



New Mexico State Investment Council



INVESTMENTS & PENSIONS OVERSIGHT COMMITTEE

INVESTMENT PERFORMANCE

LONG TERM INVESTMENT STRATEGY

MANAGEMENT FEES

JULY 10, 2013



STATE INVESTMENT COUNCIL

Investment Performance as of May 31, 2013

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General Market Commentary

The US housing market continues to show signs of recovery, and the S&P/Case-Shiller 20 City Composite Index value for March reached its highest level since 2008. The index has increased 10.87% over the trailing one-year period.

Europe's dismal economic performance continues, as real GDP contracted by 0.8% annualized during the first quarter in the Eurozone. Unemployment rose to 12.2% in April, youth levels reaching 24.4%.

Equity markets posted mixed returns in May as the S&P 500 (Cap Wtd) Index returned 2.34% and the MSCI EAFE (Gross) Index returned -2.31%.

The Barclays US Aggregate Bond Index returned -1.78% in May, underperforming the Barclays US Treasury return of -1.06%.

Absolute return strategies, as measured by the HFN FOF Multi-Strat Index, returned 0.78% for the month and 8.43% over the trailing one-year period.

Crude oil's price fell by 1.59% during the month but has increased by 6.29% over one year.

NMSIC Performance Summary

US equities were additive to total fund absolute performance in May, outperforming their primary benchmark by 38 basis points, while non-US equities returned -2.50% and underperformed their benchmark by 19 basis points.

Both international developed and emerging markets posted negative absolute returns over the month.

The large-cap US equity composite returned 2.23% in May, tracking the Russell 1000 Index. The small/mid cap US equity pool returned 5.79%, 270 basis points higher than the Russell 2500 Index.

Brown Brothers returned 1.38%, lagging the Russell 1000 Index by 84 basis points. Donald Smith returned 5.75%, outperforming the Russell 2000 Value Index by 276 basis points.

In May, the core bonds pool returned -1.94%, trailing the Barclays US Aggregate Bond Index by 16 basis points. All fixed income managers underperformed their respective benchmark during the month.

Land Grant Asset Allocation vs. Interim Target

	Asset Allocation (\$)	Asset Allocation (%)	Interim Target (%)	Differences (%)
Land Grant Total Fund Composite	12,263,637,922	100.00	100.00	0.00
US Equity	4,736,089,963	38.62	37.00	1.62
Non-US Equity	1,757,135,911	14.33	15.00	-0.67
Fixed Income	2,847,308,313	23.22	20.00	3.22
Absolute Return	782,778,830	6.38	7.00	-0.62
Private Equity	1,149,317,452	9.37	10.00	-0.63
Real Estate	697,899,832	5.69	8.00	-2.31
Real Return	236,129,957	1.93	3.00	-1.07
Cash Equivalent	56,977,664	0.46	0.00	0.46

Severance Tax Asset Allocation vs. Interim Target

	Asset Allocation (\$)	Asset Allocation (%)	Interim Target (%)	Differences (%)
Severance Tax Total Fund (Ex. ETI) Composite	3,960,037,062	100.00	100.00	0.00
US Equity	1,540,418,001	38.90	37.00	1.90
Non-US Equity	608,242,948	15.36	15.00	0.36
Fixed Income	869,738,174	21.96	20.00	1.96
Absolute Return	251,051,063	6.34	7.00	-0.66
Private Equity	358,934,280	9.06	10.00	-0.94
Real Estate	252,747,762	6.38	8.00	-1.62
Real Return	56,997,687	1.44	3.00	-1.56
Cash Equivalent	21,907,147	0.55	0.00	0.55

	MTD	QTD	CYTD	FYTD	1 Year	3 Years	5 Years	10 Years
NMSIC Total Fund Composite	0.43	2.00	7.03	14.32	17.75	11.13	3.92	6.99
Land Grant Total Fund Composite	0.45	2.03	7.11	14.48	17.81	11.18	4.10	7.12
<i>Land Grant Policy Index</i>	<i>0.29</i>	<i>1.51</i>	<i>6.76</i>	<i>13.81</i>	<i>17.22</i>	<i>12.21</i>	<i>4.50</i>	<i>7.17</i>
Difference	0.16	0.52	0.35	0.67	0.59	-1.03	-0.40	-0.05
Severance Tax Total Fund Composite	0.40	1.88	6.52	13.35	17.03	10.59	2.97	6.44
<i>Severance Tax Policy Index</i>	<i>0.29</i>	<i>1.51</i>	<i>6.76</i>	<i>13.81</i>	<i>17.22</i>	<i>12.27</i>	<i>4.38</i>	<i>7.25</i>
Difference	0.11	0.37	-0.24	-0.46	-0.19	-1.68	-1.41	-0.81

NMSIC Total Fund - Schedule of Investable Assets

Periods Ending	Beginning Market Value (\$)	Net Cash Flow (\$)	Gain/Loss (\$)	Ending Market Value (\$)	%Return
CYTD	16,272,051,380	-48,352,246	1,142,093,283	17,365,792,417	7.03



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Investment Performance

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- **Preliminary June 30 data: SIC assets under management are \$17.013 billion**
 - Permanent Funds & governmental client accounts
 - All time high for FY end
 - LGPF estimated value: \$12.024 B
 - STPF estimated value: \$4.124 B
- **New FY high for LGPF**
 - \$1.3 billion increase year-over-year
- **STPF grew by \$600 million year-over-year**
 - Remains \$600 million below all-time FY high in 2007
 - Why?



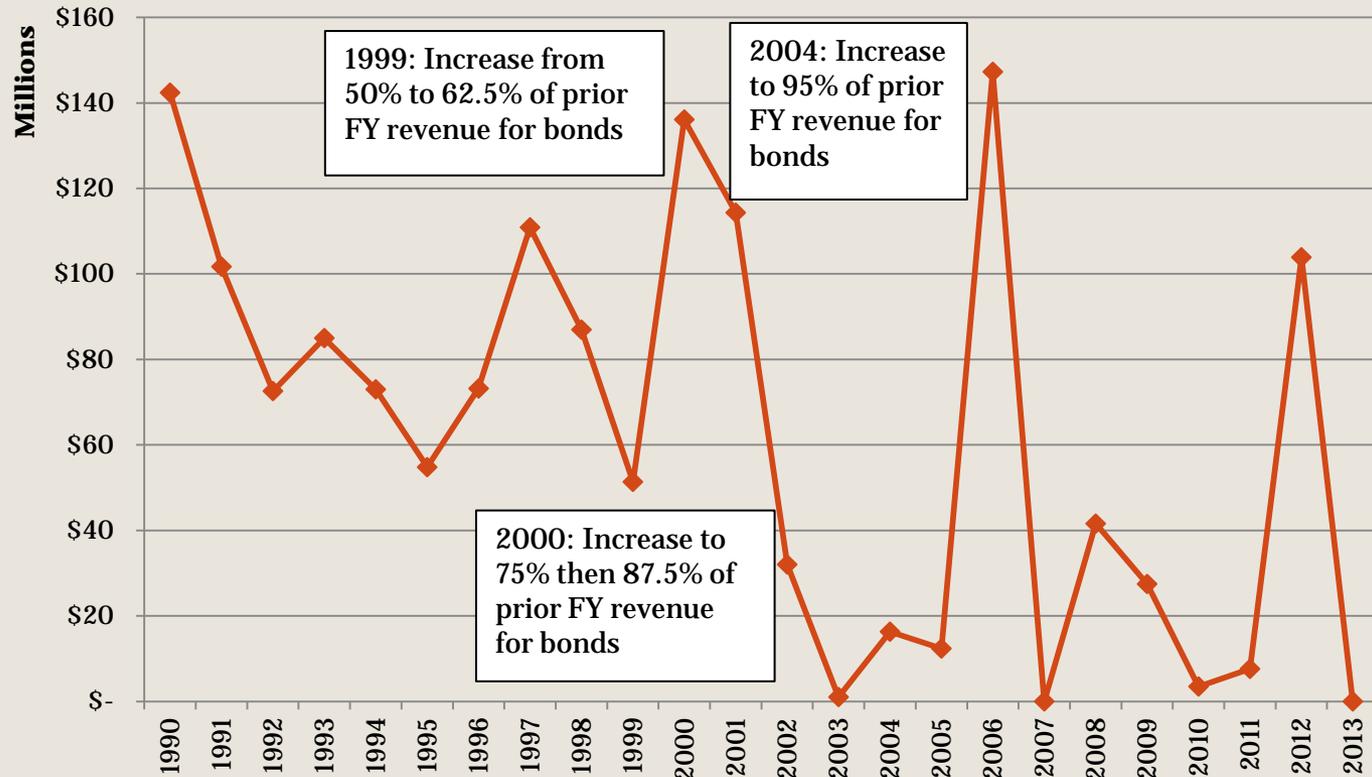
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Transfers from Severance Tax Bonding Fund to STPF

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Calendar Year	Amount Transferred
1990	\$ 142,400,000
1991	\$ 101,700,000
1992	\$ 72,600,000
1993	\$ 85,000,000
1994	\$ 73,000,000
1995	\$ 54,800,000
1996	\$ 73,200,000
1997	\$ 110,895,604
1998	\$ 86,966,166
1999	\$ 51,356,981
2000	\$ 136,113,342
2001	\$ 114,325,831
2002	\$ 32,034,751
2003	\$ 1,032,282
2004	\$ 16,318,268
2005	\$ 12,371,958
2006	\$ 147,282,474
2007	\$ 8,029
2008	\$ 41,590,792
2009	\$ 27,472,206
2010	\$ 3,488,067
2011	\$ 7,617,058
2012	\$ 103,888,282
2013	\$ 85

Severance Tax Contributions to Severance Tax Permanent Fund





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Defining long-term return targets

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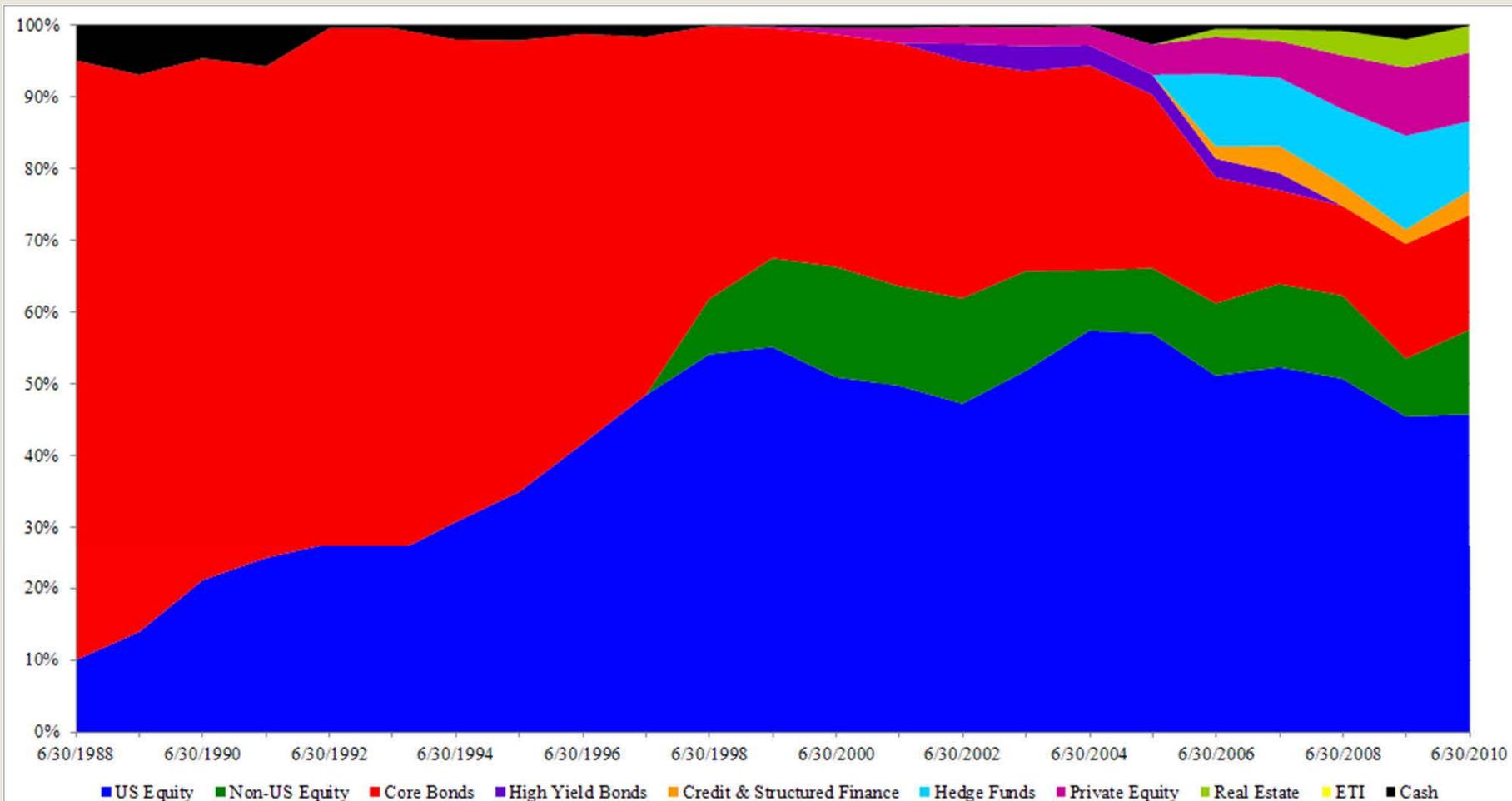
- **Asset allocation paramount to achieve strong returns**
- **2011 Council asset allocation study**
 - Council, advisor RV Kuhns & staff participated
 - Reviewed current portfolio target and risk level
 - 8.5% target lowered to 7.5%
- **Goal: reduce risk & volatility**
 - Shift focus away from public equity risk
 - Increase diversification & income stream; decrease volatility
 - Increase exposure to income-producing investments that protect purchasing power
 - Decrease exposure to assets that rely on capital gains for returns



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SIC Asset allocation history

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Asset allocation study results

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- 2011 study results:
- Real Estate
 - Increase from 5% to 10%
- Real Return
 - Increase from 0% to 10%
- Absolute Return
 - Increase from 5% to 8%
- US Equity
 - Reduce from 45% to 31%
- Fixed Income
 - Reduce from 20% to 16%

	Current Target	Potential #2	Difference
Broad US Equity	45%	31%	-14%
Broad International Equity	15%	15%	0%
Int. Duration Fixed Income	20%	16%	-4%
Real Return	0%	10%	10%
Core Real Estate	5%	10%	5%
Absolute Return	5%	8%	3%
Private Equity	10%	10%	0%
Total	100%	100%	
Thematic Categories			
Capital Appreciation	70%	56%	-14%
Capital Preservation	20%	16%	-4%
Alpha	5%	8%	3%
Inflation	5%	20%	15%
Portfolio Statistics			
Expected Return (Arithmetic)	7.82%	7.73%	-0.09%
Risk (Standard Deviation)	13.84%	12.33%	-1.51%
Return (Compound)	6.94%	7.03%	0.09%

All Public Plans > \$1 Billion Peer Group Median					
US Equity	Non-US Equity	Fixed Income	Real Estate	Alternatives	Cash
35%	19%	27%	7%	10%	2%



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Asset Allocation & Investment Management Fees

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- **Strategy impact on management fees**
 - Investment strategy is what determines fee structure
 - Fees should not determine investment strategy
- **Don't limit diversification needed to meet goals**
- **Define investment objectives**
 - Identify how you can reach goals with least risk
 - Diversify portfolio
 - Consider best-in-class managers charging market-rate
 - Then negotiate fees
- **Lower fees to bigger funds/economies of scale**

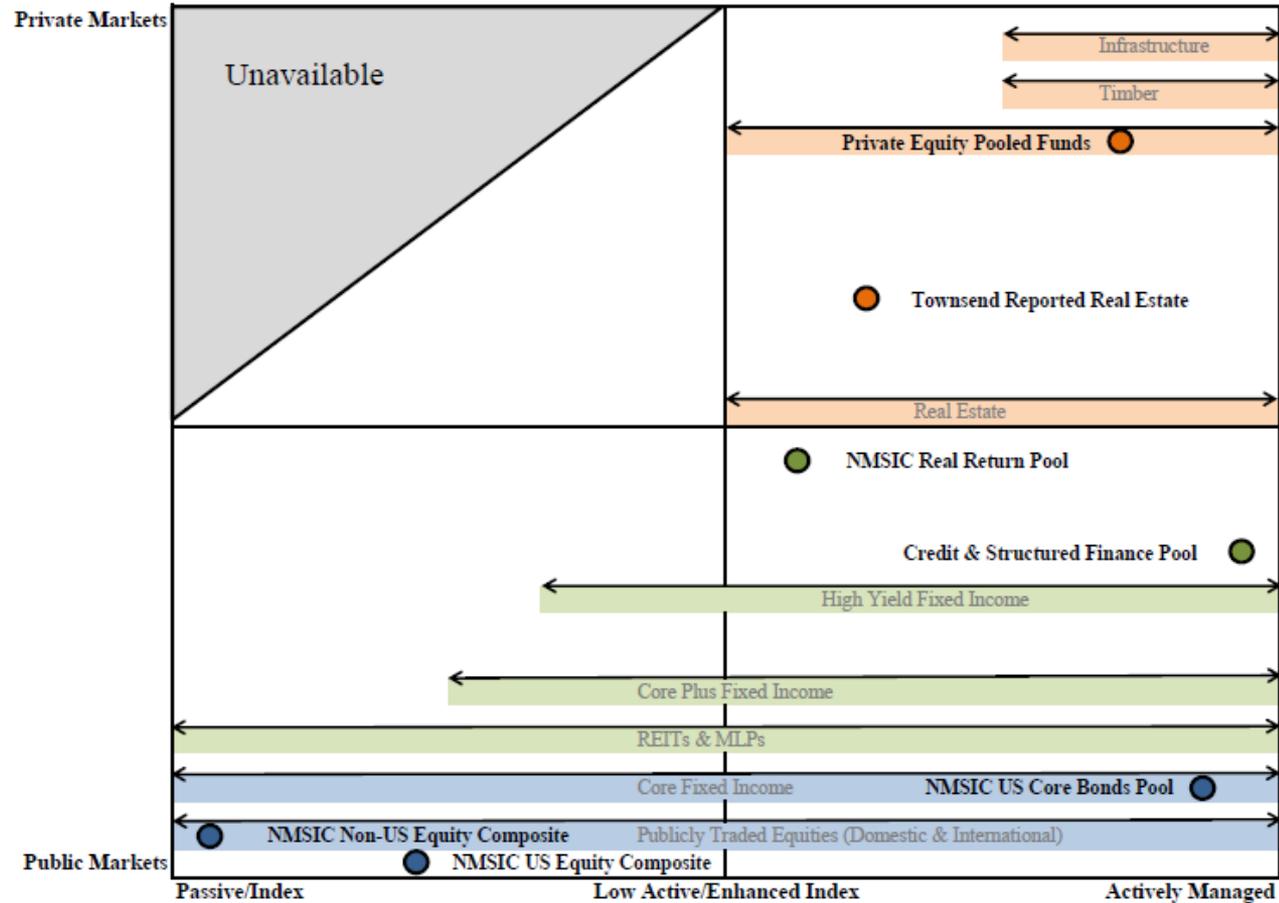


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Asset allocation & Investment Management Fees

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New Mexico State Investment Council
Investment Strategy Matrix
As of March 31, 2013





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Understanding Investment Management Fees

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- **Publicly traded stocks and bonds**
 - Management fees based on total assets
- **Sometimes there is an incentive fee for performance**
 - SIC does not use performance fees (risk incentive)
- **Fees paid through budgeting process**
- **Alternative investments**
 - Management fees typically “embedded” w/assets under mgmt
 - Various cost ranges depending on asset class
- **Various fee structures**
 - Goal is to align manager’s interest with ours



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Understanding Investment Management Fees

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- **Example: NMSIC Private Equity**
 - Mature portfolio, \$1.5 billion
 - ✦ 120 funds, 1997-2013 vintage
 - ✦ Market average management fee of 1.5%-2%, plus carried interest
 - Manager makes capital calls to fund investments, fees included
 - 102 of 120 SIC (85%) fund contracts require fees to be refunded with SIC's preferred rate of return on invested capital
 - SIC gets 8% preferred return, plus fees back
 - Manager then gets share of profits (usually 20%)
 - So majority of time, SIC pays "no" fees if the fund is profitable
- **Manager incentivized to produce high profits**



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Final Thoughts

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- **How do SIC management fees relate to our peers?**
 - Market rate or lower
 - Council always attempts to negotiate lower fees
- **Returns on investment**
 - ROI expected to be \$2-\$3 for every additional \$1 paid in fees
- **Alternatives**
 - Active vs. Passive
 - ✦ Benefits to using combination
 - Additional internal management
 - ✦ Would require restructuring of current organization, qualifications and compensation abilities of SIC