

New Mexico State Investment Council

Presentation to

Investments Oversight Committee

Investment Performance & Ongoing Changes at SIC

June 9, 2011

State Investment Officer Steve Moise
Deputy SIO Vince Smith
SIC General Counsel Evan Land

SIC overview & update since Dec 2010 IOC

- SIC investment performance improvement
 - Investment gains of \$1.9 billion in 12 months ending 3/31/11
 - \$1.7 billion in last 6 months (ending 3/31)
 - Top quartile performance for 1 year
 - 3 year, 5 year and longer term performance improving
- Investment process changes
- Governance changes
- Council membership changes
- Pursuing investment recovery litigation

SIC overview & update since Dec 2010 IOC

- Recovery suits filed in state & federal courts
 - Attorney General & Day Pitney
 - Gary Bland, Guy Riordan, Marc Correra, Anthony Correra
 - 12 placement agents & other defendants
 - First salvo
 - Cooperation with DOJ
- Legislation passed:
 - SB 86 – Contingency fee authorization
 - SB 82 – Removes SIO from boards
 - HB 31 – Water Permanent Fund standard of care
 - Short list of priority legislation for 2012

SIC overview & update since Dec 2010 IOC

- Governance changes
 - New Council members:
 - Governor Susana Martinez
 - Land Commissioner Ray Powell
 - DFA Secretary Rick May
 - Scott Smart, VP of Business Affairs @ ENMU
 - Two vacancies
 - SIC committees
 - Audit
 - Governance
 - Investment
 - Private Equity Investment Advisory Committee

SIC overview & update since Dec 2010 IOC

- Governance changes
 - 14 policies/procedures adopted or updated
 - Ennis Knupp recommendations:
 - 49 of 82 implemented or in progress
 - Staff Code of Ethics
 - Mission Vision Values



NEW MEXICO STATE INVESTMENT COUNCIL

Mission:

"To protect and grow the state's permanent endowment funds for current and future generations, through prudent, professional investment management"

Vision:

"To become one of the best performing, most respected sovereign wealth funds worldwide"

Values:

Accountability – Being: responsible, knowledgeable, trustworthy

Excellence – Possessing: skills, professionalism, quality

Integrity – Exhibiting: ethics, principles, honesty

Pride – Showing: leadership, ownership, commitment

Respect – Encouraging: teamwork, communication, collegiality

SIC overview & update since Dec 2010 IOC

- Performance Goals: Consistently at least 2nd Quartile
- Investment changes
 - Investment philosophies adopted
 - Investment staff restructuring
 - Asset allocation study under RV Kuhns guidance
- New investment consultants
 - RV Kuhns – Overall investment consultant
 - LP Capital – private equity consultant
- Investment managers
 - Nine external managers terminated for underperformance
 - Several RFPs completed, several more pending
 - Increased external management

SIC overview & update since Dec 2010 IOC

- SIC Investment Performance Improvement
 - Funds grew from \$13.999B to \$15.350B, year ending 3/31

Weight	New Mexico State Investment Council	Market Value (\$ in Millions)	Fiscal													
			Quarter	Rank	YTD	Rank	1 Year	Rank	3 Years	Rank	5 Years	Rank	10 Years	Rank	15 Years	
1	70%	Land Grant Permanent Fund ¹	\$10,682	5.0%	10	22.0%	8	14.2%	17	3.2%	32	4.2%	60	5.4%	68	7.2%
2		Land Grant Allocation Index ²		5.1%	7	22.5%	5	15.2%	7	3.1%	34	3.8%	68	5.1%	73	n/a
3		Land Grant Policy Index ³		5.5%	6	23.6%	6	15.9%	5	3.3%	32	3.9%	67	5.2%	72	6.8%
4	26%	Severance Tax Permanent Fund ¹	\$3,952	5.5%	6	22.0%	8	13.5%	26	1.9%	61	3.2%	73	4.6%	79	6.8%
5		Severance Tax w/o ETI ⁴	\$3,651	5.5%	6	23.4%	6	14.3%	17	2.8%	45	3.8%	68	5.1%	73	7.3%
6		Severance Tax Allocation Index ²		5.3%	7	22.9%	5	15.4%	7	2.2%	56	3.4%	72	4.9%	74	n/a
7		Severance Tax Policy Index ³		5.5%	6	23.6%	6	16.2%	4	3.1%	34	4.0%	66	5.3%	72	7.0%
8		60% S&P500 / 40% BC Aggregate Index		3.7%		18.4%		11.8%		4.1%		4.4%		4.6%		6.9%
9		90 Day T-Bills		0.0%		0.1%		0.2%		0.5%		2.2%		2.2%		3.3%
10		ICC Endowments / Foundations > \$250 M Median		3.3%		16.2%		12.4%		2.6%		4.5%		6.2%		--
11	5%	All Other Funds	\$715													
12	100%	Total NMSIC Investments	\$15,350													
13		Land Grant Permanent Fund ⁵	\$10,728	4.9%	10	21.6%	9	13.8%	23	3.5%	21	4.4%	57	5.5%	66	7.2%
14		Severance Tax Permanent Fund ⁵	\$3,937	5.5%	6	21.0%	9	12.5%	47	1.9%	62	3.2%	73	4.6%	79	6.8%

1 Performance reflects unrealized gain/loss due to securities lending. Rank is versus the ICC Endowment & Foundations > \$250 M Universe.

2 Allocation Index is calculated by taking the actual manager allocations and multiplying by the return of the respective manager's benchmark.

3 Policy Index is calculated by taking the investment policy target asset class weights and multiplying the return of the respective investment policy benchmarks.

4 Performance and market values reflects Severance Tax Permanent Fund without ETI & State PE allocation.

5 Performance does not reflect unrealized gain/loss due to securities lending.

Note: Returns are gross of fees

SIC overview & update since Dec 2010 IOC

- Investment Performance for year ending 3/31/11:
 - Land Grant Permanent Fund up 14.2%
 - Severance Tax Permanent Fund up 14.3%
 - STPF returns 13.5% with ETI drag
- Investment Performance for quarter ending 3/31/11:
 - Top 10% or better performance ranking vs. ICC peers
 - Top 5% vs. peers in Wilshire TUCS Universe
- One-year returns top quartile (ending 3/31/11)
 - Longer-term performance improved
 - Previously lower bottom quartile, now moving toward median

SIC Investment Philosophies & Beliefs

Macro Beliefs

- Institutional investing is a “global” endeavor, long-term in nature, and requires patience and steadfastness.
- The economic environment is a major driver of asset returns and the impact of current economic conditions and future economic direction on the major asset groups must be understood and monitored.
- Valuation plays a significant role in determining asset returns and should be monitored and managed.

Portfolio Construction Beliefs

- Asset allocation (beta) is the primary determinant of our portfolio’s return.
- Strategy selection and asset class (or group) construction--the implementation of the asset allocation--drives portfolio returns second-most.
- Manager performance relative to benchmarks (alpha) has the least impact on long-run portfolio returns.

Management Beliefs

- Asset allocation is a policy decision and must be arrived at by consensus and directly by the primary fiduciaries of the funds.
- Portfolio construction and implementation should be the focus of a core group of trained and seasoned investment professionals.
- Responsibilities and accountabilities must clear and well understood by all.

Moving Toward Portfolio Management Consistent with Investment Philosophies & Beliefs

- ***Reduce dependence (within established constraints) on domestic (U.S.-based) investments***
 - Greater economic growth, and therefore greater potential returns, exist outside of the U.S.
 - The majority of the world's stock market, the majority of the world's bond market, and the majority of the world's real estate market exist outside of the U.S. (enhances the investment opportunity set).
 - Greater diversification of the portfolio can be achieved (meaning the same return at lower risk is available or greater return for the same risk can be achieved).
- ***Reduce dependence on publicly-traded equity as a return driver***
 - Increases diversification – can provide similar return at lower risk.
 - Decreases the excess liquidity presently in the portfolio to gain return from the 'illiquidity premium'
- ***Focus on asset allocation as the primary method of generating return***
 - Engage the full Council, the investment consultant, and staff in regular, structured studies and reviews of asset allocation. Arrive at conclusions in a consensus-based environment.
 - Seek to employ an understanding of the economic environment in portfolio management.
 - Seek to employ an understanding of valuation in portfolio management.
- ***Focus the professional staff on implementing the asset allocation with most effectiveness***
 - Reduce internal management of portfolios – this is the least effective way to generate return.
 - Increase use of external managers – this increases availability of strategies
 - Restructure staff, make new hires, and focus staff on implementation, strategy selection, portfolio construction and manager selection.

Asset Allocation Study – The Basis of Generating Return

Asset classes used in the study. Each asset class has a unique assumption regarding return, risk and correlation.

Asset class constraints that specify the minimum/maximum amount of exposure the model can select. Constraints are based on investment policy objectives and qualitative judgment.

Efficient portfolios constructed by the optimization model based on risk, return and correlation to other assets.

Your portfolios' target allocation

Thematic investing allocations that bucket the asset classes into four distinct investment objectives.

Capital Appreciation includes US and Int'l Equities. Capital Preservation includes Fixed Income. Alpha includes Absolute Return. Inflation includes Real Return and Real Estate.

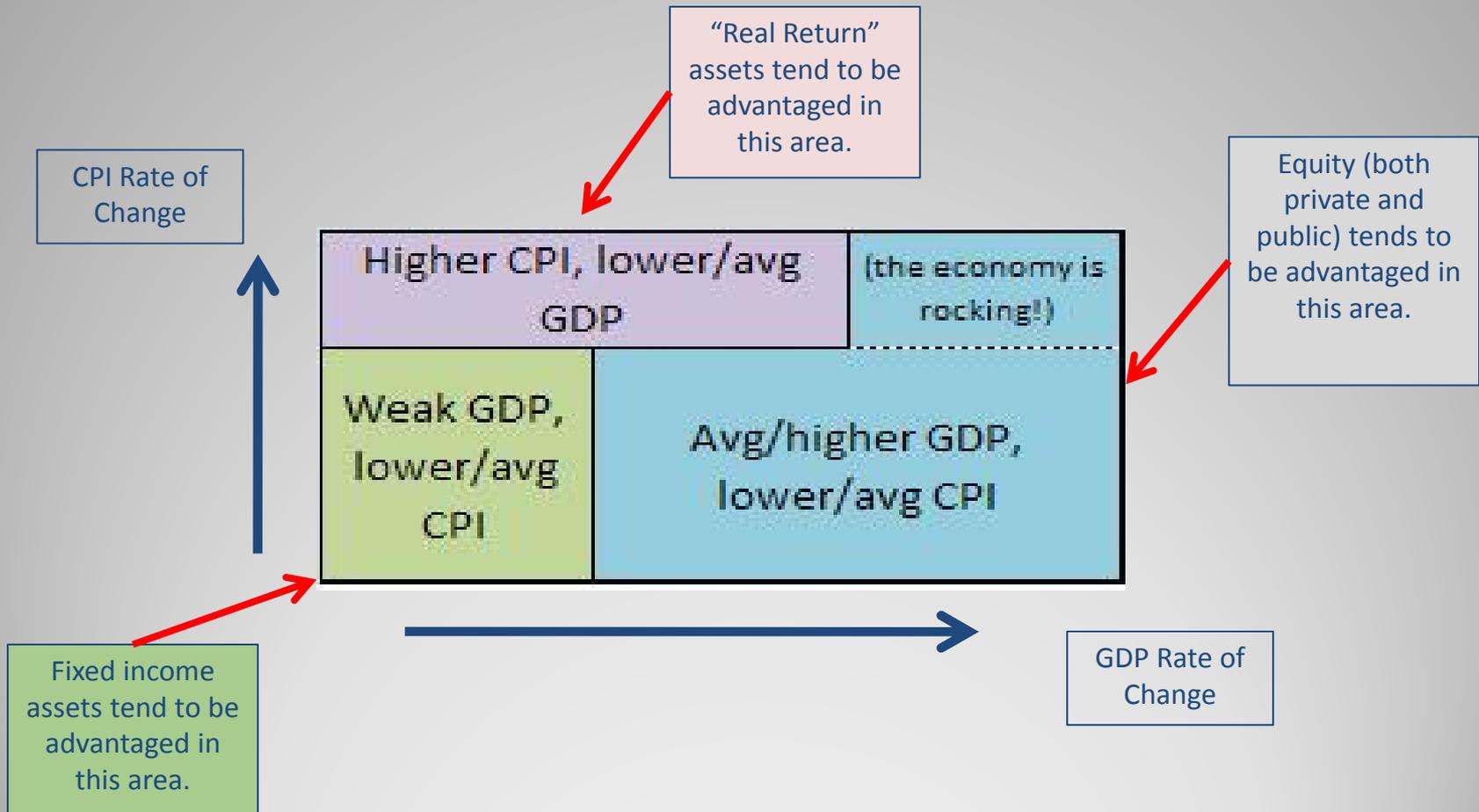
Expected Return = the long-term weighted average return of the portfolio based on the asset mix identified above.

Risk = the expected portfolio volatility based on the individual asset volatilities, correlations, and asset mixes for each portfolio.

	Min	Max	1	2	3	4	5	6	7	8	9	10	Land Grant	Severance Tax
Broad US Equity	0	60	40	34	30	27	24	28	32	36	40	50	51	48
Broad International Equity	0	10	4	7	7	7	10	10	10	10	10	10	10	10
Int. Duration Fixed Income	10	30	30	30	30	30	28	24	20	16	12	10	15	12
Core Real Estate	0	6	6	6	6	6	6	6	6	6	6	0	3	3
Absolute Return	0	20	20	20	20	20	20	20	20	20	20	18	15	15
Private Equity	0	12	0	3	7	11	12	12	12	12	12	12	6	12
Total			100	100	100	100	100	100	100	100	100	100	100	100
Capital Appreciation			44	44	44	44	46	50	54	58	62	72	67	70
Capital Preservation			30	30	30	30	28	24	20	16	12	10	15	12
Alpha			20	20	20	20	20	20	20	20	20	18	15	15
Inflation			6	6	6	6	6	6	6	6	6	0	3	3
Expected Return			6.88	7.02	7.17	7.32	7.47	7.62	7.77	7.91	8.06	8.21	7.77	8.12
Risk (Standard Deviation)			9.75	9.88	10.08	10.34	10.81	11.46	12.12	12.78	13.46	14.72	13.45	14.36
Return (Compound)			6.44	6.57	6.70	6.83	6.93	7.01	7.09	7.16	7.23	7.22	6.94	7.18
Return/Risk Ratio			0.71	0.71	0.71	0.71	0.69	0.66	0.64	0.62	0.60	0.56	0.58	0.57
RVK Expected Eq Beta (LC US: Eq = 1)			0.52	0.52	0.53	0.54	0.55	0.59	0.63	0.67	0.71	0.79	0.73	0.77
RVK Liquidity Metric (T-Bills = 100)			76	73	69	66	65	65	66	66	66	72	77	71

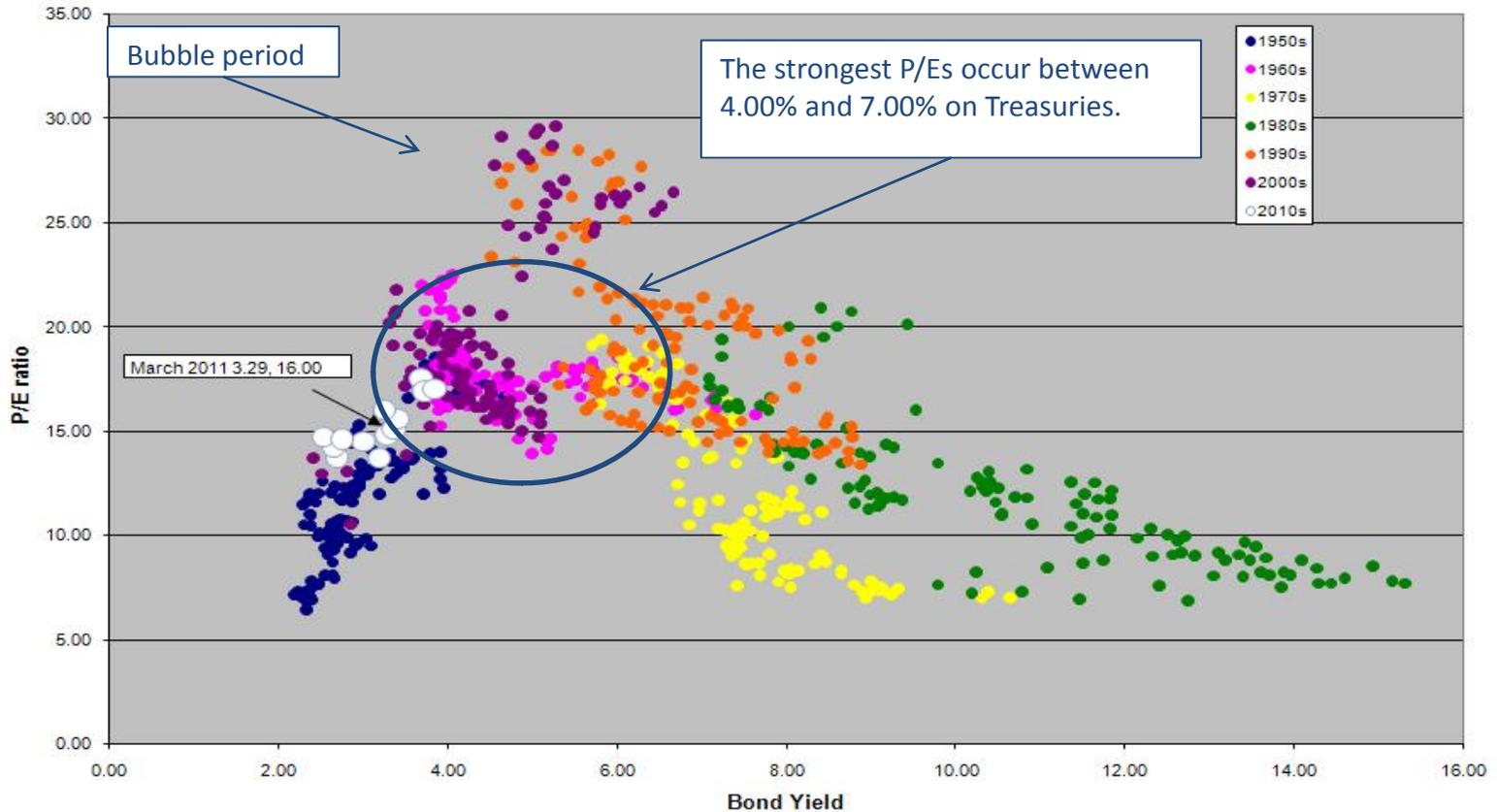
Return (Compound) = the long-term compounding return that considers portfolio volatility
 Return/Risk Ratio = A measure of the relative return per unit of risk, similar to a Sharpe Ratio
 RVK Expected Equity Beta = A measure of the movements of the portfolio relative to LS US Equity
 RVK Liquidity Metric = A measure of portfolio liquidity based on custom liquidity ratings for each asset

Economic 'Regimes' and Influence on Asset Performance

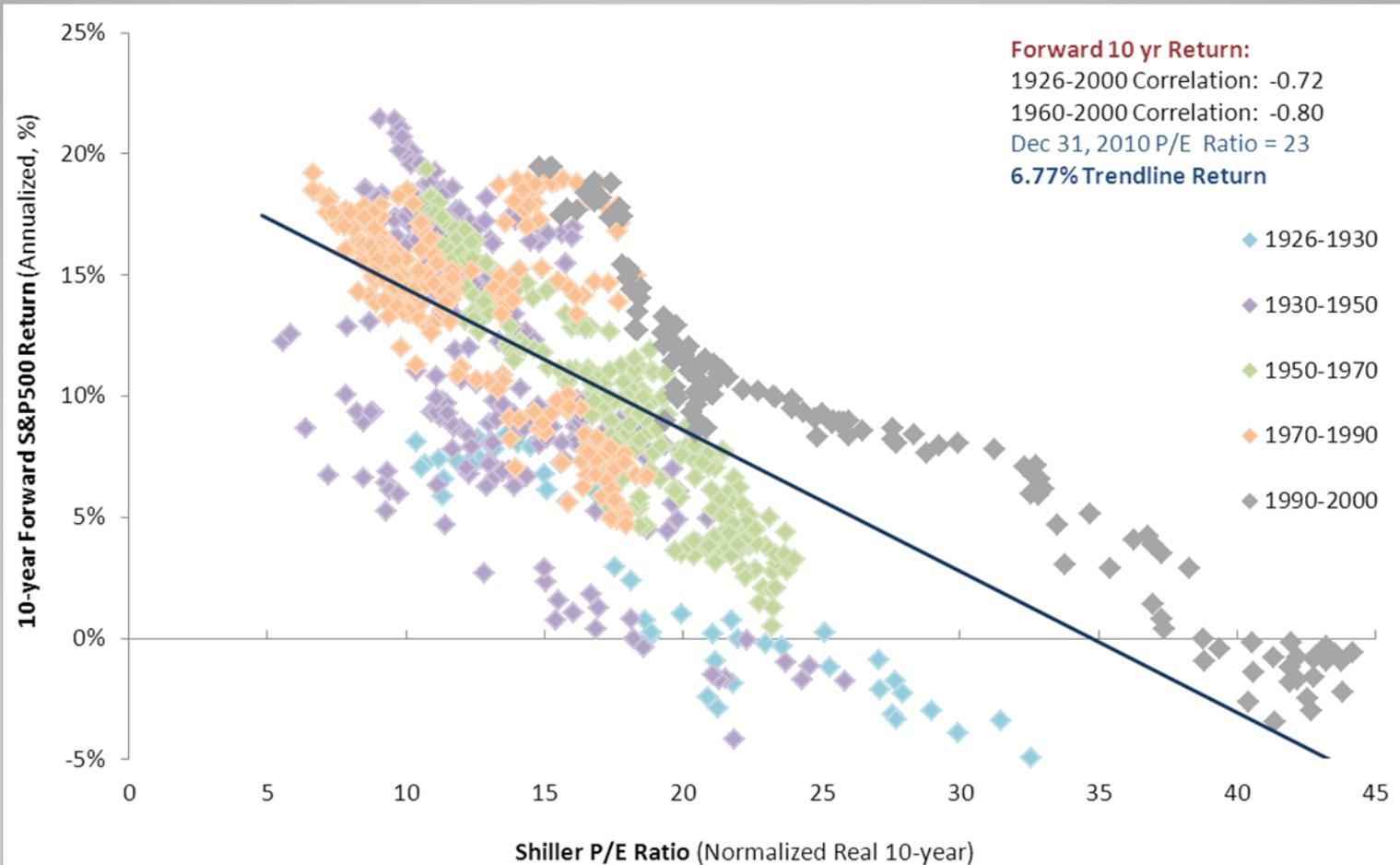


Asset Valuation

Bond Yield vs. P/E over Decades: 1950-2011



Understanding Return Expectations (Stock Market)



Understanding Return Expectations (Bond Market)

