

MINUTES  
INVESTMENT SUBCOMMITTEE OF THE BOARD OF TRUSTEES  
OF THE NORTH CAROLINA SUPPLEMENTAL RETIREMENT PLANS

February 15, 2012, 9:00 a.m.

Dawson Conference Room  
Albemarle Building, 325 N. Salisbury Street  
Raleigh, NC

The meeting of the Investment Subcommittee of the Board of Trustees for the Supplemental Retirement Plans was called to order at 9:00 a.m. by the Chair, Dexter Perry.

Members Present

Members present were: Dexter Perry and Libby George. Kel Landis and Chuck Leedy joined by phone.

Members Absent

No members were absent.

DST Staff Present

Staff members present were: Steve Toole, Timothy Dale, Greg Beuris, Angela Bondar, Joan Fontes, Blake Thomas, Jay Chaudhuri, and Jaclyn Goldsmith.

Guests Present

Prudential representatives attending were Travis Swartwood, Tim Bryan, and Bill Walsh. Jay Love and Kelly Henson from Mercer Investment Consulting were in attendance. Also in attendance were Andy Apostol from Galliard Capital Management and Plan member Robert Slade.

Conflicts

The Chair asked the Subcommittee if there were any actual conflicts, potential conflicts, or appearances of a conflict concerning any item on the meeting agenda. No conflicts were reported.

Approval of Minutes

The Chair identified a sentence in the Economic Overview of the proposed minutes that read "Mr. Perry asked if the Plans' holdings of a particular company could represent 2-3 percent of a company's stock." The Chair asked that the sentence be modified to: "Mr. Perry asked if the Plans' holdings of a particular company could represent 2-3 percent of the Plans' overall assets."

It was moved by Libby George and seconded by Chuck Leedy to approve the meeting minutes, pending the modification to the aforementioned section, of the Investment Subcommittee of the NC Supplemental Retirement Board of Trustees held on November 17, 2011. The motion passed unanimously.

### Stable Value Fund Performance Report

The Chair noted that the remaining agenda would proceed in reverse order and recognized Andy Apostol with Galliard to report on the performance of the Stable Value Fund.

Mr. Apostol began by presenting Galliard's recommended portfolio adjustments to be made in 2012. The adjustments were recommended to further diversify the Plans' assets between multiple wrap providers and investment managers. Galliard proposed the following:

- Eliminate PIMCO as an investment manager;
- Replace the Prudential wrap coverage of the Payden and Rygel portfolio with Metlife wrap coverage;
- Reduce the Great West portfolio allocation by approximately \$185 million;
- Reduce the Prudential portfolio allocation by approximately \$100 million;
- Fund a new Jennison managed portfolio;
- Add Prudential wrap coverage on the Jennison portfolio;
- Fund a new Babson managed portfolio; and
- Wrap the new Babson portfolio with Mass Mutual wrap coverage.

Mr. Apostol stated that these objectives would take time to execute once approved, as wrap providers often require significant amounts of time to review investment managers prior to providing coverage. The Subcommittee expressed concern about moving to add or eliminate investment managers without first reviewing a more detailed analysis of the managers. The Subcommittee asked Galliard to perform additional analyses on the recommended manager modifications prior to taking action. Mr. Apostol agreed to provide additional information at a future meeting.

Based on the information presented, the Subcommittee moved to recommend proceeding with Galliard's recommendations with the exception of the manager additions and PIMCO termination detailed above. It was moved by Libby George and seconded by Chuck Leedy to recommend the adjustments. The motion passed unanimously.

Mr. Apostol noted the following regarding the Stable Value Fund in the 4<sup>th</sup> Quarter of 2011:

- Market-to-Book Value was at 104.36 percent;
- Cash flow was positive into the fund, but not by a significant margin;
- Approximately 77 percent of the holdings were AAA-rated bonds;
- New wrap providers were entering the market and fees for the coverage remained in the 20-25 basis points range; and
- The Fund's crediting rate continued to rank in the top quartile when compared to the Stable Value universe.

Mr. Leedy asked about the length of the amortization period used to spread gains or losses attributable to the Fund. Mr. Apostol stated that gains and losses are spread over the average duration of the Fund, which was approximately 2.5 years.

There being no further questions, it was moved by Libby George and seconded by Chuck Leedy to accept the report from Galliard. The motion passed unanimously.

### 2012 Annual Plan Review

The Chair recognized Jay Love and Kelly Henson from Mercer to present the annual Plan Review.

Mr. Love identified three areas Mercer would like to address in 2012 as a result of its annual Plan Review:

- New inflation-sensitive investment option;
- Fund structure review; and
- A review of investment operations.

Ms. Henson noted that many defined contribution retirement plans were adding an inflation-sensitive option to their investment lineup. She stated that as the economy continues to rebound, most economists are projecting inflation to rise. She also stated that most target-date fund managers include an allocation to some type of inflation protection portfolio. While some investment portfolios use Treasury Inflation Protected Securities (“TIPS”) to hedge against inflation, many other inflation hedges exist in the marketplace. A few examples include real estate, commodities, and precious metals. Mr. Love stated that a best-in-class inflation-sensitive option would be a portfolio that integrates multiple inflation hedged asset classes. He also stated that the new option would be added to the GoalMaker allocations to receive initial funding.

Mr. Dale stated that wrap providers often put restrictions on the Plan sponsor’s ability to offer competing investment options to the Stable Value Fund. He asked whether the new inflation-sensitive option would be classified as a competing investment option for the purposes of those restrictions. Mr. Apostol from Galliard responded that Galliard has not yet seen a wrap provider restrict inflation-sensitive investment options.

It was moved by Libby George and seconded by Kel Landis to instruct Mercer to begin work on a new inflation-sensitive investment option. The motion passed unanimously.

Mr. Love continued by noting that each of the GoalMaker portfolios uses a combination of active and passive management for each asset class. He stated that GoalMaker is used as the Qualified Default Investment Alternative and utilized by participants who are less active investors. As a result, Mr. Love stated that Mercer would do a deeper analysis of different investment allocations in each asset class to determine the best allocation to active and passive management for each asset class.

Mr. Love also stated that Mercer performed a glidepath analysis that compares the GoalMaker glidepaths to the target-date fund universe. Mercer may recommend changes to smooth the glidepath if appropriate. The Subcommittee discussed Mercer’s glidepath analysis. After the discussion, the Subcommittee agreed to have Mr. Love present findings regarding the GoalMaker portfolios at a later meeting.

Mr. Love then discussed the SMid Cap Growth Fund. He noted that in 2011, Mercer had recommended adding a third investment manager to all actively managed domestic equity investment options except the SMid Cap Growth Fund. Mr. Love provided additional analysis of the two existing managers in the SMid Cap Growth Fund and concluded that the two managers complemented each other in terms of investment philosophy and performance. Therefore, Mercer did not recommend any immediate action on the Fund.

Finally, Mr. Love noted that from time to time Plan sponsors need to review and analyze the investment operations occurring at the investment transaction level. He noted that this review should include a benchmarking analysis of bid/ask spreads, market impact, opportunity costs, trade errors, fees, etc. Mr. Love recognized the fact that many Plan sponsors were beginning to review the foreign exchange trades executed by their custodian on behalf of their international investment managers.

Mr. Dale brought to the Subcommittee's attention that the Department was beginning to examine foreign exchange trades executed on behalf of the Supplemental Plans and the defined benefit pension plans. Mr. Thomas noted that the Plans were investigating the strength of any legal claims they may have concerning foreign exchange trading.

Mr. Toole informed the Subcommittee that delaying the review of investment operations may be prudent since the contract for the third party administrator for the Plans will expire at the end of 2013. If Prudential did not win the contract in 2013, or if current service levels were modified, any possible changes stemming from the investment operation review could vanish after 2013.

Based on these factors and the ongoing efforts of Department staff, the Subcommittee decided to delay recommended action on the investment operation review.

#### Economic Overview & Quarterly Investment Performance Report

The Chair again recognized Jay Love and Kelly Henson from Mercer to give an economic overview and a quarterly performance report of the Plans' investment options.

Mr. Love stated that the 4<sup>th</sup> Quarter of 2011 was a more positive quarter when compared to the market environment in the 3<sup>rd</sup> Quarter of 2011. He noted the following during the economic overview:

- Domestic equities posted strong gains;
- International equities rebounded, but not as strongly as domestic stocks;
- GDP growth was estimated at an annualized rate of 2.8 percent during the quarter;
- The dollar appreciated relative to other currencies; and
- Fixed income interest rates from all sectors remained stagnant from the 3<sup>rd</sup> Quarter.

Mercer then reported on the performance of the investment options sponsored by the Plans. Mr. Love stated that Mercer did not have any major concerns with any of the funds or the underlying managers.

The Chair thanked Mr. Love and Ms. Henson for their report.

Adjournment

There being no further business, the meeting was adjourned at 11:33 a.m.

---

CHAIR