

Oregon Investment Council

Statement
of
Investment Objectives and Policy Framework
for the
Oregon Public Employees Retirement Fund

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Contents

1. Purpose
2. Investment Objective
3. Policy Asset Mix, Risk Diversification and Return Expectations
4. Passive and Active Management
5. Public Equity Strategy
6. Fixed Income Strategy
7. Real Estate Strategy
8. Private Equity Strategy
9. Alternatives Portfolio Strategy
10. Performance Monitoring and Evaluation

Glossary of Selected Terms

Terms explained in the glossary are *italicized* when they first appear in this document.

1.0 Purpose

- 1.1 This Statement of Investment Objectives and Policy Framework (the “Statement”) summarizes the philosophy, objectives and policies approved by the *Oregon Investment Council* (the “Council”) for the investment of the assets of the *Oregon Public Employees Retirement Fund* (“OPERF”).
- 1.2 The Council approved these objectives and framework after careful consideration of OPERF benefit provisions, and the implications of alternative objectives and policies.
- 1.3 The Statement has been prepared with five audiences in mind: incumbent, new and prospective Council members; Treasury staff; OPERF active and retired members; Oregon State Legislature and Governor; and agents engaged by the Council to manage and administer Fund assets.
- 1.4 The Statement summarizes more detailed policies and procedures documents prepared and maintained by the staff of the *Office of the State Treasurer*, and numerous other documents that govern the day-to-day management of OPERF assets including agent agreements, individual investment manager mandates, and limited partnership documents.
- 1.5 The Council regularly assesses the continued suitability of the approved investment objectives and policies, initiates change as necessary, and updates these documents accordingly.

2.0 Investment Objective

- 2.1 Subject to ORS 293.721 and 293.726, the investment objective for the *Regular Account* is earning, over moving twenty-year periods, an annualized *return* that exceeds the *actuarial discount rate* (ADR), approved by the Public Employees Retirement Board (PERB) to value OPERF liabilities. Eight percent is the current actuarial discount rate.
- 2.2 The Council believes, based on the assumptions herein, that the investment policies summarized in this document will provide the highest probability of achieving this objective, at a level of *risk* that is acceptable to active and retired OPERF members. The Council evaluates risk in terms of the probability of not achieving the ADR over a twenty-year time horizon.
- 2.3 Historically, members were allowed to direct up to 75% of their contributions to the *Variable Account*. No new contributions are being made to this fund. The investment objective of the Variable Account is to perform in line with *MSCI All Country World Index*.
- 2.4 The Council has established investment objectives for individual asset classes, including that asset class to which members can direct their contributions. Individual asset class objectives are also summarized in this Statement.

3.0 Policy Asset Mix, Risk Diversification and Return Expectations

- 3.1 After careful consideration of the investment objective, *liability* structure, *funded status* and liquidity needs of OPERF, and the return, risk and *risk-diversifying* characteristics of different asset classes, the Council approved for the OPERF Regular Account the asset mix policy presented in Exhibit 1. The exhibit also summarizes the Council’s total fund asset mix policy and active management return expectations.
- 3.2 Fifty-nine percent of OPERF is targeted for investment in *equities*, inclusive of *private equity*. Equity investments have provided the highest returns over long time periods, but can produce low and even negative returns over shorter time periods.
- 3.3 The risk of low returns over shorter time periods makes 100% equity policies unsuitable for most pension funds, including OPERF. By investing across multiple equity asset classes, and in lower return but less risky *fixed-income* and *real estate*, the Council is managing and diversifying the fund’s overall risk exposure.
- 3.4 Exposures to selected asset classes are maintained within the re-balancing ranges specified in Exhibit 1.
- 3.5 With an 8.4% expected annual return, there is an estimated 50% probability of the fund earning an annualized return that equals or exceeds the current 8.0% actuarial discount rate over a 20 year horizon or, approximately, the next two to three market cycles.

Exhibit 1: Policy Mix and Return Expectations for OPERF Regular Account

Asset Class	Target Allocation (%)	Re-balancing Range (%)	Expected Annual Policy Return¹ (%)	Expected Annual Active Management Return_(net of fees) (%)	Expected Annual Total Return (%)
Public Equities	43	38-48	8.5	0.75	9.3
Private Equity	16	12-20	10.7	0.8	11.5
Total Equity	59	54-64			
Fixed Income	25	20-30	4.3	0.75	5.0
Real Estate	11	8-14	7.6	0.75	8.4
Alternatives	5	0-8	6.4	1.3	7.7
Total Fund	100		7.6	0.8	8.4

1. Based on capital market forecasts developed by the Council’s investment consultant, SIS, for the next two to three market cycles.

2. Total Fund expected returns are simply the weighted averages of the asset class returns.

- 3.6 The 7.5% expected annual asset mix policy return was developed with reference to the observed long-term relationships among major asset classes, adjusted by current market conditions. The Council believes this return expectation is reasonable, but recognizes that over shorter time periods actual mix policy returns can deviate significantly from this expectation – both positively and negatively.
- 3.7 US equity, non-US equity, and fixed-income asset classes are managed using both passive and active management strategies. Active management of public market securities and real estate assets is expected to earn 0.8% per annum of additional returns over moving five-year periods. The Council recognizes that unsuccessful active management can reduce total fund returns.
- 3.8 The OIC has provided for up to 3.0% of total plan assets to be invested in an *Opportunity Portfolio* to provide enhanced returns and diversification to OPERF. Investments are expected to be a combination of both shorter-term (1-3 years) and longer-term holdings. This allocation will not result in any of the previously established strategic asset allocation targets falling outside their ranges. No strategic target is established for the Portfolio since, by definition, investments will be pursued only on an opportunistic basis, unless changed by the OIC.
- 3.9 Cash is invested in the *Oregon Short Term Fund* and is kept at a minimum level, but sufficient to cover the short-term cash flow needs of OPERF.
- 3.10 In an effort to minimize cash exposure at both the fund and manager level, the OIC has retained a policy implementation overlay manager to more closely align the actual portfolio with the policy portfolio, generally through the buying and selling of futures contracts to increase or decrease asset class exposures, as necessary.
- 3.11 The Council shall review, at least biennially, its expectations for asset class and active management performance, and assess how the updated expectations affect the probability that the Regular Account will achieve the investment objective.

4.0 Passive and Active Management

- 4.1 Passive management uses lower cost *index funds* to access the return streams available from the world's capital markets. Active management tries to earn higher returns than those available from index funds by making value-adding security selection and asset mix timing decisions.
- 4.2 The Council uses passive management to control costs, evaluate active management strategies, capture exposure to the more *efficient markets*, manage the risk of under-performance and facilitate re-balancing to policy asset mix. Exchange traded *real estate investment trusts (REITS)* may also be used to maintain the Fund's asset class exposures within the specified policy ranges.
- 4.3 The Council approves the active management of fund assets when available investment strategies offer sufficiently high expected incremental returns, net of

- fees, to compensate for the risk of under-performance, and when the magnitude of potential under-performance can be estimated, monitored and managed.
- 4.4 The Council must accept active management of those asset classes for which there is no passive management alternative, in particular, real estate and private equity.
 - 4.5 The Council prefers active management strategies that emphasize security selection decisions rather than asset mix timing decisions. General investor experience and surveys of academic and professional studies indicate that security selection decisions are more likely to earn above index returns than asset mix timing decisions.
 - 4.6 At the aggregate level of the Regular Account, active management strategies authorized by the Council are expected to **add 0.8% of annualized excess return**, net of fees, over moving five-year periods. **Active risk of the Regular Account is managed to a targeted annualized tracking error of 2 to 3 percent, relative to the policy benchmark.**

5.0 Public Equity Strategy

- 5.1 Public equity is managed with the objective of earning at least **75 basis points** in annualized net excess return above the *MSCI All Country World Investable Market Index* (ACWI IMI – net) (unhedged) over moving five-year periods. **Active risk is managed to a targeted annualized tracking error of 0.75 to 2.0 percent, relative to the above benchmark.**
- 5.2 Key elements of the strategy:
 - (a) 25% of assets are targeted for passive management, primarily in the large and mid capitalization *sectors* of the market, which are believed to be more efficiently valued.
 - (b) Maintain a double weighting to U.S. small capitalization stocks, in an effort to enhance return. This tilt is based on the Investment Council’s belief that inefficiencies in the small and micro cap markets, relative to the large cap market, through active management, will outperform large cap stocks over the long-term.
 - (c) Multiple specialist active managers with risk diversifying complementary investment styles are employed. For example, managers that focus on either growth or value stocks and managers that focus on large or small capitalization stocks. This produces more consistent excess returns and reduces the fund’s exposure to any single investment organization.
 - (d) The Fund maximizes exposure to security selection based investment decisions by maintaining aggregate exposures to *value* and *growth* stocks, economic sectors and *market capitalizations* relative to their *benchmark exposures*, adjusted for the strategic small cap overweight.
 - (e) Active management exposure is higher for non-US equity because the Council believes the non-US markets provide more opportunities for skilled managers to earn incremental returns.

- (f) Managers with skills in security selection and country allocation are utilized. These decisions have been shown to be the principal sources of the excess return in non-US equity portfolios. Managers who have demonstrated ability to add value through currency management are permitted to do so.
- (g) Aggregate exposures to countries, economic sectors, equity management styles and market capitalization are monitored and managed relative to their benchmark exposures.

6.0 Fixed Income Strategy

6.1 Fixed income is being managed with the objective of earning **75 basis points** in annualized net excess returns above a blended benchmark of 60% *Barclays Capital US Universal Bond Index*, 10% *JP Morgan Emerging Markets Bond Index Global*, 20% *S&P/LSTA Leveraged Loan Index*, and 10% *Bank of America Merrill Lynch High Yield Master II Index* over moving five-year periods. **Active risk is managed to a targeted annualized tracking error of 1 to 2 percent, relative to the above benchmark.**

6.2 Key elements of the strategy:

- (a) At least 95% of fixed income is actively managed because active fixed income management is generally more cost effective than active equity management. Excess returns are more likely because many investors hold fixed income to meet regulatory and liability matching objectives, and are not total return investors. This produces systematic mis-pricings of fixed-income securities that skilled investment managers can exploit. Also, fixed income management fees are much lower than active equity management fees.
- (b) Multiple active generalist managers will be used for a majority of the fixed income asset class, rather than multiple sector specialists as in the US equity market. The OIC may supplement this strategy with specialist fixed income managers as warranted. Fixed income manager structures generally have little impact on total Fund risk because of overall lower allocations to the asset class and the low tracking errors. The asset class tracking error is diversified into insignificance at the total Fund level.
- (c) Managers are selected for their skills in issue selection, credit analysis, sector allocations and duration management.
- (d) Aggregate exposures to duration, credit and sectors are monitored and managed relative to corresponding exposures in the asset class benchmark.

7.0 Real Estate Strategy

7.1 Real estate investments are being managed with the objective of earning at least **75 basis points** in annualized net excess returns above the *NCREIF Index* over moving five-year periods. Because 80% of the real estate investments are traded infrequently, risk budget concepts are not applicable.

7.2 Key elements of the strategy:

- (a) Real Estate is 100% actively managed because index funds replicating the real estate broad market are not available.
- (b) *Core property investments* represent 30% of the real estate portfolio, with a range of 25% to 35%. Specialist managers are utilized. Risk is diversified by investing across the major property types: offices, apartments, retail and industrial, but may include structured investments in alternative types of property with Core type risk and return attributes.
- (c) Exchange traded real estate investment trusts (REITs) represent 20% of the real estate portfolio, with a range of 15% to 25%. Active management will include style and capitalization specialists, as well as broad market managers. Up to 50% of the REIT exposure may be invested in markets outside the United States.
- (d) *Value Added* investments represent 20% of the real estate portfolio, with a range of 15% to 25%. Investments may include direct property types listed above, as well as structured investments in alternative property types. Risk is diversified by property type and geography.
- (e) *Opportunistic real estate* investments represent 30% of the real estate portfolio, with a range of 20% to 40%. Investment strategies will be characterized as “opportunistic” based on the market conditions prevailing at the time of investment.
- (f) The Fund may also participate in *co-investment* opportunities within the real estate asset class.

8.0 Private Equity Strategy

8.1 Private equity is being managed with the objective of earning at least **300 basis points** net excess return above the Russell 3000 Index over very long time horizons, typically moving 10-year periods. Because private equity investments are traded infrequently, risk budget concepts are not applicable.

8.2 Key elements of the strategy:

- (a) Private Equity is 100% actively managed because index funds of private equity are not available.
- (b) Asset class risk is diversified by investing across different private equity fund types: *venture capital, leverage buyouts, mezzanine debt, distressed debt, sector funds* and *fund-of-funds*.
- (c) Asset class risk is further diversified by investing across *vintage years, industry sectors, investment size, development stage* and *geography*.
- (d) Private equity programs are managed by general partners with good deal flow, specialized areas of expertise, established or promising net of fees track records, and fully disclosed and verifiable management procedures.
- (e) The Fund will participate in *co-investment* opportunities in the private equity asset class.

9.0 Alternatives Portfolio Strategy

- 9.1 Alternatives investments are being managed with the objective of earning at least **400 basis points** in annualized net excess returns above the *CPI* over moving ten-year periods. Because 80% of the alternative investments are traded infrequently, risk budget concepts are not applicable.
- 9.2 Key elements of the target strategy:
- (a) Alternatives are 100% actively managed because index funds replicating the broad alternatives market are not available.
 - (b) *Infrastructure investments* represent 30% of the target alternatives portfolio, with a range of 25% to 35%. Specialist managers are utilized. Risk is diversified by investing across the major infrastructure types, investment size and geographies: energy infrastructure, transportation, ports, and water; mid sized and large capitalization; domestic and international.
 - (c) *Natural Resources investments* represent 45% of the target alternatives portfolio, with a range of 40% to 50%. Risk is diversified by investing across the major sectors: oil and gas, agriculture land, timberland, mining, and commodities. Specialist managers are across both active and passive strategies and domestic and international markets.
 - (d) *Hedge Fund investments* represent 20% of the target alternatives portfolio, with a range of 15% to 25%. Investments may include relative value, macro, arbitrage, and long short equity strategies. Risk is diversified by investing across strategies and managers.
 - (e) *Other* investments may represent 5% of the target alternatives portfolio, with a range of 0% to 10%. Investment strategies will be characterized as “other” based on the strategy and market at the time of investment.
 - (f) The Fund may also participate in *co-investment* opportunities within the alternatives asset class.

10.0 Performance Monitoring and Evaluation

- 10.1 The Council and its agents use a variety of compliance verification and performance measurement tools to monitor, measure and evaluate how well OPERF assets are being managed. Monitoring, reporting and evaluation frequencies range from hourly, to daily, to weekly, to monthly, to quarterly, to annually.
- 10.2 The Council has developed a performance monitoring and evaluation system that answers two fundamental fiduciary questions:
- Are Fund assets being prudently managed? More specifically, are assets being managed in accordance with established laws, policies and procedures, and are individual investment managers in compliance with their mandates?
 - Are Fund assets being profitably managed? More specifically, has performance affected benefit security, has capital market risk been rewarded and has active management risk been rewarded?
- 10.3 When a breach of policies, procedures or portfolio mandates is reported or detected, the Council requires a supporting report explaining how the breach was discovered, the reasons for the breach, actions taken to rectify the breach, and steps taken to mitigate future occurrences.
- 10.4 One of the many reports used by the Council to monitor and evaluate performance of the Regular Account indicates if the Regular Account has exceeded the 8.0% (ADR) return over moving five-year periods. Additionally, reports quantify if the fund was rewarded for investing in higher return but more risky equity investments over the same period, and if active management has added or subtracted returns, net of fees.
- 10.5 The reporting described in this section gives the Council a consolidated or “big picture” view of the performance of the Regular Account. This is the first level of a comprehensive four-level performance report used by the Council to monitor and evaluate performance over different time horizons. Level two examines Regular Account performance excluding hard-to-price illiquid assets such as real estate and private equities. Level three examines the performance of the Regular Account’s five individual asset class strategies: US equity, non-US equity, fixed income, real estate and private equity. Level four examines the performance of individual managers within each of the asset class strategies. The four-level reporting structure allows the Council to “drill down” to the level of detail that is needed to identify potential performance problems, and take corrective action as may be required.

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Glossary

Actuarial Discount Rate (ADR): The interest rate used to calculate the present value of a defined benefit plan's future obligations and determine the size of the state's annual contribution to the plan.

Alternative Investments: Investments that are considered non-traditional or emerging investment types. Presently, the following investment types are considered alternative investments: hedge funds, infrastructure, timber, and other commodities.

Asset Class: A collection of securities that have conceptually similar claims on income streams and have returns that are highly correlated with each other. Most frequently referenced publicly traded asset classes include US equities, US debt and US cash.

Bank of America Merrill Lynch High Yield Master II Index: HY Master II Index (market value of \$1+ trillion with over 2,000 issues at March 31, 2012) constituents are capitalization-weighted based on their current amount outstanding. The Index tracks the performance of US dollar-denominated below investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have a below investment grade rating (based on an average of Moody's, S&P and Fitch) and an investment grade rated country of risk (based on an average of Moody's, S&P and Fitch foreign currency long term sovereign debt ratings).

Barclays Capital US Universal Bond Index: The Universal Index (market value of approximately \$18.7 trillion, with over 12,000 issues, at March 31, 2012), like the Barclays Capital US Aggregate Index, is modular and combines the Aggregate Index with the following capitalization weighted Barclays fixed income indices: the US Corporate Index, Investment Grade 144A Index, the Eurodollar Index, the US Emerging Markets Index, and the non-ERISA eligible portion of the CMBS Index, including the CMBS High-Yield Index. Municipal debt, private placements, and non-dollar denominated issues are excluded from the Universal Index. The only constituent of the index that includes floating-rate debt is the Emerging Markets Index. The Aggregate represents approximately 86% of the Universal Index. However, the Universal captures an additional, approximately, \$2.6 trillion in US dollar denominated fixed income. The Universal Index was officially launched by the former Lehman Brothers on January 1, 1999.

Basis Point: One basis point is 0.01%. One hundred basis points equals one percentage point.

Benchmark: A standard by which investment performance can be measured and evaluated. For example, the performance of US equity managers is often measured and evaluated relative to the benchmark performance of the Russell 3000 Index.

Benchmark Exposures: The proportion to which a given stock or investment characteristic is represented in an investment benchmark, such as the Russell 3000 Index of US companies. Allows investors to measure the extent to which their portfolio is over or under exposed to a given stock, or investment characteristic such as market capitalization.

Co-investment: Although used loosely to describe any two parties that invest alongside each other in the same company, this term has a special meaning in relation to limited partners in a fund. By having co-investment rights, a limited partner in a fund can invest directly in a company also backed by the fund managers itself. In this way, the limited partner ends up with two separate stakes in the company: one, indirectly, through the private equity fund to which the limited partner has contributed; another, through its direct investment, generally under better investment terms.

Core Property Investments: Real estate investment strategies which exhibit “institutional” qualities, such as being well located within local and regional markets, well occupied, and of high quality design and construction.

Credit: The measure of an organization’s ability to re-pay borrowed money. Used most often in the managing fixed income portfolios. Organizations with the highest credit rating, those most likely to re-pay money they have borrowed, are assigned a AAA credit rating.

Distressed Debt: A private equity investment strategy that involves purchasing discounted bonds of a financially distressed firm. Distressed debt investors frequently convert their holdings into equity and become actively involved with the management of the distressed firm.

Duration: A financial measure used by investors to estimate the price sensitivity of a fixed-income security to a change in interest rates. For example, if interest rates increase by 1 percentage point, a bond with a 5-year duration will decline in price by 5 percent.

Efficient Markets: A market in which security prices rapidly reflect all information about securities and, by implication, active managers find it more difficult to pick stocks that consistently beat the performance of an index fund.

Equities: Investments that represent ownership in a company and therefore a proportional share of company profits.

Fixed-Income: Debt obligations of corporations and governments that specify how money previously borrowed is to be repaid. Typically, money is repaid by a series of semi-annual interest payments of fixed amounts, and final repayment of principal.

Funded Status: A comparison of plan assets with the plan liability (e.g. the projected benefit obligation (PBO)). When plan assets are greater than the PBO, the plan is overfunded. If plan assets are less than the PBO, the plan is underfunded and the state has a net liability position with respect to its pension plan.

Fund-of-funds: a fund that invests primarily in other private equity funds rather than operating firms, often organized by an investment advisor or investment bank.

Growth Stock: Stocks that exhibited faster-than-average earnings growth over the last few years and is expected to continue to do so into the near future. Growth stocks usually have high price-to-earnings ratios, high price-to-book ratios and low dividend yields.

Hedged: A term applied to a portfolio of non-domestic stocks or bonds that is unaffected by changes in the relative value of the domestic and foreign currencies. Forward currency contracts are typically used to hedge a portfolio against currency risk.

Index Fund: A portfolio management strategy that seeks to match the composition and performance of a selected market index, such as the Russell 3000.

JP Morgan Emerging Markets Bond Index Global: The EMBI Global Index (market value of approximately \$493 billion with 296 issues at March 31, 2012) tracks total returns for US dollar-denominated debt instruments issued by emerging market sovereign and quasi-sovereign entities: Brady bonds, loans, Eurobonds. The methodology is designed to distribute the weights of each country within the Index by limiting the weights of countries with higher debt outstanding and reallocating this excess to countries with lower debt outstanding.

Leverage Buyouts (LBO): The acquisition of a firm or business unit, typically in a mature industry, with a considerable amount of debt. The debt is then repaid according to a strict schedule that absorbs most of the firm's cash flow.

Liability: A claim on assets by individuals or companies. In a pension context, liabilities represent the claim on fund assets by active and retired members of the pension plan.

MSCI All Country World Investable Market Index (ACWI-IMI): A free float-adjusted market capitalization index that is designed to measure equity market performance in the global developed and emerging markets, by capturing up to 99% of the developed and emerging investable market universe, covering over 9,000 securities. As of April 2012 the MSCI ACWI-IMI consisted of 45 country indices comprising 24 developed and 21 emerging market country indices. The developed market country indices included are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom and the United States. The emerging market country indices included are: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey.

MSCI ACWI Ex US: The same as the MSCI ACWI, except that stocks in the United States are not included.

MSCI World Ex US Index: A free float-adjusted market capitalization index that is designed to measure global developed market equity performance, excluding the United States. As of April 2012 the MSCI World Ex US Index consisted of the following 23 developed market country indices: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom.

Market Capitalization: The value of a corporation as determined by multiplying the price of its shares by the number of shares outstanding. Investors often use market capitalization as an indicator of portfolio risk or volatility. In general, smaller capitalized companies are more volatile or risky than larger capitalized companies.

Mezzanine: Either a private equity financing undertaken shortly before an initial public offering, or an investment that employs subordinated debt that has fewer privileges than bank debt but more than equity and often has attached warrants.

NCREIF Index: The National Council of Real Estate Investment Fiduciaries (NCREIF) is an association of institutional real estate professionals who share a common interest in their industry. The NCREIF Property Index (NPI) is a quarterly time series composite total rate of return measure of investment performance of a very large pool of individual commercial real estate properties acquired in the private market for investment purposes only. All properties in the NPI have been acquired, at least in part, on behalf of tax-exempt institutional investors - the great majority being pension funds. As such, all properties are held in a fiduciary environment. The qualifications for inclusion in the NPI are:

- Operating properties only
- Property types - apartments, hotels, industrial properties, office buildings, and retail only
- Can be wholly owned or in a joint venture structure.
- Investment returns are reported on a non-leveraged basis. While there are properties in the NPI that have leverage, returns are reported to NCREIF as if there is no leverage
- Must be owned/controlled by a qualified tax-exempt institutional investor or its designated agent
- Existing properties only (no development projects)

Office of the State Treasurer: Headed by the State Treasurer as the chief financial officer for the state, the Office of the State Treasurer is responsible for managing the day to day investment operations of the state pension fund (and other funds), issuing all state debt, and serving as the central bank for state agencies. Within the Office of the State Treasurer, the Investment Division also manages the investment programs for the state's deferred compensation plan and college savings plan, and serves as staff to the Oregon Investment Council.

Opportunistic Real Estate Investments: Higher risk but higher expected return real estate investments that are usually very illiquid, not currently income-producing and are often distressed purchases and/or highly leveraged.

Opportunity Portfolio: Non-traditional and/or concentrated investment strategies that may provide diversification and return potential outside of the OIC formally approved asset classes. The Portfolio may be populated with innovative investment approaches across a wide range of investment opportunities with no limitation as to asset classes or strategies that may be used. The Opportunity Portfolio investment program seeks to achieve its investment objective by investing in strategies that fall outside the OIC's previously identified asset classes because of the expected time horizon, tactical nature of the investment, or some other unique aspects which must be clearly defined in the written recommendation provided to the OIC.

Oregon Investment Council (OIC): Oregon Revised Statute (ORS) 293.706 establishes the OIC, which consists of five voting members, four of whom are appointed by the Governor and subject to Senate confirmation (the Treasurer serves by position, and is not subject to confirmation). The members appointed by the Governor must be qualified by training and experience in the field of investment or finance. In addition, the Director of the Public Employees Retirement System is an ex-officio member of the OIC. ORS 293.721 and 293.726 establish the investment objectives and standard of judgment and care for the OIC: Moneys in the investment funds shall be invested and reinvested to achieve the investment objective of the investment funds, which is to make the moneys as productive as possible, subject to the prudent investor standard.

Oregon Public Employees Retirement Fund (OPERF): Holds the assets of beneficiaries of the Oregon Public Employees Retirement System (PERS). PERS is a statewide-defined benefit retirement plan for units of state government, political subdivisions, community colleges, and school districts. PERS is administered under ORS chapters 237, 238, 238A, and applicable provisions of the Internal Revenue Code by the Public Employees Retirement Board (PERB). Participation by state government units, school districts, and community colleges is mandatory. Participation by most political subdivisions is optional but irrevocable if elected. All system assets accumulated for the payment of benefits may legally be used to pay benefits to any of the plan members or beneficiaries of the system. PERS is responsible for administering the management of the plan's liability and participant benefits.

Oregon Short Term Fund (OSTF): The state's commingled cash investment pool managed internally by Treasury staff. The OSTF includes all excess state agency cash, as required by law, as well as cash invested by local governments on a discretionary basis. The OSTF is invested in accordance with investment guidelines recommended by the state's Oregon Short Term Fund Board and approved by the OIC.

Overweight: A stock, sector or capitalization exposure that is higher than the corresponding exposure in a given asset class benchmark, such as the Russell 3000 Index.

Private Equity: Venture Economics (VE) uses the term to describe the universe of all venture investing, buyout investing and mezzanine investing. Fund of fund investing and secondaries are also included in this broadest term. VE is not using the term to include angel investors or business angels, real estate investments or other investing scenarios outside of the public market. See also *Alternative Investments*.

Real Estate: Investments in land and/or buildings.

Real Estate Investment Trusts (REIT): A real estate portfolio managed by an investment company for the benefit of the trust unit holders. Most REIT units are exchange traded.

Regular Account: That portion of the Oregon Public Employees Retirement Fund that excludes the Variable Account. A diversified investment portfolio, with an OIC established asset allocation. Tier One member funds in the regular account are guaranteed a minimum rate of return based on the long-term interest rate used by the actuary. The rate is currently 8 percent per year. Tier Two member funds in the regular account have no guaranteed rate of return. Tier Two regular accounts receive whatever is available for distribution.

Return: The gain or loss in value of an investment over a given period of time expressed as a percentage of the original amount invested. For example, an initial investment of \$100 that grows to \$105 over one year has earned a 5% return.

Risk: A statistical measure of the possibility of losing or not gaining value. May also be expressed as the probability of not achieving an expected outcome.

Risk-diversifying: Reducing risk without reducing expected returns by combining assets with returns that move in opposite directions over a given time period thereby reducing the total portfolio risk. A decline in the price of one asset is offset by the increase in the price of another asset in the portfolio. In laypersons terms, this is often described as putting your eggs into more than one basket.

Russell 3000 Index: Measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market.

S&P/LSTA Leveraged Loan Index: The S&P/LSTA Leveraged Loan Index (market value of approximately \$470 billion with over 900 facilities at March 31, 2011) mirrors the market-weighted performance of the largest institutional leveraged loans based upon market weightings, spreads and interest payments.

Sector: A particular group of stocks or bonds that usually characterize a given industry or economic activity. For example, “pharmaceuticals” is the name given to stocks of companies researching, manufacturing and selling over-the-counter and prescription medicines. “Corporates” is the name given to fixed-income instruments issued by private and public companies.

Sector Funds: A pooled investment product with investments that focus on a particular industry or economic activity. For example, pooled funds that invest principally in technology stocks would be termed a technology sector fund.

Tracking Error: When using an indexing or any other benchmarking strategy the amount by which the performance of the portfolio differed from that of the benchmark. In reality, no indexing strategy can perfectly match the performance of the index or benchmark, and the tracking error quantifies the degree to which the strategy differed from the index or benchmark. Usually defined as the standard deviation of returns relative to a pre-specified benchmark.

Unhedged: A term applied to a portfolio of non-domestic stocks or bonds that is affected by the changes in the value of domestic and foreign currencies.

Value Added: As used in real estate, may include office, retail, industrial and apartment properties, but may target structured investments in alternative property types such as hotels, student housing, senior housing, and specialized retail uses. The Value Added portfolio is expected to produce returns between Core and Opportunistic portfolios but may experience greater vacancy or interest rate risk than the Core portfolio. Value Added properties may exhibit “institutional” qualities such as being well located within local and regional markets, and be of high quality design and construction but may need redevelopment, or significant leasing to achieve stabilized investment value. Value Added investments may include development opportunities with balanced risk/return profiles.

Value Stock: Stocks that appear to be undervalued for reasons other than low potential earnings growth. Value stocks usually have low price-to-earnings ratios, low price-to-book ratios and a high dividend yield.

Variable Account: The Variable Annuity Program allowed active members to place a portion of their yearly employee contributions exclusively within a domestic equity portfolio. No contributions were allowed after December 31, 2003. Active members who participated in the Variable Program had part of their member account balance in the regular account and part in the variable account. Unless a member elected to participate in the Variable Program, all of the member’s employee contributions went into the regular account. This “primary” election allowed members to place 25 percent, 50 percent, or 75 percent of their employee contributions in the variable account. Variable account balances increase or decrease depending on the performance of the variable fund; accounts are credited for whatever is available for distribution, whether it is a gain or a loss. The OIC only sets asset allocation policy at the Regular Account level, since the OIC cannot control historical employee directed investment options.

Venture Capital: Independently managed, dedicated pools of capital that focus on equity or equity-linked investments in privately held, high growth companies. Outside of the United States, the term venture capital is used as a synonym for all types of alternative or private equity.

Vintage Year: The group of funds whose first closing occurred in the same year. For example, venture capital funds of vintage year 1995 were closed to additional investors in 1995.

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