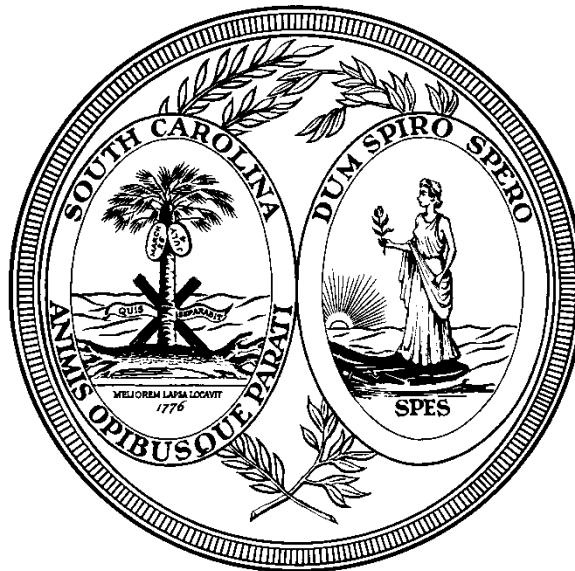


**SOUTH CAROLINA RETIREMENT SYSTEM
INVESTMENT COMMISSION**

**ANNUAL INVESTMENT PLAN
FISCAL YEAR 2014-2015**



as adopted by the Retirement System Investment Commission
on May 1, 2014; effective on July 1, 2014

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SECTION 1: OVERVIEW AND PURPOSE

Overview

Annually, the Commission adopts a Statement of Investment Objectives and Policies (“SIOP”), which provides the objectives, policies, and guidelines for investing the assets of the South Carolina Retirement Systems (the “Fund” or the “Plan”). The SIOP provides the framework by which the RSIC, at the direction of the Chief Investment Officer (“CIO”), drafts a proposed Annual Investment Plan (“AIP”). South Carolina law requires the CIO to submit the proposed AIP to the Commission no later than April 1st of each year, and the Commission must adopt a final AIP no later than May 1st of each year for the following fiscal year which begins on July 1. The Commission may amend the AIP during the fiscal year as it deems appropriate.

Purpose

The purpose of the AIP is to provide a formal document for investing and managing the Retirement System’s assets to achieve the Commission’s investment objectives and mission as stated in the SIOP, which is incorporated therein. The relevant portion of the SIOP may constitute parts of the AIP pursuant to Section 9-16-50(B). The Commission adopts the SIOP, in its entirety, into the AIP, in accordance with Section 9-16-50(B) and to satisfy compliance with the requirements of Section 9-16-330(B).

SECTION 2: STRATEGIC INITIATIVES

Each year the Investment Staff undertakes initiatives approved by the Investment Commission within the AIP with the goal of improving capabilities and performance of the Plan. Staff will continue working on prior initiatives set by the Commission, which include:

- Develop a Statement of Investment Beliefs that will become part of the AIP once adopted by the Commission.
- Implement the outcome of the RFPs for risk management and administrative services.
- Build the accounting and administrative functions to support the reporting requirements of the Commission.
- Incorporate the trade order management and portfolio management systems required to support the current assets managed internally.
- Build out risk systems, including working with the development of the Enterprise Risk Management function.
- Create a dedicated Human Resources function to develop and lead the overall human resource strategy for the RSIC.
- Re-structure the Strategic Partnership model and explore use of customized fund-of-one solutions for both traditional and alternative assets and investment strategies.
- Continue to rationalize the external manager allocations to achieve the most efficient portfolio implementation strategy.
- Grow the internal investment research function to serve as a key input for all investment decisions across the organization, focusing primarily on investment strategy, tactical asset allocation, and direct/co-investment opportunities.
- Continue to negotiate for lower fees and better terms with managers.

The staff's ability to address these initiatives may be impacted by the budget approval process. These initiatives may also be amended by the Commission based on the recommendations from the fiduciary audit by Funston Advisory Services, LLC.

SECTION 3: INVESTMENT STRATEGIES AND TRANSITION

Strategic Partnerships

The Commission has approved several Strategic Partnerships, which are customized, flexible, and opportunistic investment mandates managed jointly by RSIC and an external investment manager. Each Strategic Partnership has an Investment Committee overseeing its operations and investment mandate. The Investment Committee in each case consists of several members from the general partner (the external manager) and either one or both of RSIC's Chief Investment Officer and Deputy Chief Investment Officer as delegated by the Commission and as outlined within each Strategic Partnership agreement. The Strategic Partnerships follow a similar approval process for each investment, which requires that each new investment or investment strategy undergo due diligence by the investment manager and RSIC Staff, be approved by the RSIC's Internal Investment Committee, and then receive unanimous consent of the Strategic Partnership's Investment Committee.

The Commission's Investment Consultant will be informed of the investment decisions within each Strategic Partnership, serve as an input to the IIC as needed, provide a prudence memo to the Commission for proposed investments, and maintain due diligence records on each Strategic Partnership.

The governing body of each Strategic Partnership maintains and manages policies, procedures, and budgets for the respective entity.

Asset Class Policy Targets and Commentary

Staff, in conjunction with the Consultant, recommends no change to the Policy asset allocation for the fiscal year ending 2015. The recommendation to maintain a conservative asset and risk allocation is driven from analyzing the liabilities and the financial health of the Retirement Systems. We believe that the current Policy asset allocation will achieve the goals and objectives of the Commission over a long term horizon. Recommendations will be made to the Commission to amend the asset allocation as warranted. Over the shorter term, Staff will continue to monitor the economic environment and make asset allocation tilts within the portfolio, maintaining compliance with the SIOP.

The Investment Staff will review and seek ways to create a more efficient implementation within a number of asset classes, utilizing a combination of passive, active, enhanced, and hedged strategies. The goal of this review and future recommendations to the Commission will be to further enhance the risk-return ratio while still achieving growth, income and stability of the assets.

Global Equity

The Global Equity target asset allocation consists of 31% to publicly traded securities and 9% to private equity, for a total of 40%.

Global Public Equity

Currently, the portfolio is diversified across the various regional components (United States, Developed World ex-United States, and Emerging Markets) of the policy benchmark for global public equity, the MSCI All Country World Index (“MSCI ACWI”). The portfolio is managed to maintain similar weights of the regional components of the index. As a result, the United States has the largest allocation making up approximately 50% of the global public equity allocation, with Emerging Markets being the smallest at roughly 10% of the global public equity allocation. Within the United States, the portfolio has an overweight to small capitalization stocks, which traditionally have a higher beta to the policy benchmark.

For FY 2014-15, there will be a focus on transitioning the portfolio from specific regional components to a more global structure. In addition, Staff will be exploring enhanced index strategies as a method of providing flexibility in transitioning to a more global portfolio structure, while balancing passive and active strategies. Enhanced index strategies tend to be low to modest tracking error strategies that are the result of small, factor-based deviations from an index. The result of this strategy can be a higher information ratio, which implies more consistency around generating excess returns.

Market exposure will continue to be maintained through allocating to managers as well as through the Overlay program. Staff expects to use a combination of active, passive, enhanced, and hedged strategies within global public equity.

Private Equity

Currently, there is a slight over allocation to private equity with current levels at 9.6% of Plan assets. The pacing for the coming year is expected to be approximately \$150-450M, depending upon, and subject to changes in, market conditions, pacing requirements and other factors.

For FY 2014-15, there will be a focus on making commitments to the Energy, Growth Equity, and Buyout segments of the asset class. Energy, in particular, presents multiple compelling long term opportunity sets.

In addition to fund commitments, staff is pursuing a variety of methods to execute on co-investment transactions. Co-investments are a way to invest in managers’ best ideas at favorable economics, and they are expected to generate excess returns. Staff may pursue co-investment opportunities sourced both by Strategic Partners and certain managers who are not formal Strategic Partners.

Real Assets

Real Estate and Commodities are the components of the Real Assets policy allocation. Real Estate’s policy weight is 5% and Commodities’ is 3%. Staff will assess adding other investment strategies within this category, such as infrastructure.

Real Estate

As of February 2014, the Real Estate asset class was underweight at 3.9% of plan assets. This is primarily due to the call down nature of investing in private market strategies. The pacing schedule for FY 2015 is expected to be approximately \$125-300 million, depending upon, and subject to changes in, market

conditions, pacing requirements and other factors. Staff anticipates committing a large portion of this allocation to core real estate. Staff is working with several managers to determine the feasibility of a separate account structure to build this allocation over the next several years.

Commodities

As of February 2014, the Commodities allocation was approximately 2% of Plan assets, an underweight of 1%. As a result of hedge fund reclassifications and terminations, the Commodities allocation is presently implemented entirely through the Overlay program, using swaps for passive benchmark and roll-select implementations. During FY 2014-15, Staff will seek to add trading strategies and explore merchant-based (hold physical positions) commodity investment strategies.

Diversified Credit

The Credit category is included in return-seeking assets with a target allocation of 19%. This category includes a 6% allocation to Mixed Credit, a 6% allocation to Emerging Markets Debt and a 7% allocation to Private Debt.

Mixed Credit

Mixed credit is made up a variety of non-core fixed income investments, including high yield bonds, bank loans, credit-oriented hedge funds, mortgages and asset backed securities. As of February 2014, the Mixed Credit allocation was 8.2%, which exceeded the target allocation by 2.2%. This allocation will be reduced and brought back closer to Policy. Staff will review high yield bond and bank loan managers, and recommend changes, as warranted.

Emerging Market Debt

Emerging Market Debt has a policy target of 6% and as of February 2014, was underweight at 4.1%. The asset class is divided into debt issued in US dollars and debt issued in each country's local currency. Staff will conduct new manager searches in this area.

Private Debt

The Private Debt asset class has a target allocation of 7% of total Plan assets. As of February 2014, the allocation was approximately 5.9%. For 2014-15, there will be a focus on commitments to Energy Debt opportunities (to complement the Energy Equity invested in the PE portfolio), Direct Lending, and Mezzanine investments. Distressed Debt generally has compelling opportunities despite the market cycle, and is usually industry- and company-specific.

Opportunistic

The Opportunistic asset class includes both low beta hedge fund and GAA strategies. The category is expected to improve diversification (i.e., decrease risk) of the Fund as a result of asymmetric performance – reasonable positive contributions to the Fund while avoiding significant drawdowns.

Hedge fund strategies can be implemented through the Low Beta Hedge Fund classification or through the following asset classes: Global Public Equities, Mixed Credit, Commodities, GTAA/Risk Parity, Emerging Markets Debt and Private Debt. When hedge funds are utilized in a traditional asset class, its benchmark will be consistent with the asset class, and when classified as a Low Beta Hedge Fund, the benchmark is the HFRI Fund Weighted Composite Index. In total, hedge funds have a maximum target of 15% of Plan assets.

Hedge Funds

The current portfolio has hedge funds in three asset classes: Low Beta Hedge Funds, Global Public Equities and Mixed Credit. For FY 2014-15, Staff will continue to focus on optimizing the Low Beta Hedge Fund portfolio to reflect high conviction, market neutral strategies.

The use of hedge funds in the asset classes noted above will continue to be reviewed on a case-by-case basis to ensure that the structure of the investment is appropriate for a higher beta strategy.

Global Asset Allocation

The Opportunistic asset class also includes a 10% allocation to Global Asset Allocation (GTAA/Risk Parity) strategies. This asset class has historically included both Global Tactical Asset Allocation and Risk Parity strategies. Approximately 35% of the exposure to the asset class is passive. During the year, Staff intends to evaluate new strategies with the expectation of converting the passive exposure to actively-managed, alpha-oriented strategies. Any new strategies will be funded through a reduction to the existing passive exposure.

Conservative Fixed Income

The Conservative Fixed Income asset class is intended to provide a source of diversification as a lower risk, liquid, short duration, and/or high credit quality component of the Fund. The category is also managed as the primary source of capital to pay benefit obligations. Within the Conservative Fixed Income category, the Policy target allocation to Cash/Short Duration is 5% in total, Core Fixed Income is 7%, and Global Fixed Income is 3%.

Staff plans to initiate a broad, comprehensive review of the entire Conservative Fixed Income asset class over the coming year.

Core Fixed Income

The allocation as of February 2014 was 8.9%; however, this level is likely to decline as capital is shifted to other asset classes that are currently underweight. While there is a clear diversification benefit offered by this asset class, the current forecasts call for low returns for the next several years. As a result, the rationale for the current overweight is to serve as a funding source for other asset classes where a call down structure is used.

The RSIC's Core Fixed Income mandates have historically included primarily domestic government, agency, corporate, and asset-backed securities. The Staff will continue to evaluate the potential impact of managing a greater portion of these assets internally. Additionally, the Staff will continue to collaborate with the Consultant to monitor the existing managers, as well as to identify opportunities to improve the implementation of the asset class.

Global Fixed Income

The current allocation is 3.7% and will decline as capital is re-allocated to other asset classes. As with Core Fixed Income, Staff expects the asset class to serve a diversifying role in the overall portfolio. Staff will conduct a comprehensive review during the year.