SOUTH CAROLINA RETIREMENT SYSTEM

INVESTMENT COMMISSION

ANNUAL INVESTMENT PLAN

FISCAL YEAR 2017-2018

as adopted by the Retirement System Investment Commission
on April 27, 2017; effective on July 1, 2017

TABLE OF CONTENTS

SECTION 1. OVERVIEW AND PURPOSE 2
SECTION 2. STRATEGIC INITIATIVES 2
SECTION 3. ASSET CLASS INITIATIVES 3

SECTION 1: OVERVIEW AND PURPOSE

Overview

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

Purpose

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

SECTION 2: STRATEGIC INITIATIVES

Each year Staff undertakes initiatives approved by the Investment Commission within the AIP with the goal of improving its investment, operational, and governance capabilities that will lead to more efficient and effective implementation of investment strategies and positively contribute to the financial health of the South Carolina Retirement System trust funds. These initiatives are interconnected and are often multi-year or on-going in nature, requiring collaboration across the organization.

Concerns about global growth, political uncertainty across the United States and Europe, and divergent monetary policy have left global short term interest rates low, the effectiveness of further monetary stimulus less impactful, and prospective returns on risky assets (equities, credit, real assets) below the actuarial assumed rate of return. While global economic indicators suggest an uptick in global growth and consumer confidence in the U.S., uncertainty remains as the U.S. embarks on a tightening of monetary stimulus in exchange for anticipated fiscal stimulus through lower taxes and government spending. Interest rates have increased and are forecasted to rise, while inflation expectations are beginning to move higher. Several of the initiatives outlined herein are designed to help the Portfolio adapt to a multi-year period of forecasted lower returns with heightened volatility.

1. In addition to the asset class initiatives described below, the Investment Team will focus on the following key initiatives in support of the Commission's goals and objectives as expressed in the SIOP.
    a. Challenging beliefs – Since the fall of 2015, the Investment Team has been engaged in a process of challenging its investment beliefs. This process is designed to encourage rigorous debate over an array of important topics that relate to the investment program. Investment staff members are expected to present the most compelling arguments possible on one side of an issue, regardless of their actual belief. This process will continue for the foreseeable future and, as it unfolds, the Investment Team expects to develop and present additional portfolio recommendations reflecting these beliefs.
    b. Implementation of the long-term asset allocation approved in February 2016 and modifications adopted in April 2017 – In February 2016, the Commission adopted both a long-term target asset allocation and a 'glide path' which is intended to provide an appropriate amount of time to transition the Portfolio. In

April 2017, the Commission approved certain modifications to both the long-term asset allocation and glide path. The Investment Team will continue implementing the long-term target asset allocation, as modified, with a goal of attaining the interim target allocations for FY 17-18 approved by the Commission.

c. Active/Enhanced/Passive Framework – The Investment Team will continue to strengthen its quantitative framework for identifying the appropriate uses of active, enhanced, and passive strategies. The goal is to improve the cost-effectiveness at the plan level. Further work in this area will seek to understand the persistence of managers' ability to generate excess returns.

d. Risk Management – RSIC's Reporting team is responsible for the implementation of the investment risk system. During the fiscal year, the Reporting team will focus on the production of risk reporting for use by the Investment team, thereby supporting the strengthening of risk monitoring and management. This work will focus on the development of customized reporting elements, as well as for supporting improved communication with the Commission relating to risk.

e. Rebalancing and Tactical Asset Allocation ("TAA") – The Investment Team will continue to strengthen its rebalancing and TAA capabilities by enhancing the principles and decision-making framework for these functions.

f. Fee and expense review – The Investment Team, in conjunction with other RSIC units, will continue to examine the investment program's structural and variable costs, with a goal of identifying potential cost reduction opportunities.

2. The Operations team will focus on the following key initiatives in order to provide the operational infrastructure to maintain the appropriate administrative, accounting, and data management services to support the investment, risk management, and reporting functions of the RSIC:

    a. Continued build out of the administrator platform in order to enhance reporting and analytics capabilities.

    b. Research potential enhancements and/or replacements to the current Research Management solution.

    c. Completion of RFP process for portfolio accounting system replacement and begin implementation/ conversion.

    d. Transition the investment risk platform from testing phase to production phase for Plan risk management.

SECTION 3: ASSET CLASS INITIATIVES

Each year, every asset class leader lays out the goals and initiatives that will guide their work and focus for the subsequent fiscal year. These plans take into account the broad market outlook, the outlook for each individual asset class, and Portfolio-level objectives, as stated in the SIOP. The plans for fiscal year 2017-2018 are outlined below.

The Investment Team will continue working to reduce its total number of relationships with investment managers. The goal of this process will be to consolidate assets with those managers in which the team has the highest conviction, and to improve the cost of the investment program. In order to achieve this, the Investment Team will focus on developing a robust assessment of the key value drivers for these strategies.

Equity

The equity asset classes are the Portfolio's investments that reflect an ownership of a business, and includes global public equity and private equity. The long-term target allocation to the equity allocation is 49% of the Portfolio, and the FY 17-18 target allocation is 47%. Broadly speaking, equities performed well in 2016 following a volatile start to 2016. The target allocation to equities will rise for FY 17-18, with the marginal increase coming from equity options strategies. The inclusion of these strategies reflects a desire to add equity exposure without taking the full risk of traditional equity market exposure. Furthermore, such strategies would be expected to provide superior returns (versus a traditional approach) in both low and negative return environments.

Global Public Equity

While the long-term target allocation for global public equity is 40%, the FY 17-18 target allocation is 38%, an increase of 2% over the FY 16-17. The current global public equity implementation includes strategies that invest globally and those that focus on a specific region or thematic group (for example, the U.S. or emerging markets). Current implementation features a combination of passive, enhanced, and active mandates.

Key Initiatives: Incorporating enhancements to the passive/enhanced/active tools while researching strategies that improve the existing implementation. Re-underwrite existing active strategies and develop bench managers across small cap and emerging markets.

Global Public Equity - Equity Options Strategies

Of the 38% FY 17-18 global public equity allocation, 5% is targeted for equity options strategies. This exposure is implemented through a combination of enhanced and active strategies. Enhanced strategies will focus on systematic improvements to the index construction. Active strategies will utilize quantitative and fundamental analysis to minimize equity drawdown risk, capture the volatility risk premium, and improvements to the management of cash collateral.

Key Initiatives: Explore the efficacy of equity options strategies in international markets.

Portable Alpha

The long-term expected allocation for Portable Alpha is 10%, which is targeted to reach its 10% allocation in FY 17-18. Portable Alpha is comprised of certain synthetic exposures (which currently include equity, fixed income, and commodity exposures) and alpha strategies. The alpha strategies are expected to generate uncorrelated alpha while minimizing embedded market beta over time.

Key Initiatives: Evaluate lower-cost alternative beta strategies for potential inclusion in the alpha strategies portion of the portfolio. Continually monitor and recommend changes to the composition of the alpha and beta portfolio.

Private Equity

The private equity asset class transitioned from a fixed policy target of 9% to a floating target of the actual weight in the portfolio. In the absence of a fixed target, RSIC looks to allocate to private equity by seeking long-term relationships with the best-in-class managers expected to generate superior returns (net of fees) over time. Thus, the actual private equity allocation may vary over time, based on both availability of attractive investment opportunities and prevailing market conditions.

Key Initiatives: Following up on conclusions reached in challenging convictions review, continue to evaluate use of an external service provider to assist Staff in sourcing and/or underwriting co-investment opportunities, with the goal of presenting recommendations to the Commission during 2017. Continue to explore ways in which quantitative tools and resources can be used to (i) enhance Staff's understanding of value creation by managers and (ii) assist Staff in the conduct of due diligence.

Real Assets

The real assets asset classes include both the Portfolio's real estate and infrastructure investments. These assets have a tendency to benefit from a rising inflation environment. The long-term target allocation for the real assets allocation is 11% of the Portfolio, and the FY 17-18 target allocation is 10%.

Real Estate

The long-term target allocation for real estate is 8%, which includes 7% for private real estate and 1% for publicly-traded real estate (REITs). The FY 17-18 asset allocation plan identifies a 6% target for private market real estate and a 2% target for REITs. Effective July 1, 2016, the real estate component of the real assets allocation transitioned from a fixed policy target to a floating target designed to reflect the actual allocation to private real estate. The real estate portfolio is divided into three main strategies: core, value-add, and opportunistic, and encompasses both debt and equity real estate. The core component has materially increased in size since the beginning of FY 15-16, but the portfolio continues to have a heavy weighting to non-core real estate, particularly opportunistic strategies.

The Investment Team will continue to strive to improve the balance between core and non-core strategies. A balanced core/non-core portfolio will be achieved over time through investments in core and core-plus open-end commingled funds, fund-of-one accounts, and select investments in non-core, value-add, and opportunistic strategies.

Key Initiatives: Continue to pursue the objective of achieving a more balanced portfolio by identifying compelling equity and debt investments in core and core plus strategies. Evaluate the costs, benefits, risks, and overall feasibility of internally-managed core real estate.

Infrastructure

The long-term target allocation for infrastructure is 3%, while the FY 17-18 target allocation is 2% of plan assets. This remains a nascent asset class for the Portfolio, with one dedicated infrastructure investment, a listed infrastructure mandate.

Key Initiatives: Review and reaffirm the multi-year investment plan for the asset class.

Opportunistic

The opportunistic asset classes include global asset allocation, the subset of hedge funds that are not a part of the Portable Alpha program ("opportunistic hedge funds"), and a component that can consider an array of other opportunistic investments. The long-term target allocation for the opportunistic allocation is 10%. Given the factors involved in transitioning the Portfolio to attain the long-term target allocation, the glide path in the asset allocation plan identifies a 13% target for the opportunistic allocation during the period July 1, 2017 through November 30, 2017, and 12% for the remainder of FY 17-18, a reduction from the prior fiscal year's target allocation of 17%. Effective July 1, 2016, the components of the opportunistic allocation were transitioned from a fixed policy target to a floating target reflecting the component's actual weight in the portfolio.

Global Asset Allocation

The long-term target allocation for global asset allocation ("GAA") is 8%. The FY 17-18 target allocation is 8% during the period July 1, 2017 through November 30, 2017, and 7% during the remainder of FY 17-18, down from the prior fiscal year's target allocation of 10%. The current GAA portfolio invests in three main categories: global tactical asset allocation strategies, risk parity strategies, and other idiosyncratic strategies.

Key Initiatives: Perform broad manager search for GAA portfolio. Implement GAA strategies with an enhanced focus on tactical asset allocation, with specific consideration paid to aligning the GAA portfolio with the overall Plan.

Opportunistic Hedge Funds (non-PA)

The long-term target allocation for opportunistic hedge funds will decline from 4% to 2% in FY 17-18. Hedge funds that have higher factor or beta exposures to traditional betas are classified as opportunistic hedge funds.

Key Initiatives: Continue to monitor the wind-down of the Opportunistic Hedge Funds and accelerate liquidity when available.

Other Opportunistic Strategies

The long-term target allocation for other opportunistic strategies is 2%, while the FY 17-18 target allocation is 3%. The objective of this component is to identify investments that, while they may not fit into other asset classes, still offer compelling opportunities for the Portfolio. These investments may offer either high returns, diversifying returns, or both. Examples of potential investments include, but are not limited to, commodities, CTAs, TIPS, and insurance strategies.

Key Initiatives: Explore insurance-related structures and recommend potential actions. Continue to identify compelling opportunities for inclusion in this new asset class.

Diversified Credit

The diversified credit allocation consists of a group of asset classes that derive a significant share of their expected return from credit risk, as opposed to core, investment grade debt securities. Among the asset classes included in the diversified credit allocation are mixed credit, emerging market debt, and private debt. The target allocation for the diversified credit allocation is 18%.

Mixed Credit

The long-term target allocation for mixed credit is 6%. The Policy Benchmark for mixed credit incorporates equal amounts of high yield and bank loans. The mixed credit exposure is entirely actively managed. As the private debt allocation progresses toward its target weight, the mixed credit portfolio will decline toward its target weight.

Key Initiatives: Continue to monitor return versus risk trade-off between public and private credit, and the portfolio mix between secured and unsecured credit based on forecasted returns and market fundamentals.

Emerging Market Debt

The long-term target allocation for emerging market debt is 5%. The Policy Benchmark for emerging market debt is an even blend of USD-denominated and local market debt securities. The portfolio uses a combination of active and passive strategies.

Key Initiatives: Reassess the active and passive exposures already in place to ensure the most efficient implementation. Monitor and adjust the exposures between local market and USD-denominated debt securities.

Private Debt

The private debt asset class transitioned from a fixed policy target of 7% to a floating target of the actual weight in the portfolio. The Investment Team remains constructive on private debt as a result of the secular shift in the regulatory landscape for banks. Global banking regulations continue to curtail the aggregate lending activities of the banking sector, thereby creating opportunity for non-bank lenders. This creates meaningful opportunities for institutional investors to capture attractive returns. Staff will continue to focus on larger allocations to its highest conviction managers, with an emphasis on structures that capture lower fees and increase customization.

Key Initiatives: Develop a public and private credit dashboard to monitor changes in the credit markets and identify the most attractive opportunities. Senior lending strategies will remain a priority, while also maintaining the flexibility to take advantage of credit market turbulence with distressed and special situations investments. Additionally, there will be a secondary focus on identifying niche private debt strategies. Expand the allowable range for Private Debt to account for recent capital commitments and the current compelling market opportunity offered by the private debt asset class. Monitor regulatory changes and the potential impact on the future attractiveness of private debt strategies.

Conservative Fixed Income

The conservative fixed income allocation is comprised of the Portfolio's core fixed income and short duration fixed income investments. The long-term target allocation for conservative fixed income is 12% of the Portfolio, but, as further described below, the allocation for conservative fixed income will be 12% from July 1, 2017 through November 30, 2017 and 13% for the remaining portion of FY 17-18.

Core Fixed Income

Both the long-term and FY 17-18 target allocations for core fixed income are 10%. The existing core fixed Income portfolio includes investment grade securities across several sectors, including: Treasuries/sovereign, government-related (agency), corporate, and asset-backed securities.

Key Initiatives: Continue to manage the balance between physical and synthetic exposure in the asset class while exploring opportunities for maximizing the return and/or diversification benefits that this asset class can provide.

Cash and Short Duration

Due to the need to manage a short-term spike in benefit payments resulting from the termination of the TERI program, the target allocation to cash and short duration will be 2% during the period July 1, 2017 through November 30, 2017, and 3% for the remainder of FY 2017-18. This allocation includes both short duration and cash portfolios. The short duration portfolios encompass a range of strategies, including very conservative strategies as well as strategies that seek to generate higher returns. The short duration portfolios currently include a combination of internally managed and actively managed strategies.

Key Initiatives: Exposures will continue to be managed with a special emphasis on providing for the Plan's liquidity needs, which is expected to include approximately $1.9 billion (net of contributions) for retiree benefit payments during FY 2017-18. While this need for liquidity is the primary objective, it is balanced to a limited extent with a desire to generate returns that exceed those of the benchmark.

Securities Lending

Though it is not an asset class, the Investment Team pays specific attention to matters of Securities Lending ("SL"). RSIC continues to employ very conservative investment guidelines within the SL program. While the State Treasurer's Office has traditionally coordinated the SL program on behalf of the RSIC, a change in State law effective July 1, 2017 placed full responsibility for monitoring and oversight of the SL program on the Commission.

Key Initiatives: Evaluation of the risks and benefits of increasing lending activities, as well as expanding reinvestment guidelines.

ATTACHMENT A - CURRENT STRATEGIC ASSET ALLOCATION

Asset Class	FY17-18 (a)	FY17-18 (b)	FY18-19	Policy Ranges
Equity	47%	47%	49%	42-52%
Global Equity	33%	33%	35%	20-36%
Private Equity	9%	9%	9%	6-14%
Equity Options Strategies	5%	5%	5%	0-6%
Conservative Fixed Income	12%	13%	12%	10-16%
Cash & Short Duration	2%	3%	2%	0-7%
Core Bonds	10%	10%	10%	5-15%
Diversified Credit	18%	18%	18%	15-21%
Mixed Credit	6%	6%	6%	2-8%
Private Debt	7%	7%	7%	4-12%
Emerging Markets Debt	5%	5%	5%	3-7%
Opportunistic	13%	12%	10%	9-19%
GAA	8%	7%	8%	3-12%
Hedge Funds (non-PA)	2%	2%	0%	0-8%
Other Opportunistic Strategies	3%	3%	2%	0-5%
Real Assets	10%	10%	11%	8-14%
Real Estate (REITs)	2%	2%	1%	0-3%
Real Estate (Private)	6%	6%	7%	4-12%
World Infrastructure	2%	2%	3%	0-5%
Starting Date	7/1/2017	12/1/2017	7/1/2018	7/1/2017
Ending Date	11/30/2017	6/30/2018	6/30/2019	6/30/2019

ATTACHMENT B – CURRENT BENCHMARKS

Asset Class	Indices for Policy Benchmark
Equity	
Global Equity	MSCI All Country World Investable Market Index
Private Equity	80% Russell 3000/20% MSCI EAFE + 300 basis points on a 3-month lag
Equity Options Strategies	CBOE S&P 500 BuyWrite Index (BXM)
Conservative Fixed Income	
Cash & Short Duration	Merrill Lynch 3-Month T-Bills
Core Bonds	Barclays Aggregate Bond Index
Diversified Credit	
Mixed Credit	50% S&P LSTA Leveraged Loan Index/50% Barclays High Yield Index
Private Debt	S&P LSTA Leveraged Loan Index + 150 basis points on a 3-month lag
Emerging Markets Debt	50% JP Morgan EMBI Global Diversified (USD)/50% JP Morgan GBI-EM Global Diversified (Local)
Opportunistic	
GAA	50% MSCI World Index/50% Barclays Aggregate Bond Index
Hedge Funds (non-PA)	50% MSCI World Index/50% Barclays Aggregate Bond Index
Other Opportunistic Strategies	50% MSCI World Index/50% Barclays Aggregate Bond Index
Real Assets	
Real Estate (REITs)	FTSE NAREIT Equity REITs Index
Real Estate (Private)	NCREIF ODCE Index + 75 basis points
World Infrastructure	Dow Jones Brookfield Global Infrastructure Index