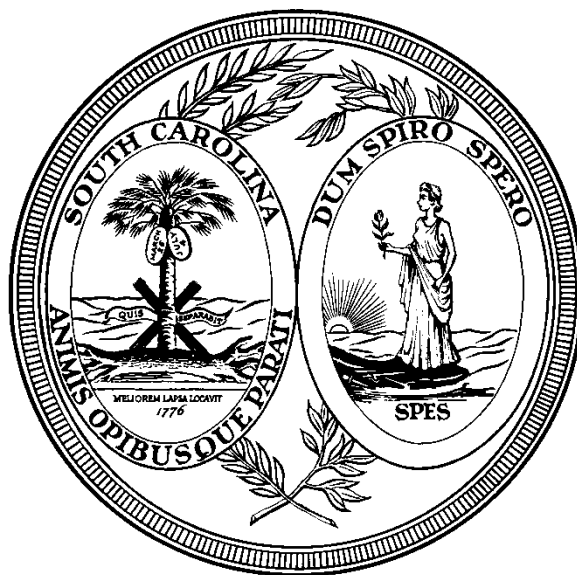


SOUTH CAROLINA RETIREMENT SYSTEM
INVESTMENT COMMISSION
ANNUAL INVESTMENT PLAN
FISCAL YEAR 2016-2017



as adopted by the Retirement System Investment Commission
on April 21, 2016; effective on July 1, 2016

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SECTION 1: OVERVIEW AND PURPOSE

Overview

Annually, the Commission adopts a Statement of Investment Objectives and Policies (“SIOP”), which provides the objectives, policies, and guidelines for investing the assets of the South Carolina Retirement Systems (the “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 moderating global growth, coupled with the increasingly limited ability of central banks to mobilize any further meaningful stimulative response, are driving economic growth forecasts -- as well as expected returns for equities -- lower. With U.S. investment grade bonds yielding an average of 2.14% (as of 4/13/2016), investors face a shortage of high quality income-generating investments. Several of the initiatives (infrastructure, equity options, portable alpha, cost rationalization, etc.) outlined herein are designed to help the Portfolio adapt to a multi-year period during which very few expect that markets will generate returns consistent with the actuarial assumed rate of return.

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, as amended on November 19, 2015.
 - 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 which takes effect on July 1, 2016 – The Commission has 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. Three key FY 16-17 initiatives for the Investment Team flow from this action taken by the Commission:

- i. Beginning the implementation of the new long-term target asset allocation, with a goal of attaining the interim target allocations for FY 16-17 approved by the Commission;
 - ii. Commencing implementation of the Portable Alpha Program; and
 - iii. Commencing implementation of the equity options strategies component of the equity allocation.
 - 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 – The Risk Management professionals will leverage the Barra risk system to strengthen risk monitoring and management, and will work to develop useful reporting elements for Staff use as well as for improved communication with the Commission.
 - e. Rebalancing and Tactical Asset Allocation (“TAA”) – The Investment Team will 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 examine the investment program’s structural and variable costs, with a goal of identifying potential cost reduction opportunities.
 - g. Strategic Partnerships – The Investment Team will reassess the value proposition of its Strategic Partnerships.
 - h. Host an annual strategic review with the Commission, which will include a discussion of the evolution of the Portfolio’s asset allocation, current assumptions and implementation, possible revisions to the asset allocation, an overview of the asset-liability framework, and considerations of risks (including currency, inflation, liquidity, and an extended low return environment).
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 Conifer platform in order to enhance reporting, analytics, accounting, and data management.
 - b. Completion of RFP process for portfolio accounting system replacement and begin implementation/conversion.
 - c. Transition the Barra risk platform from implementation and 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 2016-2017 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 47% of the Portfolio, and the FY 16-17 target allocation is 45%. Broadly speaking, equities had a difficult year in 2015 and a volatile start to 2016. The target allocation to equities will rise for FY 16-17, with the marginal increase coming from equity options strategies. The inclusion of these strategies reflects a desire to add domestic 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 38%, the FY 16-17 target allocation is 36%. 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.

Global Public Equity - Equity Options Strategies

Of the 36% FY 16-17 global public equity allocation, 5% is targeted for equity options strategies. As this is a new allocation, there are no dedicated strategies currently in the portfolio. This new exposure will be 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: Fund approved mandates during the first half of the fiscal year.

Portable Alpha Program

The long-term expected allocation for the Portable Alpha program is 10%, while the expected FY 16-17 allocation is 8%. The Portable Alpha program will employ portions of both the equity and conservative fixed income allocations. The alpha strategies will be expected to generate uncorrelated alpha while seeking to eliminate any embedded market beta. The Portable Alpha program will include certain strategies currently in the low beta hedge fund portfolio.

Key Initiatives: 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, evaluate use of an external service provider to assist Staff in sourcing and/or underwriting co-investment opportunities. 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 16-17 target allocation is 8%.

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 16-17 asset allocation plan identifies a 5% 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 current portfolio exposure is more heavily-weighted to non-core real estate, particularly opportunistic strategies.

Over the next several years, the Investment Team will 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: Implement the U.S. REIT strategy and accelerate the objective of achieving a more balanced portfolio by identifying compelling investments in core and core plus strategies. Explore opportunities to invest in more conservative debt-oriented real estate strategies.

Infrastructure

The long-term target allocation for infrastructure is 3%, while the FY 16-17 target allocation is only 1% of plan assets. As this is a new asset class for the Portfolio, there are not currently any dedicated infrastructure investments in the portfolio.

Key Initiatives: Establish a multi-year investment plan for the asset class, evaluate publicly traded infrastructure investments, and identify at least one core infrastructure investment.

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 12%. 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 17% target for the opportunistic allocation in FY 16-17. Effective July 1, 2016, the components of the opportunistic allocation will be 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 6%, while the FY 16-17 target allocation is 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 a comprehensive evaluation of the existing GAA strategies in accordance with the direction received from Challenging Beliefs debate.

Opportunistic Hedge Funds (non-PA)

The long-term target allocation for opportunistic hedge funds is 4%. Hedge funds that have higher factor or beta exposures to traditional betas will be classified as opportunistic hedge funds.

Key Initiatives: Evaluate alternative beta strategies designed to reduce total expenses for the hedge fund portfolio, and deliver to the CIO a cost-benefit analysis related to the use of these investments.

Other Opportunistic Strategies (formerly Commodities)

The long-term target allocation for other opportunistic strategies is 2%, while the FY 16-17 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, alternative beta and insurance strategies.

Key Initiatives: Identify compelling opportunities for inclusion in this new component.

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, bank loans, and mortgage-backed securities. 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: Transition to structures that favor traditional strategies for the high yield, bank loan, and structured credit components. Develop a public and private credit dashboard to monitor changes in the credit markets and identify the most attractive opportunities.

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. In light of the recent weakness of many emerging market economies, Staff will work to identify compelling opportunistic strategies that complement the core portfolio already in place.

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.

Conservative Fixed Income

The conservative fixed income allocation is comprised of the Portfolio's core fixed income and short duration fixed income investments. At target, the conservative fixed income allocation represents 12% of the Portfolio.

Core Fixed Income

The long-term allocation to core fixed income is 10%, consisting of a long-term strategic target of 6% for core fixed income and a strategic target of 4% for the Portable Alpha program's expected utilization of core fixed income. For FY 16-17, the asset allocation plan identifies a target of 7% to core fixed income and 3% to the core fixed income component of the Portable Alpha program. 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: Implement the core fixed income component of the Portable Alpha program, and explore opportunities for maximizing the return and/or diversification benefits that this asset class can provide.

Short Duration

As of July 1, 2016, the target allocation to short duration is 2%. 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 more than \$1 billion (net of contributions) for retiree benefit payments. 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. The State Treasurer’s Office has traditionally coordinated the SL program on behalf of the RSIC.

Key Initiatives: Evaluation of the risks and benefits of increasing lending activities, as well as expanding reinvestment guidelines. As a continuation of the previous fiscal year initiative, Staff will continue to evaluate the addition of a third party lending agent as a way to modestly enhance the returns available from the SL program, while maintaining a conservatively-managed program.

ATTACHMENT A - CURRENT STRATEGIC ASSET ALLOCATION

Asset Class	Long-Term Policy Allocation	Long-Term Policy Ranges	FY16-17	FY17-18	FY18-19
Equity	47%	42-52%	45%	47%	47%
Global Equity	33%	22-36%	31%	33%	33%
Private Equity	9%	6-12%	9%	9%	9%
Equity Options Strategies	5%	0-6%	5%	5%	5%
Conservative Fixed Income	12%	10-16%	12%	12%	12%
Cash & Short Duration	2%	0-7%	2%	2%	2%
Core Bonds	10%	5-15%	10%	10%	10%
Diversified Credit	18%	15-21%	18%	18%	18%
Mixed Credit	6%	4-8%	6%	6%	6%
Private Debt	7%	4-10%	7%	7%	7%
Emerging Markets Debt	5%	3-7%	5%	5%	5%
Opportunistic	12%	9-19%	17%	13%	12%
GAA	6%	3-12%	10%	6%	6%
Hedge Funds (non-PA)	4%	0-8%	4%	4%	4%
Other Opportunistic Strategies	2%	0-5%	3%	3%	2%
Real Assets	11%	8-14%	8%	10%	11%
Real Estate (REITs)	1%	0-3%	2%	2%	1%
Real Estate (Private)	7%	4-10%	5%	6%	7%
World Infrastructure	3%	0-5%	1%	2%	3%

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 (BMX)
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