Defined Benefit Plans & Cash Balance Benefit Plans

An Overview of Strategies

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Nebraska Defined Benefit Plan & Cash Balance Benefit Plan

An Overview of Strategies

Nebraska's Defined Benefit and Cash Balance Benefit Plans employ a variety of strategies to meet the state's investment goals. This overview covers the six asset classes utilized within the Plans: U.S. Equity, Non-U.S. Equity, Global Equity, Fixed Income, Real Estate, and Private Equity. It also describes the investment managers engaged by the Nebraska Investment Council (the Council) to implement these asset class exposures.

U.S. EQUITY

The U.S. equity component provides exposure to all segments of the U.S. equity market, including growth and value stocks of large-, mid- and small-capitalization U.S. companies.

- **BlackRock:** The Council is invested in the BlackRock Russell 1000 Index fund, which provides a passive investment in the large cap segment of the U.S. stock market and holds issues in their appropriate weights based on the Index.

- **Dimensional Fund Advisors L.P.:** The Council is invested in the DFA U.S. Small Company strategy, which seeks to capture the returns and diversification benefits of the U.S. small cap asset class while maintaining low transaction costs. DFA invests in "smaller" small cap companies and attractively valued companies relative to the Russell 2000 Index.

NON-U.S. EQUITY

The non-U.S. equity component provides exposure to developed and emerging economies outside of the United States. The component benchmark, the MSCI All Country World ex-U.S. IMI, includes large-, mid-, and small-capitalization companies across 22 developed and 23 emerging market countries and covers approximately 99% of the international equity investment opportunity set.

- **BlackRock:** The Council is invested in the BlackRock All Country World ex-U.S. IMI, a passive fund that is designed to track the returns of the MSCI All Country World ex-U.S. IMI, an index that includes large-, mid-, and small-capitalization companies across 22 developed and 23 emerging market countries. The fund is weighted proportionately to the weights of those companies that constitute the Index.

GLOBAL EQUITY

The global equity component provides exposure to U.S., non-U.S. developed, and emerging market securities. The component benchmark, the MSCI All Country World IMI, includes large-, mid-, and small-capitalization companies across 23 developed and 23 emerging market countries and covers approximately 99% of the global equity investment opportunity set.

- **MFS Investment Management:** The Council is invested in the MFS Global Equity strategy. MFS focuses on fundamental bottom-up company analysis conducted by research analysts that are organized along global sector lines. Portfolio construction is driven by high conviction stock selection and pays little attention to indices, true to the unconstrained investment approach.

- **Arrowstreet Capital:** The Council is invested in the Arrowstreet Global Equity ACWI strategy. Arrowstreet utilizes a quantitative approach that employs an alpha forecasting model which balances “direct” (stock-specific) and “indirect” (peer group based) quantitative investment signals. Arrowstreet’s research process has led to early recognition of investment signals that differentiate its investment process from quantitative peers.

- **Dodge & Cox:** The Council is invested in the Dodge & Cox Global Equity strategy. Dodge & Cox employs a fundamental, bottom-up investment approach and seeks to invest in companies with long-term earnings and cash flow growth prospects that are selling at attractive prices. The strategy is managed by a team of experienced and talented investors that form the Global Stock Investment Committee (“GSIC”), which in turn is supported by well-resourced, high-quality industry research teams.

- **Wellington Management Company:** The Council is invested in the Wellington Global Perspectives strategy. The strategy’s investment process is opportunistic, focusing on sourcing the best ideas from various parts of Wellington’s business – i.e., taking into account Wellington’s macroeconomic perspective, input from Wellington’s quantitative model, and Wellington’s more traditional fundamental research. The portfolio focuses mainly on small- and mid-capitalization companies.

FIXED INCOME

Fixed income generally serves as a risk-reducing asset class. The purpose of the fixed income portfolio is to preserve and grow principal and offset some of the volatility of the equity portfolio. The Barclays Universal Bond Index is used to benchmark the fixed income component. The Index consists of the following sectors:

- **Treasuries:** Bonds supported by the full faith and credit of the United States government, and therefore essentially free of default risk. Treasuries have a fixed coupon rate and repay principal at final maturity.

- **Agencies:** Bonds issued by government agencies such as Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, Federal Home Loan Bank, and Farm Credit System.

- **Mortgage-Backed Securities (MBS):** Securities that are bundled mortgages, guaranteed by the Federal Home Loan Mortgage Corporation, the Federal

National Mortgage Association, or the Government National Mortgage Association, or privately issued. Investors receive a proportional share of all principal and interest payments.

- **Asset-Backed Securities (ABS):** Securities that consist of bundled credit card receivables, auto and home-equity loans, student loans, small business loans, or other securitized cash flows.

- **Corporates:** Investment grade, fixed-rate, and taxable bonds publicly issued by corporations within the industrial, utility, and financial sectors. Investment grade corporates carry a rating of BBB or higher.

- **High Yield:** Bonds with a credit rating below investment grade. High yield bonds carry a rating below BBB and typically offer a higher coupon than do investment grade bonds.

- **Global Debt:** Bonds issued by developed and emerging markets around the world. Global debt includes fixed-rate treasury, government-related, corporate and securitized bonds.

- **Emerging Market Debt:** Consists of liquid, fixed-rate, debt instruments issued by emerging market sovereign, quasi-sovereign or corporate entities, including Brady bonds, loans, and Eurobonds. Emerging Market Debt may be denominated in local currency or in U.S. dollars.

The Council fixed income portfolio also includes an allocation to **bank loans**. The primary purpose of the allocation to bank loans is to hedge the fixed income portfolio against a rise in interest rates.

- **Bank Loans:** Loans made to businesses with credit ratings that are below investment grade. Bank loans are secured by the assets of the company and rank at the top of the capital structure, which can be expected to provide a level of recovery in event of default. Coupons on bank loans are floating rather than fixed, and are typically based on 3-month LIBOR which resets each month or quarter to the prevailing level of interest rates.

Fixed Income Managers

- **BlackRock:** The Council is invested in the BlackRock Aggregate Bond Index fund, a fund designed to track the return of the Barclays Aggregate Bond Index. BlackRock uses a combination of cellular stratified sampling and a risk factor model to capture the overall risk and return characteristics of its relevant benchmark universe.

- **BlackRock:** The Council is invested in the BlackRock Core-Plus Universal strategy. BlackRock employs both fundamental and technical factors, including macroeconomic trends, supply and demand analysis, yield curve structure, and volatility and convexity analysis when making sector and security decisions.

- **<u>Pacific Investment Management Company (PIMCO):</u>** The Council is invested in PIMCO's Core-Plus Total Return strategy. PIMCO employs a top-down and bottom-up process that implements active management of duration, yield curve exposures, country/sector allocation, security selection, and tactical allocation to non-benchmark sectors. PIMCO uses fixed income derivative instruments both for hedging purposes and as synthetic investments.

- **<u>Neuberger Berman:</u>** The Council is invested in Neuberger Berman's Core Plus Bond strategy. The strategy employs a process that combines top-down and bottom-up sources of active management, and utilizes quantitative models to calibrate the manager's views. Neuberger Berman seeks to add value through a diversified set of active management techniques, including interest rate strategies, sector allocation strategies, and security selection.

- **<u>Loomis Sayles:</u>** The Council is invested in the Loomis Sayles Multi-Sector Full Discretion strategy. Loomis Sayles' investment process emphasizes security selection through bottom-up research while incorporating top-down themes through the process. With fundamental research at its core, this absolute return strategy opportunistically invests across the global fixed income universe.

- **<u>Wellington Management Co.:</u>** The Council is invested in the Wellington Global Aggregate strategy. The investment team focuses on risk control and macro and sector views to add value and to generate consistent excess returns. The strategy generates alpha through four sources: key macroeconomic themes, a quantitative model, credit, and emerging markets.

- **<u>Loomis Sayles:</u>** The Council is invested in the Loomis Sayles Bank Loans strategy. Loomis Sayles constructs its bank loan portfolio in a conservative and benchmark-aware framework. Portfolio construction is driven by a combination of bottom-up security selection and top-down macroeconomic analysis, with a focus on the higher quality segments of the market.

- **<u>Franklin Templeton:</u>** The Council is invested in the Franklin Templeton U.S. Floating Rate Bank Loans portfolio. The long-term focused, conservative bank loan strategy applies a bottom-up approach that is supplemented with top-down industry views. The portfolio is constructed to produce a high level of income while maintaining principal stability.

The Council fixed income portfolio includes two longer-term **"opportunistic"** strategies. These strategies are sized conservatively and seek to achieve higher returns than the balance of the fixed income component in exchange for less liquidity and increased credit risk.

- **<u>Pacific Investment Management Company (PIMCO):</u>** The Council is invested in the PIMCO BRAVO II fund, a closed-end opportunistic credit fund that aims to capture liquidity and complexity premiums in the U.S. and European residential mortgage and commercial real estate credit markets. The disciplined investment approach combine's PIMCO's firm-wide macro views with asset-level analysis geared toward limiting write-downs.

- **<u>Oaktree Capital Management:</u>** The Council is invested in the Oaktree Real Estate Debt Opportunities fund, a closed-end opportunistic fund with a value-orientation and a focus on downside protection. The fund seeks to build a modestly levered diversified portfolio of investments across six areas of focus: commercial, FDIC/bank portfolios, residential, corporate, structured finance, and non-U.S.

REAL ESTATE

Core Real Estate: is the most conservative investment strategy in real estate and focuses on owning high quality, stabilized properties in the most liquid and economically diverse markets. Core investment strategies are defined by their low use of leverage and a significant focus on current income yield. Core real estate is often referred to as the Beta of the asset class. The Council has three managers in this space.

- **<u>Barings Real Estate Advisors</u>** – The Council is invested in the Barings Core Property Fund. The Barings Fund is a U.S. open-end, diversified Core fund that is managed with an emphasis on research, targeting "barrier" markets, which are perceived to reduce the risk of oversupply and offer potential for outsized rent growth and appreciation.

- **<u>Prudential Real Estate Investors</u>** – The Council is invested in the Prudential Real Estate Insurance Separate Account (PRISA), one of oldest and largest U.S. Core open-end commingled real estate funds available in the marketplace. PRISA invests primarily in Core, well-leased, operating properties with a focus on income.

- **<u>UBS Realty Investors</u>** – The Council is invested in the UBS Trumbull Property Fund ("TPF"). TPF is an open-ended, diversified Core fund focusing on the four main property types with a small exposure to hotels and focusing on the top markets for high-quality Core institutional real estate assets.

Core Real Estate Debt: comprised of a more indirect method of real estate investing and is accomplished through the issuance or purchase of mortgages that are collateralized by real estate.

- **<u>UBS Realty Investors</u>** – The Council is invested in the Trumbull Property Income Fund ("TPI"). The Fund is an open-end, diversified core real estate debt fund that targets participating mortgages. The Fund's strategy is to build an actively managed portfolio of income-oriented real estate investments that have hybrid debt and equity return characteristics. It seeks to provide attractive returns while limiting downside risks through a combination of fixed income, participation in cash flow and equity upside.

Core Plus Real Estate: Almost an identical strategy to Core investment strategies, just with a higher degree of leverage and a higher policy limit to Value-Add property exposure.

- **Prudential Real Estate Investors** – The Council is invested in the Prudential Real Estate Insurance Separate Account II (PRISA II), a periodically open-ended, broadly diversified U.S.-focused commingled real estate equity fund pursing an enhanced-Core strategy. Established in 1980, this long-standing Fund offers a diversified real estate portfolio with solid income growth but with stronger appreciation potential compared to a core "beta" portfolio.

Value-Added Real Estate: is a style of real estate investing which focuses on a balance of increasing property level income and enhancing underlying asset appreciation to create value through the execution of leasing, repositioning, and redevelopment strategies. Value-Added strategies employ moderate leverage.

- **Almanac** – The Council is invested in Almanac Realty Securities Funds V, VII and VIII, which are closed-end commingled funds with a 7 to 10 year lifecycle. Almanac is a real estate manager that provides growth capital and organizational resources to private and public real estate operating companies ("REOC").

- **Beacon Capital Partners** – The Council is invested in Beacon Capital Partners Fund V, a closed-end commingled fund with a 7 to 10 year lifecycle. Beacon Capital Partners focus on the development, redevelopment, leasing, and recapitalization of office investments in primary, urban markets. Beacon targets investments primarily within the U.S. with some investments expected to be made in Western Europe.

- **Heitman** – The Council is invested in Heitman Value Partners Fund II, a value-added closed-end commingled fund with a 7 to 10 year lifecycle. The Fund invests in real estate primarily through joint ventures with proven public and private real estate operating companies within the United States. The Fund's strategy is to acquire assets in need of repositioning in major U.S. markets and to create value by executing asset-level business plans and selling the asset to core real estate buyers.

- **Rockwood Capital Real Estate Partners** – The Council is invested in Rockwood Capital Real Estate Partners Fund IX and in 2016 committed to Rockwood Capital Real Estate Partners Fund X, both of which are closed-end commingled fund with a 7 to 10 year lifecycle. The Funds target a combination of current income and value creation by employing active asset and portfolio management to reposition, re-lease, rehabilitate, and/or develop to optimize overall Fund performance. Rockwood Capital is a primarily U.S. focused manager investing in office and other workspace, retail, hotel, and residential assets located in coastal markets with high barriers to entry.

Opportunistic Real Estate: is the most tactical style of real estate investing and is usually focused on enhancing and creating significant value appreciation through development, capital stack restructuring, change of property use, distressed asset/ownership/market conditions, public-to-private transactions, emerging sectors, and secondaries. Opportunistic strategies employ a significant amount of leverage and have a limited focus on current income. This style of investing is most successful when there is an imbalance in the real estate or capital markets.

Note: Value-Added and Opportunistic strategies often share a significant overlap, thus these segments are commonly combined and called **"Non-Core" real estate investing.*

- **Angelo, Gordon & Co.** – The Council is invested in Angelo Gordon Realty Fund VIII, a closed-end commingled fund with a 7 to 10 year lifecycle. The Fund focuses on acquiring interests in sub-performing and distressed real estate assets and debt which often require significant capital restructuring and asset repositioning. Distressed debt situations where market peak investors are overleveraged and require material capital infusions are targeted.

- **CBRE Global Investors** – The Council is invested in the CB Richard Ellis Strategic Partners U.S. Opportunity Fund V, a closed-end commingled fund with a 7-to-10 year lifecycle. This Fund focuses on a variety of strategies including repositioning programs, early stage development, acquiring portfolios, and investing in operating companies with high quality real estate in major metropolitan markets.

- **Landmark Real Estate Partners** – The Council is invested in Landmark Real Estate Partners Fund VI, Landmark Real Estate Partners Fund VII and in 2017 committed to Landmark Real Estate Partners Fund VIII. These are all closed-end commingled funds with a 4 to 8 year lifecycle. Landmark's Opportunistic funds focus on targeting the acquisition of secondary interests in existing real estate partnerships.

- **Rockpoint Group** – The Council is invested in Rockpoint Real Estate Fund III, a closed-end commingled fund with a 7 to 10 year lifecycle. The Fund focuses on creating value among distressed assets including both equity and debt opportunities. The manager targets investments primarily within the U.S. and focuses on investing in major metropolitan areas that have both market depth and liquidity.

- **Torchlight Investors** – The Council is invested in the Torchlight Debt Opportunity Funds IV, V and VI, closed-end commingled funds with a 5 to 8 year lifecycle. The Funds focus on high yield real estate debt investments in both the private and public markets.

PRIVATE EQUITY

Private equity is broadly defined as investments in privately-negotiated securities that typically do not trade in a capital market. Investments are typically illiquid and long-term in nature, thereby introducing greater risk into a portfolio, but offer the potential for higher returns than traditional asset classes. The Council portfolio includes four categories of private equity investments: Buyouts, Venture Capital, Special Situations, and Fund-of-Funds.

Buyout partnerships provide funding to acquire majority or controlling interests in a business or product lines from either a public or private company. These partnerships are generally diversified by industry and other relevant measure. Buyout partnerships cover company sizes ranging from mega to small-market.

- **Accel-KKR Capital Partners (Funds III & IV)** – A buyout Firm targeting majority-ownership positions in cash flow positive, mid-market software and technology-enabled services companies. Focus is on sectors in which vertical market domain expertise creates a sustainable competitive advantage, competition is fragmented and end-market growth is strong.

- **Beecken Petty O'Keefe** – A buyout fund investing in middle market companies based in the United States and operating in the healthcare industry, primarily in the services and product sectors.

- **Bridgepoint (IV, V & VI) –** A pan-European buyout firm focusing on the mid-market. The Firm operates out of seven offices and has been investing in Europe since 1991.

- **CVC (Capital Partners VI & European Equity Partners V)** – A global private equity and investment advisory firm with a network of 21 offices across Europe, Asia and North America. Investment strategy focusses on large buyouts of market leading businesses in Europe, North America and Asia.

- **Francisco Partners** – A middle market technology buyout firm focused on complex transactions. Portfolio consists of value and growth-oriented transactions located primarily in the United States (approximately 20% outside of the United States).

- **Genstar Capital Partners** – A private equity fund focused on making growth buyout investments primarily in North American middle-market businesses that operate in the financial services, software, industrial technology, and healthcare spaces.

- **Green Equity Investors (VI & VII)** – A middle-market buyout firm investing in companies located in North America. Focuses on companies operating in: retail/consumer products, distribution, healthcare, aerospace/defense, and consumer/business services.

- **Lightyear Capital** – A middle market buyout firm focused on making investments in the financial service sector principally based in the United States.

- **Lincolnshire Equity** – A buyout fund investing in small and middle market companies operating predominantly in the manufacturing and service sectors.

The Fund targets companies in niche sectors with strong potential for operational improvements located in the US.

- **McCarthy Capital (Fulcrum & McCarthy Funds)** – A lower middle market buyout and growth equity firm investing in a broad range of industries across the United States.

- **New Mountain Capital Partners (III and IV)** – A middle to large market buyout firm focusing on control-oriented business building and growth opportunities with a focus on defensive growth industries in the U.S.

- **Pine Brook Capital** – A middle market private equity firm focused exclusively on making investments in the financial service and energy sectors (approximately 50% in each sector). Primarily focused on companies in the United States and Canada.

- **Resolute (II, III, & IV; the Jordan Company)** – A middle market generalist buyout firm targeting control private equity investments principally based in North America. Investment approach includes partnering with management and supporting investments with a hands-on operational strategy.

- **TRG Growth Partners** – A buyout fund targeting investments in companies with significant operations and businesses based in the developed markets where they outsource services or manufacturing to Asia, emerging Europe, or Latin America.

- **Wynnchurch Capital** – Focuses on control investments in complex, overlooked and underperforming lower middle-market companies in the U.S. and Canada where it believes it can implement focused operational value creation strategies to significantly improve company performance.

Venture Capital partnerships invest in newer high growth companies typically addressing technology, life sciences, and other specialty growth industries. Venture Capital partnerships can be divided into three categories (Seed, Early-Stage and Later-Stage) which invest in different stages of the lifecycle of a new idea, product or business.

- **CMEA Ventures (Presidio Partners)** – An early stage venture capital firm focused on technology, life sciences, and clean technology companies primarily located in the San Francisco Bay Area.

- **New Enterprise Associates (13 and 14)** – A broadly diversified venture capital fund focused on technology, life sciences, and clean technology companies. Invests approximately 75% in early stage and 25% in venture growth opportunities primarily in the US with opportunistic investments outside the U.S.

Special Situation partnerships are private corporate finance investment strategies that either a) do not fall under the Buyout or Venture Capital categories or b) do not justify a separate long-term strategic allocation. Such partnerships include: Distressed Debt/Turnaround, Subordinated Debt (Mezzanine), Energy, and Secondaries.

- **Ares Corporate Opportunities Fund (III, IV, V)** – A distressed debt, buyout, and growth equity fund that invests in middle-market companies with strong franchises and attractive growth opportunities in a broad range of industries.

- **Ares Mezzanine Partners** – Managed by the Private Debt Group of Ares Management LLC, the Firm makes mezzanine investments in middle-market companies focusing on investing capital in predominantly non-syndicated first and second lien loans and mezzanine debt, which may include an equity component.

- **Ares EIF US Power Fund** – Focuses on control-oriented investment opportunities in the US power sector including power generation and transmission assets, gas pipelines, storage facilities and related energy investments, by either acquiring existing operating facilities or by investing in the development and/or construction of new facilities.

- **HarbourVest (Dover Street; VIII & IX)** – A secondary manager investing in global purchases of venture capital, buyout, and other private equity assets. The Fund invests across all vintage years, industries and geographies.

- **The Energy and Mineral Group** – A natural resources manager focusing on midstream assets, minerals, and oil and gas companies that have unique resources needed by the economy that provide a deep value position making them less sensitive to commodity price volatility.

- **Longroad Asset Management** – Specializes in distressed situations where it can achieve effective control over the governance through debt securities, obligations and assets of lower middle-market companies located primarily in the United States and Canada.

- **Merit Mezzanine** – A mezzanine fund that provides financing to smaller middle-market companies ($5 million to $25 million in annual EBITDA) located primarily in the United States that are not owned by private equity sponsors. Investments typically take the form of subordinated debt with equity participation through warrants or equity.

- **Quantum Energy Partners (V, VI, & VII)** – Primarily focuses on upstream oil and gas in North America, with additional minor exposure to power generation, midstream energy and energy services. Portfolio to be relatively concentrated and focused on middle market growth-equity transactions in unconventional resources.

- **Sun Capital Partners** – Focuses primarily on investments in distressed, operationally challenged, and special situation middle-market companies in

North America and Europe that can benefit from its in-house operating professionals and experience.

- **Wayzata (II and III)** – A control-oriented investor in distressed small and middle market companies, including those in bankruptcy or undergoing financial restructuring or reorganization. The Firm may invest throughout the capital structure in situations that are undervalued, including debt and equity securities of public and private companies.

Fund-of-Funds partnerships are set up to distribute investments among a selection of direct private equity fund managers, who in turn invest the capital directly. Fund-of-funds may be able to provide investors with a route to investing in particular funds that would otherwise be closed to them or provide a broadly-diversified private equity portfolio through the investment of a small amount of capital.

- **Abbott Capital Private Equity** – A private equity Fund of Funds vehicle providing institutional investors access to diversified private equity investments in venture capital, buyout and special situation partnerships.

- **Pathway Private Equity** – A private equity fund of funds vehicle focusing on a bottom-up approach to the manager selection process to construct a global diversified high conviction portfolio.