



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

**MINUTES OF MEETING**

**February 21, 2018**

**Time and Location:** Investment Subcommittee (the “Subcommittee”) of the North Carolina Supplemental Retirement Board of Trustees (the “Board”) met at 9:00 a.m. on Wednesday, February 21, 2018, in the Dogwood Conference Room of Longleaf Building, 3200 Atlantic Avenue, Raleigh, North Carolina.

**Members Present:** The following members were present: Dale R. Folwell, CPA (Chair), Melinda Baran, Karin Cochran. Hal McKinney attended via phone. Ron Copley, Supplemental Retirement Plans Board member, attended via phone.

**Staff and Guests present:** The following staff and guests attended the meeting. From the Department of State Treasurer: Steve Toole, Mary Buonfiglio, Loren de Mey, Reid Chisholm, Maj a Moseley, Rekha Krishnan, Catherine Jarboe, Patti Hall, Fran Lawrence, Frank Lester. From Mercer: Kelly Henson and William Dillard. From Prudential: Michael McCann, Ann Cashman and Aaron Koval. Jessica Quimby attended via phone. From Galliard: William Weber.

**AGENDA ITEM WELCOME AND INTRODUCTIONS**

Meeting convened at 9:00 a.m.

The Chair welcomed staff and guests.

**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 NOVEMBER 15, 2017, 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 AMENDMENT OF INVESTMENT POLICY STATEMENTS**

The Chair recognized Mr. Chisholm, who presented a summary of a Board resolution that confirmed GoalMaker's default retirement age of 65 and revised the investment policy statements for the NC 401(k)/457(b) and the NC 403(b) to incorporate amended glidepath and model allocations in both Plans and the Program, the addition of the NC TIPS Fund and the removal of the NC Global Equity Fund from the NC 401(k) and NC 457 Plans, and the replacement of the international equity fund and the addition of a TIPS fund in the NC 403(b) Program. The resolution was included in the Subcommittee's materials and was before the Subcommittee for recommendation to the Board for adoption.

Ms. Baran made a motion to approve the resolution as presented, and Ms. Cochran seconded. The motion passed unanimously.

#### **AGENDA ITEM –INVESTMENT UPDATE**

The Chair recognized Ms. de Mey, who provided an update regarding a newly selected vendor, Institutional Shareholder Services (ISS). ISS will administer the requirements of House Bill 161, which requires state divestment from, and prohibits the state from contracting with, companies that boycott Israel. The vendor compiled an initial divestment list of 17 companies, and the final list will be published on February 28.

Ms. de Mey also noted that all investment managers are compliant with their respective

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#### **AGENDA STABLE VALUE PORTFOLIO REVIEW**

The Chair recognized Mr. Weber, who noted that there were no meaningful changes within the firm or the stable value product industry for the quarter. He summarized the book value returns of the Fund and the Fund's net-of-fees performance. He also noted that the portfolio continues to be fully invested and has experienced lower than average (4 per cent) cash outflows in 2017, which lends itself to positive wrap fee negotiations: Nationwide fee was renegotiated from 21 basis points down to 18 basis points. Galliard continues to negotiate with MetLife and AGL, and an update on these negotiations will be provided by the end of the second quarter.

Mr. Weber added that all managers have outperformed their respective benchmarks for the quarter and there have been no changes to portfolio contract quality.

The Chair requested that fee savings be provided in dollar value in addition to basis points value. Subcommittee members, staff and Mr. Weber briefly discussed the ongoing "clean slate" proposal for the NC Stable Value Fund portfolio, noting that the new investment management agreement between Galliard and the Board/Department is expected to be signed soon.

#### **AGENDA ITEM ECONOMIC OVERVIEW AND 4<sup>th</sup> QUARTER INVESTMENT PERFORMANCE REPORT**

The Chair recognized Mr. Dillard and Ms. Henson. Ms. Henson directed the attendees' attention to the executive summary included in the Board meeting materials and provided a summary of updates regarding the Plans' investment managers and their performance. Mr. Dillard discussed the two managers on the watch list, Hotchkis and Wiley and Sands, noting that Mercer continues to have conviction in both strategies. He noted that the third strategy on watch, TimesSquare SMID Growth, will be discussed as a separate agenda item. Mr. Dillard also provided a general market update: Mercer expects an increase in market volatility during the current calendar year; however, the overall macroeconomic outlook remains strong. Ms. Henson added that the negative returns experienced in the fixed income sector are rare and were connected to the Federal Reserve's interest rate increases.

#### **AGENDA ITEM SMID MANAGER REVIEW**

Ms. de Mey offered a review of the current NC Small/Mid Cap Core Fund status and the portion managed by TimesSquare, which constitutes 23.8 percent of the total portfolio or approximately \$250 million, with an investment management fee of 0.65 percent. She discussed TimesSquare's strategy of focusing on higher quality companies and downside protection within the Fund, and the manager's continued underperformance since having been placed on the watch list over a year ago.

Mr. Dillard highlighted the notable events in the manager's and the Plans' relationship history, noting the 2011 inception and subsequent analyst personnel changes in 2014 and 2015, which led to an on-site, due diligence visit from Mercer. The manager's failure to meet the performance criteria caused the strategy to be placed on watch in the third quarter of 2016. At that time, Mercer noted that the strategy was underweight in the health care sector but that Mercer had conviction in the other areas of the portfolio. Mercer reviewed the health care coverage with the manager again during another on-site visit in January of 2018. The staff turnover, the lack of adequate coverage in the health care sector and inadequate security selection in that same sector continued to be of concern and caused Mercer to change the strategy rating to Provisional (P).

Ms. Henson described the next steps of the review process: Mercer would like to revisit the NC Small/Mid Cap Core Fund to ensure the optimal fund structure and mix of underlying investment managers. Ms. Henson emphasized the need to continue to maintain the core allocation, without a bias to value or growth. Mercer would present the research findings at the next Subcommittee meeting and obtain the members' feedback.

Following the presentation, Subcommittee members, the staff and the investment consultant discussed the impact of the investment manager's termination on the Fund's portfolio and options to re-allocate the portion managed by TimesSquare. The Chair said that he was in favor of moving the assets into the passive sleeve as a means to reduce complexity. Ms. Henson emphasized that, currently, the recommended allocation to the passive sleeve in the NC SMID Core Fund is five percent of the liquidity buffer, and that an addition of 25 percent of assets in

the passive sleeve of this fund would be a deviation from the current “active” definition of this fund. She added that Mercer, staff and Subcommittee need to evaluate decisions made in the NC SMID Cap Core Fund as stand-alone investment option for Plan participants.

The Chair moved to accept the staff and investment consultant’s recommendation to terminate the TimesSquare SMID Growth strategy and Ms. Cochran seconded. The motion passed unanimously.

Mr. Copley noted an average lower cost of passive investment options, and in his opinion, the Plans would be better served by management fee savings than an attempt to gain a performance advantage through active management. Ms. Cochran stated that both cost and performance should be considered in the evaluation of investments offered, and moved to begin a search for an active manager replacement, concurrently with conducting research on a possible passive option solution. Ms. Baran seconded the motion. The Chair voted against, while Ms. Cochran, Ms. Baran and Mr. McKinney voted for the recommendation. The motion passed by majority vote.

**AGENDA ITEM NC 403(b) PROGRAM 4<sup>th</sup> QUARTER INVESTMENT PERFORMANCE REVIEW**

Ms. de Mey provided a summary of Program’s assets, which have reached a total market value of \$13,282,331 as of December 31, 2017. She also noted the overall satisfactory performance of the Program’s passive and active investment options. Ms. de Mey noted that the performance of the active funds was strong in calendar year 2017, with all by one of the active equity funds outperforming their respective benchmark during the year.

**AGENDA ITEM - SUBCOMMITTEE MEMBERS QUESTIONS/COMMENTS**

No comments were offered.

**AGENDA ITEM PUBLIC COMMENT**

No public comments were offered.

Ms. Baran moved to adjourn the meeting and Mr. McKinney seconded. The meeting adjourned at 10:14 a.m.



Secretary