State of New Mexico
LEGISLATIVE FINANCE COMMITTEE

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LFC INVESTMENT REPORT FOR THE QUARTER ENDING MARCH 31, 2016

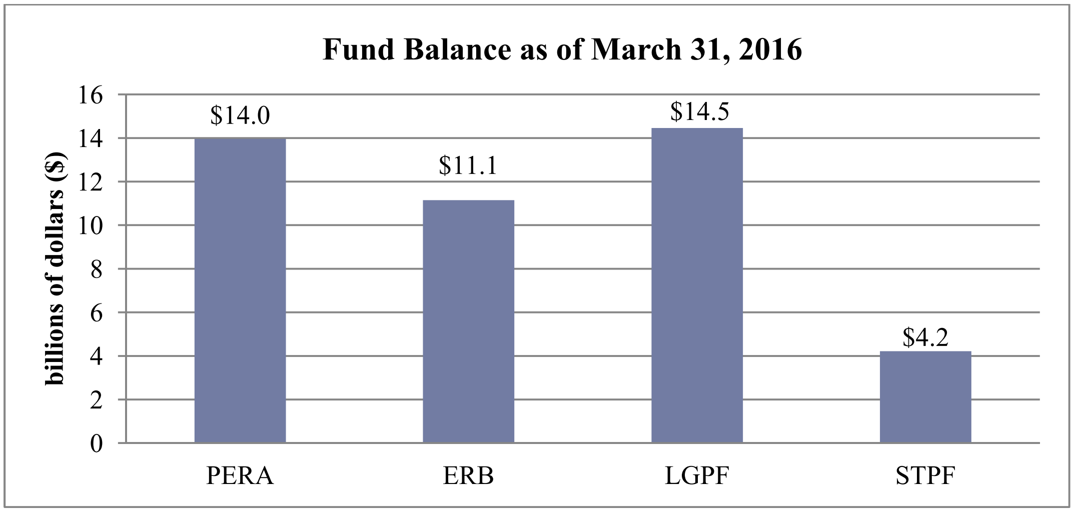
This report details the comparative investment performance of the three investment agencies: the Educational Retirement Board (ERB), the Public Employees Retirement Association (PERA), and the State Investment Council (SIC). The report outlines how the returns generated by these agencies differed from that of the archetypical public investment fund and how management and consultants added or subtracted value. As long-term performance is an important metric, this report includes fund returns and comparative rankings for the one, three, five, and ten-year periods.

Market Environment.

- U.S. Federal Reserve Chair Janet Yellen stated during the March meeting that less favorable global economic indicators and financial conditions 'have increased the risks' to the outlook, leading to a cautious stance for potential interest rate hikes later in the year.
- The U.S. yield curve fell sharply during the quarter, with the lowest point in February when the 10-Year Treasury dropping to historic low territory of 1.6 percent.
- The deep decline in oil prices reached a floor in February; a rally in March provided a reprieve and a slight recovery to earlier losses.
- Japan followed the European Central Bank in adopting a negative overnight interest rate policy, charging banks to hold cash with the national bank. Divergent global monetary policies continued as quantitative easing and negative interest rates provided support for markets in a slow economic growth environment.
- Anxiety grew over the upcoming vote on June 23rd in the U.K., the 'Brexit' referendum, to determine continued participation in the European Union.
- Global currencies strengthened against the U.S. dollar lifted by investor confidence and commodity price upward support during the quarter.

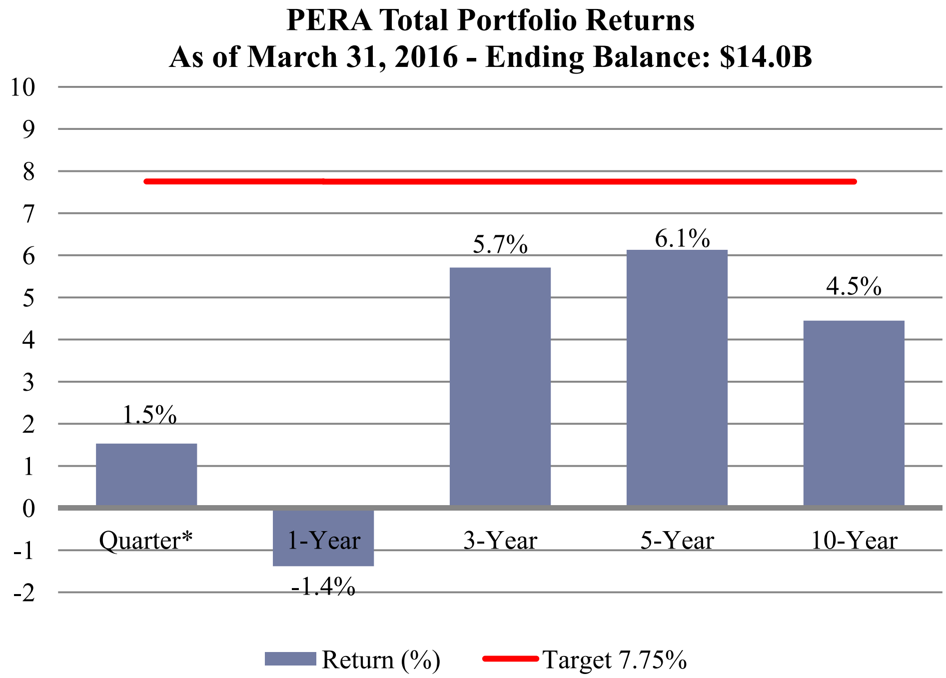
Market Environment as of March 31, 2016				
Index Returns (%)	**Q1 2016**	**1 Year**	**5 Years**	**10 Years**
S&P 500	1.4	1.8	11.6	7.0
Wilshire 5000	1.2	0.2	11.0	7.0
Russell 3000	1.0	-0.3	11.0	6.9
Dow Jones Industrial	2.2	2.1	10.3	7.6
MSCI EAFE	-3.0	-8.3	2.3	1.8
Barclays Govt/Credit	3.5	1.8	4.0	4.9

Returns and Ending Balances. The following tables summarize the ending balances for the quarter March 31, 2016 as well as the agencies' investment returns for the quarter and for the one, three, five, and ten-year periods, on the following page.

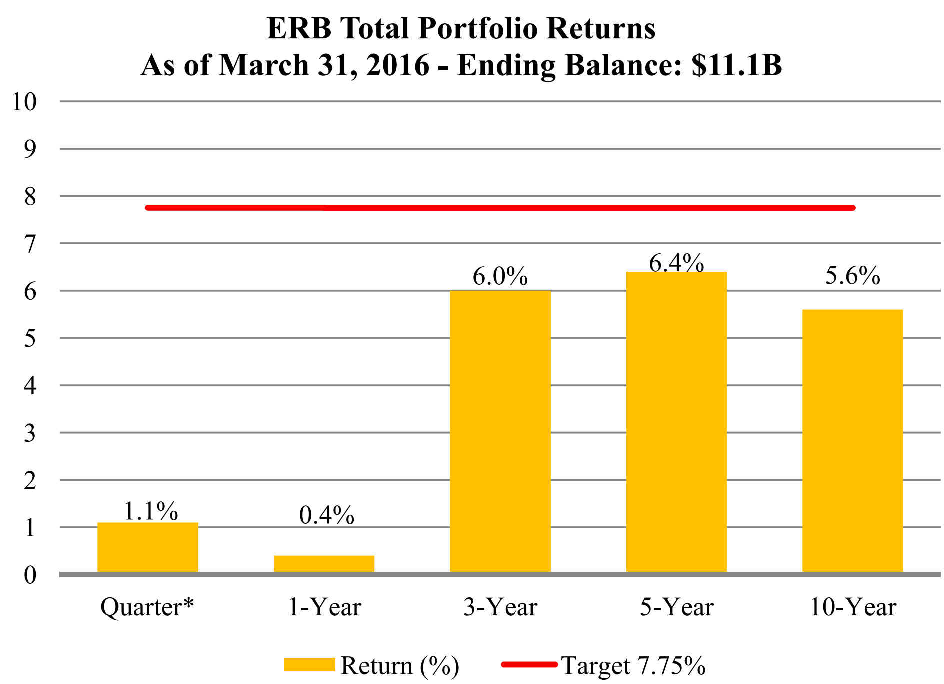


The third quarter of the fiscal year began with volatile market swings leading to speculation as to whether a continued downturn was in store. Macro activities through mid-February gave way to an upswing in the market. By the end of the quarter the market had reversed some of the losses experienced during the prior quarter ended December 31. The reverse in direction helped investment agencies to stabilize performance to meet their return targets. The short term one year period was especially sensitive to volatility in global markets and a continued drop in the oil market which has diminished investment balances and long term potential returns. The longer investment periods reflect the economic and market post-recession recovery after 2009. Ten-year returns fall short of long-term targets because they reflect challenged investment performance during the global financial crisis. Long range performance also reflects narrow investment portfolio diversification through the restriction of alternative asset investments given policy terms in place at the time. All three investment agencies actively pursue diversifying and creating depth in their respective portfolios to permit fewer investment losses during periods of broad market swings.

Each of the portfolios established a return policy target. ERB and PERA are 7.75 percent. SIC has lowered the investment target at 7.0 percent for the LGPF and at 6.75 percent for the STPF. The lower target for STPF considers the inclusion of economically targeted investments (ETIs). SIC's decision to lower the targets included a review of factors including the distribution policy, maintaining intergenerational equity, future return expectations and risk levels. Significantly lower contributions from the State Land Office due to the broad decline in oil prices over the last year, presented pressure for investments to generate larger returns as an off-set to keep the LGPF and STPF healthy. ERB and PERA are currently reviewing their return targets. The agencies have noted that future return assumptions in volatile markets have steadily declined throughout the investment industry over the last eight years.



Source: Investment Agency Reports
*not annualized



Source: Investment Agency Reports
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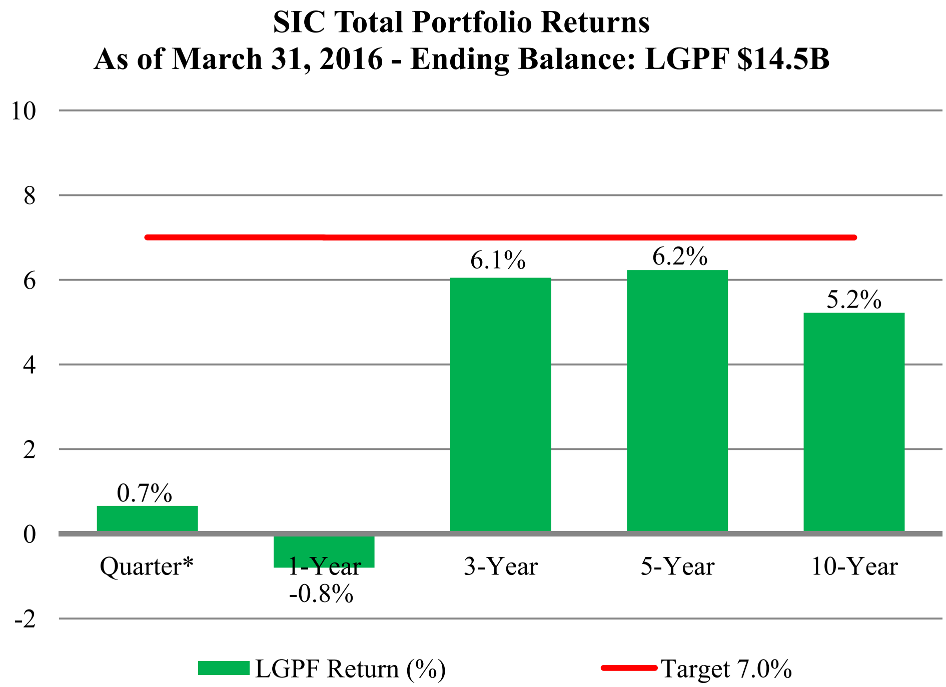

Source: Investment Agency Reports
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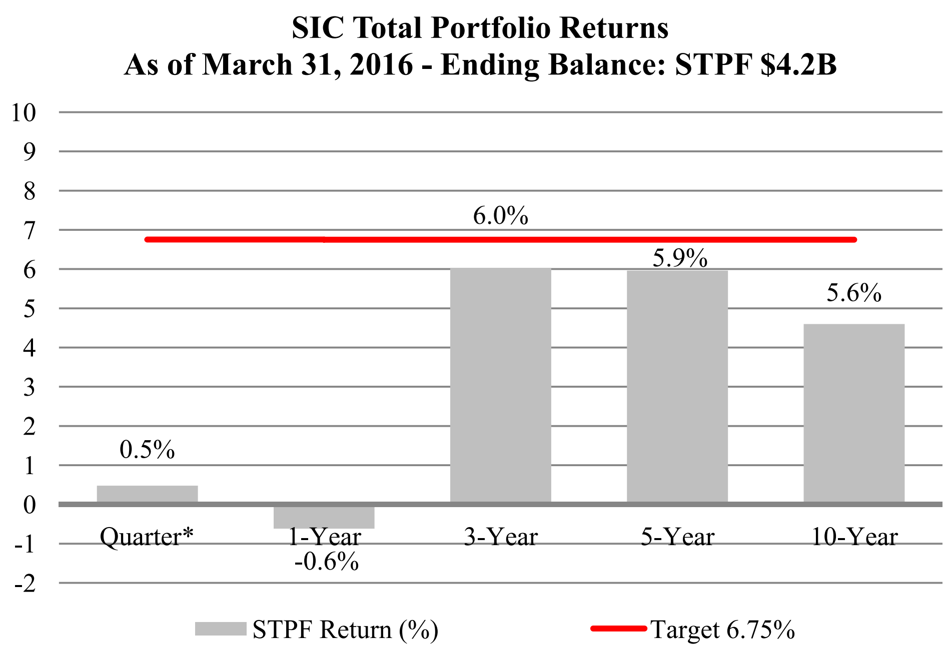

Source: Investment Agency Reports
*not annualized

Peer Total Return Rankings.

The following table shows net-of-fees peer total return rankings for the agencies' large funds for the quarter, one, three, five, and ten-year periods. A lower rank (1st is best) denotes better performance when compared to other public funds within a comparable investment universe. These comparisons are completed by the Wilshire Trust Universe Comparison Service (TUCS), a benchmark service which evaluates the performance and allocation of institutional investment assets. New Mexico's investment agencies are evaluated alongside approximately 50 public funds with more than $1 billion in assets. SIC notes not all of its investments report returns net-of-fees[1].

During the third quarter, PERA improved, shifting their ranking from 75th percentile the quarter prior to 28th percentile. ERB, LGPF and STPF significantly declined in rankings as the impact of market swings took its toll. When compared against comparable funds in the universe, ERB ranked at the 61st percentile, a deep drop from the 35th percentile earned earlier. LGPF and STPF which ranked at the 59th and 23rd percentiles during the prior quarter fell to 88th and 93rd percentiles respectively.

For the recent year, ERB continued to outperform at the 23rd percentile as PERA, LGPF and STPF ranked at 68th, 57th and 50th percentiles. All four investment funds have underperformed in the three, five and ten year percentile rankings. The rankings reflect the ability to manage volatility through asset allocation, correlation between asset classes and defensively balance portfolio risk and return. Over the longer ten-year period, all of the investment agencies reflect the market challenges of the last 18 months, subsequently impacting their attempts to achieve established long term investment goals.

Staff from all three investment agencies acknowledge their performance rankings in the long-term are impacted by policy limitations of their asset allocations during the measured time periods and by extreme economic conditions during the great recession. As the agencies adjusted their investment policies to permit diversified portfolios through the inclusion of alternative investments, the volatility of equity markets had a stronger impact on their returns. If the investment agencies meet or exceed their annual return targets in the short- and mid-terms there is an expectation their long-term (10 years and greater) performance rankings will improve over time.

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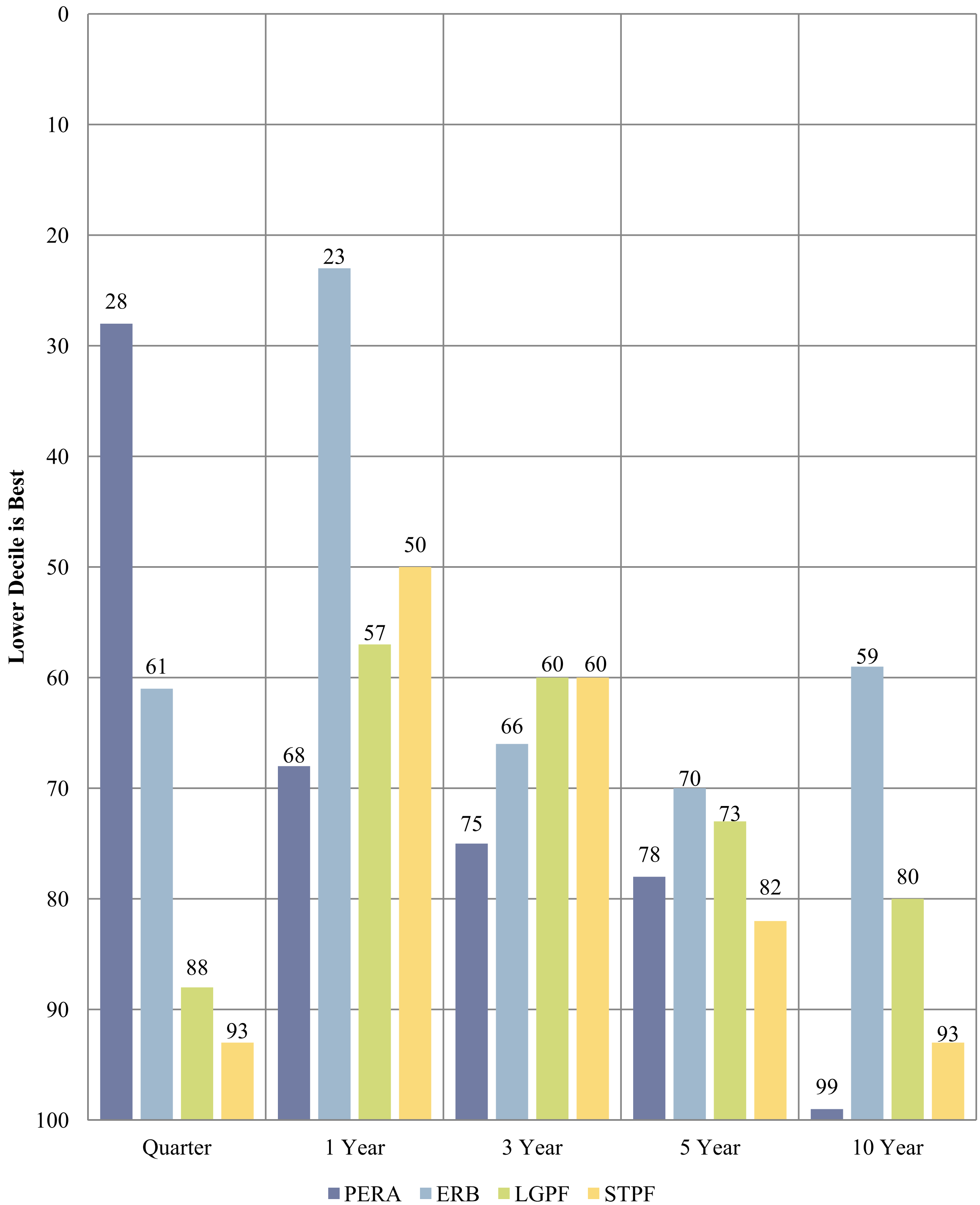
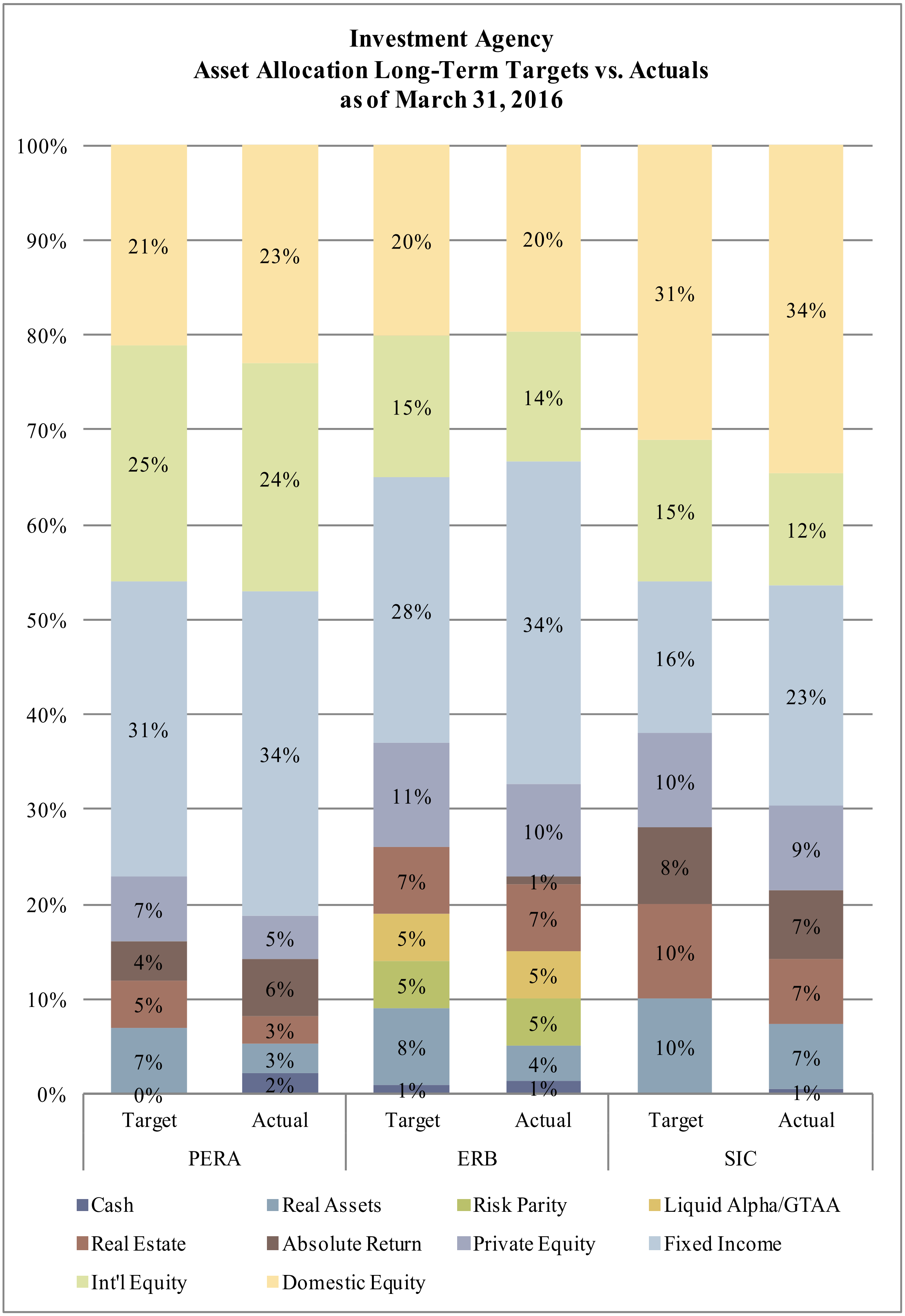
[1] In those cases, SIC's primary investment consultant (RVK) manually adjusts the returns by applying generic costs by asset class, a common practice performed by at least 95 percent of the funds included in TUCS. As SIC's investment advisor, RVK does not have access to the active versus passive mix for any individual fund within the universe, SIC acknowledges in some cases the application of a generic fee could represent an estimated adjustment. The rankings reported in the table reflect gross of fees for LGPF and STPF.

TUCS Universe Rankings
(Public Funds > $1 Billion)
For Period Ending March 31, 2016




Investment Agency
Asset Allocation Long-Term Targets vs. Actuals
as of March 31, 2016
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
21%
25%
31%
7%
4%
5%
7%
0%
23%
24%
34%
5%
6%
3%
3%
2%
20%
15%
28%
11%
7%
5%
5%
8%
1%
20%
14%
34%
10%
1%
7%
5%
5%
4%
1%
31%
15%
16%
10%
8%
10%
10%
34%
12%
23%
9%
7%
7%
7%
1%
Target
Actual
Target
Actual
Target
Actual
PERA
ERB
SIC
Cash
Real Assets
Risk Parity
Liquid Alpha/GTAA
Real Estate
Absolute Return
Private Equity
Fixed Income
Int'l Equity
Domestic Equity