SOUTH CAROLINA RETIREMENT SYSTEM INVESTMENT COMMISSION

ANNUAL INVESTMENT PLAN FISCAL YEAR 2011-2012

as adopted by the Retirement System Investment Commission on April 21, 2011; effective on July 1, 2011

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Section I. General Operational and Investment Policies

Organizational Overview and Purpose

The South Carolina Retirement Systems ("SCRS"), a division of the South Carolina Budget and Control Board, administers a comprehensive program of retirement benefits, performing fiduciary duties as stewards of the contributions and disbursements for five defined benefit pension trust funds—the South Carolina Retirement System, South Carolina Police Officers Retirement System, Retirement System for Judges and Solicitors of the State of South Carolina, Retirement System for Members of the General Assembly of the State of South Carolina, and National Guard Retirement System (collectively, "Retirement System").

The South Carolina Retirement System Investment Commission ("Commission") was established by South Carolina law to invest and manage all assets of the Retirement System. The Commission's fiduciary responsibilities are addressed in its Governance Policies, include authorizing investment decisions and overseeing the management of the business affairs of the agency, the Retirement System Investment Commission ("RSIC"), in accordance with applicable laws, ensuring legal and ethical integrity, adhering to fiduciary standards, and maintaining accountability.

The Commission employs a Chief Investment Officer, who also serves as its Chief Executive Officer and agency head ("CEO/CIO" or "CIO"). The CEO/CIO is responsible for the RSIC staff ("Staff"), and manages day-to-day operations of the Commission in accordance with the Commission's *CEO/CIO Roles and Responsibilities Policy*. Pursuant to this policy, the CEO/CIO may delegate responsibilities to the Staff as he deems appropriate, provided that such delegation is consistent with the policies approved by the Commission. Together, the CEO/CIO and Staff manage the investment functions to implement the Commission's investment decisions, including administration, legal, risk management, compliance, and other functions of the RSIC and Commission.

Several committees and cross-functional work teams were created to coordinate and execute the ongoing organizational and operational functions of the RSIC. These standing committees are the Executive Committee, the Investment Committee and the Co-Investment Committee.

The Executive Committee focuses on organizational, operational and budgeting topics and assists the CEO/CIO in executing the strategic initiatives approved by the Commission.

The Investment Committee reviews current asset allocations, portfolio structure, risk exposures, makes recommendations for new investments, and advises the CIO on rebalancing existing investments as well as other investment related matters in accordance with policies and procedures as approved by the Commission.

The Co-Investment Committee is responsible for reviewing, analyzing and making recommendations to the Investment Committee for direct co-investments, which will be implemented upon approval by the Investment Committee in accordance with policies and procedures as approved by the Commission.

Annually, the Commission adopts a Statement of Investment Objectives and Policies ("SIOP"), which provide the objectives, policies, and guidelines for investing the assets of the Retirement System. The SIOP provides the framework by which the RSIC, at the direction of the CIO, drafts a proposed Annual Investment Plan ("AIP"). The purpose of the AIP is to provide a formal plan for investing the Retirement System's assets to achieve the Commission's investment objectives and mission and to comply with applicable laws. 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 meet no later than May 1st of each year to adopt the proposed AIP for the following fiscal year. The Commission may amend the AIP during the fiscal year as it deems appropriate.

Investment and Operational Process Overview

The Commission, CIO, and Staff believe that the policy strategic asset allocation will be the primary determinant of return and risk for the Retirement System's total portfolio ("Portfolio"). Secondly, additional sources of value can be achieved through tactical shifts to the policy asset allocation, manager selection, opportunistic direct investments, cost effective implementation, and by adhering to well defined policies and procedures with clear, measurable guidelines and constraints.

The investment process begins with a forecast of expected risks and returns of a broad set of asset classes. Typically this exercise is performed annually in conjunction with the Investment Consultant ("Consultant"). The resulting estimates are based on historical results adjusted for current market conditions to develop a reasonable, intermediate-term projection for each asset class. The estimates are used to generate an efficient frontier from which the Consultant, the CIO and Staff develop an asset allocation plan designed to achieve reasonable returns at an acceptable level of risk. The recommended asset allocation as well as the expected returns and risks are then presented for approval by the Commission.

The approved asset allocation determines the percentage to be invested in each asset class. Differences between current and targeted asset allocation normally lead the CIO and Staff to adjust the current allocations to conform directly through existing managers, through the Overlay program and/or as a result of the manager search and selection process.

If a manager search is undertaken, the CIO and Staff, in conjunction with the Consultant, will develop a list of qualified managers for the specific mandate. Individual Commissioners may work with the CIO and Staff to conduct on-site and/or other due diligence meetings. Based on these visits and ensuing analyses, the Commission may approve investments in accordance with its policies.

Once approved, the RSIC's legal counsel will work with Staff and the investment manager, partnership, or company, as the case may be, to develop the necessary legal documents that will govern the Retirement System's investments. External counsel may be engaged upon approval by the South Carolina Attorney General to assist in review and analysis of the constituent documents for investments. After legal documents are executed, custodial accounts and operational procedures are established to facilitate daily management of the Retirement System's assets. The initial funding of assets to new investment managers is approved by the State Treasurer's Office, which serves as the custodian of the assets by state statutory authority.

The Commission has approved several Strategic Partnerships, which are customized, flexible, and opportunistic investment mandates. Each Strategic Partnership has an Investment Committee overseeing the investment mandate, which consists of several members from the general partner and either one or both of RSIC's CIO and Deputy CIO as delegated by the Commission and as outlined within each Strategic Partnership agreement. The Strategic Partnerships follow a similar review process for each investment, which requires that each investment undergo due diligence by the investment manager, be reviewed by the Investment Committee, and then receive unanimous consent of the Investment Committee.

Ongoing monitoring is conducted by the Consultant and Staff through meetings, conference calls, and collecting and reviewing analytical data, reports, and other resource materials. Staff periodically hosts calls with the Consultant to discuss managers retained by the Commission and identify any concerns with managers.

The accounting department of the SCRS tracks all investment activity and investment holdings. The monthly accounting records of the SCRS accounting department and the SCRS's asset custodian ("Custodian") are the basis of periodic reports provided to the RSIC. Each month, the Custodian reports the estimated value and performance of the Portfolio by manager and asset class as available. In addition to monthly reports, Staff and/or the Consultant prepare quarterly analytical reports of the Portfolio and its underlying managers in greater detail. Tactical rebalancing decisions within the asset allocation ranges approved by the Commission may be performed by the CIO or his designee in consultation with Staff. Additional analysis and reporting will be conducted at fiscal year-end or as necessary to achieve the goals and objectives of the Commission.

Portfolio Implementation and Disclosure

The Commission strives to be as transparent as possible regarding all decisions, both business and investment. However, since public disclosure of the details of transition plans or specific investments may jeopardize the Commission's ability to effectively implement the plan or achieve investment objectives, pursuant to S.C. Code Ann. §9-16-80 and §9-16-320, these items will be considered confidential and will remain within the confines of Executive Session during Commission meetings. Information relating to the Commission's actions will be made available to the public as soon as the plan is implemented or at such time as public disclosure of the information will no longer jeopardize the RSIC's ability to achieve its investment objectives or implement the investment plan.

Strategic Plan and Initiatives Overview

The development of adequate infrastructure to support the operations of a successful investment program will be critical to the success of the mission, vision, and objectives outlined in the SIOP and AIP. During 2009, the Commission approved a three-year Strategic Plan, which included human resources as well as the tools and facilities required to implement the goals and objectives of the organization. The Commission, CIO, and Staff will continue to focus on the remaining key areas of the Strategic Plan as discussed below.

Staff Recruitment

In order to effectively and prudently achieve the goals of the Strategic Plan and implement the AIP, the Commission will need to increase the level of staff who have industry expertise in several disciplines, such as risk management, audit and compliance, operations, underwriting private market investments and manager due diligence.

Enterprise and Investment Risk Management

The RSIC is committed to achieving the best practices for enterprise and investment risk management. Accordingly, the Commission has approved hiring Deloitte & Touche to perform an enterprise wide risk assessment and to assist with developing an internal audit and compliance function. This engagement is expected to evolve over the next several years, resulting in a gap analysis, recommendations, action plans, and then the development of industry standards or best practices within these areas.

The RSIC continues to develop both quantitative and qualitative approaches to risk management. A more quantitative approach to risk management will be pursued with assistance from several strategic partners including, but not limited to, Lighthouse, Goldman Sachs, Mariner, and Bridgewater. The objective is to develop a suite of risk reports and tools to provide more timely and actionable output within a dynamic risk management framework.

Portfolio Initiatives

In addition to human resource and infrastructure needs, the Strategic Plan outlines several key portfolio initiatives, which include:

- Enhance risk budgeting process that is integrated with newly created Strategic Plan;
- Review and evaluate all public market investment strategies, both equity and fixed income;
- Transition from Fund of Hedge Funds managers to a direct and strategic partnership model, maximizing the utility of the Lighthouse separate account platform for data and risk aggregation of the hedge fund program and broader public and private markets allocations when feasible;
- Continue to build out the Private Equity, Private Debt and Real Estate allocations. These allocations will be achieved through a combination of direct fund investments, direct co-investments and through strategic partnerships;
- Continue to develop South Carolina co-investment program to allow the Portfolio to benefit from private market investments in South Carolina and southeastern United States;
- Expand the short-duration fixed income asset class to improve returns over cash, as well as improve cash flow/liquidity management;
- Enhance and create automated reporting, data aggregation and risk analytics.

General Policies and Procedures for Hiring Consultants, Professional Services, and Investment Managers

In addition to State processes and applicable law, the Commission has adopted a Service Provider Selection Policy to govern the selection, monitoring, and reporting of RSIC's service providers. The policy does not include or apply to associate legal counsel, which may be retained upon approval by and in accordance with the procedures required by the South Carolina Attorney General. According to the Commission's policy, service providers are classified in two general categories: Named Service Providers and Other Service Providers. Named Service Providers include investment managers/advisors, investment consultants, consultants retained for non-investment related matters pertaining to the CEO/CIO (e.g. recruiting firms), financial and/or actuarial professionals for services relating to the RSIC and/or investments, and other service providers as deemed appropriate by the Commission. The CEO/CIO is responsible for coordinating and/or conducting all necessary due diligence relating to the engagement of Named Service Providers and making recommendations to the Commission. The Commission reviews and approves the selection of Named Service Providers. Other Service Providers include providers of investment analysis tools, operational service providers, technical support assistance, and other service providers as appropriate. Unless the Commission determines otherwise, the CEO/CIO will be responsible for engaging and terminating service providers other than Named Service Providers. In selecting a service provider, the Commission and CEO/CIO will consider as broad a universe of qualified service providers as is practical and reasonable given the budgetary, staffing, time, and other relevant factors and in accordance with the South Carolina Procurement Code and Commission policies.

All service providers are subject to regular and appropriate monitoring throughout the term of the engagement. Criteria for review may include performance, Staff satisfaction, continued reasonableness of fees/costs, quality of reporting, compliance with contractual terms and other criteria deemed appropriate for the engagement. The CEO/CIO is responsible for informing the Commission of any material issues or actions taken pertaining to service providers. Monitoring and reporting is conducted on an individual basis based on the nature of the provider and/or services and in accordance with the contract, Commission policies, and applicable law. Termination of a contract with a service provider may be based on factors including, but not limited to, compliance with the terms of the engagement, laws or regulatory standards.

The guidelines for the manager search process are outlined in the SIOP, but are summarized here, as required by South Carolina law. After the Commission has determined a manager search is appropriate, minimum criteria for eligibility and general selection criteria will be established. Once objective screening is complete, the search team, which will include Staff and may include the Consultant and one or more Commissioners, may rely on additional quantitative and qualitative input to further narrow the field to a manageable number of qualified candidates. The preliminary list of candidates will be evaluated to create a list of finalists. The Staff and Consultant will prepare a report detailing strengths and weaknesses of the investment management firms. The search team will review the report with the Consultant to select a reasonable number candidates for further due diligence. The search team will determine which managers are best suited for the mandate and will recommend a manager or managers to the Commission for approval. Upon approval and execution of legal documents between the Commission and the manager, the manager will be funded as appropriate.

Service providers, including investment managers, will be compensated commensurate with the services provided and industry practices. The Commission will pursue cost savings through structural efficiencies and striving for fee reductions through negotiations.

Both service providers and managers are hired through contractual engagements, which have a terminal date or event. The Commission may terminate a service provider or manager subject to the terms on the contractual arrangement for a variety of reasons to include, but not limited to, breach of contract, change of services required, and for performance reasons.

SECTION II. INVESTMENT OBJECTIVES AND PLAN

The investment objectives center on developing and implementing a diversified, cost efficient investment strategy consistent with the Commission's mission and vision while achieving the goals described in the SIOP. The Commission and RSIC are focused on asset allocation as the primary determinant of variability in long term total investment performance. Accordingly, the investment decision structure and process is intended to balance the risks and opportunities across and within global markets. The asset allocation policy provides the baseline expectations, and Staff has discretion within well defined ranges approved by the Commission to deviate from the targets as dictated by internal and external analyses, market conditions, and availability of appropriate investment vehicles, among other determinants. The Staff also seeks to add value through manager selection, opportunistic direct investments, cost efficient implementation, and adhering to investment policies.

The development of the investment strategy involves a process to produce a forecast of the expected risks and returns of a broad set of asset classes, which culminates in the determination of reasonable and acceptable combinations of risk and return expectations. These ranges guide asset class targets and acceptable limits around the targets. The Commission and Staff use an overlay strategy to manage and adjust exposure in the context of the total portfolio. External investment managers are engaged to implement market exposure to specific asset classes.

The investment plan will be implemented by the Staff, aided by the Investment Consultant and other approved investment and service providers, as appropriate. The investment plan outlines the target asset allocation with ranges, maximum manager level allocations, an overview of the investment strategies, and performance standards and benchmarks.

Asset Allocation

The Investment Consultant and Staff provide the Commission with a recommended asset allocation based upon the Consultant's assessment of historical, current, and expected economic and market conditions along with the corresponding influence of expected returns/risks for each asset class. The primary inputs are expected return, expected risk, and correlation, which are derived from the categories listed below. Staff monitors the trends for these and other factors that may influence investment performance, such as, but not limited, to the items below.

- Interest rates, equity earnings, valuations, and yields
- Economic conditions (i.e., employment, monetary/fiscal policies, growth expectations, sector trends)
- Capital markets conditions (i.e., volatility, liquidity, technical trends, fundamentals)
- Geopolitical risk

Staff revisits the assumptions and the asset allocation targets frequently, guided by the parameters established within the SIOP and the AIP. Current domestic conditions are characterized by expectations of moderate economic recovery, low yields, stabilizing equity fundamentals, and continued fiscal and monetary stimulus. With a few exceptions, these conditions also exist in international markets with the added complexities of less developed fiscal and monetary systems in many regions of the world. In addition, international risks are elevated in some regions where social or political dynamics are creating heightened geopolitical uncertainty.

Staff currently highlights the following as potential near term factors affecting asset allocation, in no particular order:

- Slow economic recovery in the U.S.
- Continued weakness in the housing sector
- Restructuring of the Government Sponsored Enterprises(“GSEs”)
- Increasing probability of higher interest rate environment
- Inflationary pressures/rising commodity prices driven by growth of emerging market economies
- Changes to fiscal and monetary stimulus policies, compounded by regulatory initiatives
- Geopolitical events (leadership transitions, energy supplies)
- Consumer financial condition and limited ability to restructure debt obligations
- Eurozone structural weakness, especially with regard to monetary policy
- Increased opportunities for providers of liquidity

Staff works to quantify and assess the potential impact these and other factors on the portfolio, from both risk mitigation and opportunistic perspectives, and to corroborate internal observations with those of external investment managers. Recommendations for changes to target allocations and, as appropriate, the ancillary rebalancing required to affect the change, will be confined to the approved allocation range for each asset class. The combined effects of diversification and flexibility should mitigate risk while allowing Staff to adjust to changing inputs, dynamic factor and asset correlations, and capital market opportunities, with the goal of maintaining a reasonable expectation for achieving the highest risk adjusted return for the Portfolio.

Based on the combined aggregation of the latest asset-liability study, projected net benefit payments, estimates and assumptions for capital markets as discussed above, and a portfolio optimization process, Table 1 on the next page details the projected five to seven year returns associated with the underlying asset classes and the portfolio risk that would result from the approved asset allocation weightings. Pursuant to and consistent with South Carolina law, the Portfolio will target weights in the asset classes listed below, which are defined in the SIOP as approved by the Commission.

Pursuant to S.C. Code Ann. §9-16-340(B), this Plan must also include the minimum and maximum allocations to equity investments on an ongoing basis, not to exceed 70 percent. While the equity asset class maximums specified below may appear to exceed 70% in the aggregate, the equity investments of the Portfolio shall not exceed 70%. The statute is not clear whether the limitation is at cost or market, and the Commission defines this limit as at cost. Therefore, in the event that the allocation to equity investments exceeds 70% solely due to an increase in value of those investments, the CIO is not required to rebalance the portfolio taking into consideration transaction costs and market conditions, but must advise the Commission at its next regularly scheduled meeting.

When considering allocations to the private markets assets (private equity, private debt, and real estate), the Commission and Staff will use a common industry practice of committing more than the target allocation by approximately 150% to 200% in order to reach the actual target allocation. This implementation strategy is used due to call down and return of capital features within most private market investments. Staff manages and tracks the liquidity needs of the Portfolio by monitoring the unfunded commitments, realized distributions, forecasted capital calls and distributions compared to the target allocation and committed capital ratio. The results of this analysis will impact the frequency, timing, and size of new commitments. Staff expects to utilize this approach, as appropriate, for both direct fund investments and private market investments within Strategic Partnerships. To clarify, the commitment level within Strategic Partnerships for private market investments with a call down structure may exceed the total approved investment level, at cost; provided that if the level of actual invested capital will exceed the, at cost, approved investment level by greater than 10% for longer than 120-days, then the CIO and Staff must seek approval from the Commission for the higher allocation.

Table 1. Assumptions, Targets and Ranges for the Recommended Asset Allocation.

Asset Class	Expected Return	Expected Standard Deviation	Long-Term Target Allocation[2]	Minimum	Maximum
Large Cap Equity	7.8%	18.0%	9%	0%	25%
Small/Mid Cap Equity	8.0%	23.0%	5%	0%	20%
International Equity	8.0%	21.0%	8%	0%	25%
Emerging Markets Equity	9.5%	29.0%	8%	0%	20%
Total Equity			**30%**	**0%**	**70%[4]**
Core Fixed Income	3.8%	7.0%	10%	0%	50%
Global Fixed Income	3.3%	10.0%	3%	0%	25%
High Yield Fixed Income	8.0%	12.0%	3%	0%	20%
Emerging Markets Debt	6.5%	15.0%	3%	0%	20%
Global TIPS	3.5%	7.0%	0%	0%	50%
Short-Duration Fixed Income	2.8%	4.0%	3%[3]	0%	100%
Cash	2.0%	1.5%	7%[3]	0%	100%
Total Fixed Income			**29%**	**29%**	**100%**
GAA[1]	7.1%	10.5%	10%	0%	20%
Opportunistic Alpha	7.5%	12.0%	5%	0%	20%
Opportunistic Credit	8.0%	12.0%	8%	0%	15%
Private Equity	10.0%	30.0%	10%	0%	12%
Real Estate	7.0%	15.0%	6%	0%	10%
Commodities	4.8%	22.0%	2%	0%	10%
Total Alternatives			**41%**	**1%**	**50%**
Total Expected Return (Plan)	**8.33%**	**N/A**			
Total Expected Risk (Plan)	**N/A**	**10.9%**			
Total			**100%**		

Source: NEPC, LLC ("NEPC", formerly New England Pension Consultants) for the expected returns and standard deviation by asset class.

[1]Global Asset Allocation (GAA) is a composite of Risk Parity and Global Tactical Asset Allocation mandates.
[2]A discussion on rebalancing can be found in the SIOP.
[3]The target amounts for Cash and Short Duration should equal 10%.
[4]The equity allocation at cost shall not exceed 70%.

Manager Level Allocations and Investment Strategies

In implementing the manager allocations, the CIO or his designee has the ability to rebalance and reallocate capital, as agents of the Commission, to and from managers previously approved by the Commission, subject to the asset class exposure ranges approved by the Commission and set forth in the SIOP, AIP and the percentages shown in Table 2 below. Upon recommendation of the CIO, the Chairman the Commission may authorize an additional 1% allocation of Plan assets higher than the percentage listed in Table 2, and such additional allocation must be reported to the Commission no later than its next regularly scheduled meeting. Any additional allocations beyond the limit require prior approval by the Commission.

The CIO will notify the Commission at the next meeting of any rebalancing decisions that reduce the asset levels of a manager to zero. The decision to rebalance to zero is not meant to constitute termination of a manager; this decision will reside with the Commission.

Table 2. Manager Allocation Limits within Asset Classes of Total Plan Assets.

Asset Class	Maximum (%)[1]	Maximum ($)[2]
Public Market Assets		
Large Cap Equity	4%	$1,000 mm
Small/Mid Cap Equity	3%	$750 mm
International Equity	4%	$1,000 mm
Emerging Markets Equity	3%	$750 mm
Core Fixed Income	5%	$1,250 mm
Global Fixed Income	4%	$1,000 mm
High Yield Fixed Income	3%	$750 mm
Emerging Markets Debt	3%	$750 mm
Global TIPS	3%	$750 mm
Opportunistic Alpha	3%	$750 mm
Absolute Return	3%	$750 mm
GAA	5%	$1,250 mm
Commodities	3%	$750 mm
Short-Duration Fixed Income	5%	$1,250 mm
Cash	10%	$2,500 mm
Private Market Assets[3]		
Opportunistic Credit (Private Debt)	3%	$750 mm
Private Equity	3%	$750 mm
Real Estate	3%	$750 mm

[1]The percentage allocation is the guideline to be followed and is based on cost.
[2]The dollar allocation is based on total Plan assets of $25 billion. The market value will fluctuate, which is why the percentage exposure is the factor that establishes the limit.
[3]The percentage allocation for private markets is based on commitment amount.

Strategic Partnerships

The Commission approved several key Strategic Partnerships with managers believed to offer key characteristics sought by the Commission to facilitate differentiated idea generation and provide resources, such as knowledge transfer, expertise in risk management, and so forth as deemed appropriate by the Commission. The Strategic Partnerships are vehicles with broader investment guidelines, allowing for flexible and efficient execution of various investment ideas. The asset exposures of the investments within each Strategic Partnership are included in and subject to the Portfolio's overall asset allocation guidelines.

Passive Versus Active Investment Strategies

The Portfolio's asset allocation will be implemented by employing a combination of passive and active investment strategies. Passive strategies will normally be emphasized for highly efficient asset classes, like large cap domestic stocks, which are typically characterized by a large number of highly informed investors. Passive strategies often prove effective when a majority of investors have difficulty exceeding benchmark returns net of management fees for active investment strategies. The Commission has invested a significant portion of the portfolio assets in passive strategies at relatively lower fee structures.

The Commission will also emphasize passive investment strategies to quickly gain or reduce exposures to certain asset classes in order to achieve a desired asset allocation. Derivative securities such as futures and swaps will often be used to quickly achieve a desired asset allocation at relatively lower costs.

Active strategies are normally emphasized for more inefficient markets or asset classes, like emerging markets, which are typically characterized by fewer highly informed investors. These markets offer greater opportunities to profit based upon insightful deviations from the benchmarks.

The Commission has invested a large portion of the Portfolio in active strategies, paying higher fees than passive strategies, with the expectation that those fees will result in more attractive risk-adjusted returns. Some of the active managers operate currently under pay-for-performance fee structures, earning more for superior performance and less for not meeting their benchmark.

Overlay Program

The Overlay program is expected to continue to function as a tactical means by which to manage incremental shifts in broad market exposures in an efficient manner using both physical and synthetic securities, including, but not limited to, exchange-traded-funds/notes, options, futures, swaps and forward currency contracts. The allocation to this portfolio is intended to be a dynamic target, relative to the total Portfolio. If a question arises with respect to the type of instrument to be used, the CIO or his designee may seek approval from the Chairman of the Commission, either before or after implementation as circumstances and prudence dictate.

Public Markets Allocation

The target allocation to public market assets (securities with a higher degree of liquidity and typically able to be priced daily) is 76% of Plan assets. The public markets allocation includes equity, fixed income, GAA, hedge funds, short duration and cash strategies. While the underlying securities of the Public Market investments are considered more liquid, overall liquidity is subject to contractual and fund level terms.

U.S. Equity: Since early 2007, the Commission has dramatically reduced the Portfolio's long-only U.S. equity exposure in an effort to improve the Portfolio's overall risk composition. The total allocation to U.S. Equity is 14%, consisting of 9% to large cap and 5% to small-mid cap equities.

The large cap equity allocation will be implemented primarily through the use of the Overlay program, which constitutes the use of passive investment vehicles for the market exposure and uses absolute return strategies to generate returns in excess of the market return. The Commission believes in the prudence of low-cost asset class exposure, especially in very efficient markets like U.S. large cap equities, so a large portion of the U.S. long-only equity exposure will likely continue to be achieved using passive instruments in the future.

Within the small-mid cap equity allocation, the Commission believes that inefficiencies exist where active management can add significant value over the passive implementation.

International/Emerging Markets (Non-U.S.) Equity: In November 2006, a constitutional amendment allowing for the inclusion of Non-U.S. Equity in the Portfolio was approved in a statewide referendum and subsequently ratified by the General Assembly. At present, the Commission is targeting 8% of the Portfolio to developed international equity and 8% to emerging markets equity. For much of Fiscal Year 2011-12, a significant portion of these exposures may be synthetically achieved through the Overlay program, and Staff has begun to identify active managers who offer services for these asset classes.

Core Fixed Income: The long-term target allocation for this asset class is 10% of the Portfolio. This strategy seeks a favorable long-term total return through income, while also giving special consideration to capital preservation. This strategy focuses on high-quality, investment-grade fixed income securities and is measured against the Barclays Capital U.S. Aggregate Index. A portion of Core Fixed Income is managed internally and serves a variety of purposes such as collateral positions, liquidity/cash management, and as a tool for rebalancing and managing risk at both the asset class and plan levels. The Internal fixed income allocation may own public, private, synthetic, cash, and near-cash related securities, including but not limited to futures, 144A, and repurchase agreements (see S.C. Code Ann. §9-1-1310, §9-16-20, and §9-16-50).

Non-Core Fixed Income: The target allocation for this asset class totals 9% of the Portfolio and is diversified into three distinct asset classes:

1) *High Yield* – 3% target allocation: This strategy seeks returns that outperform the Barclays Capital High Yield Index and seeks to provide attractive risk-adjusted returns by investing in fixed income securities rated below investment grade.

2) *Global Fixed Income* – 3% target allocation: This strategy seeks to outperform the Barclays Capital Global Aggregate Index. This strategy allows managers to seek and capture the best relative values among global markets and to manage currency exposure to capture incremental return. Managers have the flexibility to invest across the full range of developed markets.

3) *Emerging Market Debt* – 3% target allocation: This strategy seeks to outperform the JP Morgan EMBI Global Diversified Index and strives to achieve strong risk-adjusted returns by tactically investing in a diversified portfolio of local currency and corporate debt securities from emerging countries and companies.

Short Duration & Cash: In response to the historically low interest rate environment in 2010, the Commission approved an allocation to a new sub-asset class designed to provide Staff with the ability to pursue yield-enhancing investments to increase the returns to the Portfolio. In January 2010, the Commission authorized Staff to internally manage a short-duration fixed income asset class in order to pick up incremental yield as well as to match specifically identified short-term liabilities. The short duration internal allocation may invest in Treasuries, Agencies, Commercial Paper, Repo's, and other similar money market type securities (see S.C. Code Ann. §9-1-1310, §9-16-20, and §9-16-50).

Also, the Commission recognized that the actual target weight to this asset class should be driven by both the actual market opportunities at any one point in time as well as by the ongoing liquidity needs of the plan, rather than by a static target. As a result, while the combined target weight for both Cash and Short Duration is 10% of the Portfolio, the target mix of these is determined by the actual investments. For example, if the Portfolio holds 4% Short Duration investments, then the target cash exposure will be 6% of the Portfolio. The "Cash" portion of this strategy is used to meet daily liquidity needs, while the "Short Duration" portion is used to pick up incremental yield as well as to match specifically identified short-term liabilities.

External managers may be used for short duration mandates, which include investments in money market instruments, investment grade and high yield bonds, bank loans, structured products, and other similar credit instruments with a maximum, final maturity of three years.

Global Asset Allocation ("GAA"): The target allocation for this asset class is 10% of the Portfolio currently. Managers included in this asset class are expected to follow strategies conforming roughly to one of the following two areas: Traditional Global Tactical Asset Allocation ("GTAA") and Risk Parity. These can be described as follows:

- GTAA: portfolio strategies that attempt to tactically allocate assets across global markets and asset classes including stocks, bonds, and commodities to achieve more attractive risk-adjusted returns;
- Risk Parity: portfolio strategies that attempt to diversify market risk equally across asset classes including stocks, bonds, and commodities.

Hedge Fund Allocation: The Absolute Return and Opportunistic Alpha strategies collectively constitute the Portfolio's primary exposure to Hedge Fund strategies. The aggregate target weight is 20% of the Portfolio versus the actual weight of 16.7% as of February 28, 2011. The designation between Absolute Return hedge funds are considered the "alpha engine" for the Overlay program as discussed above.

- **Absolute Return (“AR”):** The target allocation for this asset class is 15% of the Portfolio. These strategies are designed to seek absolute returns. The AR managers are allowed a broader set of investment tools, such as shorting and the use of leverage. The return profiles for AR strategies tend to exhibit low correlation to traditional equity and fixed income strategies.

  The AR portfolio may be implemented with hedge fund of funds, multi-strategy hedge funds, and other direct hedge fund investments. Current capital committed to AR managers is below 10%, as Staff continues to implement the hedge fund mandate. Initial reviews of commodity, global macro, fundamental equity, hedge fund seeding, and niche credit strategies, among others, are underway.

- **Opportunistic Alpha (“OA”):** The target allocation for this asset class is 5% of the Portfolio. These strategies are designed to produce superior risk adjusted absolute returns. The OA managers are allowed a broader set of investment tools, such as shorting and the use of leverage. The return profiles for OA strategies tend to exhibit low correlation to traditional equity and fixed income strategies. Current capital committed to OA strategies exceeds 7% of the Portfolio, which is above the target allocation but consistent with Commission intentions for performance and risk diversification in the current market environment. Changes or reallocations in this asset class are expected to favor event-driven, distressed, and fundamentally based global sector strategies benefitting from investments across the capital structure.

Commodities: The target allocation to commodities is 2% and may be accessed through the Overlay program, fund partnerships, co-investments, Strategic Partnerships, or other vehicles deemed appropriate by the Commission or CIO, as applicable. The target allocation to Commodities is expected to provide important diversification benefits to the Portfolio due to its low correlation to the more traditional asset classes.

Private Markets Allocation

The target allocation to private market assets (assets that are typically not exchange-traded or easily priced on a daily basis) is 24% of the Portfolio. The private markets allocation includes private equity, private debt and real estate investments. The Opportunistic Credit allocation is anticipated to be a significant source of capital to fund these investments. All of these asset classes are listed under Alternatives in Table 1, above.

Private Equity: The target allocation for Private Equity is 10% of the Portfolio currently. Full funding of the Private Equity portfolio will occur over approximately four years. Currently the asset class is approximately 60% invested. Considering that not all of the capital is invested at a single point in time, but rather, drawn down over a period of years, the amount of capital actually invested may be substantially less than the total committed capital. In recognition of this characteristic, a committed allocation to private equity will be significantly larger than the policy target allocation (which reflects the market value of invested capital).

To effectively implement the Private Equity investment strategy, the Commission uses a Core-Satellite approach. Core funds and fund of funds provide geographical and strategic diversification to the private equity market; direct funds with specific strategies target unique opportunities to complement the core private equity portfolio.

In Fiscal Year 2007-08, the Commission adopted and implemented a plan that emphasized commitments to private equity funds that historically have mitigated the “J-Curve” risks associated with traditional buyout and venture capital funds. These vehicles include mezzanine debt funds and secondary funds. The benefit to the Portfolio is that invested capital will be returned at a more rapid pace through the receipt of interest income and through shorter funding and distribution periods. Currently, this emphasis is planned to be maintained in Fiscal Year 2011-12.

In Fiscal Year 2011-12, the Commission plans to continue to review attractive co-investment opportunities sponsored by investment managers of funds that have received capital commitments by the Commission. The Commission has approved and may continue to approve co-investment side-car vehicles or investments alongside several investment managers/funds through which co-investments may be executed. Co-investments provide an opportunity to invest Retirement System assets at lower management fees and carried interest.

In Fiscal Year 2011-12, the Commission plans to develop a program within the Private Equity portion of the Portfolio whereby investment opportunities arising within South Carolina or in the southeastern U.S. may receive allocations from private equity investment managers that have received capital commitments by the Commission, provided that such investments comply with fiduciary standards and applicable state law. In addition, where attractive co-investment opportunities arise, funds may be committed to invest alongside private sponsors in accordance with the investment guidelines and policies approved by the Commission. No investment will be made absent a private sponsor with risk and return objectives complying with those of the Portfolio.

Real Estate: With a target allocation of 6% of the Portfolio, Staff will implement a plan during Fiscal Year 2011-2012 following the process outlined in the SIOP. The implementation plan was updated during the Commission’s Annual Retreat in November 2010. Similar to Private Equity, this asset class is accessed typically through limited partnerships that invest capital as new opportunities are identified. Commitments and funding for the Real Estate program will be a long-term process, focusing on the next four to seven years, and then on an ongoing basis thereafter. Additionally, real estate exposure can be accessed through direct investments, co-investments, or Strategic Partnerships. These commitments will be diversified across sector, geography, capital structure, and liquidity. As the investments are liquidated, capital will be returned to the Portfolio, decreasing the amount of funds invested in the asset class. For these reasons, a committed allocation to Real Estate may be significantly higher than the policy target allocation (which reflects the market value of invested capital).

Opportunistic Credit (Private Debt)

The Opportunistic Credit asset class was created to take advantage of the dislocations across the various credit markets. This includes private debt and various credit funds that have a long-only or long-short mandate. The current target strategy for this asset is 8% of the Portfolio, and new opportunities will be evaluated on a case by case basis depending on prevailing market conditions. This asset class is characterized at times by invested capital which is significantly less than the total commitment.

Performance Objectives and Benchmarks

The performance objectives for the Portfolio's asset classes are specified below. Each asset class defines the Manager's investment strategy and Strategy Benchmarks, as well as the corresponding Policy Benchmarks. Individual manager performance within these composite asset classes will be evaluated against individual or blended performance benchmarks as specified in their mandate when Managers are hired. The Policy benchmarks for composite asset classes will be blended based upon the appropriate target weights of the underlying asset classes.

Table 3. Summary of Investment Benchmarks

Equities	Policy Benchmark	Manager[1] & Strategy Benchmark
U.S. Large Cap Growth	S&P 500	Russell 1000 Growth
U.S. Large Cap Value	S&P 500	Russell 1000 Value
U.S. Large Cap Core	S&P 500	Russell 1000
U.S. Large Cap Core (Indexed or Enhanced)	S&P 500	S&P 500
U.S. Small/Mid Cap Growth	Russell 2500	Russell 2500 Growth
U.S. Small/Mid Cap Value	Russell 2500	Russell 2500 Value
U.S. Small/Mid Cap Core	Russell 2500	Russell 2500
U.S. Small Cap Growth	Russell 2000	Russell 2000 Growth
U.S. Small Cap Value	Russell 2000	Russell 2000 Value
U.S. Small Cap Core	Russell 2000	Russell 2000
International Equity	MSCI EAFE Net	MSCI EAFE Net
Emerging Markets Equity	MSCI EME Net	MSCI EME Net
Fixed Income		
Cash	90 Day Treasury Bills	90 Day Treasury Bills
Short-Duration Fixed Income	Merrill Lynch U.S. Treasuries 0-3 Year Index	Merrill Lynch U.S. Treasuries 0-3 Year Index
Core Fixed Income	BarCap U.S. Aggregate	BarCap U.S. Aggregate
Global Fixed Income	BarCap Global Aggregate	BarCap Global Aggregate
High Yield Fixed Income	BarCap High Yield	BarCap High Yield
Emerging Markets Debt	J.P.M. EMBI Global Diversified	J.P.M. EMBI Global Diversified
Alternatives		
GAA	50% MSCI World; 50% S&P/Citi WGBI	
GTAA	50% MSCI World; 50% S&P/Citi WGBI	50% MSCI World; 50% S&P/Citi WGBI
Risk Parity	50% MSCI World; 50% S&P/Citi WGBI	90 Day Treasury Bills + 5%[3]
Opportunistic Alpha	HFRX Global Hedge Fund Index	HFRX Global Hedge Fund Index
Private Equity	Venture Economics	Venture Economics
Opportunistic Credit/Private Debt	Blended Benchmark[2]	Blended Benchmark[2]
Real Estate	NCREIF	NCREIF
Commodities	UBS/DJ Commodity	UBS/DJ Commodity

[1] Manager benchmarks will be specified in the contractual documents.
[2] Blended benchmark is comprised of 1/3 Barclays Capital High Yield, 1/3 S&P/LSTA Leveraged Loan Index and 1/3 Barclays Capital MBS Index.
[3] Represents manager benchmark only.

The Staff in conjunction with the Commission and NEPC will implement a benchmark policy that strives to reflect the Global Investment Performance Standards ("GIPS") as set by the CFA Institute. Consistent with GIPS, real estate and private equity benchmarks must reflect the investment mandate, objective, or strategy; and have the same vintage year.

Portfolio Return

The Commission's goal is to construct a Portfolio whose returns exceed the returns of both the Policy and Strategy Benchmarks. At its essence, this can be accomplished through two key portfolio decisions: allocation and manager selection. The allocation decision refers to the decision to deviate from the asset allocation targets outlined by the Commission. The manager selection decision measures the Staff's ability to identify and recommend superior managers (active management) to implement the asset allocation.

Policy Benchmark Index

The difference between the Strategy Benchmark Index return and the Policy Benchmark Index return measures the effects of deviating from the target allocation. The Policy Benchmark is calculated by using index rates of return for each asset class in which the Portfolio is invested multiplied by the percentage of assets targeted to each asset class. If the Strategy Benchmark Index return is greater than the Policy Benchmark Index return, then deviating from the target allocation has added value.

Strategy Benchmark Index

The difference between the Strategy Benchmark Index return and the Portfolio return measures the effect of active management. The Strategy Benchmark return is calculated by using index rates of return for each asset class in which the Portfolio is invested multiplied by the actual percentage of assets allocated to each asset class. If the Portfolio return is greater than the Strategy Benchmark Index return, then management selection has added value.