

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

MINUTES OF MEETING

November 12, 2015

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, November 12, 2015, in the Dogwood Conference Room of Longleaf Building, 3200 Atlantic Avenue, Raleigh, North Carolina.

Members Present: The following members were present: Melinda Baran, Chair; Karin Cochran. Robert Orr attended via phone.

Staff and Guests present: The following staff and guests attended the meeting. From the Department of State Treasurer: Steve Toole, Mary Laurie Cece, Mary Buonfiglio, Blake Thomas, Lisa Page, Marni Schribman, Joan Fontes, Rhonda Smith, Casey High, Rekha Krishnan, Catherine Jarboe, Maja Moseley; Kevin SigRist attended via phone. From Mercer: Kelly Henson and Liana Magner. From Prudential: Michael McCann, Tom Conlon, Kathleen Neville; and Jessica Quimby attended via phone. From TIAA-CREF: James Simone. From Galliard: William Weber.

AGENDA ITEM – WELCOME AND INTRODUCTIONS

Meeting convened at 8:33 a.m.

Ms. Baran, Subcommittee Chair, welcomed everyone and asked that the public comments be held until the end of the meeting. Ms. Baran also introduced and welcomed Catherine Jarboe, newly hired Communications Officer for the Plans, noting Ms. Jarboe previously served as the Director of State Networks and Organizations for the Catholic Mobilizing Network and holds a bachelor’s degree in marketing communications from Virginia Tech, and a master’s degree in education from Bellarmine University.

**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 AUGUST 13, 2015 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 – MINUTES FROM AUGUST 27, 2015 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 – MINUTES FROM SEPTEMBER 3, 2015 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 – STABLE VALUE PORTFOLIO REVIEW

The Chair recognized Mr. Weber to give a review of the Stable Value Portfolio. Mr. Weber stated that there were no notable updates regarding Galliard itself. Mr. Weber stated that the stable value markets continue to improve providing more leverage on guideline and contract terms negotiation, as well as leverage for lower fees. Due to the Plans' unbundling, the work on the commingling of both the NC 401(k) and the NC 457(b) Stable Value Funds continues and is on pace to have a seamless transition. Galliard also facilitated the clearing of the Great West account open receivable, which was completed in August, 2015; the impact to the fund was effective on October 1, 2015, when Great West reset their contract: overall, the Fund went down 6 bps. Ms. Buonfiglio noted that this was in-line with expectations. [The net of fees performance for the Fund remains competitive at 48 bps for the quarter ended September 30, 2015, and 1.85% for the 12 months ended September 30, 2015.] Assets increased slightly for the quarter and the average holdings quality remains at AA, while the blended yield reached 1.91%. The portfolio has a market/ book value ratio of 101.54%. The portfolio cash flow remained neutral, which is a positive trend in comparison to other clients of Galliard. With respect to market value performance for each manager, Mr. Weber noted that Jennison's and Dodge and Cox's overweight to the corporate sector was a negative impact to performance, but Galliard's sectors weights produced positive relative performance. Great West's negative result was largely due to the write-down of the open account receivable item.

Ms. Buonfiglio inquired whether Galliard will be providing performance metrics that reflect the write-down on ongoing basis and Mr. Weber replied that Galliard is currently discussing with Great West the removal of this from the performance, and recapturing it independently in a footnote. Mr. Weber stated that more information regarding appropriate disclosures in financial statements and fund fact sheets will be available within a week.

Mr. Weber stated that Galliard continues to evaluate the managers on an ongoing basis and will be presenting an annual due diligence report. Mr. Weber also said that Galliard is focusing on facilitating a smooth transition to the commingled Stable Value Fund structure on January 1, 2016, and thanked Ms. Cece for her role in the process.

Ms. Baran inquired whether more wrap contract managers would be added and what factors drive such expansion. Mr. Weber believed that the fund is very well diversified, with five wrap contract managers and the industry standard being four to five. Ms. Baran asked whether there was appropriate vendor capacity, should the balance in the Fund double and Mr. Weber replied that there is ample capacity, and Galliard strives to maintain a 20% allocation to each manager

AGENDA ITEM – ECONOMIC OVERVIEW AND 3RD QUARTER INVESTMENT PERFORMANCE REPORT

The Chair recognized Ms. Magner and Ms. Henson. Ms. Magner began the presentation by summarizing the market conditions for the quarter. US economic conditions softened and the Eurozone continued to have a moderate recovery. The growth in China has slowed considerably, to the lowest levels since 2008. Volatility in the markets created overall negative results. The Federal Reserve considered raising interest rates but did not do so due to the turbulent global economy. The S&P 500 was down overall 6.4%, with large cap stocks faring better than small caps. Utilities and consumer staples sectors posted positive results, while health, materials and energy were the worst performers; emerging markets experienced significant currency declines. Fixed income rates fell and spreads widened: Treasuries outperformed corporate bonds and the Plan's active managers were mostly overweight to corporates. Prudential Investment Management's results were hindered by declining high yields. Sectors sensitive to commodities struggled, and high beta stocks did not perform well. Ms. Magner pointed out that this worked against Sands, a high beta and concentrated manager. Hotchkis&Wiley struggled a bit in the large cap space, being a deep value oriented manager. Brown's biotech concentration paid off this quarter. She noted that global managers also did well this quarter. In the small cap area, Earnest had no exposure to either REITs or utilities, which were two of the best performing sectors. Commodities indices declined, which had negative impact on the PIMCO Inflation Responsive (IRMAF) portfolio.

Ms. Magner noted that there were no changes in the Plans' investment structure or managers and continued on to the fee review: fees for most strategies remain below median, with only three managers slightly above the median expense in Mercer's peer universe. Ms. Cochran asked how

regularly Mercer tries to renegotiate fees. Ms. Magner stated that Mercer does a review of all fees every quarter, which can trigger the necessity to renegotiate them; [Mercer also conducts formal surveys with managers.]

Ms. Henson presented the performance scorecard based on a rolling three-year period. She noted that Sands' performance reduced the overall performance on the NC Large Cap Growth Fund, but the majority of the scorecard shows positive results.

In the small/mid cap space, Brown has been on the watch list. Currently they are trailing the benchmark, but outperforming their peer group. Ms. Baran asked why Brown was rated "R" and Ms. Henson replied that this means Mercer thinks that this manager is not the most competitive in the space Mercer has researched this manager, did not find them compelling enough to assign a higher rating, but does not feel they need to be replaced. Mercer believes they should continue to be monitored. Ms. Henson specified that manager changes should not be made based on the rating alone. Ms. Magner also noted that "R" stands for "researched interest" and that this is the rating Brown has always had. She stated that the Mercer team feels at this point that Brown is fine, but just that there are other managers for which they have a higher conviction. But, Mercer has reviewed them and believes they have merit to stay in the portfolio.

Mr. Orr stated that he considers this rating a "yellow light" for the manager. That they do not necessarily need to be replaced, but the Board should monitor. He added that since Mercer is still comfortable with this particular manager, it appears to him that the research and review process in place is working as designed. In his opinion, having a structured process in place is appropriate and protects the Plans.

Ms. Baran proposed a review for Brown in the 2nd quarter of 2016 and Ms. Henson added that Mercer will be doing a full review at the one-year mark, and will come back to the Board with a recommendation.

Ms. Henson continued with a performance summary and noted strong results for fixed income, and the NC Inflation Responsive Fund in particular, which did well against its benchmark, but less so against its peers. She noted that the Inflation Responsive manager PIMCO is very conservative in this market so it is not unusual that they would underperform against their peers when there is an equity rally. Mercer recommends that PIMCO IRMAF be taken off the watch list at this time. Ms. Henson reminded that attendees that PIMCO was placed on watch largely due to the departure of Bill Gross from the firm, and the subsequent outflow of assets. Currently, assets continue to grow and stability has been restored and the strategy is sound.

After a discussion on the issue the subcommittee determined that PIMCO IRMAF should remain on watch until this issue of Mr. Gross suing the firm, and the firm countersuing, is resolved. It was agreed that PIMCO IRMAF would stay on watch until further notice.

Ms. Henson also noted a slight drop in the combined Plans' assets for the quarter, to \$8,719,172.378 and added that with respect to fund performance versus peer group and benchmark, Loomis Sayles added value for the quarter, while Earnest Partners, as well as Hotchkis & Wiley struggled.

Ms. Baran asked whether Mercer has already met with the JP Morgan manager, temporarily relieving Doug Swanson, and Ms. Henson replied that the meeting took place at the end of October and a research note will be available shortly.

AGENDA ITEM – INVESTMENT COMPLIANCE REPORT REVIEW

Next, Ms. Henson presented a brief overview of portfolio compliance, noting that none of the managers breached their contractual obligations. There were a couple of areas of non-compliance on a fund level, with respect to the NC Large Cap Value Fund and the NC Global Equity fund. She reiterated that both the Investment Policy Statement, as well as the manager guidelines are being redrafted to ensure consistency and eliminate discrepancy.

AGENDA ITEM – INVESTMENT POLICY STATEMENT PROJECT UPDATES

Ms. Henson summarized the changes made to the Investment Policy Statement (IPS). She stated that the specific guidelines regarding sector allocation and security level holdings were removed. Each fund now has a defined investment objective, investment management structure and performance objective.

Ms. Buonfiglio added that compliance monitoring will now occur at the manager level and not the fund level. The staff has leveraged the Investment Management Division's manager guideline template and negotiated guidelines with each manager individually. This will ensure detailed compliance monitoring, which can be tied back to the investment management contracts.

Ms. Smith recognized the work Ms. Buonfiglio and Ms. Cece put into the project, and Mr. SigRist added that the development was very collaborative among SRP and IMD.

Ms. Buonfiglio asked if there were any Board comments with regard to the IPS and Ms. Baran asked whether the phrase "local employers" should in fact state "local government employers", asked for clarification the subcommittee definition, and felt that the subcommittee appointment language also needed clarification. She also asked to have the term "competitive" defined within the policy. However Ms. Henson noted that the term is broad on purpose, in order not to create rigid guidelines. Mr. Orr and Ms. Cochran agreed that the term should be left undefined.

Ms. Henson noted that all the roles and responsibilities laid out in the IPS have been updated, and duties performed each quarter are now defined and documented. Ms. Buonfiglio also reiterated that the role of the new SRP position was considered during the revision of the responsibilities section of the document.

Ms. Baran asked for a motion to approve the IPS draft (with requested revisions) and to present it to the full Board during the meeting in December.

Ms. Cochran so moved and Mr. Orr seconded. The motion passed unanimously.

AGENDA ITEM – NC 403(b) PROGRAM 3RD QUARTER INVESTMENT PERFORMANCE REVIEW

Ms. Magner then presented a report on the 403(b) Program. She noted the current and proposed Program investment structure and stated that the goal to have the options more aligned with the investment options in the 401(k) and 457 Plans was voted on during the October 2015 special Board meeting. Mercer chose reasonably similar options for mapping, for example Wells Fargo Target Date funds would move over to Custom Portfolios. TIAA Real Estate fund posed the biggest challenge but will be mapped to the JP Morgan Core Bond Fund due to the fact that they have similar characteristics. Mr. Toole noted the importance of having a well-crafted participant communication, describing the mapping event.

Ms. Henson summarized the watch list, where the PIMCO All Asset Fund will be removed, and the PIMCO IRMAF will remain. She noted that the Vanguard Windsor Fund had a strong performance in the 3rd quarter but will also remain on watch. AllianzGI NFJ International Value Fund is still on watch also due to underperformance but this option is being eliminated as part of the Custom Portfolio implementation. Ms. Henson noted that Program assets continue to grow, up to \$4.5 million. Based on the rolling three-year performance, most funds are fairly competitive, noting that all the specialty options are being eliminated. The international funds were also performing well but will be consolidated into the new structure. With respect to fees, the target funds are above the median expense and they will be replaced with Custom Portfolios in the 1st quarter of 2016.

AGENDA ITEM – GLIDEPATH FOR CUSTOM PORTFOLIO IMPLEMENTATION UPDATE

The Chair recognized Mr. SigRist to discuss the glidepath for the new Custom Portfolios for the NC 403(b). He noted that three model allocations are proposed: conservative, moderate and aggressive. These models have been constructed with funds available in the Program. Mr. SigRist pointed out he and his staff modeled the NC 403(b) glidepath after the glidepath for the 401(k) and 457 plans; noting that in constructing the glidepath there were three main differences between the plans investment options and the 403(b) program options. Mr. SigRist made the following recommendations:

1. The NC 403(b) Program has a small cap core funds rather than small/mid cap value fund/mid cap growth fund, found in the NC 401(k)/ NC 457 Plans. The associated

benchmark is the Russell 2500 rather than the Russell 2000. The recommendation is to map the Plans' combined SMID Value and SMID Growth model allocation to the DFA Small Cap Core Fund.

2. The international fund benchmarks are different: MSCI ACWI ex US versus MSCI EAFE ex US. The recommendation is to map the Plans' model allocation to MFS Institutional International Equity Fund.
3. The Program has no global equity fund. Based on the statistical analysis conducted, recommended action is to map the Plans' model allocation for the global fund with approximate MSCI ACWI index weights to the Vanguard Windsor II Fund, T. Rowe Price Blue Chip Growth Fund, and MFS Institutional International Equity Fund. The allocations should be reviewed on annual basis. This action would result in a good approximation over time. Quarterly reports will be used to monitor the performance of these fund allocations. Mr. SigRist noted that given the small size of assets in the Program, a global fund is not a recommended addition.

Mr. SigRist explained that an annual review of the Custom Portfolios glidepath would be appropriate in the first quarter of 2017 – a full year after the transition. Ms. Buonfiglio confirmed for Ms. Cochran that TIAA-CREF will also provide continuous feedback regarding this new structure.

The Chair entertained a motion to recommend to the full Board the glidepath for Custom Portfolio implementation. Ms. Cochran so moved and Mr. Orr seconded. The motion passed unanimously.

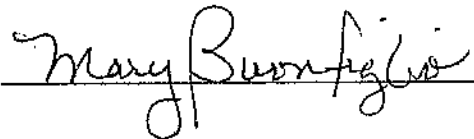
AGENDA ITEM - SUBCOMMITTEE MEMBERS QUESTIONS/COMMENTS

No further comments were offered.

AGENDA ITEM – PUBLIC COMMENT

No public comments were offered.

The Chair moved to adjourn the meeting and Mr. Orr seconded. The meeting adjourned at 10:31 a.m.


Secretary