

DRAFT

**INVESTMENT SUBCOMMITTEE OF THE NORTH CAROLINA SUPPLEMENTAL
RETIREMENT BOARD OF TRUSTEES**

MINUTES OF MEETING

AUGUST 18, 2016

Time and Location: Investment Subcommittee (the “Subcommittee”) of the North Carolina Supplemental Retirement Board of Trustees (the “Board”) met at 8:30 a.m. on Thursday, August 18, 2016, in the Dogwood Conference Room of Longleaf Building, 3200 Atlantic Avenue, Raleigh, North Carolina.

Members Present: The following members were present: Melinda Baran. Karin Cochran attended via phone.

Staff and Guests present: The following staff and guests attended the meeting. From the Department of State Treasurer: Steve Toole, Reid Chisholm, Blake Thomas, Mary Buonfiglio, Lisa Page, Kevin SigRist, Rhonda Smith, Casey High, Loren de Mey, Rekha Krishnan, Catherine Jarboe, Maja Moseley. From Mercer: Kelly Henson, Liana Magner, and William Dillard. From Prudential: Michael McCann, Ann Cashman, Kathleen Neville; Jessica Quimby attended via phone. From Galliard: William Weber. From SEANC: David Collins.

AGENDA ITEM – WELCOME AND INTRODUCTIONS

Meeting convened at 8:32 a.m.

Ms. Baran, the Chair, welcomed the staff and guests. Ms. Buonfiglio welcomed the new SRP Assistant Director of Investments, Loren de Mey. Mr. Toole recognized Mr. SigRist, Ms. Smith, and the IMD team for their efforts related to the plans.

**AGENDA ITEM – ETHICS AWARENESS AND IDENTIFICATION OF CONFLICTS
OR POTENTIAL CONFLICTS OF INTEREST**

The Chair asked Subcommittee members to review the agenda for the meeting and identify any actual, implied or potential conflicts of interest. There were no conflicts identified.

**AGENDA ITEM – MINUTES FROM MAY19, 2016 INVESTMENT SUBCOMMITTEE
MEETING**

The Chair stated that the minutes have already been approved and are included for reference only; no action is needed.

AGENDA ITEM - GLIDEPATH PROJECT UPDATE

The Chair recognized Mr. SigRist. Mr. SigRist stated that in July, a Request for Proposal was initiated and sent to six firms. Responses have been received from four firms, which constitutes a good mix of investment managers and consultants. Phone interviews will be conducted the week of August 22. The team is looking at practical aspects of what can be done in the GoalMaker system and helping the Board determine where the glidepath design might go in the future. Each of the responding firms is aware of the concept of the desired solution. Finalists will be selected late September or early October, and a recommendation will be presented during the Investment Subcommittee meeting in November and can be presented to the full Supplemental Retirement Board. .

In response to Ms. Baran's question, Ms. Buonfiglio confirmed that a special Board meeting will be called prior to the December meeting to discuss this matter, as well as the search for an alternative manager for the core bond strategy. A special meeting regarding the core bond strategy manager will allow the bond fund to be transitioned prior to late December.

AGENDA ITEM – STABLE VALUE PORTFOLIO REVIEW

The Chair recognized Mr. Weber. Mr. Weber noted that the quarter was rather uneventful and the overall portfolio performance was strong, consistent, and competitive. Three to four percent cash inflows from existing participants were recorded due to a reallocation to safety and a need for more conservative assets, probably related to the "Brexit" vote and other global events. There were no changes to portfolio rating or duration or manager distribution. A slight uptick in corporate bonds was observed, but Mr. Weber noted that there will not be much material change as the underlying investment philosophy remains focused on high quality credit. Mr. Weber provided a summary of the short and intermediate duration managers and noted that yields were falling across the curve; however the overall impact to the portfolio was a one basis point increase.

Mr. Weber highlighted the next steps for the portfolio, now that it is fully invested and diversified. Galliard will focus on managing liquidity and minimizing the yield drag of cash. In addition, good progress has been made with regards to Great West, and Galliard will provide the staff with an updated contract to review. A due diligence in-person visit has been conducted with Great West, as well as a follow-up teleconference in July. Another visit is planned within the next two months to address remaining open items. A summary of the due diligence process will be shared by Galliard later this year.

Ms. Buonfiglio noted that the September National Association of Government Defined Contribution Administrators conference in Denver presents a good opportunity for the Board

members and staff in attendance to meet with Great West as they are headquartered there. A meeting is planned with the portfolio management team.

Ms. Baran asked what market changes might Galliard anticipate through the end of the year, and Mr. Weber replied that at least one rate hike is expected. Mr. Weber also noted the ongoing market reaction to “Brexit” remains to be seen.

AGENDA ITEM – ECONOMIC OVERVIEW AND 2nd QUARTER INVESTMENT PERFORMANCE REPORT

The Chair recognized Ms. Magner, Ms. Henson, and Mr. Dillard. Ms. Magner began by describing the economic overview of the quarter, noting that the U.S. economy has been rebounding but that the “Brexit” decision increased volatility: With the vote, equities fell and subsequently rebounded in several weeks. This created yield decreases and caused the investors to flee to safety. High dividend yield managers, such as Mondrian, performed well in these conditions; high-beta managers, such as Sands, did not do as well. Most sectors were positive during the quarter: Energy, telecom and utilities were the best performers, while technology, consumer discretionary and materials did not do as well. Small cap stock performed better than large cap, and value outperformed growth, although the portfolio’s value funds struggled. U.S. equities fared better than non-U.S. and the dollar strengthened. Developed markets declined modestly while emerging markets grew. Long duration bonds performed better than short duration, and corporate bonds fared better than Treasuries, which still did better than TIPS. REITS and commodities did well, as did Prudential’s core bond plus strategy and PIMCO Inflation Responsive Multi-Asset fund.

Mr. Dillard presented the total plan performance overview, noting an overall strong performance for the quarter, which outpaced the benchmark. Value-oriented managers struggled a bit, as a majority of them were overweight to REITs and high-yields, which created headwinds for them. Underperformance was also observed in small and mid-cap value strategy, driven by Hotchkis & Wiley, who was underweight to REITs and overweight to retailers and banks. The consumer discretionary sector was a detractor during the course of the quarter. Mr. Dillard noted that while Hotchkis & Wiley’s investment style has been out of favor, Mercer’s team has confidence in their team and ability.

The NC SMID Cap Growth Fund was the best performer overall. Brown has been the top performer in the small and mid-cap growth market, and they tend to be a more concentrated manager. Mr. Dillard noted that Brown has been on the watch list since 2015 due to their healthcare position but has done extremely well over the trailing 18 months. Mercer updated Brown’s strategy to “B+” this year, and the only thing preventing the “A” rating is a new relationship: George Sakellaris, Equity Research Analyst, is a recent addition to the team, and Mercer needs to establish a better understanding of this change. Ms. Henson added that Brown’s Portfolio Manager, Christopher Berrier, presented the strategy to the Board previously and it has

been implemented as planned. Ms. Smith agreed with Mercer's team, noting that the NC Pension plan also uses this manager and they were monitored due to rapid organizational growth and expanded global outlook. She questioned whether assets under management will grow too fast but noted that it is levelling off.

Mercer's team recommended that Brown Advisory be removed from the watch list and Ms. Cochran so moved and stated that she was encouraged by Brown's improvement; Ms. Baran seconded, and the motion passed unanimously.

Mr. Dillard continued on to the NC International Equity Fund, highlighting Mondrian's performance.

Mr. Dillard also noted that the NC Fixed Income Fund outperformed its benchmark, driven by Prudential, whose core plus strategy was aided by being overweight to investment grade, longer duration bonds.

Ms. Henson provided a brief update on the search for an alternative manager to J.P. Morgan's core bond strategy in the NC Fixed Income Fund. Mercer collaborated with the department's Investment Management Division to develop search criteria. Out of a pool of 120 potential candidates, seven semi-finalists were identified. In-person meetings will be conducted in September, and the teams and staff will reconvene again to discuss the best fit with Prudential's strategy and fund objective. Three finalists will be invited to Raleigh: DoubleLine, TCW and Baird Advisors. Mercer will provide final recommendation once the in-person interviews have been concluded. The intent is to present the recommendation at the November Investment Subcommittee meeting, have the Board of Trustees vote during a special meeting, and then implement the transition in early December.

AGENDA ITEM – INVESTMENT COMPLIANCE REPORT REVIEW

The Chair recognized Ms. Buonfiglio. Ms. Buonfiglio directed the Subcommittee members' attention to the compliance memorandum, included in the Board materials. She commented that the focus in the 2nd Quarter was on obtaining accurate exceptions. She noted the Plans' compliance with the Iran Divestment Act and continuous work on keeping the prohibited holdings list up-to-date. One security was divested in the 2nd Quarter, ahead of schedule for the October deadline. She stated that there were no concerns or egregious breaches during the quarter. Ms. Baran asked about the system used to monitor the guidelines and whether bugs had been identified within the system or process; and Ms. Buonfiglio replied that the Plans use BNYM's system and that the system and process is working smoothly.

AGENDA ITEM– NC 403(b) PROGRAM 2nd QUARTER INVESTMENT PERFORMANCE REVIEW

The Chair recognized Ms. Smith, who noted that there were no material asset allocation changes during the quarter. Modest asset increases were observed across all tiered investment options. The Wells Fargo target-date funds are trailing their benchmarks. There were no real concerns with passive core, only modest underperformance. In the active core, Ms. Smith noted that the performance of the PIMCO Inflation Responsive Multi-Asset Fund should be monitored. In the specialty options, the PIMCO All Asset Fund underperformed; and will be removed from the portfolio as part of the mapping on October 4. Vanguard Windsor II Admiral Fund continues to underperform and remains on watch. Per the Investment Policy Statement, the Board has the discretion to extend the fund on the watch list. Ms. Smith added that Vanguard's strategy still has an adequate rating among its peer group. Allianz will remain on the watch list but will be removed from the portfolio during the upcoming mapping. J.P. Morgan Core Bond Fund will remain on watch as well as in the portfolio following mapping. T. Rowe Price Growth and Income Fund was the best performer and a strong stand-out in its peer universe. With respect to investment expenses, Ms. Smith noted a slight increase from the last quarter; however, the net expense ratio remains the same.

Mr. SigRist briefly discussed the TIAA Real Estate Fund and additional research performed by the IMD team. He noted the 15 percent cash allocation due to being in a participant-directed plan and dealing with significant withdrawal requests. This fund has a low loan-to-value ratio (14-15 percent), while the index's ratio is 30-35 percent. In addition, the fund invests in wholly-owned real estate and joint ventures. In a rising real estate market, these two factors cause performance to lag. The fund's low income yields also contribute to the benchmark lag. Mr. SigRist noted that this fund will be removed from the portfolio with the mapping on October 4th.

AGENDA ITEM – INVESTMENT MAPPING UPDATE

Ms. Buonfiglio noted that the investment mapping of the NC 403(b) Program is now targeted for October 4, 2016. Members will be able to see the new funds on October 5th. Ms. Jarboe and the TIAA team are working on a communication plan to members, school districts and Registered Investment Advisors. Members are also able to contact the TIAA service centers with questions prior to the mapping date. Ms. Buonfiglio noted that the J.P. Morgan Core Bond Fund will be replaced at a later date as currently a search for an alternative manager is underway. Once as replacement is selected, the fund will be mapped. Ms. Baran asked if the mapping of the TIAA Real Estate Account will be postponed. Ms. Buonfiglio responded that the TIAA Real Estate Fund will map as scheduled to the J.P. Morgan Core Bond Fund on October 4th.

AGENDA ITEM - SUBCOMMITTEE MEMBERS QUESTIONS/COMMENTS

No further comments were offered.

AGENDA ITEM – PUBLIC COMMENT

No public comments were offered.

Ms. Baran moved to adjourn the meeting and Ms. Cochran seconded. The meeting adjourned at 9:27 a.m.

Secretary