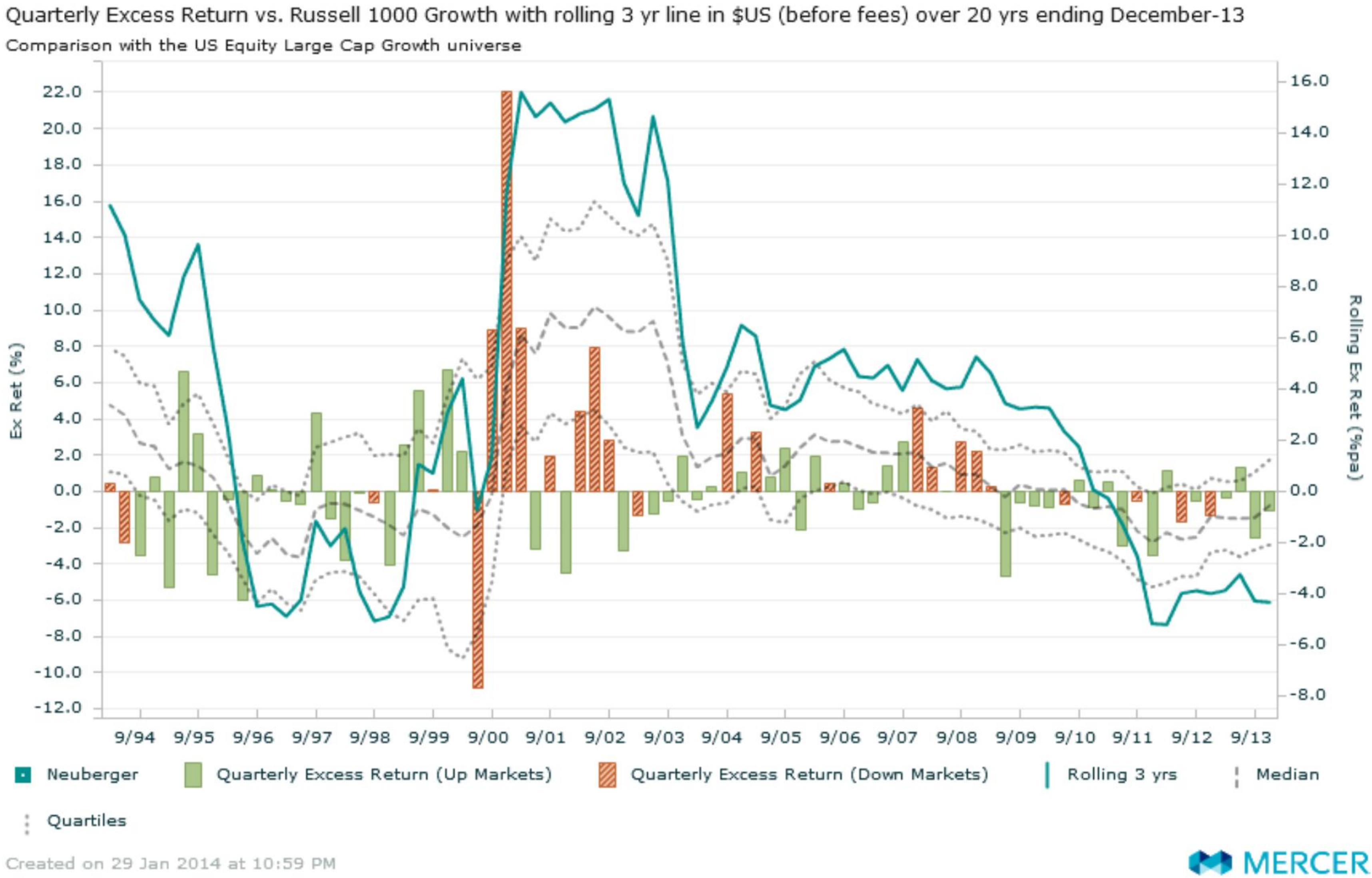
- Dramatic underperformance
- Biased towards quality and large cap
- Risky and small stocks led market
- New PMs added to team.
- # of stocks in portfolio begins to increase to around ~65
- turnover decreased

- Lagged index by 6.3% in 2011
- Poor stock selection
- Underperformed significantly in 2Q11 and 3Q11 when quality was *in favor*
- Netflix and Illumina were major detractors.

- 2012 underperformance was smaller and in line with process for a rising market
- PM team reduced to original 2 members in 2012

- 2013 underperformance expected in sharply rising market
- # stocks back down to <55, decision process streamlining

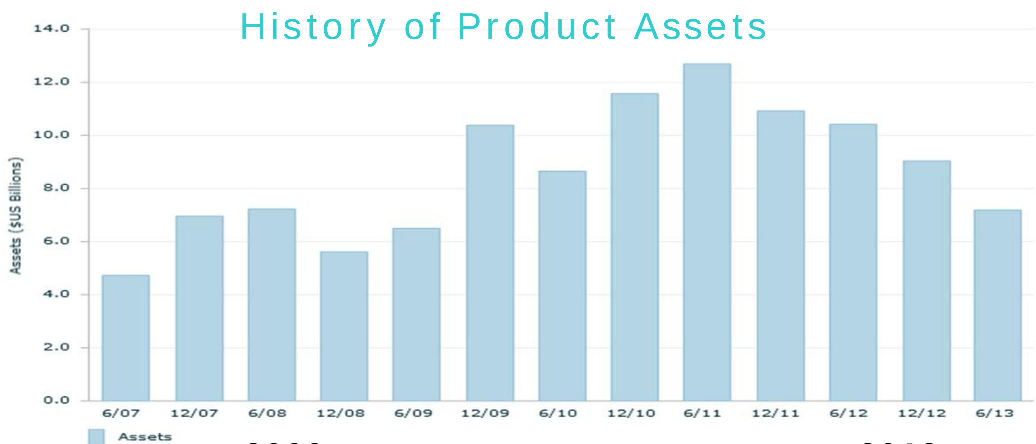
Neuberger Berman
Long Term Performance Cycle



Team and Resources

KEY TEAM MEMBERS

Name	Title	Location	Joined Firm	Joined Industry
John J. Barker	Managing Director, Portfolio Manager	New York, NY	1994	1980
Daniel H. Rosenblatt	Managing Director, Portfolio Manager	New York, NY	1990	1981
Neil Groom	Managing Director, Portfolio Risk Manager	New York, NY	2004	1999
Dedicated Research Team	5 Team Members	New York, NY	> 16 Years Avg Experience	



1997-2007

Strategy headed by co-portfolio managers, John Barker and Daniel Rosenblatt.

2009

Team moves towards a four portfolio manager structure, promoting Larry Fisher and Daniel Fletcher. Portfolio decisions had to be unanimous among portfolio managers. Client service was one of the reasons for the team expansion.

2012

The team moved back to the co-portfolio manager structure as a result of poor performance and a less efficient decision making process. Fisher and Fletcher retained their previous associate portfolio manager positions.

2012

Larry Fisher and Neuberger Berman mutually agreed to part ways. The team felt that Fisher did not react quickly enough when ideas were brought to him by analysts and was too risk averse.

Neuberger Berman
Asset & Rating History

Date	Assets ($B)	Clients	Mercer Rating	Comment
May 2009[1]	$6.5	649	B+	Mercer initially rated the Disciplined Growth Strategy
November 2010[2]	$11.6	641	A	Mercer upgraded rating to “A” based on the impressive team and investment process
September 2012	$10.5	530	B+	Mercer downgraded the fund to a “B+” due to the personnel changes within the team as well as structure change that took place in 2011
September 2013	$6.6	422	B+	Mercer reaffirmed the “B+” rating on the strategy

[1] Assets and clients as of June 30th 2009
[2] Assets and clients as of December 31, 2010

Neuberger Berman
Strategy Profile

Key Decision Makers: The core investment team consists of co-portfolio managers Dan Rosenblatt and John Barker who are the final decision makers. The investment team is supported by four research analysts, one portfolio risk manager, and one portfolio specialist. Additionally, the team has access to Neuberger's centralized buy-side analysts.

Investment Style/Philosophy: The Large Cap Disciplined Growth team invests in companies with prospective accelerating growth metrics (earnings per share, cash flow, or number of subscribers) driven by an identifiable catalyst. The team seeks companies that have an experienced and accessible management team, ample liquidity, manageable leverage, and/or the ability to generate both free cash flow and operating income growth over time. The team believes companies with these qualities have the potential for price appreciation through earnings growth and an expanding valuation brought about by improved investor perception.

Investment Process: The initial step in the investment process is a simple quantitative screen to identify stocks with market-capitalizations above $3 billion and daily dollar trading volume greater than $100 million. Additionally, debt as a percent of total capitalization and price-to-earnings ratios for each respective industry group is considered. These screens typically yield approximately 400 companies. Fundamental analysis is then performed to identify potential catalysts that could accelerate growth at particular companies. This typically reduces the field to approximately 150 names. Examples of identifiable catalysts include: new product development, regulatory change, management changes, mergers, acquisitions, demographic shifts and corporate reorganizations. Next, the team analyzes the significance of the catalyst and quantifies its impact on a company's growth. As a final step, the team will often meet with company management. The investment process typically produces five or six companies at any given time that meet the team's criteria. While the dedicated team maintains ownership of the process, its research is supplemented with the firm's centralized analyst team throughout the entire process.

The team will sell a stock if one of the following occurs: full accretion of catalyst into relevant metrics or stock price, or failure of initial catalyst. A stock will be reviewed if it declines 10% from cost or 15% from its 52-week high.

The portfolio consists of 50 to 70 holdings with no one single position exceeding the maximum of 5% or 1.5x the index weight at cost. Sector weights are restricted to fall between 50% and 150% relative to the benchmark sector (up to +/- 10% for smaller sectors). Cash is limited to 5%, ADRs are capped at 15%, and portfolio turnover averages 80%-100%.

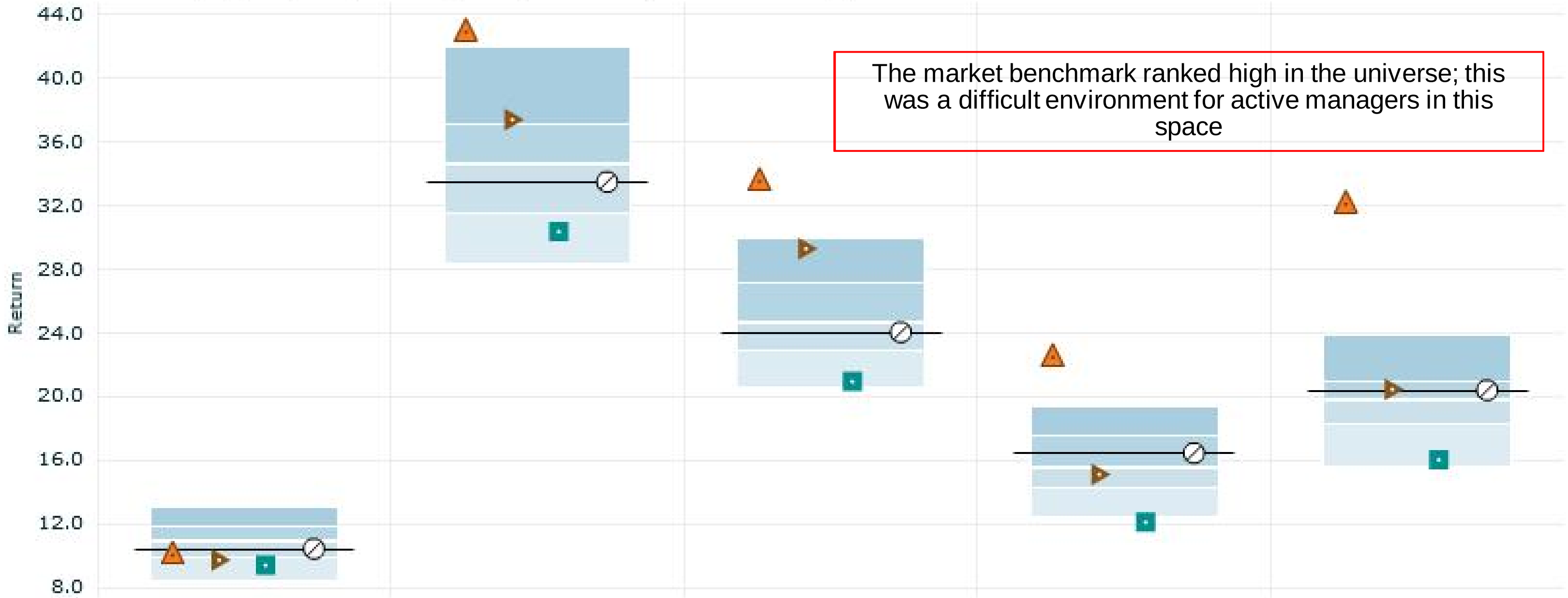
Strategy Profile
Mercer Evaluation Summary

Factor	Rating (-, =, + or ++)	Comments
Idea Generation	+	The generation of ideas is the responsibility of each team member, but ideas are approved by Rosenblatt and Barker. This growth oriented investment team seeks stocks with accelerating growth metrics, as opposed to those that meet certain high growth hurdle rates, and very specific quality metrics. This 'second derivative' approach to growth investing, while reflective of a forward looking, non-consensus oriented investment philosophy, does not necessarily translate into a defensive investment strategy on a consistent basis. Neuberger has restructured its large cap growth team over the last several years to generate more investment ideas for Rosenblatt and Barker to consider and lessen its reliance on the firm's centralized buy-side analysts (used primarily for industry overviews), but has encountered some personnel issues in doing so. On the positive side, the investment process is considered sound and research is focused on developing a non-consensus edge. We think idea generation benefits from the team being specifically dedicated to this one strategy and from the insulation of key team members from most non-investment distractions.
Portfolio Construction	+	The portfolio is well diversified but is subject to the sector tilts of the growth benchmark (Neuberger generally refrains from taking large sector bets relative to the index). Positions are weighted based on index weight plus (or minus) conviction. Neill Groom, as portfolio risk manager, is responsible for tracking the portfolio's risk exposures on a daily basis. BARRA is used to analyze ex-ante tracking error and the portfolio's Active Share is explicitly managed but not particularly high. Groom's daily dashboard review monitors multiple exposures versus the benchmark and he works very closely with the portfolio managers. A quarterly portfolio review is conducted which focuses on strategy, style, performance attribution, and risk analysis, mostly for the benefit of the firm's head of portfolio analysis and equities CIO.
Implementation	+	Trading resources are sophisticated and capacity/liquidity issues are not a concern at this time.
Business Management	+	In December 2008, following the bankruptcy of Lehman, a group of senior investment and management professionals agreed to acquire a majority interest in Lehman's Investment Management Division. We viewed this as a positive development for investors in Neuberger Berman and Lehman Brothers funds as the alignment of interests and the longer-term direction of the business was made more stable and clear. Since then, the firm has demonstrated its ability to operate as a stand alone entity while retaining talent within the firm and is moving toward 100% employee ownership over the next three years. The firm remains in a strong financial position with revenues from approximately $214 billion in assets under management. Neuberger's compensation scheme includes a deferred element of up to 25% that, for the Disciplined Large Cap Growth investment team, is invested in either Neuberger shares or this strategy.
Overall Rating (A, B+, B or C) **B+**	The insistence on both free cash flow yield and operating income growth ensure some portfolio emphasis on quality over time, but the strategy is by its nature somewhat chameleonic (i.e., not always defensive) as the team seeks companies with acceleration of a key business metric that can differ from company to company. Growth and seasoning of the team over the years has added depth to Neuberger's research capabilities. Personnel and structural changes have been somewhat disruptive, albeit beneficial. While the team leverages the Neuberger's centralized buy-side analyst team to supplement its research, this group is not utilized for idea generation. The team is knowledgeable and Rosenblatt and Barker provide solid but not necessarily passionate leadership. Moreover, the support provided by the organization allows the team the luxury of singularity of focus and a minimization of distractions within the context of a firm with an expanding product lineup.	
Additional Observations	The strategy is considered to be traditional growth and has the potential to perform well in most market environments. Those favoring lower quality or smaller cap names within the Russell 1000 Growth Index may present performance headwinds for Neuberger.	

Performance Analysis

Return in $US (before fees) over 3 mths, 1 yr, 2 yrs, 3 yrs, 5 yrs ending December-13

Comparison with the US Equity Large Cap Growth (Active) universe (Percentile Ranking)



The market benchmark ranked high in the universe; this was a difficult environment for active managers in this space

	3 mths (%)	1 yr (%)	2 yrs (%pa)	3 yrs (%pa)	5 yrs (%pa)
SANLCG1	10.0 *(72)*	42.9 *(4)*	33.5 *(0)*	22.5 *(0)*	32.1 *(0)*
WECLCG1	9.7 *(79)*	37.4 *(23)*	29.3 *(8)*	15.1 *(58)*	20.4 *(34)*
NBRLCG2	9.4 *(85)*	30.4 *(85)*	21.0 *(92)*	12.1 *(97)*	16.0 *(92)*
RU1000G	10.4 *(62)*	33.5 *(60)*	24.0 *(61)*	16.5 *(39)*	20.4 *(35)*
5th Percentile	13.0	42.0	29.9	19.4	23.9
Upper Quartile	11.8	37.1	27.1	17.5	21.0
Median	10.9	34.6	24.6	15.5	19.7
Lower Quartile	9.9	31.5	22.9	14.2	18.3
95th Percentile	8.4	28.4	20.6	12.5	15.6
Number	260	240	226	205	196

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Performance Analysis

Return in $US (before fees) over 5 annual rolling periods ending December-13

Comparison with the US Equity Large Cap Growth (Active) universe (Percentile Ranking)

The market benchmark ranked high in the universe; this was a difficult environment for active managers in this space

	3 yrs to 12/2009 (%pa)	3 yrs to 12/2010 (%pa)	3 yrs to 12/2011 (%pa)	3 yrs to 12/2012 (%pa)	3 yrs to 12/2013 (%pa)
SANLCG1	2.1 *(6)*	4.2 *(2)*	31.2 *(0)*	17.8 *(0)*	22.5 *(0)*
WECLCG1	-1.2 *(40)*	0.7 *(18)*	14.9 *(68)*	10.6 *(46)*	15.1 *(58)*
NBRLCG2	1.4 *(10)*	-0.4 *(35)*	12.8 *(87)*	7.4 *(94)*	12.1 *(97)*
RU1000G	-1.9 *(52)*	-0.5 *(36)*	18.0 *(23)*	11.4 *(31)*	16.5 *(39)*
5th Percentile	2.3	2.7	20.9	13.8	19.4
Upper Quartile	-0.3	0.3	17.9	11.8	17.5
Median	-1.8	-1.1	16.0	10.4	15.5
Lower Quartile	-3.6	-2.7	14.3	9.0	14.2
95th Percentile	-6.4	-6.9	10.7	7.3	12.5
Number	257	248	237	222	205

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Performance Analysis

Risk-adjusted return as expected. Strategy exhibited lower risk, though with lower return.

Performance characteristics vs. Russell 1000 Growth in $US (before fees) over 5 yrs ending December-13 (quarterly calculations)

Comparison with the US Equity Large Cap Growth (Active) universe (Percentile Ranking)

	Ret/SD	TE (%pa)	IR	Down Cap (%)	Up Cap (%)	Beta
SANLCG1	1.6 *(0)*	8.3 *(3)*	1.4 *(0)*	74.8 *(97)*	159.8 *(0)*	1.1 *(10)*
WECLCG1	1.0 *(79)*	5.9 *(14)*	0.0 *(34)*	123.3 *(6)*	116.0 *(7)*	1.2 *(6)*
NBRLCG2	1.0 *(87)*	3.1 *(79)*	-1.4 *(98)*	109.6 *(36)*	81.7 *(93)*	1.0 *(71)*
5th Percentile	1.4	7.3	0.8	124.3	118.3	1.2
Upper Quartile	1.2	5.1	0.1	114.1	106.8	1.1
Median	1.1	4.0	-0.1	105.0	99.0	1.0
Lower Quartile	1.0	3.2	-0.6	98.5	90.8	1.0
95th Percentile	0.9	2.1	-1.3	81.8	80.8	0.9
Number	196	196	196	196	196	196

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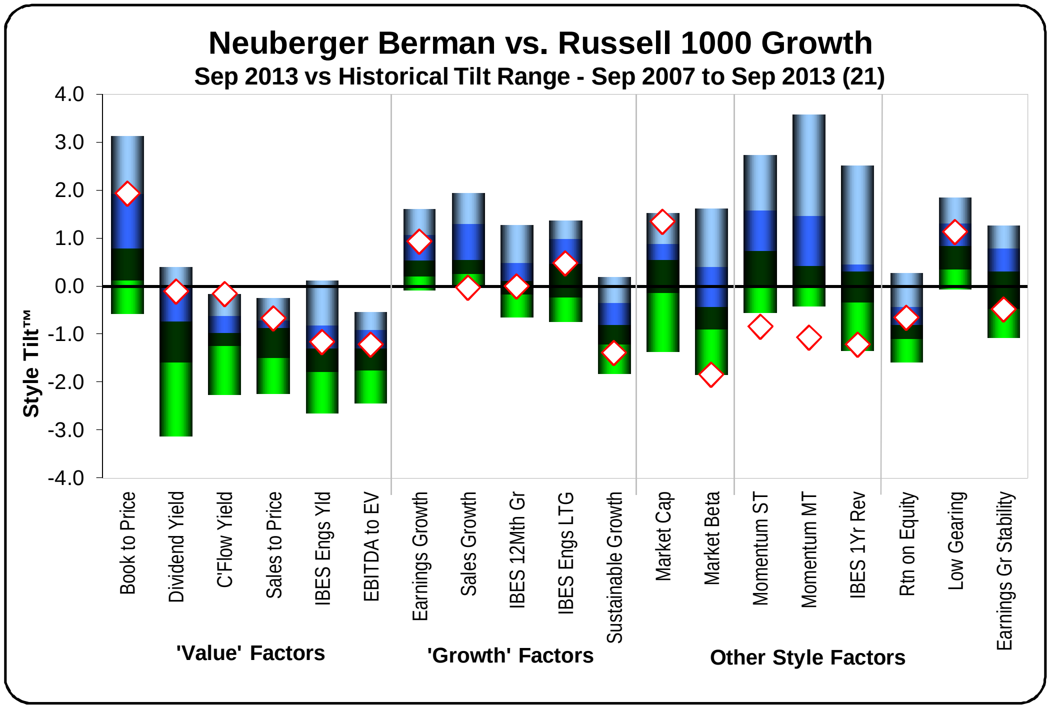
Holdings Based Style Analysis



- Portfolio exposures generally in line with philosophy
- Low Gearing (financial leverage) indicates conservative balance sheet
- Low Sustainable Growth and RoE indicate portfolio holds stocks whose financial results have not been strong (and may be poised for an improvement)
- Moderate exposure to forecast earnings growth consistent with buying stocks where market does not recognize future growth
- Low Cash Flow yield is out of character, but most recent period shows this metric increasing

Transition Costs & Risks

Visible	Explicit Costs **(Fees)**	**Commissions** **Taxes**
Not Visible	Implicit Costs **(Price Movement or Degradation)**	**Bid/Ask Spreads** **Market Impact** **Market Movement** *(a.k.a., Tracking Error or Opportunity Cost)*

(3 ~ 6 bps)

- **Known costs – Negotiable** ***(excluding taxes)***

(4 ~ 12 bps)

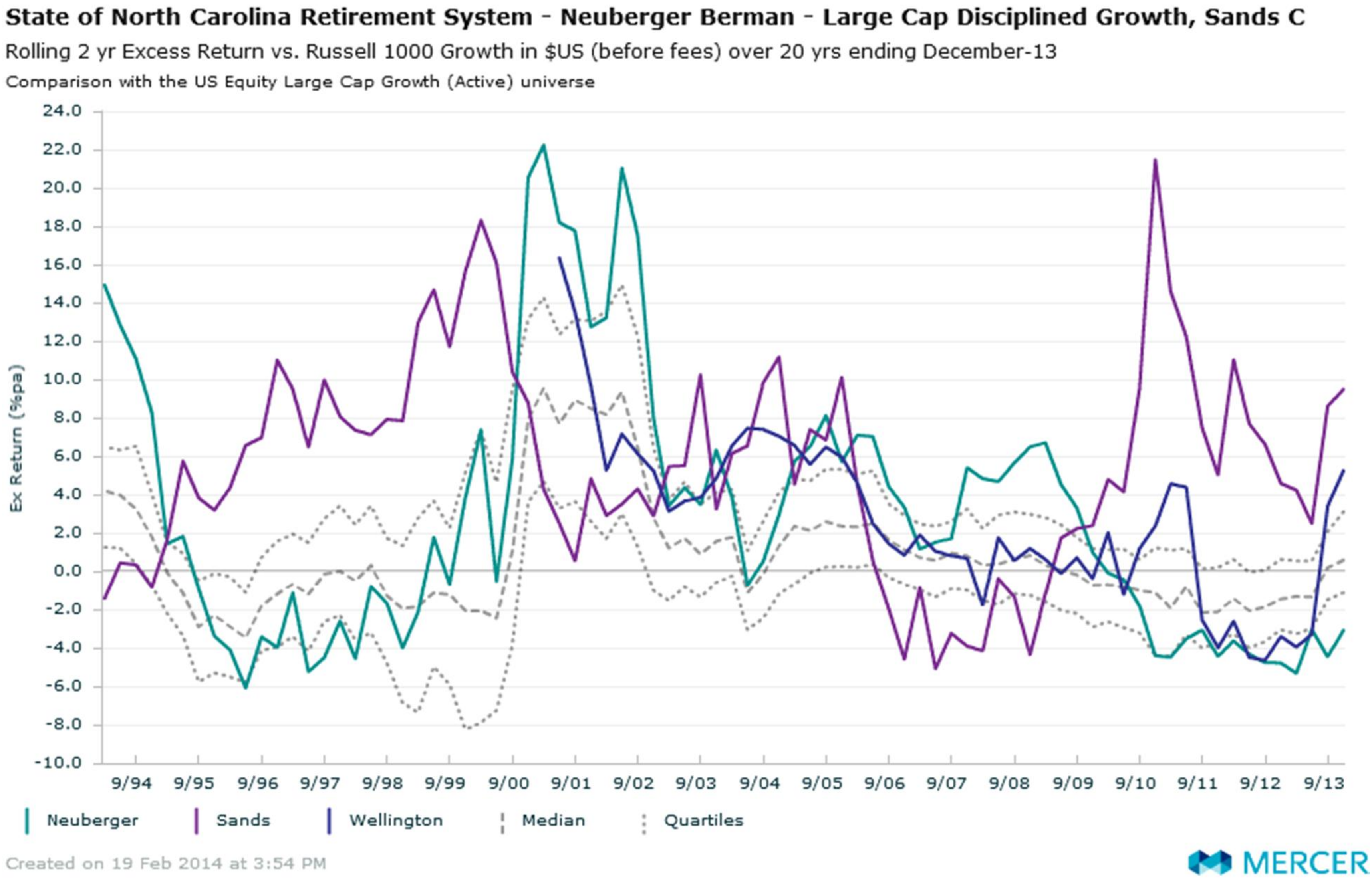
- Uncertain – Can only be managed
- Can be estimated
- Generally *greater* than explicit costs

(***+/-*** *15 ~ 25 bps, @1 std.dev.)*

- Uncertain – **Cannot** be managed ***(potentially largest costs)***

Total Cost for US Large Cap Transition 12bp ($408,000) +/- 20bp

Multi-Manager Diversification



Alternative Manager Comparison

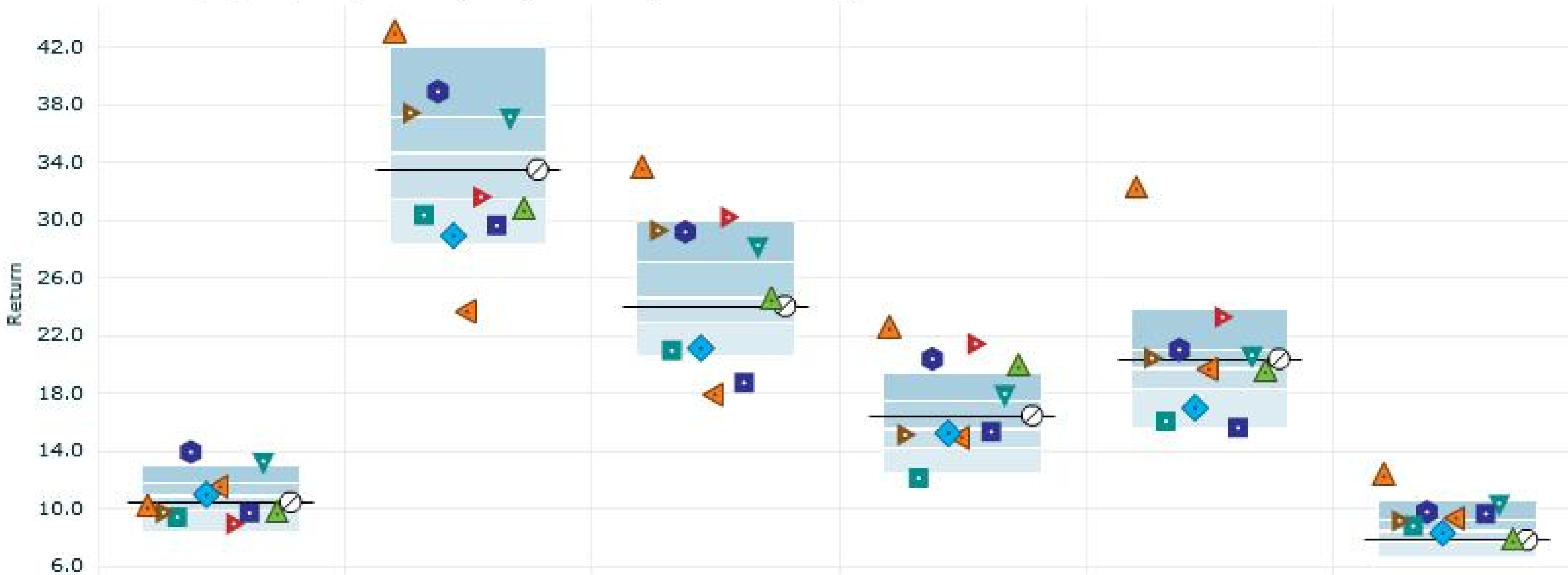
	Rating	Strategy Assets (M)	Inception	Beta (10 Year Hist)
Neuberger Berman	B+	6,812	1987	0.91
Edgewood	A(T)	8,969	1974	1.01
Montag & Caldwell	B+	13,138	1945	0.86
Polen	B+(T)	4,987	1989	0.84
HS	B+(T)	2,392	2007	0.88*
Stralem	B+(T)	3,409	1966	0.76
DSM	A(T)	4,661	2002	1.03
Vontobel	B+(T)	1,687	1990	0.69

*5 year beta

Alternative Manager Comparison

Return in $US (before fees) over 3 mths, 1 yr, 2 yrs, 3 yrs, 5 yrs, 10 yrs ending December-13

Comparison with the US Equity Large Cap Growth (Active) universe (Percentile Ranking)



	3 mths (%)	1 yr (%)	2 yrs (%pa)	3 yrs (%pa)	5 yrs (%pa)	10 yrs (%pa)
Sands	10.03 *(72)*	42.93 *(4)*	33.52 *(0)*	22.46 *(0)*	32.11 *(0)*	12.21 *(1)*
Wellington	9.75 *(79)*	37.43 *(23)*	29.29 *(8)*	15.11 *(58)*	20.45 *(34)*	9.15 *(26)*
Neuberger	9.40 *(85)*	30.36 *(85)*	20.96 *(92)*	12.12 *(97)*	16.02 *(92)*	8.79 *(34)*
Edegewood	13.95 *(1)*	38.91 *(13)*	29.19 *(8)*	20.39 *(1)*	21.01 *(24)*	9.76 *(11)*
Montag	10.99 *(47)*	28.92 *(94)*	21.13 *(91)*	15.22 *(56)*	17.00 *(86)*	8.30 *(57)*
Polen	11.54 *(34)*	23.67 *(99)*	17.89 *(99)*	14.92 *(62)*	19.65 *(54)*	9.33 *(21)*
HS	8.94 *(91)*	31.60 *(73)*	30.23 *(4)*	21.42 *(0)*	23.30 *(8)*	-
Stralem	9.70 *(80)*	29.65 *(88)*	18.72 *(98)*	15.32 *(53)*	15.61 *(94)*	9.64 *(13)*
DSM	13.31 *(3)*	37.16 *(24)*	28.26 *(12)*	17.97 *(21)*	20.64 *(32)*	10.38 *(7)*
Vontobel	9.59 *(83)*	30.60 *(83)*	24.40 *(55)*	19.78 *(3)*	19.43 *(59)*	7.69 *(77)*
RU1000G	10.44 *(62)*	33.49 *(60)*	24.04 *(61)*	16.45 *(39)*	20.39 *(35)*	7.83 *(72)*

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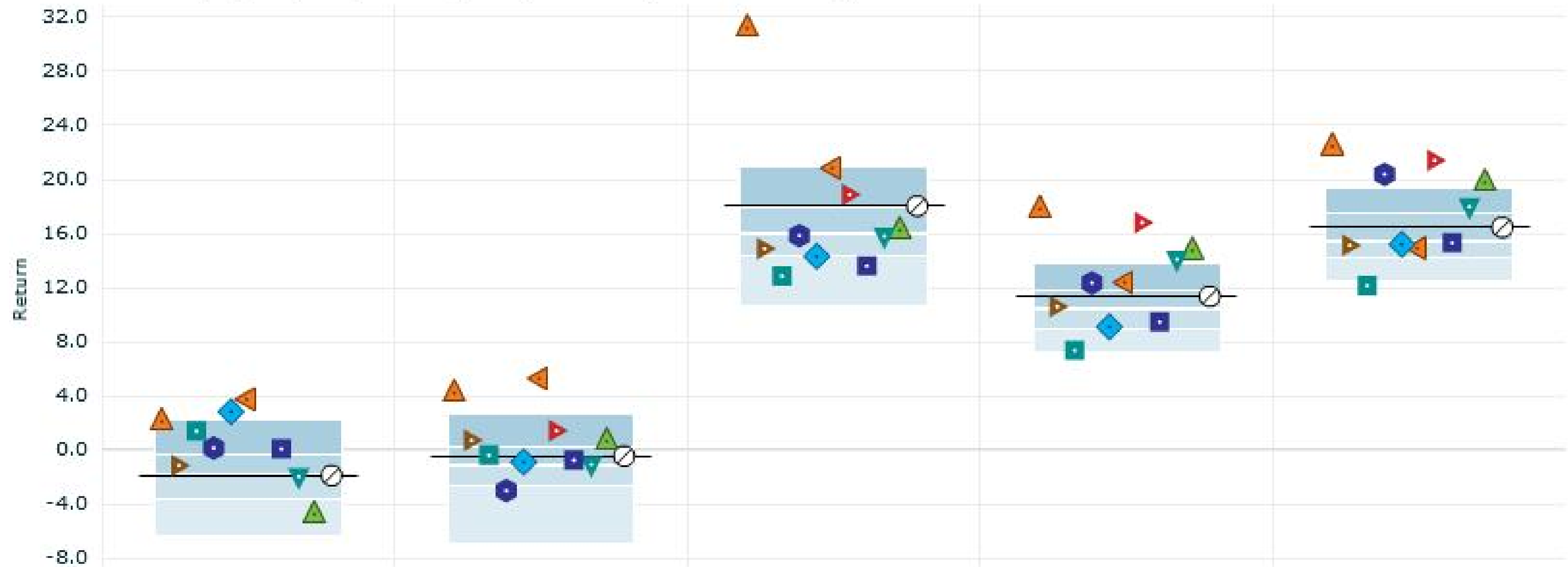
Alternative Manager Comparison

Return in $US (before fees) over 5 annual rolling periods ending December-13

Comparison with the US Equity Large Cap Growth (Active) universe (Percentile Ranking)



	3 yrs to 12/2009 (%pa)	3 yrs to 12/2010 (%pa)	3 yrs to 12/2011 (%pa)	3 yrs to 12/2012 (%pa)	3 yrs to 12/2013 (%pa)
Sands	2.11 *(6)*	4.19 *(2)*	31.18 *(0)*	17.80 *(0)*	22.46 *(0)*
Wellington	-1.15 *(40)*	0.70 *(18)*	14.89 *(68)*	10.60 *(46)*	15.11 *(58)*
Neuberger	1.40 *(10)*	-0.41 *(35)*	12.84 *(87)*	7.36 *(94)*	12.12 *(97)*
Edegewood	0.15 *(21)*	-3.00 *(79)*	15.85 *(52)*	12.34 *(18)*	20.39 *(1)*
Montag	2.82 *(4)*	-0.89 *(43)*	14.32 *(74)*	9.10 *(72)*	15.22 *(56)*
Polen	3.75 *(1)*	5.26 *(0)*	20.84 *(5)*	12.38 *(17)*	14.92 *(62)*
HS	-	1.41 *(13)*	18.89 *(16)*	16.80 *(0)*	21.42 *(0)*
Stralem	0.05 *(22)*	-0.76 *(41)*	13.58 *(81)*	9.45 *(67)*	15.32 *(53)*
DSM	-1.97 *(53)*	-1.09 *(48)*	15.81 *(53)*	14.10 *(5)*	17.97 *(21)*
Vontobel	-4.74 *(88)*	0.66 *(19)*	16.22 *(48)*	14.75 *(3)*	19.78 *(3)*
RU1000G	-1.89 *(52)*	-0.47 *(36)*	18.02 *(23)*	11.35 *(31)*	16.45 *(39)*

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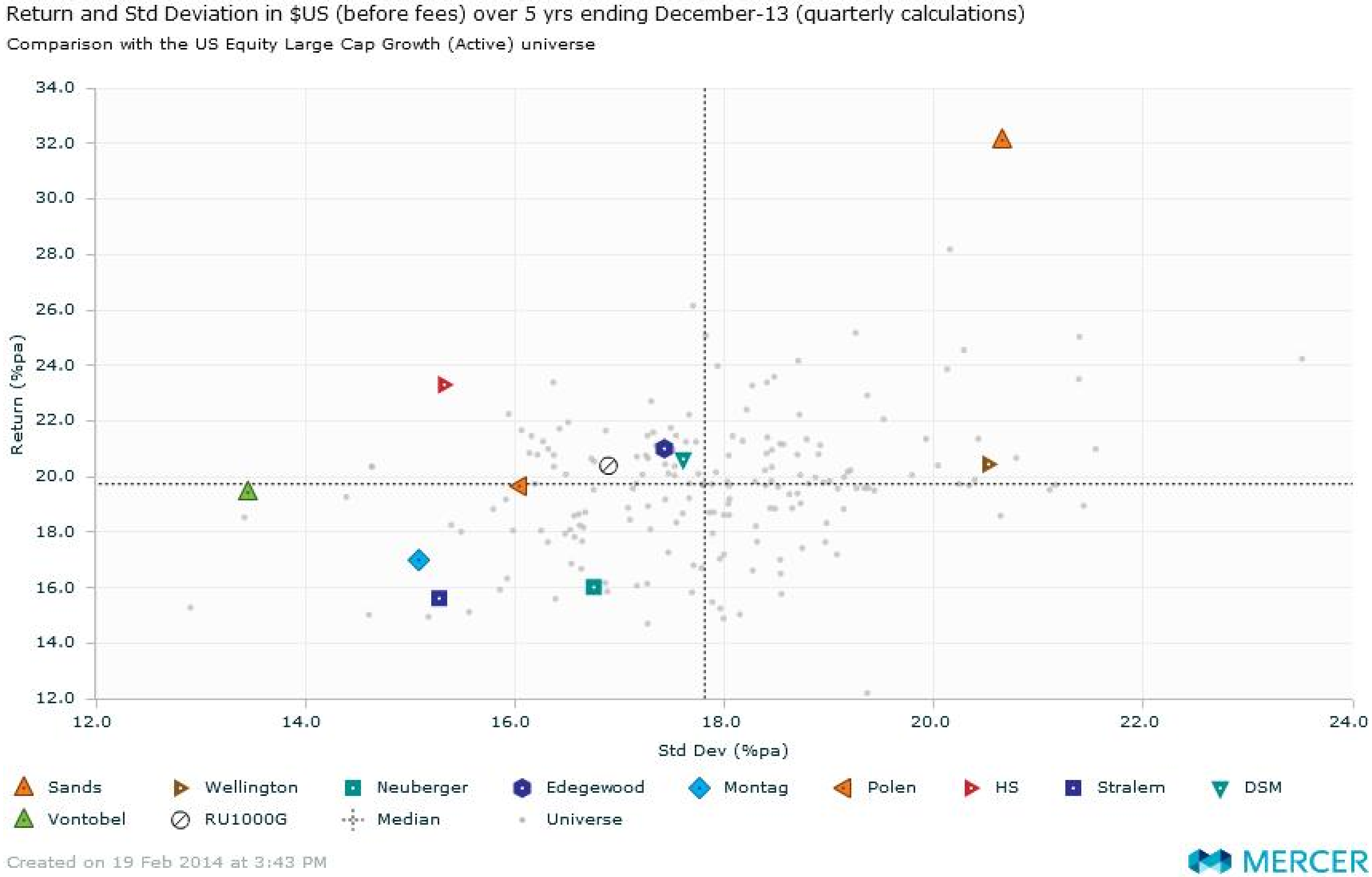
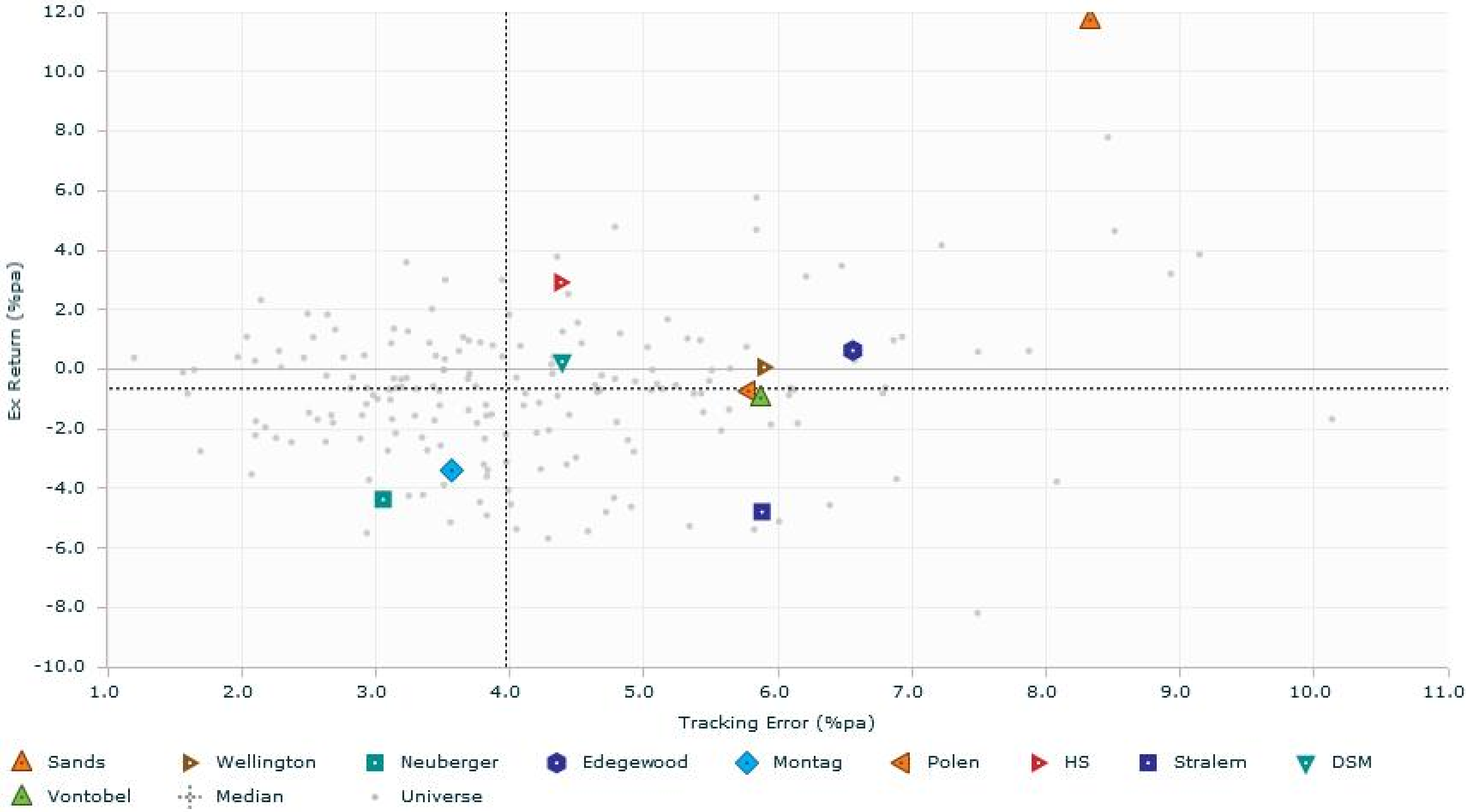
Alternative Manager Comparison



Alternative Manager Comparison

Excess Return and Tracking Error vs. Russell 1000 Growth in $US (before fees) over 5 yrs ending December-13 (quarterly calculations)

Comparison with the US Equity Large Cap Growth (Active) universe



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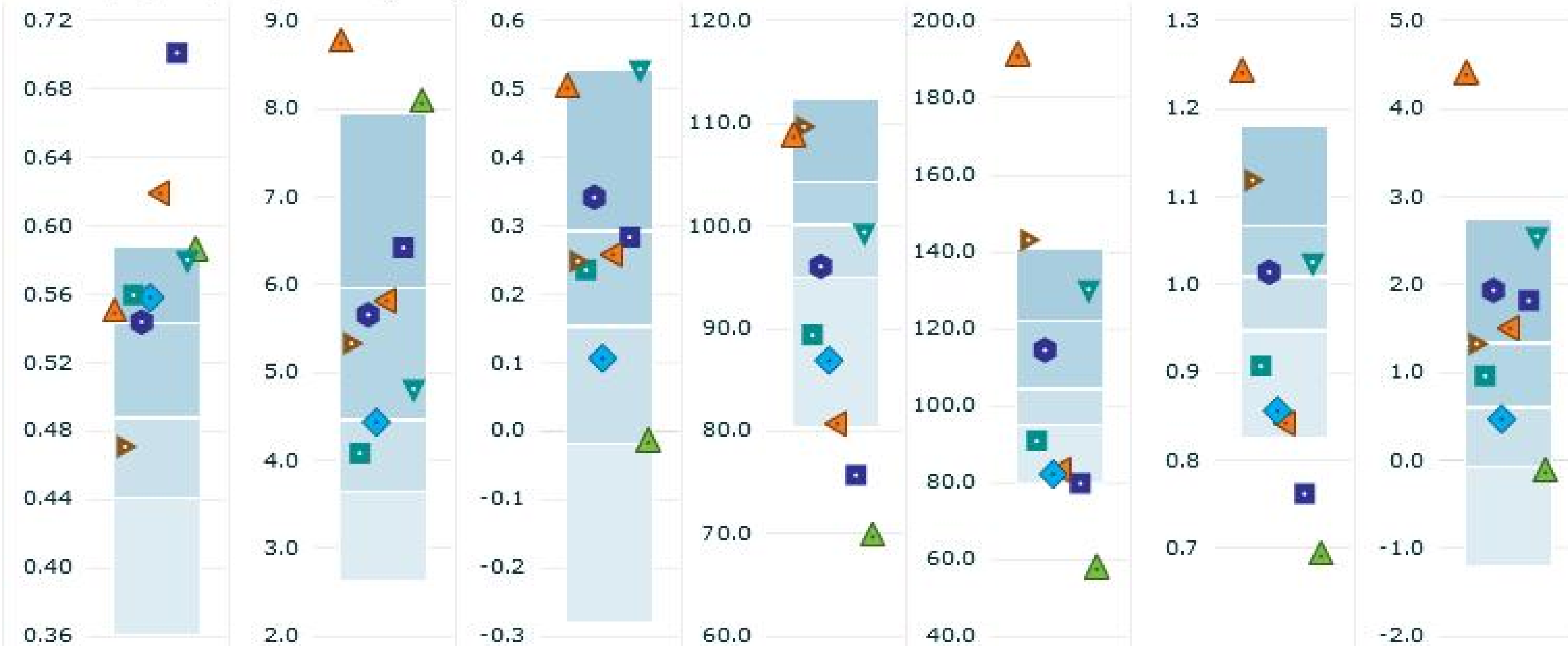
Alternative Manager Comparison

Performance characteristics vs. Russell 1000 Growth in $US (before fees) over 10 yrs ending December-13 (quarterly calculations)

Comparison with the US Equity Large Cap Growth (Active) universe



	Ret/SD	TE (%pa)	IR	Down Cap (%)	Up Cap (%)	Beta	Ex Ret (%pa)
Sands	0.55	8.75	0.50	108.67	190.90	1.24	4.39
Wellington	0.47	5.33	0.25	109.68	143.07	1.12	1.32
Neuberger	0.56	4.08	0.24	89.35	90.73	0.91	0.96
Edegewood	0.54	5.66	0.34	96.07	114.38	1.01	1.94
Montag	0.56	4.44	0.11	86.90	82.11	0.86	0.47
Polen	0.62	5.82	0.26	80.70	83.28	0.84	1.50
HS	-	-	-	-	-	-	-
Stralem	0.70	6.42	0.28	75.68	79.77	0.76	1.82
DSM	0.58	4.82	0.53	99.39	130.25	1.03	2.55
Vontobel	0.59	8.06	-0.02	69.67	57.48	0.69	-0.14

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Alternative Manager Comparison
Fit with Existing Managers

Correlation of Excess Returns vs. Russell 1000 Growth in $US (before fees) over 10 yrs ending December-13 (quarterly calculations)

		SANLCG1	WECLCG1	NBRLCG2	EMCLCG	MONLCG	PLNLCG	SRLLCG	DSMLCG	VONLCV1
Sands Capital Large Cap Growth	SANLCG1		0.43	**-0.25**	**0.15**	**-0.40**	**-0.13**	**-0.57**	**0.17**	**-0.49**
Wellington Opportunistic Growth	WECLCG1	-1.02		**0.04**	**-0.01**	**-0.29**	**-0.36**	**-0.35**	**0.26**	**-0.56**
Neuberger Berman - Large Cap Disciplined Growth	NBRLCG2	-2.08	-1.29		0.19	0.42	0.29	0.47	0.30	0.04
Edgewood - Institutional Large Cap Growth	EMCLCG	-1.64	-1.62	-1.08		0.06	0.12	-0.21	0.39	-0.25
Montag - Large Cap Growth	MONLCG	-2.55	-1.95	-0.67	-1.34		0.34	0.54	0.19	0.20
Polen - Large Cap Growth Equity	PLNLCG	-2.35	-2.41	-0.94	-1.45	-0.91		0.27	0.00	0.44
Stralem - US Large Cap Equity Strategy	SRLLCG	-3.91	-2.50	-0.71	-2.23	-0.64	-1.23		0.04	0.60
DSM - Large Cap Growth Equity	DSMLCG	-1.45	-1.04	-0.86	-0.86	-1.05	-1.54	-1.53		-0.27
Vontobel (US) - US Equity	VONLCV1	-4.17	-3.32	-1.48	-2.54	-1.27	-1.03	-0.76	-2.35	

Notes:
Correlation is shown in the right hand side of the table.
Risk Reduction is shown in the left hand side of the table.
Risk Reduction is defined as the reduction in tracking error from diversification when using a 50:50 mix of the two managers.

Appendix

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Important Notices

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