

**STATEMENT OF INVESTMENT POLICY
SAN JOSE FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM**

**Approved by the Investment Committee May 27, 2010
Approved by the Board of Administration June 10, 2010**

I.	General Environment	4
II.	Purpose	5
III.	Statement of Objectives	6
IV.	Duties and Responsibilities	7
	• Investment Committee	
	• Director, Retirement Services	
	• Consultant	
	• Custodian	
	• Investment Managers	
V.	Asset Allocation Policy	11
	• Time Horizon	
	• Risk Tolerance and Volatility	
	• Re-balancing of Strategic Allocation	
	• Liquidity	
	• Diversification	
VI.	Selection of Money Managers	14
VII.	Manager and Securities Guidelines	15
	General Mandates	
	Global Equity Investments	
	Cash Investments	
	Investment Grade Fixed Income	
	High Yield Fixed Income and Bank Loans	
	Convertible Bonds	
	Real Estate	
	Private Equity	
	Opportunistic Strategies	
	Absolute Return	
	Real Assets	
	Credit Unions	

VIII. Control Procedures 25

- Supervision
- Brokerage Policy
- Performance Objectives
- Monitoring of Money Managers
- Periodic Reviews of Manager Performance
- Extraordinary Reviews of Managers
- Proxy Voting Guidelines
- Derivatives
- Securities Lending
- Communication and Reporting

General Environment

It is the policy of the San Jose Federated City Employees' Retirement System (SJFCERS) to effect economy and efficiency in the public service by providing a means whereby career employees or employees who have become incapacitated may leave public service without hardship or prejudice, and to that end provide a retirement system consisting of retirement allowances and death benefits.

Investments in such retirement system are subject to the restrictions specified in the San Jose Retirement Code sections 3.24.350, 3.24.360, 3.28.350 and 3.28.355. Further investment management guidelines are imposed by the San Jose Federated City Employees' Retirement Board ("Board"). The Board retains its official oversight of the System but has designated the Investment Committee to act as a conduit for investment issues to be presented to the Board.

The purpose of this Investment Policy Statement (IPS) is to assist the San Jose Federated City Employees' Retirement System's Board ("Board") and its delegate in effectively supervising, monitoring and evaluating the investment of the System's assets. The System's investment program is defined in the various sections of the IPS by:

- Stating in a written document the Board's attitudes, expectations, objectives and guidelines for the investment of all the System's assets.
- Setting forth an investment structure for managing the System's assets. This structure includes various asset classes, investment management styles, asset allocation and acceptable ranges that, in total, are expected to produce a sufficient level of overall diversification and total investment return over the long-term.
- Providing guidelines for the investment System that control the level of overall risk and liquidity assumed in that System, so that all the System's assets are managed in accordance with stated objectives.
- Encouraging effective communications between the Board, the investment consultant (Consultant) and the money managers.
- Establishing formalized criteria to monitor, evaluate and compare the performance results achieved by the money managers on a quarterly basis, or as deemed appropriate.
- Complying with applicable fiduciary, prudence and due diligence requirements that experienced investment professionals would utilize, and with applicable laws, rules and regulations from various local, state, federal and international political entities that may impact the System's assets.

This IPS has been formulated, based upon consideration by the Board of the financial implications of a wide range of policies, and describes the prudent investment process that the Board deems appropriate.

The objectives of the System have been established in conjunction with a comprehensive review of the current and projected financial requirements. The Board shall:

- (1) Attempt to ensure that the Retirement System is sufficiently funded to assure that all present and future disbursement obligations will be met.
- (2) Attempt to ensure that the investment earnings be sufficiently high to provide a funding source, along with contributions from City employees and the City, in order to offset liabilities in perpetuity.
- (3) Strive for the highest total return on investment funds consistent with safety in accordance with accepted investment practices and maintain an appropriate asset allocation policy that is compatible with the objectives of the System.
- (4) Control the costs of administering the System's assets and managing the investments.

Duties and Responsibilities of the Investment Committee

The Investment Committee will be responsible for the following:

- Meet at least on a quarterly basis to evaluate and make recommendations to the Board on investment related issues
- Review the investment performance and the market value of the System and of the managers
- Make recommendations for updating the Investment Policy
- Perform other investment matters directed by the full Board, including asset allocation, manager searches and reviews
- Recommend to the Board the hiring or termination of investment managers and consultants
- Complete investment manager due diligence visits as recommended by the Investment Committee
- Conduct investment related projects or studies as directed by the Board
- Recommend to the Board any modifications of this statement, except for those responsibilities reserved for other parties
- In all instances, any actions warranted as a result of Committee review are the Board's responsibility
- Perform Real Estate duties:
 - Make recommendations to the Board on real estate related issues
 - Make recommendations for updating the real estate strategic plan, tactical plans, and the real estate operations guidelines
 - Perform other real estate matters as directed by the full Board
 - Recommend to the Board the hiring or termination of real estate advisors and consultants
 - Recommend to the Board approval of acquisitions and dispositions of real estate
 - On dispositions, recommend a listing price for approval and accept cash offer at a price that is at or above negotiated sale price
 - After Board approval of disposition, approve expenditure of funds for expenses necessary for the consummation of the sale

Duties and Responsibilities of the Director, Retirement Services

The Director is charged with the day-to-day responsibility for:

- Managing and monitoring net cash flow, so that the sum of income, contributions, and sales of securities is sufficient to provide for current payment obligations
- Implementing rebalancing directives, in concert with the custodian and any affected investment managers
- Ensuring that plan administration complies with this document and applicable state regulations
- Enforcing and monitoring the compliance of all System policies and procedures
- Annually reviewing the strategic asset allocation policy
- Reviewing and monitoring the investment managers and their compliance with investment guidelines
- Maintaining open communications with all parties to the System, especially the Board, the investment managers, custodian, and consultant
- Preparing performance reports, summaries and comments on the performance of the investment managers
- Monitoring the timeliness and accuracy of custodian reports
- Coordinating Board meetings, manager presentations and discussions, and consultant activities, presentations, and discussions
- Identifying issues to be brought before the Board, and preparing recommendations to the Board on those matters, including educational issues, new developments, new asset classes and investment vehicles
- Such other matters as are directed by the Board from time to time.

Duties and Responsibilities of the Consultant

The following responsibilities may be delegated to the Consultant with the approval of the Board.

- Assist in the preparation of a quarterly monitoring and performance report with respect to the System's investment managers. The report shall note exceptions to manager mandates or investment guidelines when apparent from performance data and continually monitor investment managers

- Attend all Investment Committee meetings and Board meetings upon request
- Advise on investment policy, implementation, and control issues as requested by the Board
- Prepare ad hoc studies as requested by the Board
- Identify and present to the Board educational issues and new developments
- Define the universe of asset managers used to compare the performance of the investment managers.
- Assist and advise the Director of Retirement Services in a manager search and selection process.

Duties and Responsibilities of the Custodian

The Custodian shall have the responsibility:

- To settle all transactions
- To collect income
- To provide safekeeping and accounting for assets
- To document the value of assets
- To provide audited accounting reports
- To provide specialized services as needed, i.e., securities lending
- To provide other reasonable services to insure the integrity of the Fund
- To provide a program for disaster recovery.

Duties and Responsibilities of the Investment Managers

The duties and responsibilities of the investment managers retained by the Board include the following:

- Investing and reinvesting the System's assets under its care, custody and/or control in accordance with the IPS objectives and guidelines set forth herein, and also expressed in separate written agreements when deviation is deemed prudent and desirable by the Board.

- Exercising investment discretion within the IPS objectives and guidelines set forth herein.
- Promptly informing the Board in writing regarding all significant and/or material matters and changes pertaining to the investment of the System's assets, including, but not limited to:
 - a. Investment strategy, especially any changes that may result in significant losses to the System
 - b. Portfolio structure
 - c. Tactical approaches
 - d. Ownership
 - e. Organizational structure
 - f. Financial condition, and any changes in the firm's total assets
 - g. Professional staff
 - h. Recommendations for guideline changes
 - i. All legal material, SEC and other regulatory agency proceedings affecting the firm.
- Utilize the same care, skill, prudence and due diligence under the circumstances then prevailing that experienced investment professionals acting in a like capacity and fully familiar with such matters would use in like activities for like System with like aims in accordance and compliance with all applicable laws, rules and regulations from local, state, federal and international political entities as it pertains to fiduciary duties and responsibilities.
- Acknowledge and agree in writing to their fiduciary responsibility to fully comply with the entire IPS set forth herein, and as modified in the future.

Asset Allocation Policy

The following policy has been identified by the Board as having the greatest expected investment return and the resulting positive impact on asset values and funded status without exceeding a prudent level of risk. The Board determined this policy after evaluating the implications of increased investment return versus increased variability of return for a number of potential investment policies with varying commitments to asset classes.

It shall be the Policy of the System to invest its assets in accordance with the maximum and minimum range, valued at market value, for each asset class as stated below:

Starting from March 2010 the following asset allocation is in effect:

Traditional Asset Allocation

<u>Asset Class</u>	<u>Minimum</u>	<u>Target</u>	<u>Maximum</u>
Global Equity	43%	49%	55%
Fixed Income	15%	20%	25%
Alternatives	26%	31%	36%

Alternatives Asset Allocation

<u>Sub-Asset Class</u>	<u>Minimum</u>	<u>Target</u>	<u>Maximum</u>
Real Estate	0%	5%	8%
Real Assets	0%	10%	15%
Hedge Funds	0%	5%	8%
Private Equity	0%	6%	9%
Opportunistic	0%	5%	8%

The investment policy is expected to have a high likelihood of meeting the objectives outlined in the “Statement of Objectives” section, which preceded this section.

The Investment Policy, including asset allocation, is intended to provide a means for controlling the overall risk of the portfolio while ensuring that investment earnings will be sufficiently high to provide a funding source to offset liabilities in perpetuity. The policy should not unduly constrain the discretionary, tactical decision-making process of the investment managers so that the funds earn the highest total returns while remaining in accordance with accepted investment practices.

The Investment Policy and the asset allocation are generated using certain market assumptions. These assumptions include the expected return and standard deviation for each asset category and the expected correlation coefficients among asset classes. When these presumptions change, the policy needs to be re-evaluated and possibly modified to compensate for those changes.

Time Horizon

The asset allocation ranges established by this investment policy represent the long-term perspective. As such, rapid unanticipated market shifts or changes in economic conditions may cause the asset mix to fall outside the policy range. These divergences should be of a short-term nature. The Director of Retirement Services will review the asset mix of the Plan on monthly basis and cause the asset mix to be rebalanced to within the policy range as necessary and in accordance with the rebalancing guidelines set forth in Procedure 454. Additionally, the Board will review the strategic asset allocation on at least an annual basis to determine if there is a need to make any changes.

Risk Tolerances and Volatility

The Board recognizes the difficulty of achieving the System's investment objectives in light of the uncertainties and complexities of contemporary investment markets. The Board also recognizes that some risk must be assumed to achieve the System's long-term investment objectives.

In establishing the risk tolerances of the IPS, the ability to withstand short and intermediate term variability were considered.

Consistent with the desire for adequate diversification, the Investment Policy is based on the expectation that the volatility (the standard deviation of returns) of the total System will be similar to that of the market. Consequently, it is expected that the volatility of the total System will be reasonably close to the volatility of a commitment weighted composite of market indices.

Re-balancing of Strategic Allocation

(Procedure 454)

The Plan's asset allocation will be reviewed relative to the targets on a semi-monthly basis and action will be taken to re-balance to within the target ranges by means of asset transfers among the categories.

When necessary and/or available, cash inflows/outflows will be deployed in a manner consistent with the strategic asset allocation of the System.

General guidelines for re-balancing the portfolio are as follows:

- (1) When the allocation to a particular asset class deviates from its target, the asset class will be re-balanced to within the policy range over the following 60 days. The cash surplus within the Fund will be used to rebalance the portfolios. **If the cash surplus is not sufficient, the following rebalancing procedures shall be implemented.**

(2) Transfers shall first be taken from asset classes above the maximum range, then from asset classes above the target but below the maximum. If there is only one manager in the asset class, transferred assets shall first consist of cash in the portfolio. If the cash is not sufficient, then the manager will be requested to liquidate that portion of the portfolio, which will result in the manager's portfolio coming within the specific target range.

(3) Transfers shall first be made to asset classes below the minimums, then to asset classes below the targets, unless the managers in those classes are already holding excess cash or they feel it would be imprudent to increase their size.

(4) All transfers should be made in accordance with the cash management policy.

(5) Rebalancing for asset classes that have deviated from their targets, but are still within their respective target ranges, may remain at their allocations if the Director and Consultant determine it would not be detrimental to the overall portfolio.

Liquidity

The Board has authorized the Director of Retirement Services to review the projected cash flow needs of the System at least annually and indicate to the investment managers the required liquidity. If necessary, cash flow needs will be coordinated through the System's rebalancing procedures as described in the previous section. If additional funds are required from the System's equity managers, the Director will communicate the cash flow requirements giving advanced written notice so the managers have sufficient time to comply.

Diversification

Investments shall be diversified with the intent to minimize the risk of large investment losses. Consequently, the total portfolio will be constructed and maintained to provide prudent diversification with regard to the concentration of holdings in individual issues, issuers, or industries.

Specifically, no single investment shall exceed the guidelines established under the Manager and Securities Guidelines section.

As a general rule, System assets placed with an investment manager should not represent more than 10% of that manager's assets.

The Board endeavors to select appropriate investment managers to manage the System's assets. Manager candidates should meet the following minimum criteria:

- (1) Be a bank, insurance company, investment management company, or investment adviser.
- (2) Provide historical quarterly performance numbers calculated on a time-weighted basis, when appropriate, based on a composite of all fully discretionary accounts of similar investment style, and reported net and gross of fees.
- (3) Provide performance evaluation reports prepared by an objective third party that illustrate the risk/return profile of the manager relative to other managers of like investment style, when appropriate.
- (4) Provide detailed information on the history of the firm, key personnel, key clients, fee schedule, and support personnel and demonstrate financial and professional staff stability. This information can be a copy of a recent Request For Proposal (RFP) completed by the manager.
- (5) Clearly articulate the investment strategy that will be followed and document that the strategy has been successfully adhered to over time.
- (6) Selected firms should have no outstanding legal judgments or past judgments, which may reflect negatively upon the firm.

In addition, Subsection B and C of Sections 3.28.375 and 3.24.370 of the San Jose Municipal Code entitled "Investment Counseling Restrictions" states that the Board may enter into any contractual arrangements with the following persons or associations:

- (a) Any person or association whose principal business consists of investment counseling services;
- (b) Any person or association who is a registered investment adviser under such laws as may require such registration.
- (c) With respect to real estate advisors, the Board shall enter into contractual arrangements only with persons or associations whose principal officers are engaged in the business of advising and evaluating commercial, industrial or residential real estate investments, mortgage banking, or property management, and which are duly licensed to perform real estate advisor services in the jurisdiction where the real property is located.

General

Every investment manager selected to manage the System's assets must adhere to the following guidelines.

- The investment manager will at all times be expected to exercise due diligence regarding his/her account and to perform in a prudent manner and within the specific terms of appointment.
- The manager will have full discretion to direct and manage the investment and reinvestment of assets in accordance with this document, applicable federal and state statutes and regulations, and the executed contract.
- Benchmarks shall be specified for the investment manager. It is expected that the managers will adhere to the style concepts and the investment principles that were in use at the time the Board appointed the firm to manage a portion of the System's assets.
- It is the Board's desire that an investment manager be fully invested in his/her own asset class. However, the manager shall retain the discretion to invest a portion of the assets in cash reserves. (Procedure 451) The Board prefers that the managers hold under 6-7% cash. Any manager who holds over 7% in cash on average over two months shall notify staff in writing. If market conditions dictate, the manager may exceed 10% cash holdings with written approval of the Director of Retirement Services. The manager will be evaluated against their peers on the performance of the total assets under their management. Any intent to deviate from this strategy should be communicated to the Board prior to implementation.
- Turnover standards shall be set whenever it is appropriate to the investment manager's style, the asset class, or the return target. Trading expenses shall be minimized and managed by the investment manager and all transactions shall be governed by general "best execution" guidelines.
- Transactions that would jeopardize the tax-exempt status of the System should not be undertaken.
- The Board has the authority to "vote" on all issues presented to stockholders, but as a matter of practice will designate an authorized third party to vote the proxies. It is expected that the designee will vote for the sole purpose of benefiting the beneficiaries of the Plan and in accordance with the adopted general proxy voting guidelines.
- The investment manager is expected to comply with all laws, regulations, and standards of ethical conduct.

Global Equity Investments

The primary emphasis of the global equity portfolio should be on high quality, readily marketable securities. The investment managers employed to manage equity securities will have discretion in the day-to-day management of funds under their control, subject to the following guidelines:

- (1) Global equity securities (with the exception of preferred stocks) shall be traded on a national exchange (including NASDAQ) and be substantially diversified.
 - The number of issues held, their geographic and economic sector diversification shall be left to the investment manager's discretion provided, however, that the portfolio shall be appropriately diversified as consistent with the manager's stated investment approach.
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- (2) The following transactions are prohibited:
 - Purchase of stocks that are not publicly traded.
 - Purchase of restricted stock.
 - Short sales and purchases of securities on margin.
- (4) American Depository Receipts (ADR's) and Real Estate Investment Trusts are permitted equity investments.
- (5) The manager may enter into currency exchange contracts (forward exchange or future) provided that such contracts have a maximum maturity of one year. Furthermore, any currency hedging shall be limited to a defensive posture only. The use of such contracts is designed to dampen portfolio volatility rather than lever portfolio risk exposure. There shall be no direct foreign currency speculation or any related investment activity. Cross-hedging will be permitted. Securities held in the portfolio may be denominated in any currency at the discretion of the investment manager. The investment manager will include in his/her quarterly report to the Director of Retirement Services and the Board a report on the status of the outstanding hedged positions.

Cash Investments

The following investment vehicles are approved for the investment of short-term funds of the Federated City Employees Retirement System:

- (1) All U.S. Government and federal agency issues
- (2) All U.S. Dollar denominated foreign commercial paper that is rated either A1 or P1 by Moody's or by Standard & Poor's. If the issuer had public debt outstanding, said debt

Manager and Securities Guidelines Statement of Investment Policy – 06/10/2010

should not be rated below the top three letter ratings (AAA, AA, A) of either Moody's or Standard & Poor's.

- (3) If the issuer of commercial paper (CP) is a bank, purchase of its CP is approved only when purchase of its certificates of deposit (CD's) is also approved
- (4) Domestic and foreign Certificates of Deposit (CD's) and Banker's Acceptances
- (5) Repurchase Agreements with banks and with broker-dealers registered under the Securities and Exchange Act of 1934
- (6) Reverse Repurchase Agreements - Only upon the specific approval of the Retirement Board
- (7) Insured time deposits
- (8) The custodial bank's Short Term Investment Fund provided that said Fund satisfies the requirements of 1 through 7 above

Investment Grade Fixed Income

The investment grade fixed income portion of the System's assets shall generally be invested in investment grade, marketable, fixed-income securities, although up to 10% investment in below investment grade securities will be permitted with written authorization of the Board. The investment managers employed to manage domestic fixed-income securities will have discretion in the day-to-day management of the funds under their control. The following instruments are acceptable for purchase:

- (1) Commercial Paper or Variable Rate notes of P-1 or equivalent rating. Pools containing lower quality issues of this security type (P-2 and P-3 or equivalent ratings) may be used where diversification reduces the quality risk.
- (2) Certificates of Deposit and Bankers Acceptances.
- (3) United States Treasury Bonds, Notes, and Bills.
- (4) Repurchase agreements with U.S. Treasury securities and agencies of the U.S. Government as collateral. No reverse repurchase agreements will be allowed without specific written approval by the Board.
- (5) Debt instruments of the U.S. Government or its agencies.
- (6) "Yankee" bonds issued by foreign countries and denominated in dollars so long as they are rated Baa/BBB or better by Moody's or Standard & Poor's.

- (7) Investment grade U.S. pay corporate debt issues including those rated Baa/BBB or better by Moody's or Standard & Poor's. Should a current holding fall below this standard, the manager shall immediately notify staff of the downgrade and confer with staff as to whether the security will continue to be held or disposed. However, investments in non-investment grade securities of BB or B classification will be permitted up to 10% with written authorization of the Board.

The Fixed-Income investments shall be appropriately diversified. The investment manager may engage in "active" bond management and it is therefore anticipated that there may be turnover as shifts are made between and within sectors, quality and maturity.

No more than 10% of a single manager's assets shall be invested in securities of any single issuer with the exception of the U.S. Government and its agencies.

High Yield Fixed Income and Bank Loans

The High Yield Bonds and Bank Loans portion of the plan assets shall be invested predominantly in below investment grade securities and bank loans. The investment managers employed to manage high yield and bank loan instruments will have discretion in the day-to-day management of funds under their control. The High Yield and bank loan managers shall have discretion to invest in all the instruments allowed for investment by the domestic bond managers, plus the investments that meet the following criteria:

- (1) U.S. corporate bonds, including zero-coupon, step-up, convertible, toggle and pay-in-kind bonds and Non-dollar corporate bonds (which should be hedged), Private placement securities, Bank loans, participations and assignments.
- (2) U.S. dollar denominated bonds issued by entities not domiciled in the United States (Yankee bonds / euro bonds).
- (3) U.S. Treasury futures, Currency forward or futures contracts, and Credit default swaps may be used for hedging purposes.
- (4) No more than 3% of the portfolio shall be invested in obligations of a single non-governmental issuer.
- (5) The number of issues held, the sector and the industry diversification constraints shall be detailed in each manager's investment guidelines. The portfolio shall be appropriately diversified as consistent with the manager's stated investment approach.

Convertible Bonds

Manager and Securities Guidelines Statement of Investment Policy – 06/10/2010

The Convertible Bonds portion of the plan assets shall be invested predominantly in convertible securities. The Manager may invest in investment grade or below investment grade U.S. and non- U.S. convertible securities, including convertible bonds, convertible preferred stock, bonds or preferred stock with warrants, and zero-and low-coupon convertibles across the entire credit quality spectrum. In addition, the investment manager can utilize convertible structured notes issued by third parties, as well as synthetic convertible securities created by the investment manager. The investment manager(s) employed to manage the convertible instruments will have discretion in the day-to-day management of funds under their control. The convertible bond manager(s) shall have discretion to invest in all the instruments allowed for investment by the domestic bond managers, plus the investments that meet the following criteria:

- (1) At the time of purchase at least 95% of the instruments must have a minimum rating of B- or B3, or if unrated, of a comparable quality rating as determined by the investment manager. Should more than 5% of a portfolio fall below this standard, the investment manager shall notify the Board of the downgrade immediately and submit a plan for returning the portfolio to the standard. Other eligible investments are U.S. Treasuries, U.S. corporate bonds, (including zero-coupon, step-up, toggle and pay-in-kind bonds), non-U.S. corporate bonds, private placement securities, bank loans, participations, and assignments.
- (2) U.S. dollar denominated bonds issued by entities not domiciled in the United States (Yankee bonds / euro bonds).
- (3) U.S. Treasury futures, currency forward or futures contracts, and credit default swaps may be used for hedging purposes.
- (4) No more than 3% of the portfolio shall be invested in obligations of a single non-governmental issuer.
- (5) The portfolio shall be appropriately diversified by the number of issues held, sector, industry, and country weightings, consistent with the manager's stated investment approach.

Real Estate

The Board may elect to invest in commercial, industrial, and residential real estate or real estate related debt instruments provided that:

- (1) The real estate is defined as any real property within the United States improved by multifamily dwelling, industrial or commercial buildings.
- (2) Real estate debt instruments shall be defined as first mortgages.

- (3) The fund shall at no time invest directly more than 5% of the Fund's assets, valued at market, in any one property, project, or debt instrument regardless of the manner of the instrument.

Private Equity

Private markets investments include, but are not limited to, venture capital partnerships, leveraged buyout funds, private debt, and private placements. While it is expected that the majority of these assets will be invested within the United States, a portion can be allocated to non-U.S. investments. Investments may be made in secondary investments on an opportunistic basis.

It is expected that these investments will typically be structured as Limited Partnerships, with Federated City Employees' Retirement System serving as one of the Limited Partners, but not as a General Partner. It is also expected that the Plan will not engage in direct investments or co-investments, in which the Plan would purchase majority control in individual corporate entities, unless authorized by the Board.

Opportunistic Strategies

Investment in any of the instruments or vehicles allowed in other sections is also allowed in this section. Other investments are acceptable as long as they are approved by the Board in writing. In addition, investment in the credit market is also allowed and may be implemented through:

1. Pooled funds; Separate accounts; Limited Partnerships; or Limited Liability Companies;
2. Credit linked notes;
3. Direct investment.

Absolute Return

Absolute Return Funds, also called Hedge Funds, are private investment vehicles that may not be registered with the U.S. Securities and Exchange Commission (SEC); they may be offered in Limited Partnerships or Limited Liability company form.

The allowed Absolute Return Strategies include but are not limited to :

1. Any of the following single strategies:
 - a. Equity long/short including Absolute Return Strategies specializing in Emerging Markets, Market Capitalization, Regional, Sectoral or Global Market subsets;
 - b. Equity Market timing;
 - c. Short or dedicated short;
 - d. Distressed securities;
 - e. Merger Arbitrage;

- f. Event driven or Risk Arbitrage;
 - g. Fixed Income Arbitrage;
 - h. Convertible Bond Arbitrage;
 - i. Equity Market Neutral;
 - j. Statistical Arbitrage;
 - k. Relative Value Arbitrage;
 - l. Global Macro or Global Tactical Asset Allocation;
 - m. Managed Futures and Commodity Trading Advisors (CTA's).
2. Multi-Strategy or Fund of Funds are also allowed and combine several individual Absolute Return strategies into a single portfolio. The combination provides, in some circumstances, diversification of risk in a single investment.

Real Assets

The following strategies are allowed, through both direct investments and through equity investments in companies that are involved with the following strategies:

a. **Commodities**

The strategy targets liquid investments in the commodities markets via derivatives (e.g. futures and swaps). Certain strategies may also include, to a lesser extent, investment in physicals for forward delivery. Exposure includes four major commodity market sectors: Energy, Agriculture/Livestock, Industrial Metals, and Precious Metals. Expected total return is due primarily to spot price appreciation; secondarily to contract roll forward dynamics, or the differential between spot and future price (between near and longer term contracts); and thirdly to modest collateral income.

The Real Asset program may employ both passive and active commodity management. Examination of cash collateral, in particular the quality of fixed income market exposure, will be considered in risk mitigation.

b. **Energy**

The strategy targets both public and private energy-related entities. The Energy investment strategy consists of three segments: upstream, midstream, and downstream businesses. Opportunities include core diversified global conglomerates that may span across segments and specific, concentrated satellite investments that may focus on a specific Energy market segment. Investments may include both traditional (oil, natural gas, coal) & alternative (wind, solar) energy sources.

The *Upstream Investment Strategy* focuses on the production of oil and gas, and includes petroleum Exploration and Production (E&P) businesses and power generation.

The *Midstream Investment Strategy* focuses on transporting the upstream products from the source to the end user, and includes storage and processing, as well as oilfield services (the equipment and services required to produce petroleum) and electricity transmission equipment and services. Midstream assets include pipelines, gathering and storage facilities, refining, power lines, and transformer stations. Services are also considered midstream elements, such as oilfield equipment like drill bits, drill rigs, well trees, and geologic and mapping services.

The *Downstream Investment Strategy* focuses on the end users of upstream production. Power generation is an end user of petroleum products, while households and businesses are the downstream users of power generation. Downstream assets can also be local distribution centers, such as home heating oil distributors or gas stations.

Each segment of the strategy has different investment characteristics, income profiles, and risks.

c. **Metals & Mining**

Public equities in the Industrial and Precious metals-related industries. Investment opportunities include large core diversified global conglomerates and more specific, concentrated investments. Supply chain position may include upstream, midstream, and downstream companies. Expected total return is due primarily to appreciation and some income.

d. **Public Agriculture-related**

These investments are made primarily in Agriculture-related companies. Exposure may include both traditional agriculture and livestock investments and renewable energy sources. Supply chain position may include upstream, midstream, and downstream companies. Equity-based agriculture exposure ranges from upstream producing companies (i.e. growers) or those who are closely related to them, such as seed and agricultural chemicals companies, to downstream packaged foods producers. Opportunities include core diversified global conglomerates that may span across segments and specific, concentrated satellite investments that may focus on a specific market segment. Expected total return is due primarily to appreciation and some income.

e. **Timberland**

The strategy targets both public and private Timberland Investment Management Organizations, TIMO. The Investment strategy includes investing in entities that derive their returns from the growth and harvest of timber, a renewable and biologically growing asset. The investments may include both plantations who utilize intensive management techniques to enhance biological growth and naturally regenerating strategies. The investment strategy has varying time

horizons to liquidity, shorter term for softwoods (e.g. for pulp and lumber) to longer term time horizon (e.g. hardwoods).

f. **Infrastructure**

Public and private investments in direct physical assets, or a company that operates assets that provide essential services to society. Ranges from publicly held equities to very illiquid private partnerships. Exposure includes toll-oriented projects (e.g. roads, bridges, tunnels), transport-focused (e.g. railroads, airports, seaports); regulated utilities (e.g. gas pipelines; water/sewer treatment facilities); and social services (e.g. schools, hospitals). High toll-orientation offers inflation protection. Expected total return is due primarily to current income and to a lesser extent capital appreciation. Satellite strategies typically use more leverage than core.

Typically, infrastructure assets exhibit one or more of the following qualities: monopolistic or quasi-monopolistic, high barriers to entry, long term assets, and significant regulatory or permitting constraints.

g. **Farmland/Agribusiness**

This investment strategy targets the market segment of agriculture. Farmland consists of two main property types: row and permanent crop properties. Row crops are harvested from soil and are categorized as commodity, (corn and soybean) and vegetable, (potatoes and lettuce). Permanent crops grow on trees and have three categories: citrus fruit, (oranges and grapefruits); fruit, (apples and grapes); and nuts.

- h. This investment strategy targets the market segment of water-related infrastructure, assets, and properties. Investors may soon view water as an increasingly scarce commodity, not unlike oil. Increasingly stringent water quality standards and the adaptation of water systems to meet changing climactic and hydrological conditions may result in investment opportunities in the water industry.

Credit Unions

No retirement fund monies shall be deposited in any institution in excess of an amount insured by an agency of the Federal Government, and shall be made only if the rate of return and degree of safety offered are competitive through other investment opportunities.

Supervision

The Investment Manager shall continually supervise the investment securities in the Fund, and shall purchase, sell, substitute, redeem, or convert securities, as they should deem advisable.

Brokerage Policy

All transactions effected for the System will be "subject to the best price and execution." The lowest commission rate need not mean the best realized price. Execution capability, price, and overall effectiveness shall be considered, along with commission rate.

Any manager who is engaged in or has a direct pecuniary interest in a business other than investment counseling, such as a broker or dealer in securities shall not be permitted to use such business with regard to the System assets without prior written approval by the Board.

If a manager utilizes brokerage from the plan assets to effect "soft dollar" transactions, detailed records will be kept and communicated to the Board.

The Plan's investment managers shall follow the direction of the Board. It is the policy of the Board to instruct the investment managers to direct transaction orders to particular broker-dealers, including equity, fixed income, both domestic and international. The instructions from the Board currently is for the investment managers to direct as much as possible of the Plan's commission business as is practicable, subject to the best price and execution. The instruction and direction is to be construed within the normal activity of the investment manager, with no increased or decreased trading activity to occur because of the instruction. Where given discretion to establish and execute transactions through accounts with one or more broker-dealer firms as it may select, the manager must attempt to obtain "best available price and most favorable execution" with respect to all of the portfolio transactions.

Soft Dollars accumulated through the System's brokerage program may be used to pay for any System expense permitted under the regulations of the Department of Labor (including, but not limited to, legal, accounting, education, management, etc.) and approved by the Board.

Performance Objectives

Investment performance will be measured quarterly but it is not expected that the performance goals identified below will be satisfied in any single quarter or year. It is expected that these goals will be satisfied over a rolling five-year period or a full market cycle. However, action by the Board with regard to retention or dismissal of investment managers is not precluded by virtue of these time periods.

Total Fund Investments

The total fund’s performance, in aggregate, will be expected to achieve a rate of return, which exceeds a fund benchmark representative of the Asset Allocation objective as follows:

BENCHMARK
Russell 3000
MSCI ACWI
MSCI EAFE
MSCI Emerging Markets
Barclays Capital Aggregate Bond Index
Credit Suisse First Boston Leveraged Loan Index
Merrill Lynch High Yield Master Index
Merill Lynch Global 300 Convertible Index
NCREIF Property Index
Venture Economics Private Equity Index
Hedge Fund Research Institute Equity Hedge Index

Specific guidelines and benchmarks are established below for each category of managers. Generally, however, investment managers are expected to perform within the top half of an appropriate database, rank in the top half of a database of similarly styled managers, and earn an average return, which exceeds an appropriate index over rolling five year periods.

Managers are considered to have achieved this objective if their performance meets all guidelines on a cumulative five year annualized period. If the performance is longer than five years, the manager is expected to satisfy the performance objectives in a majority of the rolling five year periods.

Investment managers with less than five years of experience with the Fund are considered to have achieved performance objectives if their performance meets guidelines in the majority of the annualized time periods since inception.

If managers with less than five years experience with the Fund fail to meet any investment objectives, the following should be applied:

- If a manager fails to meet investment objectives for one or two consecutive quarters, this may not be a cause for concern.
- If a manager fails to meet investment objectives for three consecutive quarters, they merit probationary status.
- If a manager fails to meet investment objectives for four consecutive quarters, they should be critically reviewed by the Board and considered for termination. The Board may grant the manager an extended probation after officially recognizing the substandard performance.

Passive Fixed Income Investments

The objective for investment managers of the passive fixed income component of the total portfolio is to achieve returns equal to the appropriate index with minimal tracking error.

Active Fixed Income Investments

The objectives for investment managers of the domestic fixed-income component of the total portfolio are:

- (1) Earn an average annual return from income and capital appreciation, which exceeds an appropriate index (i.e. Barclays Credit Index, etc.) over a rolling five year time period net of fees. If the performance history extends beyond five years, the manager will be required to exceed the index over a majority of the rolling five year periods.

Global Equity Investments

The objectives for investment managers of the domestic equity component of the total portfolio are:

- (1) Achieve returns which exceed an appropriate index, (i.e. Russell 3000, etc.) over a rolling five year time period net of fees. If the performance history extends beyond five years, the manager will be required to exceed the index over a majority of the rolling five year periods.

Passive Equity Investment

The objective for investment managers of the passive domestic equity component of the total portfolio is to achieve returns equal to the appropriate index with minimal tracking error.

Global and International Equity Investments

The objectives for investment managers of the international equity component of the total portfolio are:

- (1) Achieve returns which exceed an appropriate index over a rolling five year time period net of fees. If the performance history extends beyond five years, the manager will be required to exceed the index over a majority of the rolling five year periods.

High Yield and Bank Loan Investments

The objective for the investment managers of the High Yield and Bank Loan component of the total portfolio are:

- (1) Achieve rates of return, which exceed an appropriate index (i.e. Merrill Lynch US High Yield Master Index, CSFB Leveraged Loan Index) over rolling five year time periods net of fees. If the performance history extends beyond five years, the manager will be required to exceed the index over a majority of the rolling five year periods.

Convertible Bond Investments

The objective for the investment managers of the Convertible Bond component of the total portfolio are:

- (1) Achieve rates of return, which exceed the Merrill Lynch Global 300 Convertible Index over a rolling five year time period net of fees. If the performance history extends beyond five years, the manager will be required to exceed the index over a majority of the rolling five year periods.

Real Estate Investments

- (1) Achieve returns which exceed an appropriate index, (i.e. NCRIF) net of fees over a five-year market cycle.

Private Equity Investments

- (1) Achieve returns, which exceed an appropriate index (i.e., Venture Economics Private Equity Index) net of fees over a five-year market cycle.

Real Assets

- (1) Achieve returns which exceed an appropriate index (i.e., Dow-Jones UBS Commodity Index, SSgA Brookfield Infrastructure Index) net of fees over a five-year market cycle.

Hedge Funds

(1) Achieve returns which exceed an appropriate index (i.e., HFRI Equity Hedge Index) net of fees over a five-year market cycle.

Monitoring of Money Managers

It is the Board's policy to monitor the portfolios of the investment managers for prudent adherence to the approved performance guidelines. Quarterly performance should be evaluated to test progress toward the attainment of longer term targets. It is understood that there are likely to be short term periods during which performance deviates from market indices. During such times, greater emphasis shall be placed on peer-performance comparisons with managers employing similar styles. In addition, manager holdings will be periodically monitored to ensure that they are adhering to expected investment styles and disciplines.

On a timely basis, the Board shall meet to focus on:

- Manager's adherence to the IPS guidelines;
- Material changes in the manager's organization, investment philosophy and/or personnel; and,
- Comparisons of the manager's results to appropriate indices and peer groups as described in the performance objectives and control section.

The risk associated with the manager's portfolio, as measured by the variability of quarterly returns (standard deviation), must not exceed that of the benchmark index and the peer group without a corresponding increase in performance above the benchmark and peer group.

Major organizational changes also warrant immediate review of the manager, including:

- Change in professionals
- Significant account losses
- Significant growth of new business
- Change in ownership

The performance of the System's investment managers will be monitored on an ongoing basis and it is at the Board's discretion to take corrective action by replacing a manager if they deem it appropriate at any time.

Periodic Reviews of Manager Performance

The performance of each manager should be reviewed versus its benchmark at least every quarter. These benchmarks will normally consist of both asset class indexes and peer group universes. Each manager's performance should exceed their passive index benchmark net of fees

and each manager should be above the median of an appropriate universe over most full market cycles.

As good managers will occasionally have poor performance for several periods, there is some grace period permitted for performance to improve. Conversely, the performance should be reviewed with sufficient frequency to permit identification of substandard performance as quickly as possible.

All managers will be reviewed continuously by the Consultant, Staff, and the Director. Underperforming managers will be reviewed on a case by case basis, and written records shall be kept. All managers are subject to termination at the Board's request, based on advice from the Consultant, Staff, and the Director.

Extraordinary Reviews of Managers

If an event occurs within a manager's organization or is likely to impact the manager's organization, the Director, Retirement Services, shall make a determination whether such event compromises the investment process or in any other manner might negatively impact the management of the Plan's assets.

Such events would include but are not limited to:

- a) Loss of any significant investment professional directly involved with the management of Plan assets or of such significance to the manager's overall investment process as to call into question the future efficacy of that process.
- b) Sale, offer for sale, or offer to purchase the manager's business to/by another entity.
- c) Significant financial difficulty or loss of a sizable portion of the manager's assets under management.
- d) Filing or announcement of regulatory action of non-trivial nature, particularly that involving violations of the Investment Advisers Act of 1940, the Securities Act of 1933, or the Securities Exchange Act of 1934, or any state Blue Sky Law to which the manager is subject.
- e) Any other event which in the discretion of the Director appear to put the Fund's assets at risk of loss, either actual or opportunity.

Any of these events may trigger a due diligence visit to the firm by the Investment Committee, Consultant, and/or Staff, being placed on the watch list, being put on probation or termination depending on the seriousness of the event and the probability of impacting the management of the Plan's assets.

Proxy Voting Guidelines

This section sets forth the general policy and procedures of the Board with regard to the voting of proxies. The Board has delegated its proxy voting authority on all domestic securities to an authorized third party. Managers are responsible for voting the proxies on all international securities, and shall provide a report to the Board. At this time, the Board believes proxy voting to be a significant responsibility and this statement provides the Board's perspective on this matter.

The Board strongly believes that proxies must be voted in the best interest of the shareholders. The authorized third party will vote in accordance with the fiduciary responsibilities pursuant to the adopted proxy voting guidelines between the authorized third party and the Board and within prudent standards.

Derivatives

Derivatives are defined as investment instruments, which "derive" value from an underlying commodity, index, or security. Examples include futures, options, and collateralized mortgage obligations (CMOs).

Investment managers and the custodial trustee may use derivative securities in the following manner so long as the inclusion of such instruments is consistent with the strategy originally specified when the firm was initially retained.

- It is recognized that futures contracts can provide a cost effective means of maintaining an asset allocation or gaining exposure to an asset in portfolio in the event of a manager termination or transfer. The Board retains the right to review the specific use of these securities under special circumstances.
- An international System manager may hedge currency as a part of the investment management and risk reduction process and as described in the Section VII provisions pertaining to the international equity and fixed income managers. Currency forward or futures contracts may be used in this process.
- New York Stock Exchange listed American Depository Receipts (ADRs) may be used.
- The fixed-income investment manager may include GNMA, FNMA, and FHLMC mortgage-backed instruments as well as asset backed securities in the portfolio. Inverse floating, interest only and principal only CMO derivatives, or other highly volatile instruments are prohibited.
- The custodian bank is prohibited from using instruments, which are not deemed to be appropriate by the Securities Exchange Commission (SEC) for use in a money market System. Floating rate instruments, which do not approximate par at reset, would be an example of such a

prohibited instrument. Additionally, inverse floating and other highly volatile instruments are prohibited.

- Options and swaps may be used to provide a cost effective means of maintaining an asset allocation, gaining exposure to an asset, or reducing risk. The Board retains the right to review the specific use of these securities under special circumstances.

Securities Lending

If so approved by the Board, the Plan may participate in a securities lending arrangement with the current trustee or a third party. The primary purpose of a securities lending program will be to increase the return on the Plan's portfolio of securities by authorizing the trustee to lend securities to one or more stated borrowers.

It is the policy of the fund that revenue generated from securities lending should not be a driving force behind policy formulation. Rather the management of risk and the consistent application of investment prudence across functions essential for the safety and success of the program. Although the Investment Manager operates within an agent relationship for securities lending, investment discretion shall be provided for the benefit of the plan and within prudent guidelines.

The investment objective for the securities lending program is to generate optimal incremental income within a high quality investment program that safeguards the return of principal, maintains adequate daily liquidity, ensures diversification and tightly controls exposure to fluctuating interest rates.

The securities lending process shall be transparent to other investment managers. Marking to market shall be performed and the diligent maintenance of collateral.

The asset/liability management of loans and investments (gap management) shall be performed consistently and with the proper application of prudence. The duration of loans and assets (gap positions) shall be reported by the Investment Manager on a monthly basis.

The Investment Manager shall perform ongoing credit analysis of brokers and establish concentration limits. Broker default indemnification, provided by the Investment Manager, shall not relieve the Investment Manager from on-going credit review.

Communication and Reporting

The investment manager(s) are responsible for frequent and open communication with the Board on all significant matters pertaining to investment policies and the management of the System's assets. Some of the key reporting responsibilities include the following obligations. When appropriate, the Investment Manager should:

- Meet with the Board to discuss the economy and the securities markets to assist the Board in determining and re-examining basic investment policies.
- Review the policies between meetings in light of changing market conditions or changes in the requirements of the Fund and recommends the appropriate actions to the Board.
- Prepare quarterly appraisals giving a listing of securities held and showing the composition, average cost, and market values of the assets under supervision.
- Report major changes in the investment manager's investment outlook, investment strategy, and portfolio structure.
- Report any significant changes in the ownership, organization structure, financial condition, or senior personnel of the investment manager.
- Provide monthly transaction and valuation reports, including an accounting of the hedging activity during the period as well as a report on the use and status of derivatives during the period.
- Ensure that all documents, exhibits, and written materials are received by the Director of Retirement Services at least two weeks in advance of any meetings.
- Provide the Board with a description of how plan assets are protected in the event of a breach of fiduciary duty, including proof of any liability and fiduciary insurance coverage.
- Acknowledge in writing the ability and agreement to invest within the guidelines set forth in this investment policy.
- Advise the Board of any change in the portfolio manager assigned to the account.
- Meet with the Committee upon request.
- Provide a monthly reconciliation report, reconciling the statement of assets between the manager and the custodian.