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## INV 1203: Statement of Investment Objectives and Policy Framework for the Oregon Public Employees Retirement Fund

### PURPOSE

1. This Statement of Investment Objectives and Policy Framework (the "Statement") summarizes the philosophy, objectives and policies approved by the *Oregon Investment Council* (the "OIC" or the "Council") for the investment of *Oregon Public Employees Retirement Fund* ("OPERF" or the "Fund") assets.
2. The Council approved these objectives and framework after careful consideration of OPERF benefit provisions, and the implications of alternative objectives and policies.
3. The Statement has been prepared with six audiences in mind: 1) incumbent, new and prospective Council members; 2) investment division staff of the *Oregon State Treasury* ("OST"); 3) the Public Employees Retirement Board ("PERB"); 4) active and retired Oregon Public Employees Retirement System (OPERS) members; 5) the Oregon State Legislature and Governor; and 6) agents engaged by the Council to manage and administer Fund assets.
4. The Statement summarizes more detailed policy and procedure documents prepared and maintained by investment division staff, 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.
5. The Council regularly assesses the continued suitability of its approved investment objectives and policies, initiates change as necessary and updates these documents accordingly.

### INVESTMENT OBJECTIVE

1. The Council believes, based on the assumptions outlined herein, that the investment policies summarized in this document will provide the highest possible *return* at a level of *risk* that is appropriate for active and retired OPERF members. The Council evaluates risk in terms of both short-term asset price volatility and long-term plan viability.
2. Subject to ORS 293.721 and 293.726 and the risk parameters described directly above, the objective for the *Regular Account* is to maximize the net, annualized, risk-adjusted return on OPERF capital consistent with Council investment policies, particularly those concerning asset allocation and prudent diversification.

This objective further contemplates a consecutive ten-year forecast horizon, and the Council also understands that estimates of forward-looking OPERF returns are a primary consideration during PERB's biennial determination of its *actuarial discount rate* (ADR).

3. Historically, OPERF members were allowed to direct up to 75% of their annual, employee retirement contributions to the *Variable Account*. While no longer receiving new contributions, the Variable Account's objective remains investment performance consistent with the *MSCI All Country World Investable Market Index*.
4. The Council has established investment objectives for individual asset classes that are also summarized in this Statement.

## POLICY ASSET MIX DIVERSIFICATION AND RETURN EXPECTATIONS

1. After careful consideration of OPERF's investment objective, *liability* structure, *funded status* and liquidity needs, as well as the return, risk and *diversification* characteristics of different asset classes, the Council's approved asset mix policy for the Regular Account is summarized in Exhibit 1, and its active management return expectations are summarized in Exhibit 2.
2. Of total Fund assets, 55 percent of OPERF is targeted for investment in *equities*, inclusive of *private equity*. Equity investments have generated the highest returns over long time periods, but can also produce low and even negative returns over shorter time periods.
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*, *real estate* and *alternatives* asset classes, the Council manages and diversifies the Fund's overall risk.
4. Specific asset class exposures are maintained within the ranges outlined in Exhibit 1.

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

Asset Class	Target Allocation (%)	Re-balancing Range (0%)	Expected Annual Policy Return <sup>1</sup> (%)
Public Equity	37.5	32.5-42.5	7.1
Private Equity	17.5	14.0-21.0	9.5
Total Equity	55.0	50.0-60.0	
Fixed Income	20.0	15.0-25.0	3.0
Real Estate	12.5	9.5-15.5	6.7
Alternatives	12.5	0.0-12.5	6.3
<b>Total Fund<sup>2</sup></b>	<b>100.0</b>		<b>7.1</b>

<sup>1</sup> Based on capital market forecasts developed by the Council's investment consultant, Callan Associates.

2 Total Fund expected returns are calculated *geometrically* using the investment consultant's forecasts for the *arithmetic* returns and covariances of the asset classes. Accordingly, the Total Fund's expected returns are not equivalent to the weighted average of individual asset class returns listed in Exhibit 1.

5. The policy mix's 7.1% average annual return expectation was developed with reference to observed long-term relationships among major asset classes, adjusted to account for current market conditions. The Council believes this return expectation is reasonable, but recognizes that *realized* returns can deviate significantly from expectations – both positively and negatively.
6. The OIC has allocated up to 3.0% of total Fund assets for investment in an *Opportunity Portfolio*, the objective of which is to enhance OPERF returns and/or diversification. Investments in the Opportunity Portfolio are expected to comprise a combination of both shorter-term (1-3 year) and longer-term holdings. The Opportunity Portfolio has no strategic target since, by definition, eligible investments are only pursued on an opportunistic or episodic basis; moreover, the Opportunity Portfolio allocation shall not result in an allocation range breach for any of the other five, primary asset class allocations.
7. OPERF cash balances are invested in the *Oregon Short Term Fund* and managed to levels that are deliberately minimized but still sufficient to cover OPERF's short-term cash flow needs.
8. In an effort to minimize cash balances at both the Fund and manager level, the OIC has retained an overlay manager to more closely align the actual Fund portfolio with the approved policy mix, generally through the purchase and sale of futures contracts to increase or decrease specific asset class exposures, as necessary.
9. 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 its investment objective.

## PASSIVE AND ACTIVE MANAGEMENT

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 through the application of manager skill in the form of sector and security selection as well as market and/or asset mix timing decisions.
2. The Council uses passive management to control costs, evaluate active management strategies, capture exposure to *efficient market* segments, manage *tracking error* and facilitate policy mix re-balancing activities. Exchange-traded *real estate investment trusts (REITs)* may also be used to maintain the Fund's real estate exposure within specified policy ranges.
3. The Council approves active management of Fund assets when proposed active strategies offer sufficiently high expected incremental returns, net of fees, and when the magnitude of potential under-performance can be estimated, monitored and managed.
4. Public equity and fixed income asset classes are managed using both passive and active management strategies. Active management of the Fund's public market equity and fixed income allocations is expected to earn annual return premiums of 0.50% and 0.25%, respectively, over rolling, consecutive five-year periods (and relative to those allocation's respective benchmarks). The Council recognizes that unsuccessful active management can reduce total Fund returns.
5. The Council must accept active management in those asset classes for which there are no passive management alternatives; in particular, private real estate, private equity and other alternative and opportunistic investment strategies.

6. The Council prefers active management strategies that emphasize sector and/or security selection decisions rather than market and/or asset mix timing decisions as the former are much better supported by professional experience and academic research.
7. At the aggregate, Regular Account level, and as outlined in Exhibit 2, active management strategies authorized by the Council are expected to **add 0.4% of annualized excess return**, net of fees, over rolling, consecutive five-year periods. **Relative to the policy benchmark, Regular Account active risk shall be managed to a 2 to 3 percent annualized tracking error target.**

**Exhibit 2: Active Return Expectations for the OPERF Regular Account by Asset Class**

Asset Class	Target Allocation (%)	Target Active Return (%)	Target Active Contribution (%)
Public Equity	37.5	0.50	0.19
Fixed Income	20.0	0.25	0.05
Real Estate	12.5	0.50	0.06
<b>Total Fund</b>			<b>0.30</b>

## PUBLIC EQUITY STRATEGY

1. OPERF's public equity allocation is managed with the objective of earning at least **50 basis points** in annualized net excess return relative to the *MSCI All Country World Investable Market Index (ACWI IMI – net)* (unhedged) over rolling, consecutive five-year periods. **Relative to that same benchmark, active risk shall be managed to a 0.75 to 2.0 percent annualized tracking error target.**
2. Key elements of the strategy include the following:
  - a. In an effort to enhance return, strategy will include maintaining an over-weight to small capitalization stocks and other well supported sources of return premia. These strategic overweights or "tilts" are based on and supported by robust empirical research that historically links persistent and pervasive evidence of excess returns to systematic "factor exposures" such as size (i.e., small cap), value and momentum. Implementation of other factor tilts may be considered at the manager, strategy or mandate level upon approval of both the Chief Investment Officer (CIO) and OIC.
  - b. Multiple, specialist active managers with complementary investment styles are employed. For example, some OPERF managers focus on growth stocks, some on value stocks, some on large capitalization stocks and others on small capitalization stocks. This diversified approach produces more excess return opportunities and minimizes the Fund's exposure to any single investment organization.
  - c. Active management is more common within OPERF's non-U.S. equity allocation because non-U.S. markets appear to provide more opportunities for the successful application of manager skill.
  - d. Managers with skills in security selection and country allocation are utilized as these attributes have historically been the principal sources of excess returns in non-U.S. equity portfolios. In addition, managers who have demonstrated an ability to add value through currency management are permitted to do so.
  - e. Aggregate exposures to countries, economic sectors, investment styles and market capitalization tiers are monitored and managed relative to corresponding benchmark exposures.

## FIXED INCOME STRATEGY

1. OPERF's fixed income allocation is managed with the objective of earning **25 basis points** in annualized, net excess returns relative to a blended benchmark comprised of 46% *Bloomberg Barclays U.S. Aggregate Index*, 37% *Bloomberg Barclays U.S. Treasury Index*, 13% *S&P/LSTA Leveraged Loan Index* and 4% *Bank of America Merrill Lynch High Yield Master II Index* over rolling, consecutive five-year periods. **Relative to the above-described benchmark, active risk within the OPERF fixed income allocation is managed to a 0.5 to 1.0 percent annualized tracking error target.**
2. Key elements of the strategy include the following:
  - a. A significant proportion of the OPERF fixed income allocation is actively managed due to performance and cost considerations. Specifically, excess returns from active fixed income management are likely as many investors hold fixed income securities to meet regulatory and liability matching objectives, and hence are not total return oriented. This market dynamic produces systematic mis-pricings of fixed income securities that skilled investment managers can exploit. Active fixed income management fees are also 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 the specialist manager approach used within OPERF's public equity allocation. However, the OIC may utilize specialist fixed income managers as warranted or necessary, although fixed income manager mandates generally have little impact on the Fund's total risk due to fixed income's lower overall Fund allocation and fixed income managers' generally low tracking error.
  - c. Fixed income 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 fixed income allocation benchmark.

## REAL ESTATE STRATEGY

1. OPERF's real estate allocation is managed with the objective of earning at least **50 basis points** in annualized, net excess returns relative to the *NCREIF Fund Index – Open End Diversified Core Equity (NFI-ODCE)*, net of management fees, over rolling, consecutive five-year periods. Because 80% of the Fund's real estate investments are illiquid and/or traded infrequently, passive management approaches and conventional risk budget concepts are generally not applicable.
2. Key elements of the strategy include the following:
  - a. Real Estate is 100% actively managed because a passive replication of the full breadth and depth of the real estate asset class is not viable.
  - b. *Core* property investments represent 55% of the Fund's real estate allocation, with a range of 45% to 65%. Specialist managers are utilized. Risk is diversified by investing across the following major property types: office; apartments; retail; and industrial. The OPERF real estate allocation may also include structured investments in alternative property types with Core-like risk and return attributes.
  - c. Exchange traded real estate investment trusts (REITs) represent 5% of the Fund's real estate allocation, with a range of 0% to 10%. 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* property investments represent 20% of the OPERF real estate allocation, with a range

of 10% to 30%, and may include direct investments in each of the property types listed above, as well as structured investments in alternative property types. Risk is diversified by property type and geography.

- e. *Opportunistic* property investments represent 20% of the OPERF real estate allocation, with a range of 10% to 30%. Relative to Core and Value Added strategies, real estate investments will be characterized as "opportunistic" based on higher risk/return expectations and other prevailing market conditions.
- f. Within its real estate allocation, the Fund may participate in *co-investment* opportunities.

## PRIVATE EQUITY STRATEGY

1. OPERF's private equity allocation is managed with the objective of earning at least **300 basis points** in annualized, net excess returns relative to the Russell 3000 Index over very long time horizons, typically rolling, consecutive 10-year periods. Because private equity investments are often illiquid and/or traded infrequently, passive management approaches and conventional risk budget concepts are generally not applicable.
2. Key elements of the strategy include the following:
  - a. Private Equity is 100% actively managed because private equity index funds are not available.
  - b. Risk within OPERF's private equity allocation is diversified by investing across different fund types and strategies including *venture capital, leverage buyout, mezzanine debt, distressed debt, sector funds, secondaries and fund-of-funds*.
  - c. OPERF's private equity allocation is further diversified by investing across *vintage year*, industry sectors, investment size, development stage and geography.
  - d. OPERF's private equity investments are managed by external managers operating as general partners. Considerations for private equity manager selection include access to transactions (i.e., "deal flow"), specialized areas of operating expertise, established or promising net of fees performance track records, unique or differentiated investment methodologies and transparent/verifiable reporting processes.
  - e. Within its private equity allocation, the Fund may participate in co-investment opportunities.

## ALTERNATIVES STRATEGY

1. OPERF's allocation to Alternatives is managed with the objective of earning at least **400 basis points** in annualized, net excess returns relative to *CPI* over rolling, consecutive ten-year periods. Because 80% of the OPERF alternatives allocation is illiquid and/or traded infrequently, passive management approaches and conventional risk budget concepts are generally not applicable.
2. Key elements of the strategy include the following:
  - a. Alternatives are 100% actively managed because index funds replicating the broad alternatives market are not available.
  - b. *Infrastructure* investments represent 25% of the Fund's alternatives allocation, with a range of 20% to 30%. Specialist managers are utilized, and risk is diversified by investment type, size and geography. Specific infrastructure sector exposures will likely include energy, transportation, ports and water in both domestic and international markets and comprising both mid-size and large capitalization enterprises.

- c. *Natural Resource* investments represent 35% of the Fund's alternatives allocation, with a range of 30% to 40%. Risk is diversified by investing across multiple industry sectors including oil and gas, agriculture, timberland, mining and commodities. Specialist managers are utilized in both domestic and international markets and across both active and some passive strategies.
- d. *Diversifying Strategies* represent 40% of the Fund's alternatives allocation, with a range of 35% to 45%. *Diversifying Strategies* investments may include relative value, macro, arbitrage and long/short equity strategies. The objective of this sleeve is to invest in strategies with returns uncorrelated with those of the broader Fund. Risk is diversified by investing in multiple managers and across several strategies.
- e. *Other* investments may represent 5% of the Fund's alternatives allocation, with a range of 0% to 10%. Investment strategies will be characterized as "other" based on prevailing market conditions as well as a specific strategy's unique "value proposition" or investment thesis.
- f. Within its alternatives allocation, the Fund may also participate in *co-investment* opportunities.

## PERFORMANCE MONITORING AND EVALUATION

1. The Council and its agents use a variety of compliance verification and performance measurement tools to monitor, measure and evaluate the management of OPERF assets. Monitoring, reporting and evaluation frequencies range from daily to annually, although quarterly is the most commonly used reporting frequency.
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 Fund assets being managed in accordance with established laws, policies and procedures, and are individual investment managers in compliance with their respective mandates?
  - Are Fund assets being profitably managed? More specifically, has Fund investment performance improved benefit security, and has capital market risk in general and active management in particular been sufficiently rewarded?
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.
4. One of many reports used by the Council to satisfy the above requirements is a simple comparison of Regular Account investment performance relative to the Council's assigned total Fund benchmark over rolling, consecutive multi-year periods. Other reports help the Council assess whether or not the Fund was rewarded for its allocations to higher return, higher risk equity investments and whether or not the active management strategies utilized added or subtracted from policy returns on a net of fees basis.
5. The reporting described in this section gives the Council a consolidated or "big picture" view of Regular Account investment performance. This view is the first level of a comprehensive four-level performance report used by the Council to monitor and evaluate Regular Account investment performance over different time horizons. Level two examines Regular Account investment performance excluding hard-to-price illiquid assets such as real estate and private equity investments. Level three examines Regular Account investment performance across seven, primary asset allocation categories: U.S. equity; Non-U.S. equity; Fixed Income; Real Estate; Private Equity; and the Alternatives and Opportunity portfolios. Level four examines the performance of individual managers within each of the asset allocation

categories. This four-level reporting structure allows the Council to "drill down" to the level of detail it may need to identify potential performance problems and take whatever corrective actions that may be required.

## 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 plan sponsor's annual contribution. The ADR currently approved by the PERB is 7.5%.

*Alternatives:* Investments that are considered non-traditional or emerging in nature. Presently, the following investment types are included within the OPERF alternatives allocation: hedge funds; infrastructure; natural resources; and 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. The most frequently referenced asset classes include equities, fixed income, real estate and cash.

*Bank of America Merrill Lynch U.S. High Yield Master II Index:* This index tracks the performance of publicly-issued, U.S. dollar-denominated, below investment-grade corporate debt. Its constituents are capitalization-weighted based on their current amount outstanding times the market price plus accrued interest and must conform to the following parameters:

- Be rated below investment-grade rating based on an average of Moody's, S&P and Fitch;
- Have at least 18 months to final maturity at the time of issuance and at least one year remaining to final maturity as of an index rebalancing date;
- Have a fixed coupon schedule and a minimum outstanding of \$100 million; and
- Qualifying securities must have risk exposure to countries that are members of the FX-G10, Western Europe or territories of the U.S. and Western Europe (the FX-G10 includes all Euro members, the U.S., Japan, the UK, Canada, Australia, New Zealand, Switzerland, Norway and Sweden).

*Bloomberg Barclays U.S. Aggregate Index:* This index covers the U.S. investment-grade fixed rate bond market, and includes government, corporate, mortgage pass-through and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis. Its constituents are SEC-registered, taxable, dollar-denominated securities and must conform to the following parameters:

- Have at least one year to final maturity regardless of call features;
- Be rated investment-grade (Baa3/BBB- or higher) by at least two of the major ratings agencies (Moody's, S&P or Fitch);
- Be fixed rate, although securities with a coupon that steps up or changes according to a predetermined schedule are permitted;
- Be dollar-denominated and non-convertible; and
- Be publicly issued, although 144A securities with registration rights and Reg-S issues are included.

*Bloomberg Barclays U.S. Treasury Index:* This index is a sub-component of the Bloomberg Barclays Aggregate Index and includes public obligations of the U.S. Treasury that have remaining maturities of more than one year. Its constituents must conform to the following parameters:

- Be a U.S. Government or investment-grade credit security;
- Have at least one year to final maturity regardless of call features;

- Have at least \$250 million par amount outstanding;
- Be rated Baa3/BBB- or higher (i.e., "investment grade") by at least two of the major ratings agencies (Moody's, S&P or Fitch);
- Be fixed rate, although securities with a coupon that steps up or changes according to a predetermined schedule are permitted;
- Be dollar-denominated and non-convertible; and
- Be publicly issued.

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

*Benchmark:* A standard by which investment performance can be measured and evaluated. For example, the performance of U.S. equity managers is often measured and evaluated relative to the Russell 3000 Index. In this case, the Russell 3000 Index serves as or represents the U.S. equity benchmark.

*Benchmark Exposure:* The proportion that a given stock represents within a benchmark, such as the Russell 3000 Index of U.S. equity securities. Allows investors to measure the extent to which a portfolio or specific investment strategy is over- or under-exposed to a particular stock or investment characteristic (e.g., market capitalization) relative to a benchmark.

*Co-investment:* Although used loosely to describe any two parties that invest alongside one another in the same company, this term has a special meaning in the context of an investment fund's limited partners. By having co-investment rights, a limited partner can invest directly in a company that is simultaneously backed by the fund's general partner. In this way, the limited partner has two separate stakes in the company: the first, an indirect investment through its participation in the general partner's fund; the second, a direct investment alongside the general partner. While the direct, co-investment opportunity is usually offered at terms and conditions more favorable than the fund investment, the direct, concentrated nature of the co-investment opportunity implies higher risk for the limited partner.

*Core:* Real estate investment strategies which exhibit "institutional" qualities, such as superior location, high occupancy and premium design and construction quality.

*Credit:* Used most often in a fixed income context, the measure of an organization's ability to re-pay borrowed money. Organizations with the highest credit rating (i.e., those most likely to re-pay borrowed money) 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 in the management of the distressed firm.

*Diversifying Strategies:* Investment strategies that attempt to systematically capture certain risk premia beyond traditional equity and fixed income market exposures using alternative investment techniques.

*Diversification:* Reducing risk without a commensurate reduction in expected return by combining assets and/or investment strategies with low or uncorrelated return and volatility profiles. For example, a decline in the price of one asset (e.g., oil stocks) is offset by an increase in the price of another asset (e.g., airline stocks). In lay terms, this principal is often described as "putting your eggs in more than one basket".

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

*Efficient Market:* A market in which security prices rapidly reflect all information germane to the price discovery process. A primary implication of an efficient market is that active management efforts often fail to produce

results that consistently beat the performance of an index fund or other passive strategy net of fees, transactions costs and other expenses.

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

*Fixed Income:* Debt obligations that specify the precise repayment of previously borrowed money. Typically, repayment takes the form of a series of fixed-amount, semi-annual interest payments and a single, final repayment of principal.

*Funded Status:* A comparison of a pension plan's assets and liabilities where the latter are often referred to as the plan's projected benefit obligation (PBO). When a plan's assets exceed its PBO, the plan is considered overfunded. Conversely, if a plan's assets are less than its PBO, the plan is considered underfunded and the plan sponsor has a net liability position with respect to its pension plan.

*Fund-of-funds:* Often organized by an investment advisor or investment bank, a fund that invests in other funds rather than directly in securities, operating firms or other assets.

*Growth Stock:* Stocks exhibiting faster-than-average earnings growth with expectations that such growth will continue. Growth stocks usually have high price-to-earnings ratios, high price-to-book ratios and low to no dividend yields.

*Hedged:* A term applied to one, more or an entire portfolio of assets indicating that the base country value of such assets is partially or wholly protected from foreign currency fluctuations. Forward currency contracts are typically used to hedge or offset the effects of these fluctuations.

*Index Fund:* A portfolio management strategy that seeks to match the composition and performance of a select index such as the Russell 3000 or S&P 500.

*Leverage Buyout (LBO):* A strategy in which debt financing is used to acquire a firm or business unit, typically in a mature industry. LBO debt is usually repaid according to a strict schedule that absorbs most of the acquired 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 plan beneficiaries.

*MSCI All Country World Investable Market Index (ACWI-IMI):* A capitalization-weighted index that includes approximately 9,000 publically-traded equity securities and is designed to measure equity market performance across developed and emerging markets. This index consists of over 40 separate developed and emerging market country indices.

*MSCI World Ex-U.S. Index:* A subset of the MSCI All Country World Index that contains only securities from developed market countries, excluding those from the U.S.

*Market Capitalization:* The value of a corporation as determined by multiplying the price of its shares by the number of shares outstanding. In general, the share prices of smaller capitalized companies are more volatile than those of larger capitalized companies.

*Mezzanine:* Either a private equity financing undertaken shortly before an initial public offering, or an investment strategy that employs subordinated debt (which has fewer privileges than bank debt but more standing than equity) and often is issued with attached equity warrants.

*NCREIF Fund Index – Open End Diversified Core Equity (NFI-ODCE):* The NFI-ODCE is an investment performance composite published quarterly by the National Council of Real Estate Investment Fiduciaries

(NCREIF). This index is a capitalization-weighted index of approximately 30 open-ended, commingled funds pursuing a "core" investment strategy. The specific qualifications for NFI-ODCE inclusion are as follows:

- At least 80% of fund market value must be in private equity operating real estate;
- At least 95% of fund market value must be in U.S. markets;
- At least 80% of fund market value must be invested in apartments, industrial properties, office buildings, and retail;
- No more than 65% of fund market value can be in one property type or one region as defined by the NPI;
- No more than 40% leverage; and
- Compliance with the NCREIF/PREA Reporting Standards.

*Oregon State Treasury:* Headed by the State Treasurer, the Oregon State Treasury 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 Oregon State Treasury, the Investment Division also manages investment programs for the state's deferred compensation and college savings plans, and serves as staff to the Oregon Investment Council.

*Opportunistic:* Higher risk but higher expected return real estate investments that are usually illiquid, produce little or no current income and are often focused on distressed and/or highly leveraged properties.

*Opportunity Portfolio:* Includes non-traditional and/or concentrated investment strategies that may provide enhanced diversification and/or unique sources of return relative to the other asset classes included in the OIC's approved policy mix. The Opportunity Portfolio's objectives are pursued by investing in strategies that fall outside the boundaries of "strategic" or approved policy mix allocations including new or innovative strategies across a wide range of potential investment opportunities and with few limitations or constraints.

*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 as an ex-officio member, and is therefore 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 Oregon Public Employees Retirement System is a non-voting ex-officio member of the OIC. ORS 293.721 and 293.726 establish the OIC's investment objectives and standards of judgment and care: "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 state-wide, 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-funds investing and secondaries are also included in this term's broadest interpretation. 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 *Alternatives*.

**Real Estate:** Investments in land, buildings or other real property.

**Real Estate Investment Trusts (REITs):** A real estate portfolio managed by an investment company for the benefit of the trust unit holders. The units of most REITs are publically traded.

**Regular Account:** That portion of the Oregon Public Employees Retirement Fund that excludes the Variable Account. A diversified investment portfolio for which the asset allocation and general investment policies are established and approved by the OIC. Tier One participants are guaranteed a minimum rate of return based on the long-term interest rate used by the actuary, currently 7.50 percent. Tier Two participants have no guaranteed rate of return and receive benefits that reflect the Regular Account's actual or realized investment return.

**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 produced a 5% return.

**Risk:** The probability of losing money or not achieving the expected investment outcome.

**Russell 3000 Index:** Measures the investment performance of a composite comprised of stocks issued by the approximately 3,000 largest U.S. companies. Based on total market capitalization, this index represents approximately 98% of the investable U.S. equity market.

**S&P/LSTA Leveraged Loan Index:** This index is designed to mirror the market-weighted performance of the largest institutional leveraged loan portfolios based on market weightings, spreads and interest payments. Facilities are eligible for inclusion in the index if they are senior secured institutional term loans with a minimum initial spread of 125 basis points and minimum one-year term. Facilities are retired from the index when there is no bid posted on the facility for at least 12 successive weeks or when the loan is repaid.

**Secondaries:** The purchase and sale of existing limited partnership commitments to other limited partners and/or fund sponsors.

**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 issued by 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 that focuses 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:** The amount by which an investor's investment performance differed from a corresponding or assigned benchmark. Usually measured and expressed as the standard deviation of returns relative to a pre-specified benchmark.

**Unhedged:** A term indicating that the value of one, more or an entire portfolio of assets may be affected by foreign currency fluctuations and that no deliberate attempt has been made to protect against such

fluctuations.

*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. Portfolios or strategies that are positioned as Value Added are expected to produce returns between Core and Opportunistic portfolios/strategies. For example, a Value Added property may exhibit some "institutional" qualities such as good location and high design and construction quality, but may need significant leasing improvements to stabilize and enhance its value. Value Added investments may also 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 (VAP) allowed active PERS members to allocate a portion of their yearly, employee retirement contributions to a domestic equity portfolio. No such contributions were allowed after December 31, 2003. Active members who participated in the VAP had part of their balance invested in the Regular Account and part invested in the Variable Account. Unless a member explicitly elected to participate in the VAP, all of that member's employee contributions were invested in 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 investment performance of the variable fund, and individual participant accounts are credited for any amount (gain or loss) available for distribution. The OIC's asset allocation policy purview only applies to the Regular Account since the OIC cannot control the investment option elections of VAP participants.

*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 calendar year in which an investment fund's first closing occurs. For example, the 1995 vintage year for venture capital includes all venture capital funds that held a first closing in 1995.

## Attachments:

No Attachments

### Approval Signatures

Step Description	Approver	Date
Oregon Investment Council	John Skjervem: Chief Investment Officer	04/2018
	Carmen Leiva: Operations Analyst	04/2018
	John Skjervem: Chief Investment Officer	04/2018