



## NORTH CAROLINA

OFFICE OF THE TREASURER

JANET COWELL, TREASURER

November 9, 2011

Joint Legislative Commission  
on Governmental Operations  
North Carolina General Assembly  
Raleigh, North Carolina 27601

Re: Quarterly report on Investment Funds for the period ended  
September 30, 2011

### Commission Members:

Pursuant to G.S.147-68, we are providing a report on the investment activities of the State Treasurer. The report outlines investment activities in summary form for:

- The Cash Management Program – responsible for managing the operating funds of the State. The primary participants in this program are the State's General Fund and Highway Funds.
- The Trust Funds Investment Program – responsible for managing assets of the Teachers' and State Employees' Retirement System, the Consolidated Judicial Retirement System, the Firemen's and Rescue Squad Workers' Pension Fund, the Local Governmental Employees' Retirement System, the Legislative Retirement System, and the North Carolina National Guard Pension Fund. Collectively, these systems and funds are referred to as the North Carolina Retirement Systems or the Pension Fund. The Trust Funds Investment Program also includes other participants such as the State Health Plan, the Disability Income Plan, and the State Educational Assistance Authority.
- The Ancillary Investment Programs - as authorized by the General Assembly, responsible for managing assets for the Escheats Fund, UNC and Public Hospital Funds, and the Local Government Other Post-Employment Benefits Fund.

### Cash Management Program

The Cash Management Program, composed mostly of the Short-Term Investment Fund ("STIF"), produced a one-year return of 0.85% for participants. It also includes the Bond Proceeds Fund which is a



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separate investment account for each state bond issue to comply with Internal Revenue Service regulations on bond arbitrage.

## Short Term Investment Fund

<u>Historical T-Bill rates</u>	<u>9/30/10</u>	<u>3/31/11</u>	<u>9/30/11</u>
3-Mo. T-Bill	0.15%	0.09%	0.02%
6-Mo. T-Bill	0.19%	0.17%	0.05%

The Short-Term Investment Fund produced a one-year return of 0.86% for participants. The investable balances earning income for the General Fund were \$328 million higher than one year earlier based on book value. The investable balances, which earn income for the Highway Funds, were \$334 million higher than at the same time last year.

The investments held by the STIF on a particular date may be accruing income at different levels from current short-term interest rates. For example, if the investments were made when interest rates were lower, the earnings would continue to be at the lower rates of return, even though current interest rates may have moved higher. This happens in reverse as well.

The Bond Proceeds Fund is managed by a private investment company under contract with the Department of State Treasurer. The investments are valued at amortized cost, which approximates fair value.

## Trust Funds Investment Program

The investment results for the Trust Funds Investment Program ("Trust Funds") are managed and reported on a cumulative total return basis. Total return includes realized income and the appreciation or depreciation of fair market value. Two funds comprise the vast majority of the Trust Funds assets. They are the Long-Term Investment Fund ("LTIF") and the Equity Investment Fund ("EIF").

	<u>1 Year</u>	<u>2 Year</u>	<u>3 Year</u>	<u>5 Year</u>
Total Trust Returns:	2.90%	6.13%	5.18%	2.96%

## Long Term Investment Fund

	<u>1 Year</u>	<u>2 Year</u>	<u>3 Year</u>	<u>5 Year</u>
LTIF Returns:	7.14%	9.28%	11.56%	8.37%



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The below table provides a trend comparison of the current Treasury yields to the previous quarter.

US Treasury Yields	<u>5 Year UST</u>	<u>10 Year UST</u>	<u>30 Year UST</u>
As of 6/30/11	1.76%	3.16%	4.37%
As of 9/30/11	0.95%	1.92%	2.91%

- Long Term assets (based on market value) ended the quarter approximately \$616 million higher than at the end of the prior reporting period.
- The realized earnings for the fiscal year to date are \$577 million.
- Approximately \$1.3 billion was used to pay benefits or was reallocated to other investment funds this quarter.

## Equity Investment Fund

	<u>1 Year</u>	<u>2 Year</u>	<u>3 Year</u>	<u>5 Year</u>
EIF Returns:	-4.96%	2.16%	1.41%	-1.23%

The below table provides third quarter equity market returns as measured by major indices.

Quarterly Index Returns:	S&P 500	-13.87%	DJIA	-12.09%
	Russell 3000	-15.28%	MSCI EAFE	-19.01%

- Assets of the fund (based on market value) ended the quarter approximately \$5.04 billion lower than at the end of the prior reporting period.

Pursuant to Session Law 2009-98 and G.S.147-69.2, the Treasurer is now authorized to invest in credit and inflation-linked strategies. These new classifications are reflected in the attached report.

## Ancillary Investment Programs

The Ancillary Investment Programs, as authorized by the General Assembly, are responsible for managing assets for the Escheats Fund, UNC and Public Hospital Funds, and the Local Government Other Post-Employment Benefits Fund.

Pursuant to G.S. 116-37, deposits are held for the University of North Carolina Hospitals at Chapel Hill Trust, New Hanover Memorial Hospital, Margaret R. Pardee Hospital, and Columbus Regional Healthcare System, all subject to compliance with G.S. 147-69.2. The assets are allocated as follows: STIF, LTIF and authorized Equity funds. For the Quarter ending September 30, 2011, the invested assets



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were valued at \$351 million after returns in the domestic and international accounts of -14.80% and -20.06% respectively.

Pursuant to G.S. 147-69.2(b)(12), up to 20% of the Escheat Fund's assets can be invested in authorized Equity, Real Estate, and Alternative Investments. For the Quarter ending September 30, 2011, \$40 million has been invested in equity, of which over \$20 million has been received in distributions; \$20 million has been invested in real estate, of which \$5.6 million has been returned; and commitments totaling \$57 million have been made to private equity, of which \$48 million has been contributed.

Pursuant to G.S. 147-69.4, deposits are held for the Local Government Other Post-Employment Benefits Fund, all subject to compliance with G.S. 147-69.2. The assets are allocated as follows: STIF, LTIF, and authorized Equity funds. For the Quarter ending September 30, 2011, the externally invested assets were valued at \$34.7 million after returns in the domestic and international equity accounts of -14.80% and -20.06% respectively.

### Other Reporting Requirements

Pursuant to Session Law 2007-323 Sec. 13.2.(b), G.S. 147-68(d1), the Treasurer "shall include a specific listing of all investments made with certified green managers and companies and funds that support sustainable practices, including the names of the companies, managers, and funds, the amount invested, and the State's return on investment." Based on currently available research, there is no validation group or process that certifies green managers for investments, and the statute provides no definition of the term "sustainable practices" that would enable the Department to determine which companies and funds would fall under this provision. Thus, it is not possible to report any relevant data at this time.

Thank you for your attention. Please feel free to contact the Department of State Treasurer if you have any questions.

Sincerely,

A handwritten signature in cursive script, appearing to read "Janet Cowell".

Janet Cowell

### Attachments

cc: Shawn Wischmeier, Chief Investment Officer  
Fran Lawrence, Chief Financial Officer

**DEPARTMENT OF STATE TREASURER**  
**COMBINED STATEMENT OF NET ASSETS AND PARTICIPANT EQUITY - ALL POOLS AND ACCOUNTS**  
**SEPTEMBER 30, 2011**

	*Cash Management Program			**Trust Funds Investment Program		All Pools
	Short-term Investment Fund	Bond Proceeds Fund	Subtotal	Subtotal	Intrafund Eliminations	Total
Net Assets:						
Investment Securities:						
Cash Equivalents	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Certificates of Deposit	37,100,000	-	37,100,000	-	-	37,100,000
Repurchase Agreements	1,930,000,000	-	1,930,000,000	-	-	1,930,000,000
Discount Notes/Bills	-	-	-	-	-	-
U.S. Treasury Bills/ Notes/ Bonds	4,922,199,987	-	4,922,199,987	8,576,564,070	-	13,498,764,057
U.S. Government Agency Notes/ Bonds	5,800,306,260	-	5,800,306,260	2,041,494,612	-	7,841,800,872
GNMA Certificates	-	-	-	7,142,221,024	-	7,142,221,024
Corporate Obligations	279,940,174	-	279,940,174	10,464,109,732	-	10,744,049,906
Other Investments	-	-	-	45,093,933	-	45,093,933
Investments in RMBS and CMBS	-	-	-	747,745,450	-	747,745,450
Investments in Equity Securities	-	-	-	5,548,129	-	5,548,129
Bond proceeds Advisory	-	82,226,815	82,226,815	-	-	82,226,815
Investments in Equity Trusts	-	-	-	28,867,180,243	-	28,867,180,243
Investments in Real Estate Trust Funds & Partnerships	-	-	-	4,738,329,657	-	4,738,329,657
Investments in Alternative Partnerships	-	-	-	3,571,279,533	-	3,571,279,533
Investments in Credit Partnerships	-	-	-	2,681,190,805	-	2,681,190,805
Investments in Inflation Partnerships	-	-	-	1,209,098,833	-	1,209,098,833
				-	-	-
Total Investment Securities	\$ 12,969,546,421	\$ 82,226,815	\$ 13,051,773,236	\$ 70,089,856,021	\$ -	\$ 83,141,629,257
Cash in Bank	172,429,445	-	172,429,445	-	-	172,429,445
Deposits in Short-term Investment Fund	-	-	-	419,116,417	(419,116,417)	-
Other Assets, Net of Liabilities	(544,958,130)	-	(544,958,130)	272,995,792	-	(271,962,338)
Total Net Assets	\$ 12,597,017,736	\$ 82,226,815	\$ 12,679,244,551	\$ 70,781,968,230	\$ (419,116,417)	\$ 83,042,096,364
Participant Equity:						
General Fund	\$ 1,963,234,576	\$ -	\$ 1,963,234,576	\$ -	\$ -	\$ 1,963,234,576
Other Funds Which Earn Interest for General Fund	1,451,887,670	82,226,815	1,534,114,485	-	-	1,534,114,485
Highway Fund	762,987,673	-	762,987,673	-	-	762,987,673
Highway Trust Fund	242,958,827	-	242,958,827	-	-	242,958,827
University Trust Funds	2,702,671,952	-	2,702,671,952	-	-	2,702,671,952
Pension Trust Funds	193,566,323	-	193,566,323	69,604,200,239	-	69,797,766,562
Other Independent Trust Funds	4,048,297,793	-	4,048,297,793	1,177,767,991	-	5,226,065,784
Local Political Subdivisions	784,655,392	-	784,655,392	-	-	784,655,392
Licensing Boards	27,641,112	-	27,641,112	-	-	27,641,112
Other Investment Funds	419,116,418	-	419,116,418	-	(419,116,418)	-
Total Participant Equity	\$ 12,597,017,736	\$ 82,226,815	\$ 12,679,244,551	\$ 70,781,968,230	\$ (419,116,418)	\$ 83,042,096,363
Percent of Total	15.17	0.10	15.27	85.24	-0.50	100.00

\* The Cash Management Program is presented at book value.

\*\*The Trust Funds Investment Program is presented at market value. Trust Funds detail is included on Combining Statement of Net Assets and Participant Equity.

**DEPARTMENT OF STATE TREASURER**  
**COMBINING STATEMENT OF NET ASSETS AND PARTICIPANT EQUITY - TRUST FUNDS INVESTMENT PROGRAM**  
**SEPTEMBER 30, 2011**

	Long-term Investment Fund	External Fixed Inc. Investment Fund	Equity Investment Fund	Real Estate Investment Fund	Alternative Investment Fund	Credit Investment Fund	Inflation Investment Fund	Totals
Net Assets:								
Investment Securities:								
Cash and Cash Equivalents	\$						\$	
U.S. Treasury Bills/ Notes/ Bonds	8,021,945,459						554,618,611	8,576,564,070
U.S. Government Agency Notes/ Bonds	1,617,578,797	28,537,584					395,378,231	2,041,494,612
GNMA Certificates	7,142,221,024							7,142,221,024
Corporate Obligations	10,464,109,732							10,464,109,732
Other Investments		45,093,933						45,093,933
Investments in RMBS and CMBS		747,745,450						747,745,450
Investments in Equity Securities					5,548,129			5,548,129
Bond Proceeds Advisory								-
Investments in Equity Trusts			28,867,180,243					28,867,180,243
Investments in Real Estate Trust Funds & Partnerships				4,738,329,657				4,738,329,657
Investments in Alternative Partnerships					3,571,279,533			3,571,279,533
Investments in Credit Partnerships						2,681,190,805		2,681,190,805
Investments in Inflation Partnerships & Other Inv							1,209,098,833	1,209,098,833
Total Investment Securities	\$ 27,245,855,012	\$ 821,376,967	\$ 28,867,180,243	\$ 4,738,329,657	\$ 3,576,827,662	\$ 2,681,190,805	\$ 2,159,095,675	\$ 70,089,856,021
Cash in Bank								
Deposits in Short-term Investment Fund	260,709,858	101,887,289	4,315,439	11,886,870	31,727,175	4,906,473	3,683,313	419,116,417
Other Assets, Net of Liabilities	273,355,695	5,945,261					(6,305,164)	272,995,792
Total Net Assets	\$ 27,779,920,565	\$ 929,209,517	\$ 28,871,495,682	\$ 4,750,216,527	\$ 3,608,554,837	\$ 2,686,097,278	\$ 2,156,473,824	\$ 70,781,968,230
Participant Equity:								
Pension Trust Funds	26,602,152,574	929,209,517	28,871,495,682	4,750,216,527	3,608,554,837	2,686,097,278	2,156,473,824	69,604,200,239
Other Independent Trust Funds	1,177,767,991	-	-	-	-	-	-	1,177,767,991
Total Participant Equity	\$ 27,779,920,565	\$ 929,209,517	\$ 28,871,495,682	\$ 4,750,216,527	\$ 3,608,554,837	\$ 2,686,097,278	\$ 2,156,473,824	\$ 70,781,968,230
Percent of Total	39.25	1.31	40.79	6.71	5.10	3.79	3.05	100.00

**DEPARTMENT OF STATE TREASURER  
ANCILLARY INVESTMENT PROGRAMS  
SEPTEMBER 30, 2011**

	<u>Escheats External Investments</u>	<u>OPEB External Investments</u>	<u>Hospital Investment Fund</u>	<u>Totals</u>
Net Assets:				
Deposits in Equity Investment Fund	\$ 12,734,235	34,661,158	351,246,411	\$ 398,641,804
Deposits in Real Estate Investment Fund	10,001,497			10,001,497
Deposits in Alternative Investment Fund	40,213,263			40,213,263
Other Assets, Net of Liabilities	101,324			101,324
Total Net Assets	<u>\$ 63,050,319</u>	<u>\$ 34,661,158</u>	<u>\$ 351,246,411</u>	<u>\$ 448,957,888</u>
 Participant Equity:				
General Fund	\$ -	\$ -	\$ -	\$ -
Other Investment Funds	<u>63,050,319</u>	<u>34,661,158</u>	<u>351,246,411</u>	<u>448,957,888</u>
Total Participant Equity	<u>\$ 63,050,319</u>	<u>\$ 34,661,158</u>	<u>\$ 351,246,411</u>	<u>\$ 448,957,888</u>

**DEPARTMENT OF STATE TREASURER  
COMBINED STATEMENT OF OPERATIONS - ALL POOLS AND ACCOUNTS  
FOR THE PERIOD ENDED SEPTEMBER 30, 2011**

	Cash Management Program			*Trust Funds Investment Program	Memorandum	
	Short-term Investment Fund	Bond Proceeds Fund	Subtotal	Subtotal	Intrafund Eliminations	Total
<b>Revenues:</b>						
Investment Income:						
Investment Earnings	\$ 29,750,148	11,600	\$ 29,761,748	\$ 785,481,961	\$ -	\$ 815,243,709
Intra-Pool Interest Earnings			-	3,638,598	(3,638,598)	-
Income from Security Lending			-	6,384,106	-	6,384,106
Commission Recapture			-	22,326	-	22,326
Other Income			-	570,098	-	570,098
Subtotal	<u>29,750,148</u>	<u>11,600</u>	<u>29,761,748</u>	<u>796,097,089</u>	<u>(3,638,598)</u>	<u>822,220,239</u>
Net Unrealized Appreciation/Depreciation				<u>(5,350,900,905)</u>	<u>-</u>	<u>(5,350,900,905)</u>
Total Investment Income	<u>29,750,148</u>	<u>11,600</u>	<u>29,761,748</u>	<u>(4,554,803,816)</u>	<u>(3,638,598)</u>	<u>(4,528,680,666)</u>
<b>Expenditures:</b>						
Treasurer's Allocated Cost	(378,624)		(378,624)	(1,101,986)	-	(1,480,610)
Management Fees		(11,773)	(11,773)	(53,846,851)	-	(53,858,624)
Foreign Income Tax			-	(7,183,456)	-	(7,183,456)
Other Cost	<u>(314,824)</u>		<u>(314,824)</u>	<u>(8,609,906)</u>	<u>-</u>	<u>(8,924,730)</u>
Total Expenditures	<u>(693,448)</u>	<u>(11,773)</u>	<u>(705,221)</u>	<u>(70,742,199)</u>	<u>-</u>	<u>(71,447,420)</u>
Net Investment Income (Loss)	<u>\$ 29,056,700</u>	<u>\$ (173)</u>	<u>\$ 29,056,527</u>	<u>\$ (4,625,546,015)</u>	<u>\$ (3,638,598)</u>	<u>\$ (4,600,128,086)</u>
<b>Total Investment Income Allocated:</b>						
General Fund	\$ 2,490,040		2,490,040	\$ -	\$ -	\$ 2,490,040
Highway Fund	1,997,216		1,997,216	-	-	1,997,216
Highway Trust Fund	583,821		583,821	-	-	583,821
University Trust Funds	6,568,449		6,568,449	-	-	6,568,449
Pension Trust Funds	1,031,855		1,031,855	(4,625,546,015)	-	(4,624,514,160)
Other Independent Trust Funds	10,668,994		10,668,994	-	-	10,668,994
Local Political Subdivisions	2,003,760		2,003,760	-	-	2,003,760
Licensing Boards	73,967		73,967	-	-	73,967
Other Investment Funds	<u>3,638,598</u>		<u>3,638,598</u>	<u>-</u>	<u>(3,638,598)</u>	<u>0</u>
Total Investment Income Allocated	<u>\$ 29,056,700</u>	<u>\$ 0</u>	<u>\$ 29,056,700</u>	<u>\$ (4,625,546,015)</u>	<u>\$ (3,638,598)</u>	<u>\$ (4,600,127,913)</u>

**Cash Return, Fiscal Year-to-Date (Annualized)**      0.857%                      0.020%                      0.851%

\*Trust Funds detail is included on the Combining Statement of Operations-Trust Funds Investment Program.



**DEPARTMENT OF STATE TREASURER**  
**COMBINING STATEMENT OF OPERATIONS - TRUST FUNDS INVESTMENT PROGRAM**  
**FOR THE PERIOD ENDED SEPTEMBER 30, 2011**

Trust Funds Investment Program

	Long-term Investment Fund	External Fixed Inc. Investment Fund	Equity Investment Fund	Real Estate Investment Fund	Alternative Investment Fund	Credit Investment Fund	Inflation Investment Fund	Totals
<b>Revenues:</b>								
<b>Investment Income:</b>								
Investment Earnings	\$ 576,857,255	18,834,419	117,156,305	58,306,236	56,090,218	(10,111,290)	(31,651,182)	\$ 785,481,961
Intra-Pool Interest Earnings	678,137	2,679,775	9,284	67,593	149,218	33,257	21,334	3,638,598
Income from Security Lending			6,384,106					6,384,106
Commission Recapture			22,326					22,326
Other Income			570,098					570,098
Subtotal	<u>577,535,392</u>	<u>21,514,194</u>	<u>124,142,119</u>	<u>58,373,829</u>	<u>56,239,436</u>	<u>(10,078,033)</u>	<u>(31,629,848)</u>	<u>796,097,089</u>
Net Unrealized Appreciation/Depreciation	1,067,135,885	(45,668,437)	(6,135,402,294)	49,463,318	(50,959)	(101,326,159)	(185,052,259)	(5,350,900,905)
Total Investment Income	<u>1,644,671,277</u>	<u>(24,154,243)</u>	<u>(6,011,260,175)</u>	<u>107,837,147</u>	<u>56,188,477</u>	<u>(111,404,192)</u>	<u>(216,682,107)</u>	<u>(4,554,803,816)</u>
<b>Expenditures:</b>								
Treasurer's Allocated Cost	(407,474)	(28,123)	(476,779)	(66,322)	(53,182)	(36,514)	(33,592)	(1,101,986)
Management Fees		(444,559)	(33,930,995)	(7,045,812)	(7,944,449)		(4,481,036)	(53,846,851)
Foreign Income Tax			(7,118,340)	(65,116)				(7,183,456)
Other Cost	<u>(229,877)</u>	<u>(387,711)</u>	<u>(842,599)</u>	<u>(4,416,778)</u>	<u>(1,675,849)</u>	<u>(725,993)</u>	<u>(331,099)</u>	<u>(8,609,906)</u>
Total Expenditures	<u>(637,351)</u>	<u>(860,393)</u>	<u>(42,368,713)</u>	<u>(11,594,028)</u>	<u>(9,673,480)</u>	<u>(762,507)</u>	<u>(4,845,727)</u>	<u>(70,742,199)</u>
Net Investment Income (Loss)	\$ <u>1,644,033,926</u>	\$ <u>(25,014,636)</u>	\$ <u>(6,053,628,888)</u>	\$ <u>96,243,119</u>	\$ <u>46,514,997</u>	\$ <u>(112,166,699)</u>	\$ <u>(221,527,834)</u>	\$ <u>(4,625,546,015)</u>
<b>Total Investment Income Allocated:</b>								
General Fund	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	-
Highway Fund	-	-	-	-	-	-	-	-
Highway Trust Fund	-	-	-	-	-	-	-	-
University Trust Funds	-	-	-	-	-	-	-	-
Pension Trust Funds	1,576,412,885	(25,014,636)	(6,053,628,888)	96,243,119	46,514,997	(112,166,699)	(221,527,834)	(4,693,167,056)
Other Independent Trust Funds	67,621,041	-	-	-	-	-	-	67,621,041
Local Political Subdivisions	-	-	-	-	-	-	-	-
Licensing Boards	-	-	-	-	-	-	-	-
Other Investment Funds	-	-	-	-	-	-	-	-
Total Investment Income Allocated	\$ <u>1,644,033,926</u>	\$ <u>(25,014,636)</u>	\$ <u>(6,053,628,888)</u>	\$ <u>96,243,119</u>	\$ <u>46,514,997</u>	\$ <u>(112,166,699)</u>	\$ <u>(221,527,834)</u>	\$ <u>(4,625,546,015)</u>
<b>Total Return, 12, 24, and 36 and 60 months:</b>								
12 months	7.14%	2.80%	-4.96%	16.49%	13.77%	8.23%	-4.38%	2.90%
24 months	9.28%	7.69%	2.16%	4.44%	11.80%	N/A	N/A	6.13%
36 months	11.56%	11.15%	1.41%	-11.02%	2.10%	N/A	N/A	5.18%
60 months	8.37%	N/A	-1.23%	-3.42%	4.39%	N/A	N/A	2.96%