



## INVESTMENT MANAGEMENT

**To:** North Carolina Supplemental Retirement Board of Trustees

**From:** Loren de Mey, Assistant Investment Director

**Date:** October 27, 2017

**Subject:** Discussion/Action: NC 403b Program - Recommendation for International Equity Fund Replacement

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### Background

The current International Equity Fund offered in the NC 403b Program is the MFS International Equity Fund (MIEIX). While there are no performance or organizational concerns with the MFS Fund at this time, there is an opportunity to move the NC 403(b) participants to the Baillie Gifford International Equity mutual fund (BGIXX) given the fund has recently re-opened to US investors. The fund was not closed due to capacity issues, but had been closed due to client service constraints at Baillie Gifford. The Baillie Gifford International strategy is one of the international equity strategies that is utilized in the North Carolina International Equity Fund within the NC 401k/457 Plans. Baillie Gifford also manages an International Equity and Emerging Markets equity mandate for the North Carolina Defined Benefit Plan.

### Fund Review

Staff reviewed performance and fees of the Baillie Gifford International Equity mutual fund (BGIXX) as compared to the current International Equity mutual fund offered in the NC 403b Program, the MFS International Equity Fund (MIEIX). In addition to bringing consistency across the Plans, replacing the MFS International Equity Fund (MIEIX) with the Baillie Gifford International Equity Fund (BGIXX) would provide the following benefits:

1. Lower fees: The Baillie Gifford International Equity Fund has a net expense ratio of 0.61% compared to a net expense ratio of 0.71% for currently offered MFS International Fund, lowering fees to participants by 10 basis points. For a participant with \$20,000 invested in this fund, this equates to an annual savings of \$20.
2. Stronger historical performance: The Baillie Gifford Fund has outperformed the MFS International Equity Fund on a trailing three-year and five-year basis by 3.42% and 0.67%, respectively.
3. Greater opportunity for alpha generation: Over the past five years, Baillie Gifford's emerging markets exposure has averaged 24% (ranging from 20%–27%) The current allocation to emerging markets for Baillie's benchmark, the MSCI ACWI Ex US is 24%. MFS's emerging markets exposure has averaged just 7% (ranging from 4.7% to 10%). The current allocation to emerging markets for MFS' benchmark, the EAFE Growth Index is 0%. Baillie Gifford's expertise investing within emerging markets provides the fund with additional opportunity for alpha generation.
4. Superior upside / downside capture: Baillie Gifford has participated in a greater percentage of market appreciation on the upside, while maintaining a comparable amount of downside protection.



*Dale R. Folwell, CPA*

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### Performance (as of 9/30/17)

	YTD	3-year	5-year
Baillie Gifford International Equity Fund	27.9	9.8	9.4
MFS International	23.1	6.4	8.8
MSCI ACWI EX US	21.1	4.7	6.9
EAFE Growth	20.4	5.5	8.9

### Upside Downside Capture Ratio:

#### Baillie Gifford:

	Upside Capture	Downside Capture
3 year	110.45	80.84
5 year	105.38	90.19

#### MFS International:

	Upside Capture	Downside Capture
3 year	96.03	84.14
5 year	98.96	85.40

*\*Ratios calculated versus MSCI ACWI ex USA as of 9/30/17*

### Timing

The Baillie Gifford International Equity Fund is not currently on Prudential's 403b platform. While Prudential and Baillie Gifford are currently in discussions to have this fund added to the platform, the timing of the negotiations could take several months. If approved, the replacement will take place once negotiations between Prudential and Baillie Gifford have concluded. Staff will keep the Board apprised of the outcome of the negotiations.

### Recommendation

Replace the MFS International Equity Fund with the Baillie Gifford International Equity Fund and add the fund to Prudential's 403(b) platform making it available to our NC 403(b) Program participants.