NEW MEXICO STATE INVESTMENT COUNCIL

INVESTMENT POLICY STATEMENT

Adopted on July 24, 2012
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I. Mission Statement
The mission of the New Mexico State Investment Council ("NMSIC") is to protect and grow the State’s permanent endowment funds for current and future generations, through prudent, professional investment management.

II. Investment Authority
The NMSIC is a non-cabinet level agency charged with managing New Mexico's Permanent Funds ("Funds"). The NMSIC was established by an act of the 23rd Legislature, which was approved on March 28, 1957 and subsequently ratified by a constitutional amendment adopted by the citizens of New Mexico in the general election of 1958. The enabling legislation of the NMSIC is located at section 6-8-1, NMSA 1978. According to the terms of the legislation, responsibility for the investment of the Land Grant Permanent Fund ("LGPF") was transferred to the State Investment Officer, subject to the policy direction of the State Investment Council. The NMSIC was assigned the responsibility for managing the Severance Tax Permanent Fund ("STPF") in 1983. In 1991 the Legislature authorized the NMSIC to provide investment management services for other State agencies. The 1997 legislature further expanded this client authorization to include all political subdivisions of New Mexico and the New Mexico Finance Authority. In 2000 the NMSIC began to manage the Tobacco Settlement Permanent Fund, and in 2006 the Legislature created the Water Trust Permanent Fund with a $40 million allocation.

III. Statement of Purpose
A. Permanent Endowment Trust Funds
The purpose of New Mexico's Permanent Endowment Trust Funds is to contribute recurring revenues for the operating budget of the State and to provide resources to various fund beneficiaries. These Funds are assets which largely represent the depletion of the State's natural resources and land grant proceeds, and are intended to provide ongoing and growing benefits for New Mexicans.

The NMSIC's primary responsibility is management of New Mexico's Land Grant Permanent Fund, Severance Tax Permanent Fund, Tobacco Settlement Permanent Fund, and Water Trust Permanent Fund. In addition, the NMSIC manages investments for other governmental clients. The Land Grant Permanent Fund and Severance Tax Permanent Fund are the state's two largest permanent funds, broadly diversified, and birthrights for New Mexicans.

The Land Grant Permanent Fund ("LGPF") is New Mexico's largest endowment. It was established through, and continues to be maintained in part by, fees the State charges for 13.4 million acres of mineral resources and 8.8 million acres of surface land. Significant portions of LGPF distributions go to New Mexico public schools and public education.
The Severance Tax Permanent Fund (“STPF”) was established to receive severance taxes collected on natural resources extracted from New Mexico lands. State severance taxes have historically been used to retire debt from bond issues that have funded capital projects. Currently, severance tax revenues first pay the required debt service on severance tax bonds issued by the state; remaining revenues are then transferred to the STPF.

The Tobacco Settlement Permanent Fund (“TSPF”) was established as the result of a legal settlement. Presently, half of the annual settlement payments are deposited into the TSPF. The remainder is transmitted directly to the State’s general fund for government operations.

The Water Trust Permanent Fund (“WTPF”) provides annual funding for infrastructure projects in New Mexico, as identified by the Water Trust Board. The WTPF was created in 2006 by the legislature with a $40 million allocation.

As provided by law, the State Investment Office may invest other state agency or local government funds pursuant to a Joint Power Agreement in any type of investment permitted for the LGPF under the same standard of care applicable to investments of the LGPF. It shall be the responsibility of the client agencies to establish asset allocations and direct the movement of their funds.

B. Investment Policy

This Investment Policy Statement (“Policy”) governs the investment of assets for the Funds and is established to provide a framework for the management of those assets. It sets forth in a comprehensive way the NMSIC’s investment objectives, philosophy, guidelines and practices and has been developed as a reference point for the management of Funds’ assets. The Policy is not intended to be a static, one-time document but is designed to capture investment opportunities while providing parameters that ensure prudence and care in the execution of the investment program. No investment or action pursuant to an investment may be taken unless permitted by this Policy or by action of the NMSIC.

The Policy provides guidance for fiduciaries which include the NMSIC, the State Investment Officer and Staff, investment consultants, investment managers, and custodians. It is the intent of the Policy to provide the foundation for management of the Funds’ assets in a prudent manner including the standards by which the NMSIC can evaluate Staff, investment consultants, investment managers, custodians and other service providers.
IV. Investment Objective
The NMSIC investment goals are to preserve the Permanent Endowment Funds for future generations and to provide future benefits by growing the Funds at a rate at least equal to inflation.

The NMSIC seeks to manage the Funds to ensure that future generations receive the same or greater benefits as current beneficiaries, while maximizing current distributions through time to provide current revenue sources to the state’s General Fund. Total return, which includes realized and unrealized gains, plus income, less expenses, is the primary goal of the Funds.

V. Investment Philosophy
In order to meet the investment objective, the NMSIC has adopted the following principles:

- Strategic asset allocation is a fiduciary duty and allocation across asset classes is the most important determinant of return variability and long-term total return.

- Risk is an unavoidable component of investing and is a major factor that must be taken into account in assessing investment policy and strategy.

- Diversification by asset class and within asset classes is a primary risk control element.

- To preserve the purchasing power of the corpus and to provide benefits to current and future generations the Funds should have a strategic asset allocation and investment strategy for a long-term investment horizon.

- Sufficient liquidity will be maintained to meet the anticipated cash flow requirements of the Funds.

A. Capital Markets Theory

1. Return
In order to meet the Funds’ objective, the NMSIC strives to achieve the highest level of investment performance that is compatible with its risk tolerance and prudent investment practices. Due to the long-term nature of the Funds and the inherent risks in short-term tactical investing, the NMSIC must maintain a long-term perspective in formulating and implementing its investment policies, and in evaluating its investment performance. As such, the NMSIC: (1) seeks to adopt a long-term rate of return goal for the Funds, (2) adopts an allocation policy that seeks to meet the rate of return goal over long periods of time, while minimizing volatility (risk) and (3) strives to minimize the costs associated with implementation of the asset allocation through efficient use of internal and/or external resources.
2. **Risk**
   The investment risk philosophy for the Funds is based on the principles of capital market theory that are generally accepted and followed by institutional investors, who by definition are long-term oriented investors. This philosophy holds that:

   - Increasing risk is rewarded with compensating returns over time and, therefore, prudent risk taking is a necessary element of long term investing.
   - Risk can be mitigated through diversification of asset classes and investment approaches, as well as diversification of individual securities.
   - The primary determinant of long-term investment performance is the strategic or long-term allocation of assets among various asset classes.
   - Relative performance of various asset classes is unpredictable in the short term and attempts to shift tactically between asset classes or implementation strategies are unlikely to be rewarded.

Given these principles, the NMSIC has established a long-term asset allocation policy that balances the returns intended to meet the Funds’ objectives and the risk level that is appropriate under existing and anticipated circumstances. In determining its risk posture, the NMSIC has considered, in addition to its fiduciary obligations and statutory requirements, each Fund’s purpose and characteristics, current and projected financial condition, liquidity needs, sources of contribution, income and general business conditions.

3. **Diversification**
   The NMSIC will rely on an investment strategy utilizing an appropriate long-term, diversified asset allocation approach. Diversification distributes a portfolio across many investments to avoid excessive exposure to any one source of risk. Investors generally diversify their portfolios along the following lines: asset classifications (stocks, fixed income, credit, real estate, real assets, hedge funds, private equity, short-term investments, etc.), domestic, international, industries, and maturity sectors. Other considerations in asset allocation modeling should take into account the purpose of the Fund, the size and financial condition of the Fund, and general business conditions. The factors mentioned here are not intended to be limiting; rather, they are outlined as a general indication of the importance of diversification to proper asset allocation. Under such an allocation, the Funds’ assets may be invested by some combination of external and/or internal managers, by active and/or passive managers, and by diverse investment strategies and styles within each asset class. The NMSIC will determine the proper allocation among asset classes and investment managers, based on advice and analysis provided by Staff and/or Consultants.
4. **Formal Review Schedule**
The NMSIC recognizes that even though the investments are subject to short-term volatility, the NMSIC shall maintain a long-term investment focus. This prevents ad-hoc revisions to the philosophy and policies in reaction to either speculation or short-term market fluctuations. In order to preserve this long-term view, the NMSIC has adopted the following formal review schedule:

<table>
<thead>
<tr>
<th>Formal Review Agenda Item</th>
<th>Formal Review Schedule</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset Allocation Policy</td>
<td>At least every three years</td>
</tr>
<tr>
<td>Manager Structure Policy</td>
<td>At least every three years</td>
</tr>
<tr>
<td>Investment Policy</td>
<td>At least every three years</td>
</tr>
<tr>
<td>Total Fund Performance</td>
<td>At least quarterly</td>
</tr>
<tr>
<td>Asset Class Composite Performance</td>
<td>At least quarterly</td>
</tr>
<tr>
<td>Investment Manager Performance</td>
<td>At least quarterly</td>
</tr>
</tbody>
</table>

VI. **Roles and Responsibilities**

A. **New Mexico State Investment Council**
The NMSIC is the primary body charged with overseeing investment activities relating to the Funds. Members of the NMSIC are fiduciaries subject to the statutory and common law duties of a fiduciary. NMSIC is a non-cabinet level agency charged with managing New Mexico's Permanent Funds. The NMSIC is dedicated to seeing the New Mexico State Investment Office accomplish its mission of ensuring intergenerational equity for New Mexicans, by providing consistently excellent, prudent investment performance.

The NMSIC’s mandate, in turn, is to manage New Mexico’s Permanent Funds ethically and optimally, working to maximize returns within acceptable levels of risk, so as to ensure future generations receive the same or greater benefits as current beneficiaries. The NMSIC must work diligently to enact positive policy, to assure that such policy is implemented, and to inject transparency into operations. NMSIC stewardship recognizes that the public demands and deserves not only average returns from the Funds, but also ethical and best-in-class investment practices in our efforts to grow the state’s permanent trust dollars.

The NMSIC is responsible for prudent investment and expenditure of the Funds and assets. The NMSIC will operate the investment program in compliance with all applicable federal and State laws and regulations. The NMSIC is responsible for
establishing and maintaining all policies and guidelines by which the Funds are managed, and by which the State Investment Office operates.

The NMSIC relies on both internal Staff and external contractors in order to properly administer the Funds and implement the Fund’s investment strategies. Because of the number of parties involved, the roles the each party as fiduciaries must be clearly identified. Such identification increases operational efficiency, ensures clear lines of responsibility and reduces or eliminates duplication of effort.

**B. Council Investment Committee**

The Council Investment Committee (CIC) is a standing subcommittee of the NMSIC with express purpose of assisting the NMSIC in carrying out their investment responsibilities for the Funds. All members of the CIC shall be appointed by the NMSIC. The NMSIC shall elect annually a Chair from among the members of the CIC and may elect other officers as necessary.

The CIC is charged with reviewing and making recommendations to the NMSIC on all investment related matters, other than those under the purview of the Private Equity Investment Advisory Committee ("PEIAC"). The CIC’s principal responsibilities are to ensure that funds managed by the NMSIC are managed in accordance with the Uniform Prudent Investor Act for the benefit of the citizens of the State of New Mexico. The CIC assists the NMSIC on investment actions including, but not limited to, the following responsibilities:

1. Formulating and recommending investment policies and guidelines regarding asset classes, asset allocation targets and ranges and prohibited investments.
2. Formulating and recommending return objectives and benchmarks for the Fund as a whole and for individual asset classes;
3. Reviewing and recommending the retention or termination of any investment consultant;
4. Reviewing and recommending the investment, reinvestment, redemption or termination of funds managed by the NMSIC, including the retention or termination of any investment manager, custodian, securities lending agent, or transition management agent;
5. Evaluating investment performance of funds overseen by the NMSIC based on a comparison of actual returns with the NMSIC’s return objectives, benchmarks and relevant external peer groups;
6. Reviewing periodically the rebalancing activities undertaken by the State Investment Office staff;
7. Attending to such other matters as the NMSIC may from time-to-time request.

**C. Private Equity Investment Advisory Committee**

The Private Equity Investment Advisory Committee (PEIAC) is composed of the State Investment Officer, one sitting member of the State Investment Council (SIC) and three other members appointed by the Council itself. All appointees are to have extensive experience in investment and finance fields and serve their fiduciary roles as a public service.
D. State Investment Office Investment Staff
The Internal Investment Staff (“Staff”) reports directly to the Deputy State Investment Officer who in turn reports to the State Investment Officer (“SIO”). The Deputy State Investment Officer functions as Chief Investment Officer (“CIO”) with primary responsibility for the implementation of the investment program consistent with the NMSIC-adopted investment policy and applicable state and federal laws. The CIO, with assistance of Investment Staff, monitors the performance of the investment portfolio, ensures that funds are invested in accordance with NMSIC policies, communicates with the NMSIC and SIO, studies, recommends, and implements policy and operational procedures that will enhance the investment program of the State Investment Office and ensures that proper internal controls are developed to safeguard the assets of the State Investment Office. In fulfilling these investment responsibilities, the CIO relies heavily on the Investment Staff and Consultant(s). The Staff exercises the same fiduciary responsibility under applicable law as the NMSIC.

E. Investment Consultant
The Consultant is hired by and reports directly to the NMSIC. The Consultant’s duty is to assist the NMSIC, its CIC and Staff in the management of the investment process. This includes regular meetings with the NMSIC to provide an independent perspective on the Funds’ goals, structure, performance and managers. In the course of the Consultant’s normal functions, the Consultant will work directly with Staff to review asset allocation, asset class structure and performance, investment manager performance, and make recommendations to the NMSIC as appropriate. The Consultant will assist Staff and the Committee with external investment manager selection and will promptly inform the State Investment Office and discuss the impact of material changes taking place within any current manager’s organization or investment process. The NMSIC may elect to retain one or more Consultants that specialize in specific areas of asset consulting. Performance of Investment Consultant(s) will be subject to review by the Staff, CIC and NMSIC.

F. External Investment Managers
The external Investment Managers (“Managers”) serve at the pleasure of the NMSIC. The Managers will be provided with explicit written individual investment guidelines providing detail, clarification of permissible securities and investment strategies, and performance evaluation criteria. Each will select, buy, and sell specific securities or investments within the parameters specified in their contractual guidelines and in adherence to this Investment Policy or to other policies set forth by the NMSIC. Managers will construct and manage investment portfolios that are consistent with the investment philosophy and disciplines for which they were hired by the NMSIC. Managers will provide performance reporting to the Staff utilizing standardized reporting formats and at intervals specified by Staff.
G. Custodian
The Custodian(s) will collect income and safekeep all cash and securities, and will regularly summarize these holdings, along with both their individual and collective performance, for Staff’s review. The Custodian will provide data and performance reports to the Staff and Consultant at intervals specified by the NMSIC’s written policy or New Mexico Department of Finance and Administration’s contract. In addition, a bank or trust depository arrangement will be utilized to accept and hold cash flow prior to allocating it to the Investment Managers, and to invest such cash in liquid, interest-bearing instruments. The NMSIC shall determine asset allocation guidelines; in order to maintain these targets, Staff will direct the Custodian to allocate cash and/or securities to the System’s Investment Managers as necessary. The Custodian may also, at the direction of the NMSIC, engage in a Securities Lending program.

VII. Standards of Care

A. The Uniform Prudent Investor Act
The Uniform Prudent Investor Act (“UPIA”) [45-7-601 to 45-7-612 NMSA 1978] governs the NMSIC and the State Investment Office. The statutes are the foundation for the NMSIC’s Investment Policy. In summary, the UPIA states that all persons responsible in making investment decisions for the NMSIC shall exercise the care, skill, prudence and diligence under the circumstances then prevailing that a prudent investor acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. Investments are to be diversified so as to minimize the risk of large losses, unless under the circumstances, it is clearly prudent not to do so. In addition, investment and management decisions respecting individual assets will be evaluated not in isolation but in the context of the portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the NMSIC.

B. Conflicts of Interest
Members of the NMSIC, Staff, consultants and investment managers involved in the investment process will refrain from personal business activity that could conflict with the proper execution and management of the NMSIC investment program, or that could impair their ability to make impartial recommendations and decisions. These parties are required to reveal all relationships that could create or appear to create a conflict of interest in their unbiased involvement in the investment process.

VIII. Asset Allocation

A. Strategic Asset Allocation
The NMSIC recognizes that the most important determinant of long-term return and risk is the asset allocation decision. The asset allocation decision is intended to reflect the return objective and risk tolerance expressed in this Investment Policy Statement. It is
designed to provide the highest probability of meeting the Funds' objectives at a level of risk and liquidity that is acceptable to the NMSIC. In establishing its risk tolerance, the NMSIC considers the Funds’ ability to withstand short- and intermediate-term volatility in investment performance and fluctuations in financial condition of the Funds.

To determine the strategic allocation, the NMSIC, with assistance from Staff and Consultants, examines the historical and projected risk and return of the approved asset classes, the correlation among these asset classes as well as the effect the expected investment performance will have on the obligations of the Funds. Based on its long-term return expectations and its determination of the appropriate risk tolerance for the Funds, the NMSIC has chosen the following Strategic Asset Allocation Policy for the LGPF and the STPF (without the Economically Targeted Investments):

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Strategic Asset Allocation Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Broad US Equity</td>
<td>31%</td>
</tr>
<tr>
<td>Broad International Equity</td>
<td>15%</td>
</tr>
<tr>
<td>Fixed Income</td>
<td>16%</td>
</tr>
<tr>
<td>Real Return</td>
<td>10%</td>
</tr>
<tr>
<td>Core Real Estate</td>
<td>10%</td>
</tr>
<tr>
<td>Absolute Return</td>
<td>8%</td>
</tr>
<tr>
<td>Private Equity</td>
<td>10%</td>
</tr>
</tbody>
</table>

The NMSIC and Staff will review the Strategic Asset Allocation Policy at least annually for reasonableness relative to significant economic and market changes or to changes in the Funds’ long-term goals and objectives. A formal asset allocation study will be conducted at least every three years to verify or amend the targets.

Recognizing that a long-term target allocation utilizing alternative asset classes can take a matter of years to implement prudently, the NMSIC delegates implementation of Strategic Asset Allocation Policy to Staff including funding of alternative asset classes and setting interim asset allocation targets.

**B. Rebalancing Strategy**

Rebalancing is the term that describes the periodic movement of funds from one asset or asset class to another in order to realign assets to the Strategic Asset Allocation target. A rebalancing strategy is an important element of asset allocation policy. Systematic re-balancing can reduce portfolio volatility and increase portfolio return over the long term. However, frequent rebalancing resulting from excessively tight ranges can lead to unnecessary transaction costs.

The NMSIC has chosen to adopt a rebalancing policy governed by allocation ranges rather than time periods. Upper and lower allocation limits have been established for each asset class. These ranges, specified in the table below, are a function of the
volatility of each asset class and the proportion of the total fund allocated to the asset class.

**Strategic Asset Allocation and Re-Balancing Ranges**

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Lower Limit</th>
<th>Strategic Asset Allocation Target</th>
<th>Upper Limit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Broad US Equity</td>
<td>26%</td>
<td>31%</td>
<td>36%</td>
</tr>
<tr>
<td>Broad International Equity</td>
<td>0%</td>
<td>15%</td>
<td>15%</td>
</tr>
<tr>
<td>Fixed Income</td>
<td>13%</td>
<td>16%</td>
<td>19%</td>
</tr>
<tr>
<td>Real Return</td>
<td>7%</td>
<td>10%</td>
<td>13%</td>
</tr>
<tr>
<td>Core Real Estate</td>
<td>7%</td>
<td>10%</td>
<td>13%</td>
</tr>
<tr>
<td>Absolute Return</td>
<td>6%</td>
<td>8%</td>
<td>10%</td>
</tr>
<tr>
<td>Private Equity</td>
<td>7%</td>
<td>10%</td>
<td>13%</td>
</tr>
</tbody>
</table>

The NMSIC has authorized the Staff to rebalance the portfolio in accordance with these policy guidelines. While the allocation to all asset classes remains within these limits, Staff will use cash flow, as available, to maintain the overall allocation as close as possible to the strategic target. When any one of the public market asset classes violates a lower or upper limit, the entire Fund may be rebalanced to within its strategic asset allocation target range. Recognizing that it may be impractical or costly to reallocate illiquid alternative assets, if an alternative asset class breaches an upper or lower limit, the asset class will be rebalanced to within its strategic asset allocation range as soon as is practically possible, subject to reasonable transaction costs.

Within the guidelines set by the NMSIC,

Staff is responsible for developing and implementing a rebalancing plan that is appropriate for existing market conditions, with a primary objective of minimizing transaction costs, market impact, opportunity costs and portfolio disruptions. Managers on the Watch List will not receive additional allocations without CIC approval. Even if a lower or upper limit is not breached, Staff may still make minor changes among asset classes and within individual asset classes, as needed, to more effectively maintain proper exposure to the NMSIC-approved Strategic Asset Allocation and asset class portfolio structures. Staff will report the results of all rebalancing activity to the CIC and the NMSIC at their regular meetings.

**IX. Investment Manager Structure**

The NMSIC must make certain strategic decisions regarding the structure of the portfolio and the structure of the individual asset classes. The NMSIC will formally evaluate on a periodic basis certain strategic decisions regarding the portfolio structure. The major types of strategic structure decisions typically include but are not limited to:

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1 Rebalancing required by State Statutes: (1) Broad US equities plus Broad international equities shall not be greater than 65% of the total LGPF, STPF or TSPF, measured separately, and (2) international investments shall not be greater than 15% of the total LGPF or TSPF, measured separately.
1. The passive vs. active management mix;
2. The internal vs. external management mix;
3. Any strategic overweights/underweights based on market capitalization, investment style or sector allocations.

The NMSIC has elected to utilize a combination of internal and external management, active and passive management, and to maintain a neutral investment strategy based on size, styles, and sectors across asset classes. However, on a periodic basis, the NMSIC will formally evaluate strategic decisions regarding the structure of the individual asset classes. The structure of the individual asset classes, based on recommendations by Staff and Consultant, will support the Strategic Asset Allocation described in the previous section and will be approved by the NMSIC. Staff, with the assistance of Consultants, will be responsible for implementation of the NMSIC-approved asset class structures, supervision of the managers, performance monitoring and reporting. Updates will be provided to the NMSIC (i) based on the schedule outlined in Section V, (ii) as requested by the NMSIC, the CIC, and (iii) as deemed necessary by Staff and Consultant.

In order to adequately diversify the roster of investment managers, the NMSIC has established ten percent of the total fund as the maximum percentage of assets allowed under management by a single active investment management firm, including a parent and any wholly or partially owned affiliates, subsidiaries, or joint venture firms. Deviations above ten percent caused by market fluctuations will not result in an automatic withdrawal of funds from the manager. However, the manager will not be eligible to receive additional funds resulting from rebalancing or from a new mandate as long as the asset level remains above ten percent.

X. Investment Manager Evaluation
When analyzing any investment manager the NMSIC believes it is important not to review it in isolation, but within the context of the structure of the entire asset class and portfolio structure. A key to portfolio construction is diversification, not just by asset class but within each asset class. The goal of diversification is to be exposed to different strategies, which will have different performance and risk patterns. Diversification is optimal when strategies are complementary.

A. Search and Selection
The NMSIC has established the following guidelines for hiring external investment managers. In establishing these guidelines, it is the NMSIC’s intention to assure all interested parties that decisions made in carrying out these actions occur in a full disclosure environment characterized by competitive selection, objective evaluation and proper documentation. Any action to hire a manager should be based on one or more of the following observations:

- Identification of a new asset class or approach which has been approved in advance by the NMSIC;
- A need for diversification of managers and styles within an existing asset class; and/or
- A need to replace an investment manager terminated by the SIC or pending termination;
- A need to retain additional managers in order to reach an asset class structure target.

The process outlined in the NMSIC Procurement Policy will be used for selection of external managers. The selection of new investment managers will adhere to a consistent process to ensure an open and competitive manager universe, proper evaluation and due diligence of all candidates, and selection of candidates that are best able to demonstrate the characteristics sought in a specific search. All efforts should be conducted in an open, competitive and transparent environment in order to assure that qualified service providers are identified, that the objectives for the manager’s mandate are clearly articulated, and that pricing is at market. The evaluation process will include a member of the NMSIC, Staff and Consultant and will include but not be limited to the following steps:

1. Establish investment manager election criteria;
2. Identify qualified candidates through minimum qualification screen;
3. Quantitative screen;
4. Qualitative screen;
5. Additional cuts based on additional qualitative/quantitative inputs;
6. Additional cuts based on manager interviews at the State Investment Office;
7. Analysis of quantitative and qualitative factors including portfolio fit and structure;
8. On-site due diligence;
9. Recommendation to Council Investment Committee;
10. Council Investment Committee recommendation to the NMSIC.

Consultant and Staff will prepare proper documentation and full disclosure of the complete search process. When reviewing the documentation regarding the hiring of an external investment service provider, the primary focus of the Council Investment Committee and the NMSIC shall be on ensuring that the NMSIC will be able to satisfy any interested party that decisions were well reasoned, thoroughly considered, and prudent. The written supporting documentation will include disclosure of all relevant issues, including the investment search process, investment sourcing and related due diligence. Potential service providers or candidates may, at the pleasure of the NMSIC, CIC or upon the recommendation of Staff and Consultant, be asked to make a formal presentation to the Committee and/or NMSIC at any time.

Each NMSIC member’s investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the Fund.

B. Monitoring and Evaluation
The decision to retain a manager can have the same potential impact on the returns of an asset class composite as manager selection decisions and should be given the same degree of attention. The NMSIC recognizes investment and management decisions
directed at individual managers must be evaluated not in isolation but in the context of the overall structure of the asset class and the Fund’s portfolio as a whole. To maintain the discipline necessary for a long-term focus, the NMSIC has adopted a framework for identification of existing and potential problems outlining how and when specific concerns and events should be addressed to avoid untimely decisions that could impact returns. This framework applies to all of the NMSIC’s external public market managers and is intended to accomplish these objectives:

- Foster a long-term approach to manager evaluation;
- Provide a review of the manager’s “fit” in the overall asset class composite;
- Provide a logical and statistically valid framework for manager skill evaluation;
- Promote timely and appropriate responses to actual and potential performance issues;
- Provide flexibility to allow application across all asset classes, management styles and market environments.

The framework for retention analysis relies on a formal performance reporting process that includes:

1. Monthly performance reports from Custodian and Consultant to Staff. These reports will detail overall performance of the Funds, asset class composites and the performance of individual managers;
2. Quarterly reports from Staff and Consultant at the CIC and the NMSIC meetings. These reports will detail performance of the Funds, asset class composites and the performance of individual managers as well as peer ranks for each category;
3. Quarterly performance reports from the investment managers to Staff.

The formal performance reports are supplemented by qualitative analysis generated in the course of regular, on-going contact between the investment managers, Staff and the Consultant.

C. **Watch List**

The objective of a Watch List Policy is to help identify managers that deserve closer scrutiny and ongoing monitoring. Watch Lists are not action lists and managers should not be terminated simply for being on the Watch List for a stated period of time. Consultant and Staff will provide, at least quarterly, in depth analysis on each manager that is on NMSIC’s Watch List.

**Quantitative Factors Resulting in Watch List Additions**

The NMSIC understands that past performance alone is a poor indicator of future performance and performance consistency is important, but periodic underperformance should be expected.

The following are guidelines that Staff and the Consultant will use when making a recommendation to the CIC to place a manager on the Watch List:
Test 1  If the manager’s rolling, three-year return (gross of fees) falls below the rolling, three-year benchmark return for three (3) consecutive quarters;

Test 2  If the manager’s rolling, three-year return (gross of fees) for three (3) consecutive quarters ranks in the bottom third of the Consultant’s peer group universe;

Qualitative Factors Resulting in Watch List Additions

Qualitative factors should be central elements of the evaluation process. The following are examples of significant and potentially adverse events that will be considered as reasons to add a manager to the Watch List:

1. Turnover of one or more key personnel;
2. Change in firm ownership or structure;
3. Significant loss of clients and/or assets under management;
4. Significant and persistent lack of responsiveness to client requests;
5. Litigation;
6. Failure to disclose significant information, including potential conflicts of interest;
7. Chronic violations of Policy; or
8. Any other issue or situation of which the NMSIC, CIC, Staff or Consultant become aware that is deemed material.

Once a manager is placed on a Watch List for either quantitative or qualitative reasons, Staff will notify the Manager that their firm, process and performance will be closely monitored and scrutinized. The manager will remain on the Watch List subject to a subsequent recommendation by Staff and Consultant to the CIC and the NMSIC. After one or more periods of rolling, three-year returns above the respective benchmark or above the bottom quartile, the CIC and NMSIC may consider removing the manager from the Watch List.

This framework provides guidelines that are useful in determining the conditions under which a contract relationship between a Manager and the Funds should be called into question. In addition, circumstances may arise in which the NMSIC may elect to terminate a manager for cause (all of the Funds’ public market investment manager contracts may be terminated, with or without cause, immediately upon notification).

A manager retention decision is very important to the continued success of the Funds' investment strategy. As such, it should not be taken lightly or made solely on quantitative or qualitative guidelines. The ultimate decision rests in the collective judgment and authority of the NMSIC, which may consult with the CIC, Staff, and Consultant.
D. Investment Manager Termination Guidelines
From time to time it will be necessary for the NMSIC to terminate a contractual relationship with an Investment Manager and these actions must be viewed in the context of the entire portfolio and as a business decision. The NMSIC has established the guidelines to assist in making these termination decisions. In establishing these guidelines, it is the intent of NMSIC to assure all interested parties that decisions made occurred with full disclosure characterized by competitive bidding, objective evaluation and proper documentation. The overriding consideration with respect to all decisions is that they shall be made solely in the best interest of the beneficiaries of the Funds.

Any action to terminate a manager should be based on one or more of the following criteria:

1. Significant changes in firm ownership and/or structure;
2. Loss of one or more key personnel;
3. Significant loss of clients and/or assets under management;
4. Shifts in the firm’s philosophy or process;
5. Significant and persistent lack of responsiveness to client requests;
6. Changes in NMSIC’s investment strategy eliminating the need for a particular style or strategy;
7. Violations of the Investment Policy or guidelines;
8. Unsatisfactory investment performance;
9. Identification of a new asset class or approach which has been approved in advance by the NMSIC;
10. Need for diversification of styles within an existing asset class; or
11. Any other issue or situation of which the Staff, Consultant and/or Committee become aware that is deemed material;
12. Need to reduce exposure to a single manager.

Prior to the termination decision, the NMSIC prefers to have all relevant considerations identified and documented in CIC and NMSIC minutes, and supporting documents. Although it may not be possible in every situation, it is the NMSIC’s intent to have a plan in place before termination of any manager.

XI. Performance Benchmarks

A. Total fund benchmark
In addition to the objective stated in Section IV., an important return objective to be considered when evaluating the Funds’ performance is measured by applying the investment performance of the asset class benchmarks to the Funds’ Strategic Asset Allocation target. The Policy Index permits the NMSIC to compare the Funds’ actual performance to its total fund benchmark, and to measure the contribution of active investment management and policy adherence.
The NMSIC has selected the following Policy Index:

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Policy Index</th>
<th>Strategic Asset Allocation Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Broad US Equity</td>
<td>Russell 3000 Index</td>
<td>31%</td>
</tr>
<tr>
<td>Broad International Equity</td>
<td>MSCI All Country Ex US Index</td>
<td>15%</td>
</tr>
<tr>
<td>Fixed Income</td>
<td>Barclays Capital Aggregate Index</td>
<td>16%</td>
</tr>
<tr>
<td>Real Return</td>
<td>Custom Index</td>
<td>10%</td>
</tr>
<tr>
<td>Core Real Estate</td>
<td>NCREIF ODCE Index (AWA)</td>
<td>10%</td>
</tr>
<tr>
<td>Absolute Return</td>
<td>HFRI FOF Composite Index</td>
<td>8%</td>
</tr>
<tr>
<td>Private Equity</td>
<td>Venture Economics All Private Equity Index</td>
<td>10%</td>
</tr>
</tbody>
</table>

Recognizing that a long-term target allocation to alternative asset classes can often take a matter of years to implement prudently, the NMSIC will also review an Interim Policy benchmark which will be adjusted as Staff makes progress towards its long-term Strategic Asset Allocation target.

B. **Asset class benchmarks**

A composite of the mandates within each asset class will be compared to its respective Policy Index (see table, XI.A.).

C. **Mandate-level benchmarks**

Individual managers will be evaluated using the following standards:

1. Against appropriate market indices on a nominal and risk-adjusted basis;
2. Against peers within their style group;
3. Based on adherence to their stated investment philosophy and style; and
4. Based on adherence to this Policy and the guidelines established in their contract.

Specific performance criteria for each sub-asset class are outlined as follows. Not all sub-asset classes will necessarily be in place at one time and exceptions may apply to the benchmarks stated below as detailed in the investment manager’s contract:

<table>
<thead>
<tr>
<th>Sub-Asset Class</th>
<th>Index</th>
<th>Peer Universe</th>
</tr>
</thead>
<tbody>
<tr>
<td>US Large Cap Value Equity</td>
<td>Russell 1000 Value Index</td>
<td>Large Cap Value Equity</td>
</tr>
<tr>
<td>US Large Cap Core Equity</td>
<td>Russell 1000 Index</td>
<td>Large Cap Core Equity</td>
</tr>
<tr>
<td>US Large Cap Growth Equity</td>
<td>Russell 1000 Growth Index</td>
<td>Large Cap Growth Equity</td>
</tr>
<tr>
<td>US Mid Cap Value Equity</td>
<td>Russell Mid Cap Value Index</td>
<td>Mid Cap Value Equity</td>
</tr>
<tr>
<td>US Mid Cap Core Equity</td>
<td>Russell Mid Cap Index</td>
<td>Mid Cap Core Equity</td>
</tr>
<tr>
<td>Category</td>
<td>Index Description</td>
<td>Category</td>
</tr>
<tr>
<td>--------------------------------------------</td>
<td>--------------------------------------------------------</td>
<td>-------------------------------</td>
</tr>
<tr>
<td>US Mid Cap Growth Equity</td>
<td>Russell Mid Cap Growth Index</td>
<td>Mid Cap Growth Equity</td>
</tr>
<tr>
<td>US Small/Mid Cap Value Equity</td>
<td>Russell 2500 Value Index</td>
<td>Small/Mid Cap Value Equity</td>
</tr>
<tr>
<td>US Small/Mid Cap Core Equity</td>
<td>Russell 2500 Index</td>
<td>Small/Mid Cap Core Equity</td>
</tr>
<tr>
<td>US Small/Mid Cap Growth Equity</td>
<td>Russell 2500 Growth Index</td>
<td>Small/Mid Cap Growth Equity</td>
</tr>
<tr>
<td>US Small Cap Value Equity</td>
<td>Russell 2000 Value Index</td>
<td>Small Cap Value Equity</td>
</tr>
<tr>
<td>US Small Cap Core Equity</td>
<td>Russell 2000 Index</td>
<td>Small Cap Core Equity</td>
</tr>
<tr>
<td>US Small Cap Growth Equity</td>
<td>Russell 2000 Growth Index</td>
<td>Small Cap Growth Equity</td>
</tr>
<tr>
<td>Non-US Developed Equity</td>
<td>MSCI EAFE Index</td>
<td>International Large Cap Equity</td>
</tr>
<tr>
<td>Non-US Small Cap Equity</td>
<td>MSCI World Ex US Small Cap Index</td>
<td>International Small Cap Equity</td>
</tr>
<tr>
<td>Non-US Emerging Equity</td>
<td>MSCI Emerging Markets Index</td>
<td>Emerging Markets Equity</td>
</tr>
<tr>
<td>Global Equity</td>
<td>MSCI All Country World Index</td>
<td>Global Equity</td>
</tr>
<tr>
<td>Global Fixed Income</td>
<td>BC US Aggregate Bond Index</td>
<td>Global Fixed Income</td>
</tr>
<tr>
<td>Core Fixed Income</td>
<td>BC US Aggregate Bond Index</td>
<td>US Broad Core Fixed Income</td>
</tr>
<tr>
<td>Core Plus Fixed Income</td>
<td>BC US Universal Bond Index</td>
<td>US Broad Core Plus Fixed Income</td>
</tr>
<tr>
<td>High Yield Fixed Income</td>
<td>BC US Corporate: High Yield Index</td>
<td>US High Yield Bonds</td>
</tr>
<tr>
<td>Credit &amp; Structured Finance</td>
<td>45 % ABX.HE.BBB-06-1, 45% S&amp;P/LTSA 1100 Names Index, &amp; 10% CDX 15</td>
<td>N/A</td>
</tr>
<tr>
<td>Cash Equivalents</td>
<td>BofA ML 3 Month T-Bill Index</td>
<td>N/A</td>
</tr>
<tr>
<td>TIPS</td>
<td>BC U.S. TIPS Index</td>
<td>US TIPS</td>
</tr>
<tr>
<td>Commodities</td>
<td>Dow Jones-UBS Commodity Index</td>
<td>N/A</td>
</tr>
<tr>
<td>Energy</td>
<td>S&amp;P GSCI Light Energy Index</td>
<td>N/A</td>
</tr>
<tr>
<td>Value Added Real Estate</td>
<td>NCREIF Townsend Value Added Index</td>
<td>N/A</td>
</tr>
<tr>
<td>Opportunistic Real Estate</td>
<td>NCREIF Townsend Opportunistic Index</td>
<td>N/A</td>
</tr>
<tr>
<td>Venture Capital Private Equity</td>
<td>Venture Economics All Venture Capital Index</td>
<td>N/A</td>
</tr>
<tr>
<td>Buyout Private Equity</td>
<td>Venture Economics All Buyouts Index</td>
<td>N/A</td>
</tr>
</tbody>
</table>
XII. Transition Management

Transition management is defined as the professional management of trading out of one portfolio of marketable securities (“legacy” portfolio) and into another portfolio of marketable securities (“target” portfolio), while controlling for the timeliness of trades, explicit and implicit costs, and market exposure relative to a predetermined benchmark. Transition management includes, but is not limited to, the termination and hiring of investment managers. It also may apply to rebalancing between asset classes, large cash contributions/withdrawals to and from a manager and strategy changes within the fund. Transitions are an important and inevitable element of portfolio management. The optimal method to use in executing a transition may vary significantly from one transition to another based on the types of assets involved, the timeframe in question and market conditions. The primary objective in a manager transition is to implement the movement of assets in a cost-effective, timely manner while maintaining the appropriate market exposure. It is imperative to note that the cost of transition is not commissions alone, but also bid/ask spread, market impact and opportunity cost. Efforts should be made to minimize the total cost rather than any single cost component.

Staff will manage the transition manager pool selection process. The transition manager pool consists of NMSIC approved transition managers. To be considered for inclusion in the transition manager pool, transition managers must complete the Transition Management Request for Proposal. Proposals will be evaluated based upon the following criteria: quality, completeness of the response, ability to fulfill the requirements of the scope of services, qualifications, experience and the overall costs and/or fees. Staff will manage each transition. Staff may seek transition bids from one or all of the managers in the transition manager pool.

In most instances transition management services will be executed by a transition manager in the NMSIC’s approved transition manager pool. However, in some instances Staff may believe it is more appropriate for one of the investment managers to provide these services.

Staff will provide a summary of transition activity to the CIC and the NMSIC at the conclusion of each transition.

XIII. Permitted Investments

The NMSIC may invest in the following securities and investment activities as long as such investments comply with the UPIA. Fund of Fund strategies are allowable in any of the asset classes. All investments are subject to approval of the NMSIC and satisfactory legal review of applicable contractual terms and conditions.

A. Equity

1. Preferred stock, common stock, initial public offerings, Real Estate Investment Trusts (“REITS”), securities of foreign issuers listed on U.S. Exchanges, and any security convertible to common stock or American Depository Receipts (“ADRs”)

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1 Investments listed here are for general information purposes only. Each manager retained by the NMSIC will be given specific guidelines with regard to permissible investments relevant to their mandate.
that are registered by the U.S. Securities and Exchange Commission ("SEC") of any corporation whose securities are listed on at least one U.S. stock exchange that has been approved by or is controlled by the SEC or on the National Association of Securities Dealers ("NASD"). Global mandates may be considered.

2. Preferred stock, common stock, and convertible issues of any non-U.S. Corporation; which may be denominated in non U.S dollars, provided that the securities are traded on one or more national stock exchanges or included in a nationally recognized list of stocks; and NMSIC shall not be invested in more than ten percent of the voting stock of any company.

B. **Fixed Income**

1. Bonds, notes or other obligations of the United States government, its agencies, government-sponsored enterprises, corporations, or instrumentalities for which the credit of the United States government is pledged for the payment of the principal and interest. Global mandates may be considered.

2. Bonds, notes or other obligations issued by a state, its municipalities or other political subdivisions, that have received an investment grade bond rating, and are registered by the SEC or the Municipal Securities Rulemaking Board ("MSRB").

3. Bonds, notes, commercial paper or other obligations of any corporation organized and operating within the United States.

4. Debt obligations of non-U.S. governmental or quasi-governmental entities, these may be denominated in foreign currencies; obligations, including but not limited to bonds, notes or commercial paper with an investment grade rating (unless otherwise approved by the NMSIC) of any corporation organized outside of the United States. Currency transactions, including spot or cash basis currency transactions, forward contracts and buying or selling options or futures on foreign currencies, shall be permitted for the purposes of hedging foreign currency risk.

5. Collateralized obligations, including but not limited to mortgages, held in trust that: (1) are publicly traded and are registered by the SEC or other Self Regulatory Organization ("SRO") and (2) have underlying collateral that is either an obligation of the United States government or else has a credit rating above or equal to BBB according to the Standard and Poor's rating system or Baa according to the Moody's investors rating system or their equivalent by a national rating agency approved by the NMSIC (unless otherwise approved by the NMSIC).

6. The Credit and Structured Finance Fund within the Fixed Income allocation will invest in various classes of securities of credit, structured finance, including but not limited to, collateralized debt obligations, collateralized loan obligations, credit opportunity funds, leveraged loan portfolios and other structured finance instruments. Eligible investments will include both rated and non-rated securities. Rated securities will include those rated investment grade and those rated below investment grade. One or more external managers may be retained to manage all or a portion of the Fund. Appropriate investment vehicles will include partnership interests, separate accounts and pooled vehicles. Pooled vehicles may be structured as publicly traded securities or private placements.
C. **Real Estate**

1. Real Estate Partnerships, including investments in private vehicles through limited partnerships or limited liability companies that have an ownership interest in direct real estate properties, whether income-producing or non-income producing. The investment strategies may include “core”, “value added” strategies, which derive their return from both income and appreciation, and “opportunistic,” which derive their return primarily through appreciation.

2. REITS, including equity investments in publicly traded securities of a company dedicated to owning, and/or, operating income-producing real estate, including but not limited to apartments, shopping centers, offices and warehouses.

D. **Real Return**

1. Inflation-indexed bonds, including investments in actively or passively managed investment vehicles. Treasury Inflation Protected Securities (TIPS) are an example of inflation-indexed bonds.

2. Commodities, including but not limited to futures and/or swaps on individually traded commodities or indexes comprising groups of commodities like the Goldman Sachs Commodity Index (GSCI) or Dow Jones – AIG Commodity Index (DJ-AIGCI). Commodities may be used as an overlay strategy on TIPS or other publicly traded instruments.

3. Timber Partnerships, including but not limited to, investments in limited partnerships or limited liability companies that have an ownership interest in properties where the majority value of the property is derived from income-producing timber.

4. Energy Partnerships, including but not limited to limited partnerships or limited liability companies that have an ownership interest in energy-related businesses. Investments may include those across the industry spectrum from upstream (exploration and production), to midstream (processing and transportation), to downstream (refining and distribution).

5. Infrastructure

E. **Absolute Return (Hedge Funds)**

1. Multi-strategy hedge funds that invest using a combination of the following strategies.

2. Hedge funds shall invest primarily in publicly traded securities and derivatives and use long and short positions and leverage, within limits as specified in each hedge fund’s governing documents, to reduce market exposure in order to profit from security selection.

3. Market Neutral strategies such as equity market neutral, fixed income arbitrage, and convertible bond arbitrage.

4. Credit strategies that typically invest in high yield bonds, bank loans and structured credit products.

5. Distressed strategies that seek to take advantage of corporate securities in default, under bankruptcy protection, in distress or heading toward such a condition or in liquidation.

6. Event Driven strategies that take advantage of transaction announcements and other one-time events, including merger arbitrage, spin-offs and restructurings.
7. Equity long/short strategies where there is a combination of long and short positions primarily in publicly traded equities, with a net market exposure less than that of the overall equity market. Strategies may be focused on U.S., non-U.S., and/or specialty mandates.

8. Global Macro strategies such as all market portfolios, opportunistic long-only, managed futures, currency, dedicated short selling strategies or other specialty strategies.

F. Private Equity
PEAIC is responsible for the Private Equity portfolio and works under a separate investment policy.

G. Cash Investment Guidelines
Staff will focus on quality when investing cash positions. Cash is an asset class that should emphasize minimal risk. Cash positions will be kept to the minimum necessary for liquidity, distributions and ongoing investment activities. The following guidelines apply:

1. Eligible securities include:
2. Repos secured by U.S. obligations or other securities backed by the U.S., A1 or P1 commercial paper, corporate obligations rated AA or better and maturing in five years or less, or asset-backed securities rated AAA. All repo collateral must have a market value of at least 102% of the market value of the contract;
3. Commercial paper issued by corporations organized and operating within the U.S. and rated “prime” quality by a national rating service;
4. Prime bankers’ acceptances issued by money center banks;
5. Funding agreements rated at least AA by a nationally recognized rating agency. As used in this paragraph, "funding agreement" means a floating or variable rate insurance company contract that is a general obligation of an insurance company organized and operating within the United States and that is senior to all other debt issued by the company; and
6. Time deposits, with banks incorporated in the United States or time deposits that are fully guaranteed by banks incorporated in the United States.

H. Derivatives Investment
If utilized, derivatives will be managed to protect market value and to maximize total returns under the following guidelines:

1. Eligible applications include, but are not limited to, the purchase, sale, exchange, conversion or other trade of exchanged traded index option contracts, over-the-counter options, domestic equity index futures, international equity index futures, international fixed income futures, commodity futures, domestic fixed income futures and swaps.
2. The total relative economic impact risk of each derivative application will be monitored on a daily basis by the most appropriate risk management tools for the particular derivatives application.
3. In order to limit the financial risks associated with derivative applications, rigorous counterparty selection criteria and netting agreements shall be
required to minimize counterparty risk. If utilized, the counterparty must be of an investment grade credit and the agreement must be marked to market no less frequently than monthly.

XIV. General Investment Restrictions and/or Guidelines

A. All investments made shall be subject to the quality and diversification restrictions established by the UPIA.

B. Assets may be held in commingled funds and/or privately managed separate accounts. Exposure through commingled funds shall be evaluated on a case-specific basis through analysis of the fund’s “offering document.” Upon review by the Staff and Consultant, and approval by the Board, the “offering document” becomes the specific investment guidelines for that allocation.

C. No more than 65% of the fair value of the LGPF, STPF and TSPF may be invested in stocks at any given time.

D. No more than 5% of the stock of any corporation may be purchased.

E. Without prior Staff approval, the securities representing debt and equity of any one company shall not exceed 6% of the market value of any Manager’s portfolio. Staff will confirm approval with the CIC and NMSIC at the following scheduled meetings.

F. No investment or action pursuant to an investment may be taken unless expressly permitted by this Policy. Exceptions may be made subject to prior review by and express written authorization from the NMSIC.

G. Cash equivalents held by Managers can be disruptive to the allocation process. Unless otherwise authorized, Managers are expected to be fully invested at all times in the types of securities for which they have responsibility, with the exception of brief periods between the sale of an existing security and the purchase of a replacement security.

H. Any use of leverage will be consistent with the strategy for which the NMSIC hired the Manager. Use of leverage will be controlled as appropriate in the Manager’s specific guidelines, and will be subject to review by Staff and Consultant.

I. The Funds are exposed to currency risk through its international equity, fixed, absolute return and private equity mandates. Over long periods of time, currency movements do not add significant returns to the portfolio. However, exposure to currency risk increases diversification due to lack of correlation with other portfolio risks. Also, hedging currency risk incurs significant expenses. Therefore, NMSIC utilizes unhedged benchmarks and does not require its Managers to hedge the currency exposure in their portfolios.

J. The Staff is authorized to engage in securities lending in accordance securities lending policies and procedures which are contained in a separate policy document.

K. Proxies shall be voted in the best economic interests of the NMSIC. Proxy voting policies and procedures are contained in a separate policy document.

L. The staff is authorized to instruct external managers to direct a portion of their brokerage costs to commission re-capture managers provided that in doing so, the Funds will obtain the best execution of our brokerage orders. Best execution means seeking to achieve the most favorable price and execution available, having in mind the Funds’ best interest, while considering all factors.
XV. Derivatives

The State Investment Council seeks to protect the market value of the funds from losses attributable to declines in the market. The State Investment Office intends to use derivatives to improve long-term performance through protection of principal during market declines. Derivatives provide means to improve investment risk/return in declining market environments.

The Staff may buy, sell, exchange, convert or otherwise trade in exchanged traded index option contracts, over-the-counter options, domestic equity index futures, international equity index futures, international fixed income futures, commodity futures and domestic fixed income futures in order to protect the market value of designated security holdings or to: increase returns through cash securitization and synthetic rebalancing; improve tracking relative to target allocations through maintaining positions during transitions/reallocations and synthetic rebalancing; and improve portfolio efficiency/flexibility through tactical moves in market exposures. The positions will remain in place over a period consistent with detailed guidelines or until it is determined that an option/futures hedge/overlay is no longer needed. Derivatives shall only be utilized to reduce the risk of adverse price movements in a particular asset class or group of assets. Derivatives shall not be used to speculate.

XVI. Economically Targeted Investments (“ETI”)

Economically Targeted Investments (“ETI”) in the Severance Tax Permanent Fund have two objectives in the statutes: first, to obtain a risk-adjusted rate of return under the Prudent Investor Rule, and second, to enhance the economy of New Mexico. To achieve these two objectives, the following specific goals will apply to the portfolio. Staff will ensure that:

- Credit quality is maintained and risk is minimized;
- Market-based yields that are proportional to the assumed risks are obtained;
- Each investment will stimulate the economy of New Mexico on a continuing basis;
- Each investment will expand business activity in the state; and
- Each investment will promote the creation and preservation of jobs.

XVII. Performance Monitoring

Performance reviews are a critical part of the portfolio management process. The NMSIC will rely on its Managers, Custodian, Consultant(s), and Staff to provide periodic performance reviews.

A. Managers

As directed by Staff, each Manager will provide periodic performance reports utilizing a standardized reporting format for public market separate accounts. Managers may provide their standard performance information in a different format as supplemental information only, at their discretion. Managers may be asked to make periodic performance presentations to Staff, the Consultant and/or the NMSIC.
B. **Custodian**
The Custodian will, as directed by Staff, provide periodic performance reports to Staff and Consultant. These reports shall detail the individual performance of Managers and the overall performance of the Funds. In addition, the Custodian shall report the results of any securities lending activities undertaken during the reporting period.

C. **Consultant**
The Consultant will provide quarterly performance reports to Staff, CIC and the NMSIC at its regular meetings. In preparing these reports, the Consultant will rely upon asset values and performance calculations reported by the Custodian.

D. **Staff**
Staff is responsible for ensuring that performance reports are received in a timely manner from the above-listed parties and will provide continual supervision of external performance reporting on the portfolio. Staff will confirm that managers are using standardized, industry-wide principles when calculating and reporting their investment results. Staff will work with the Consultants to complete a detailed performance measurement booklet on a quarterly basis. An executive summary will, at a minimum, include information for the one, three, five-year periods for the Total Fund and asset class composites.

**XVIII. Review and Approval of Investment Policy**
The NMSIC will review the Policy from time-to-time to determine if modifications are necessary or desirable but will delegate Staff to review the Policy on an annual basis. Staff will recommend modifications as warranted. If modifications are made, they shall be promptly communicated to all investment managers and other interested persons.

Modifications may occur due to:

- **A.** Operational problems that become apparent during the investment management process;
- **B.** Changes in economic prospects, Funds characteristics, the development of new investment instruments or strategies, or sponsoring employer organizations;
- **C.** Other causes as determined by the NMSIC.

By signing this Statement of Investment Policy the NMSIC indicates its agreement therewith.

By: __________________________

New Mexico State Investment Council
Glossary of Terms

**Agency Security** – a U.S. government-issued security that was not issued by the Treasury Department and may be backed by the full faith and credit of the United States depending upon the issuing agency.

**Agent** – any individual or entity acting on behalf of another.

**Alpha** – the premium an investment portfolio earns above a certain benchmark (such as the Standard & Poor’s 500 Index). A positive alpha indicates the investor earned a premium over that index.

**American Depository Receipts (ADRs)** – certificates issued by a U.S. bank and traded in this country as domestic shares. The certificates represent the number of foreign securities the U.S. bank holds in that security’s country of origin. ADRs make trading foreign securities easier by eliminating currency exchange, legal obstacles, foreign ownership transfers, and the need to trade on a foreign exchange.

**Asset Allocation Decision** – choosing among broad asset classes such as equities, fixed-income securities and real estate.

**Basis Point** – one one-hundredth of one percent.

**Benchmark** – a gauge in the securities market by which investment performance can be measured, such as the Standard & Poor’s 500 Index.

**Buyouts** - investments in acquisitions, growth equity, recovery investments, subordinated debt, and special situations, which represent a diversified strategy across many sub-categories.

**Commingled Fund** – a pooling of funds from multiple investors, managed as one account. The client owns units in the pool. Similar to a mutual fund.

**Commodities** – investments in basic goods often used as inputs in the production of other goods or services. Notable examples include oil, natural gas, gold, and other precious metals.

**Credit Quality** -

<table>
<thead>
<tr>
<th>S&amp;P</th>
<th>Moody's</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Higher Credit Quality - Investment Grade</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>AAA</td>
<td>Aaa</td>
<td>Prime grade, highest safety</td>
</tr>
<tr>
<td>AA+</td>
<td>Aa1</td>
<td>High credit quality</td>
</tr>
<tr>
<td>AA</td>
<td>Aa2</td>
<td></td>
</tr>
<tr>
<td>AA-</td>
<td>Aa3</td>
<td></td>
</tr>
<tr>
<td>A+</td>
<td>A1</td>
<td>Upper-medium credit quality</td>
</tr>
<tr>
<td>A</td>
<td>A2</td>
<td></td>
</tr>
<tr>
<td>A-</td>
<td>A3</td>
<td></td>
</tr>
<tr>
<td>BBB+</td>
<td>Baa1</td>
<td>Lower-medium credit quality</td>
</tr>
</tbody>
</table>
Lower Credit Quality - Speculative Grade

<table>
<thead>
<tr>
<th>Rating</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>BB+</td>
<td>Speculative - low quality</td>
</tr>
<tr>
<td>BB</td>
<td>Ba2</td>
</tr>
<tr>
<td>BB-</td>
<td>Ba3</td>
</tr>
<tr>
<td>B1</td>
<td>Highly speculative</td>
</tr>
<tr>
<td>B</td>
<td>B2</td>
</tr>
<tr>
<td>B3</td>
<td></td>
</tr>
</tbody>
</table>

Extremely Low Credit Quality - High Speculative or in Default

<table>
<thead>
<tr>
<th>Rating</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>CCC+</td>
<td>Very high risk, poor quality</td>
</tr>
<tr>
<td>CCC</td>
<td></td>
</tr>
<tr>
<td>CC</td>
<td>May be in default soon</td>
</tr>
<tr>
<td>C</td>
<td>Very speculative</td>
</tr>
<tr>
<td>C1</td>
<td>For income bonds - interest not being paid</td>
</tr>
<tr>
<td>D</td>
<td>Securities already in default</td>
</tr>
</tbody>
</table>

Credit Strategies – a hedge fund strategy that typically invests in high yield bonds, bank loans and structured credit products.

Discretionary Authority – the authority provided to investment managers and consultants to make investment decisions on behalf of NMSIC.

Distressed Debt – investments in the debt instruments of companies which may be publicly traded or privately held that are financially distressed and are either in bankruptcy or likely candidates for bankruptcy.

Distressed Strategies – a hedge fund strategy that seeks to take advantage of corporate securities in default, under bankruptcy protection, in distress or heading toward such a condition or in liquidation.

Diversification – spreading a portfolio over many investments (or many types of investments) to avoid excessive exposure to any one source of risk.

Duration – the average time to receipt of all the cash flows of a bond weighted by the present value of each of the cash flows. The duration value of the bond gives bond investors an indication of how interest rate changes will affect the bond’s price. It is the percentage by which the bond’s price will move, given a 100 basis point change in yield.

EAFE – the MSCI EAFE Index is a stock market index that is designed to measure the equity market performance of developed markets (Europe, Australasia, Far East), excluding the US & Canada.

Energy Partnership – investments in private vehicles with a focus on oil and gas exploration, or other alternative energy strategy.

Equity Investment – claims held by the residual owners of a firm. May also be referred to as common stock. Investments in Real Estate and certain Private Markets classifications may also be considered equity.
**Equity Long/Short Strategies** – a hedge fund strategy where there is a combination of long and short positions primarily in publicly traded equities, with a net market exposure less than that of the overall equity market. Strategies may be focused on U.S., non-U.S., and/or specialty mandates.

**ETFs** – Exchange Traded Funds.

**Event Driven Strategies** – a hedge fund strategy that takes advantage of transaction announcements and other one-time events, including merger arbitrage, spin-offs and restructurings.

**Fiduciary** – one who can exercise discretionary authority or can control important aspects of a pension Fund's management.

**Fixed Income Investment** – a security issued by a borrower that obligates the issuer to make specified payments to the holder over a specific period. Fixed income may also be referred to as "debt" or "bonds."

**Fund-of-Fund Investment Vehicles** – an investment fund comprised of any number of underlying investment funds

**Global Macro Strategies** – a hedge fund strategy with a focus on all-market portfolios, opportunistic long-only, managed futures, currency, dedicated short selling strategies or other specialty strategies.

**HFRI** – Hedge Fund Research, Inc.

**Inflation-Indexed Bonds** - investments in bonds with the principal component linked to inflation. Treasury Inflation Protected Securities (TIPS) are the most common example of inflation-indexed bonds.

**Initial Public Offering (IPO)** – the first time an equity securities issue is available for the public to buy.

**In-Kind Distribution** - a distribution made in the form of a security rather than cash.

**Leverage** – in investments, this is the control of a large amount of money by a smaller amount of money, such as buying on margin. In finance, this is the relationship of debt to equity on a company's balance sheet in the form of the debt/equity ratio.

**Limited Partnership** – a partnership with at least one of the partners holding only a limited liability. Commonly utilized in the Private Equity asset class.

**Market Cycle or Full Market Cycle** – a period of time (typically three to five years) where a market experiences increasing prices (bull market), decreasing prices (bear market), and a return to the original starting point of market strength.

**Market Neutral Strategies** – a hedge fund strategy that seeks complete avoidance (zero correlation) of market risk. Various forms of hedging strategies are typically employed.
Multi-Strategy Hedge Funds – a hedge fund that invests using a combination of any number of hedge fund strategies.

Proxy – an instrument empowering an agent to vote for a shareholder.

Qualitative Analysis – a subjective analysis of a security, with the judgment not based on financial information, such as that found on a balance sheet or income statement. Instead, the judgment may be based on such issues as labor relations.

Quantitative Analysis – an analysis of a security, with the judgment based on financial information such as that found on a balance sheet or an income statement.

Real Estate Partnerships – investments in private vehicles through limited partnerships or limited liability companies that have an ownership interest in direct real estate properties, whether income-producing or non-income-producing. This may include “value added” strategies, which derive their return from both income and appreciation, and “opportunistic” strategies which derive their return primarily through appreciation.

Re-balancing – realigning the proportions of assets in a portfolio as needed.

REITs – equity investments in publicly traded securities of a company dedicated to owning and/or operating income-producing real estate, including but not limited to apartments, shopping centers, offices, and warehouses.

Risk – the chance that an investment’s actual return will be different than expected. This includes the possibility of losing some or all of the original investment. Risk is usually measured by calculating the standard deviation of the historical returns.

Separate Account – funds managed on an individual account basis; no pooling with other investors. The client owns the securities.

Short-Term Investments – any fixed income investment with less than one year to maturity.

Split Rating – situation where rating agencies have assigned different ratings to a particular issue or issuer.

Spread – the difference between the bid price and the ask price.

Standard Deviation – a measure of the degree to which an individual probability value varies from the distribution mean. The higher the number, the greater the risk.

Timber Partnership – investments in private vehicles with a focus on the timber industry.

Total Return – interest or dividend income plus any realized or unrealized capital gain (or loss) on an investment, net of any capital contributions or distributions from the corpus.


Venture Capital - investments in companies in a range of stages of development from start-up/seed-stage, early stage, and later/expansion stage.