

SIC GENERAL INVESTMENT POLICY**Introduction**

This policy statement outlines the investment policies for the Funds managed by the State Investment Council (SIC) and the State Investment Officer (SIO). The policies herein will include the structures, review procedures, and performance benchmarks for the total assets in each Fund, individual asset class portfolios, and both internal and external investment managers. All Council policies and guidelines will be maintained in the Policy Manual.

The SIC is a non-cabinet level agency reporting to the governor and charged with the responsibility of managing the Land Grant Permanent Fund (LGPF), the Severance Tax Permanent Fund (STPF), the Tobacco Settlement Permanent Fund (TSPF), the Water Trust Fund, and other long-term trust assets invested by the SIC for a number of state agency clients.

The LGPF and STPF operate under a formal spending policy, currently distributing 5.8% and 4.7%, respectively, of the average fund market values for the preceding five calendar years. The TSPF currently distributes 100% of the current year distributions. In fiscal year 2007, the distribution policy will revert back to FY03 policy, whereby, half of each year's tobacco settlement payments are distributed. The Water Trust Fund distributes \$4 million annually, until such time as 4.7% of the five year average market value exceeds \$4 million. At that time, the 4.7% distribution formula will be used. Operating expenses are approved by the legislature and paid out of the Funds. The SIC seeks to manage the Funds to insure that future generations receive the same benefits as current beneficiaries, while maximizing current distributions through time to provide current revenue sources to the state's General Fund.

Investment Objectives

The investment program shall be structured to preserve and enhance principal over the long term, while operating under the Prudent Investor Rule. Investments of the fund shall be diversified to minimize the risk of significant losses. Total return, which includes realized and unrealized gains, plus income, less expenses, is the primary goal of the Funds.

Asset Allocation (Market Rate Investments Only)

This section on asset allocation applies to the entire LGPF, the entire TSPF, and the Market Rate Investments in the STPF. The Differential Rate Programs (Economically Targeted Investments) in the Severance Tax Permanent Fund are treated separately in the statutes and require specific allocations and policies that consider the legislative intent for these Programs. SIC Guidelines, Policies and Goals for the Differential Rate Programs are contained in a separate document. The exceptions to the Asset Allocation tables below pertain to the Tobacco Settlement Permanent Fund and Water Trust Fund, where the corpus is currently so small that there are no Private Equity (PE) investments. The PE allocations will remain in the Core Bonds Fund until the corpus of the two funds become large enough to make PE investments economically viable.

Permitted Asset Classes**Traditional Assets**

US Large Cap Equity
 US Mid/Small Cap Equity
 US Fixed Income
 US High Yield Fixed Income
 International Equity
 Emerging Market Equity

Non-Traditional Assets

Private Equity
 Real Estate
 Hedge Funds

Target Asset Mix

Table 1
Strategic Asset Allocation
Land Grant Permanent Fund
 (Based on Fair Values)

<u>Asset Class</u>	<u>Target %</u>	<u>Range %</u>
Domestic Equities¹	51.0%	37.0% - 60.0%
US Large Cap Equities	41.0%	32.0% - 46.0%
US Mid/Small Cap Equities	10.0%	5.0% - 14.0%
Non-US Equities^{1,2}	10.0%	0.0% - 15.0%
Developed Market Securities	7.0%	0.0% - 10.0%
Emerging Market Securities	3.0%	0.0% - 6.0%
Domestic Fixed Income	15.0%	9.0% - 28.0%
US Core Bonds	10.0%	9.0% - 18.0%
US High Yield Bonds	0.0%	0.0% - 6.0%
Credit & Structured Finance	5.0%	0.0% - 10.0%
Real Estate	3.0%	0.0% - 6.0%
Hedge Funds	15.0%	5.0% - 20.0%
Private Equity		
-National Program	6.0%	3.0% - 9.0%
Cash	0.0%	0.0% - 10.0%
Total	100.0%	

¹ The sum of these asset classes may not exceed 65% of the fair value of each Fund.

² The sum of all international investments (stocks & bonds) may not exceed 15% of the fair value of each Fund

Table 2
Strategic Asset Allocation
Severance Tax Permanent Fund
 (Based on Fair Values)

<u>Asset Class</u>	<u>Target %</u>	<u>Range %</u>
Domestic Equities¹	48.0%	37.0% - 60.0%
US Large Cap Equities	39.0%	32.0% - 46.0%
US Mid/Small Cap Equities	9.0%	5.0% - 14.0%
Non-US Equities^{1,2}	10.0%	0.0% - 15.0%
Developed Market Securities	7.0%	0.0% - 10.0%
Emerging Market Securities	3.0%	0.0% - 6.0%
Domestic Fixed Income	12.0%	3.0% - 21.0%
US Core Bonds	6.0%	3.0% - 9.0%
US High Yield Bonds	0.0%	0.0% - 6.0%
Econ. Targeted Investments	1.0%	0.0% - 2.0%
Credit & Structured Finance	5.0%	0.0% - 10.0%
Real Estate	3.0%	0.0% - 6.0%
Hedge Funds	15.0%	5.0% - 20.0%
Private Equity		
-National Program	6.0%	3.0% - 9.0%
-Regional Program	6.0%	3.0% - 9.0%
Cash	0.0%	0.0% - 10.0%
Total	100.0%	

¹ The sum of these asset classes may not exceed 65% of the fair value of each Fund.

² The sum of all international investments (stocks & bonds) may not exceed 15% of the fair value of each Fund.

The asset allocation weightings will be reviewed at least annually by the SIC staff and the Investment Advisor, and approved by the Council. A new asset allocation study will be completed at least every two years.

Implementation

The SIC recognizes that special expertise is required to properly invest portions of the assets described above. In highly efficient asset classes, lower cost and passive strategies may offer lower overall costs. Where appropriate, the SIC will manage these assets internally, as long as the same level of care, prudence and oversight is maintained that an outside professional investment advisor would normally provide.

Active/Passive Mix

SIC shall make use of passive strategies where passive management, after all fees and expenses, can effectively compete with actively managed portfolios in terms of returns and risk (variability of returns). The SIC staff will advise the Council on the appropriate passive allocation.

Style Allocation

The SIC will seek to maintain a neutral bias with respect to Style Allocation (growth versus value) in its developed markets equity investments. The SIC recognizes that over the long run, returns from growth and value investing tend to approximate each other; over shorter periods, however, differences in returns can be significant. The SIO, as part of the normal rebalancing responsibilities, shall use appropriate judgment and care when rebalancing style-based portfolios.

Strategic Asset Class Rebalancing

In addition to the Asset Class Weights shown above, each investment portfolio will have its separate benchmark and target weight. Market price changes will eventually move asset classes and managers away from their target weights. This process will require rebalancing the portfolios periodically to stay reasonably close to the approved targets. Because rebalancing incurs transactions costs and may be expensive, the goal is to rebalance only when necessary. Guidelines for rebalancing are as follows:

- **Rebalancing Required by State Statutes:**
 - Domestic equities plus Non-US equities, measured at their fair values, shall not be greater than 65% of the total LGPF, STPF, or TSPF measured separately;
 - Non-US investments, measured at their fair values, shall not be greater than 15% of the total LGPF, STPF, or TSPF measured separately;
 - Whenever either Fund closely approaches the policy fair value limitations listed above, that Fund will be rebalanced back towards the target weights. The rebalanced weights will allow for a margin of safety under the statutory limitations.

- **The Rebalancing Process:**
 - The staff will employ the normal cash flows into and out of the various portfolios (increased or decreased allocations, monthly distributions to the beneficiaries, etc.) to assist in the rebalancing effort.
 - The Advisor will report quarterly on the asset class allocation of the Funds. The SIO will review the actual allocation at least quarterly to determine if the asset allocation is consistent with the ranges established above. The SIO will direct staff and investment managers to transfer funds to rebalance the asset allocation as necessary, with subsequent Council notification. The SIO will consider market conditions and transaction costs, as well as any other relevant factors when rebalancing. The Advisor will report on the effect of rebalancing activities.

Total Fund Performance Benchmark

The total Fund investment portfolios will be benchmarked against a custom index made up of the following indices. The custom index was established using the target percentages in Table 1 above:

Asset Class	Custom Index	
	Weight	Benchmark
Domestic Equities (Large Cap)	42%	S&P 500 Index
Domestic Equities (Small/Mid Cap)	11%	S&P 400 Index
International Equities (Developed Markets)	7%	FTSE Index
International Equities (Emerging Markets)	3%	MSCI Emerging Markets Free Index
Real Estate	3%	NCREIF Index
Private Equity	6%	Actual Portfolio Weighting and Performance*
Hedge Funds	10%	90-Day T-Bill +200 basis points
Domestic Fixed Income (Investment Grade)	15%	Lehman Aggregate Index
Domestic Fixed Income (High Yield)	3%	Merrill Lynch BB/B Constrained Index
Cash	0%	90-Day T-Bill

* The Private Equity portfolio in the LGPF is a very immature portfolio, and the portfolio in the STPF is a bar-belled portfolio with a small mature component and a much larger immature component. In both cases, there are currently no appropriate indexes to use for comparison. The Private Equity portfolios will be monitored and an available index will be selected when a valid comparison can be made.

General Operating Guidelines

The Council staff will observe the following general operating guidelines:

- The Investment Office staff shall follow the Prudent Investor Rule as defined in the New Mexico Statutes in conducting all investment-related activities;
- Performance for the portfolios will be calculated monthly and quarterly by the SIC's primary consultant. The consultant will present the returns to the Council compared with the respective benchmarks. Additionally, the consultant will report on the asset weightings relative to the long-term targets along with any other pertinent analytical data that will inform the Council on the condition of the investment portfolios. Performance will also be calculated for each external money manager;
- External managers may be used at the discretion of the Council;

- As provided by law, the State Investment Officer may invest other state agency or local government funds pursuant to a Joint Powers Agreement in any type of investment permitted for the LGPF under the same standard of care applicable to investments of the LGPF. It shall be the responsibility of the client agencies to establish asset allocations and direct the movement of all funds;
- The staff is authorized to instruct external managers to direct a portion of their brokerage costs to commission re-capture managers provided that in doing so, we will obtain the best execution of our brokerage orders. Best execution means seeking to achieve the most favorable price and execution available, having in mind the Funds' best interest, and considering all factors.
- The staff is authorized to engage in securities lending in accordance securities lending policies and procedures which are contained in a subsequent section of this Policy Manual; and
- Proxies shall be voted in the best economic interests of the SIC. Proxy voting policies and procedures are contained in a subsequent section of this Policy Manual.

Domestic Equity Program

The Domestic Equity Program will be managed relative to the Russell 3000 Index, which is a broad index representing most of the U.S. equity market. The Domestic Equity Program will have two components: large capitalization portfolios and mid/small capitalization portfolios.

- **Large Capitalization Portfolios**
The large capitalization portfolios will comprise approximately 80% of the Domestic Equity Program. There will be two internally managed portfolios: an S&P 500 Index portfolio and an actively managed portfolio. The benchmark for both large capitalization portfolios will be the S&P 500 Index.
- **Large Cap Active Portfolio**
The Large Cap Active Portfolio will be managed internally using fundamental research techniques. In addition, external managers will be retained to manage a portion of the assets.

The internally managed portfolio will seek to exceed the performance of the S&P 500 Index by emphasizing stock selection and economic sector overweights/underweights. Both internal and external managers have the discretion to invest in mid/small cap equities for a portion of their portfolios. Nevertheless, the majority of assets in these portfolios will typically be invested in large cap equities. The following guidelines will apply:

- The universe of eligible stocks includes stocks listed and actively traded in the US;
- International stocks which derive a significant portion of revenues or profits from US markets and are listed and actively traded in the U.S. are eligible investments;

- Portfolio managers may also participate in the initial public offering (IPO) of spin-offs from equities held in the Domestic Large Cap Active portfolio. This includes tracking stocks related to a business unit, as well as those distributed as separate companies. Any shares received in this manner will be sold at the portfolio managers' discretion, or at the time that it becomes clear that the stock will not be actively traded in the US.

- Portfolio managers will not invest more than 6% of their portfolio's assets at market in any one stock.

The external managers will be selected in accordance with the SIC's procurement policy and procedures. The number and types of managers will be recommended by the SIC staff. The managers will adhere to the broad guidelines set forth in this document and any specific policies developed for the managers.

S&P 500 Index Portfolio

The S&P 500 Index portfolio will be managed using risk models and optimization software. It will be benchmarked against the S&P 500 Index, and is expected to achieve annualized returns within 25 basis points of the return of the S&P 500 Index.

Mid/Small Capitalization Program

The Mid/Small Cap Portfolio will consist of two components: an internally managed index and an externally managed active component.

S&P 400 Index Portfolio

The S&P 400 Index portfolio will be managed using risk models and optimization software. It will be benchmarked against the S&P 400 Index, and is expected to achieve annualized returns within 25 basis points of the return of the S&P 400 Index.

Mid/Small Active Portfolios

External managers will be retained to manage the Domestic Equity Program's assets in mid/small capitalization stock portfolios. The managers will be selected in accordance with the State of New Mexico's procurement procedures. The number and types of managers will be recommended by the SIC staff and the Investment Advisor. The managers will be selected to achieve a neutral balance between growth and value styles. The managers will adhere to the broad guidelines set forth in this document and any specific policies developed for the managers. The benchmark for the aggregate mid/small capitalization portfolios will be the S&P 400 Index.

Domestic Fixed-Income Program

The Domestic Fixed-Income Program will have two components: an investment-grade portfolio (the Core Bonds Fund) and a high-yield portfolio (the High-Yield Bond Fund).

- **The Core Bonds Fund**

The Core Bonds Fund will be managed internally. The Core Bonds Fund will seek to exceed the performance of the Lehman Brothers Aggregate Index through active management. Economic, market and credit research will be used in structuring the sector weightings. Bond exchanges (swaps) may be used to implement strategy changes or take advantage of market discrepancies. Authorized investment types are all bonds, notes, debentures, instruments, conditional sales agreements, securities or other evidences of indebtedness of any corporation, partnership or trust. This includes, but is not limited to: government, corporate, asset-backed, mortgage-backed, collateralized debt obligations, and collateralized loan obligation securities. All securities must be denominated in US dollars and rated investment grade at the time of purchase by one or more national rating agencies. Such ratings may apply to the return of principal only. Securities that fall below investment grade after purchase may be held at the discretion of the staff.

- **High-Yield Bond Fund**

External managers will be retained to manage the High-Yield Bond Fund. The High-Yield Fund will seek to exceed the performance of the Merrill Lynch BB/B constrained Index through active management. The number and types of managers will be determined by the SIC staff. From time to time, the High-Yield managers may be called upon to advise the SIC staff on conditions in the non-investment grade debt markets and upon the disposition of defaulted securities held by the SIC in the Core Bonds Fund. Authorized investment types are all bonds, notes, debentures, instruments, conditional sales agreements, securities or other evidences of indebtedness of any corporation, partnership or trust. This includes, but is not limited to, government, corporate, asset backed, mortgage backed, securitized bank loans, collateralized debt obligations, collateralized loan obligation securities. All securities must be denominated in US dollars and rated at least CCC- or equivalent by at the time of purchase by one or more of the national rating agencies.

- **Credit and Structured Finance Fund**

The Credit and Structured Finance Fund will invest in various classes of securities of credit, structured finance, including but not limited to, collateralized debt obligations, collateralized loan obligations, credit opportunity funds, leveraged loan portfolios and other structured finance instruments. Eligible investments will include both rated and non-rated securities. Rated securities will include those rated investment grade and those rated below investment grade. One or more external managers may be retained to manage all or a portion of the Fund. Appropriate investment vehicles will include partnership interests, separate accounts and pooled vehicles. Pooled vehicles may be structured as publicly traded securities or private placements.

Non-U.S. Equity Program

External managers will be retained to manage the Non-U.S. Equity Program's assets. The number and types of managers will be recommended by the SIC staff. The SIC will employ both developed markets (7% of the total portfolio) and emerging markets managers (3% of the total portfolio). For the developed markets, managers will be selected to achieve an overall balance in investment style. The Council will approve the number and types of managers, and all individual managers recommended by the staff.

The Non-U.S. equity managers will adhere to the broad guidelines set forth in this document and any specific policies developed for the managers

Private Equity/Alternative Investments Program

The Private Equity (PE) Market Value Portfolios will have a maximum investment of 6% of the fair value of the LGPF and STPF. The New Mexico Private Equity Portfolio (a Differential Rate program) is also authorized to invest up to 6% of the fair value of the STPF. One or more advisors will be used in the management of the Portfolio. Specific policies and procedures for selecting individual PE fund investments are contained in Section 8 in this Policy Manual.

Derivatives

The State Investment Council seeks to protect the market value of the funds from losses attributable to declines in the market. The State Investment Office intends to use derivatives to improve long-term performance through protection of principal during market declines. Derivatives provide means to improve investment risk/return in declining market environments. Derivatives may be managed internally or by one or more external managers retained by the State Investment Officer.

- **Derivative Applications**

The State Investment Officer, on behalf of all assets under management, may buy, sell, exchange, convert or otherwise trade in exchanged traded index option contracts, over-the-counter options, domestic equity index futures, international equity index futures, international fixed income futures, commodity futures and domestic fixed income futures in order to protect the market value of designated security holdings or to: increase returns through cash securitization and synthetic rebalancing; improve tracking relative to target allocations through maintaining positions during transitions/reallocations and synthetic rebalancing; and improve portfolio efficiency/flexibility through tactical moves in market exposures. The positions will remain in place over a period consistent with detailed guidelines or until it is determined that an option/futures hedge/overlay is no longer needed. Derivatives shall only be utilized to reduce the risk of adverse price movements in a particular asset class or group of assets. Derivatives shall not be used to speculate.

Authorized Investments

The eligible investments by the State Investment Council and the State Investment Officer are as follows:

Cash Investment Guidelines

Cash positions will be kept to the minimum necessary for liquidity, distributions and ongoing investment activities. The following guidelines apply:

Eligible securities include:

- Repos secured by U. S. obligations or other securities backed by the U.S., A1 or P1 commercial paper, corporate obligations rated AA or better and maturing in five years or less, or asset-backed securities rated AAA. All repo collateral must have a market value of at least 102% of the market value of the contract;
- Commercial paper issued by corporations organized and operating within the U.S. and rated "prime" quality by a national rating service;
- Prime bankers' acceptances issued by money center banks;
- Funding agreements rated at least AA by a nationally recognized rating agency. As used in this paragraph, "funding agreement" means a floating or variable rate insurance company contract that is a general obligation of an insurance company organized and operating within the United States and that is senior to all other debt issued by the company; and
- Time deposits, with banks incorporated in the United States or time deposits that are fully guaranteed by banks incorporated in the United States.
- Staff will focus on quality when investing cash positions. Cash equivalents is an asset class that should emphasize minimal risk;
- Stripped securities, or other securities that have abnormally low initial coupons, balloon payments, or other characteristics that make them difficult to price are not acceptable as collateral for Repos; and
- Whenever available, short-term investments will be executed on a competitive basis to obtain the best possible pricing and execution.

Equity Investment Guidelines

The internally managed equity portfolios will be managed to maximize total returns within the asset allocations and risk parameters established by the Council, and under the following guidelines:

- Eligible securities include common stock, preferred stock, and convertible issues of

any corporation and securities listed on one or more national stock exchanges or included in a nationally recognized list of stocks;

- Eligible securities include stocks or shares of a diversified investment company registered under the Federal Investment Company Act of 1940, as amended or collective trust funds of banks or trust companies that invest primarily in equity securities eligible for the SIC;
- No more than 65% of the fair value of the LGPF, STPF and TSPF may be invested in stocks at any given time; and
- No more than 5% of the stock of any corporation may be purchased.

Fixed Income Investment Guidelines

The internally managed fixed income portfolios will be managed to maximize total returns within the asset allocations and risk parameters established by the Council, and under the following guidelines:

- Preservation of capital in the Core Bonds Fund will be emphasized through the maintenance of well-diversified portfolios of fixed income investments with investment grade quality. Securities that fall below investment grade after purchase may be held at the discretion of the staff;
- Eligible securities are all bonds, notes, debentures, instruments, conditional sales agreements, securities or other evidences of indebtedness of any corporation, partnership or trust. This includes, but is not limited to government, corporate, asset backed, mortgage backed, collateralized debt obligations, collateralized loan obligations, credit opportunity funds, leveraged loan portfolios and other structured finance instruments. All securities must be denominated in US dollars and rated investment grade at the time of purchase by one or more national rating agencies to be eligible for purchase by the Core Bonds Fund. Such ratings may apply to the return of principal only. When practical, fixed income trades will be done on a competitive basis to obtain the best possible pricing and execution.
- Eligible securities for the externally managed High-Yield Bond Fund include the types listed above, but the rating requirements are CCC- or equivalent at the time of purchase.

International Investment Guidelines

The international portfolios will be managed to maximize total returns within the asset allocations and risk parameters established by the Council, and under the following guidelines:

General

No more than 10% of the fair value of the portfolio may be invested in international securities (including both stocks and bonds) at any given time.

Equity

- International equity may be purchased as ADRs or GDRs, as ordinary shares, or as shares in an international equity fund;
- The number of stocks in the portfolios may vary from time to time, but in no event will a single stock represent more than 5% of the portfolios' total current market value unless the stock is in an indexed portfolio; and
- Investments in international securities may be hedged against foreign currency risk using forward currency contracts if approved by the State Investment Officer.

Fixed Income

- International investments may be made directly in Sovereign and Yankee bonds that have an investment grade rating from a national rating service at the time of purchase; and
- International investments may also be made as shares in an international fixed income fund.

Derivatives Investment Guidelines

If utilized, derivatives will be managed to protect market value and to maximize total returns under the following guidelines:

- Eligible applications include, but are not limited to, the purchase, sale, exchange, conversion or other trade of exchanged traded index option contracts, over-the-counter options, domestic equity index futures, international equity index futures, international fixed income futures, commodity futures, domestic fixed income futures and swaps.
- The total relative economic impact risk of each derivative application will be monitored on a daily basis by the most appropriate risk management tools for the particular derivatives application.
- In order to limit the financial risks associated with derivative applications, rigorous counterparty selection criteria and netting agreements shall be required to minimize counterparty risk. If utilized, the counterparty must be of an investment grade credit and the agreement must be marked to market no less frequently than monthly.

Guidelines for External Managers

The Council staff will observe the following general operating guidelines:

- External money management firms may be retained to manage portfolio assets. The firms will be selected to fill specific roles for the Funds. Unless hired for a passive mandate, superior risk-adjusted performance is expected from the managers versus assigned benchmarks and relevant peer group comparisons.
- The process outlined in the SIC Procurement Policy will be used for selection of external managers. Staff will be responsible for conducting the searches and announcing results to the Council. Staff will notify the Council prior to commencing a search. For each manager search, the Council may appoint up to three Council members to monitor the selection process if desired. In addition to direct investment

in individual securities, eligible investments include commingled trusts, mutual funds, and other pooled asset portfolios provided they conform to state statutes. All purchases and sales of securities will be focused on the combination of best price and execution.

- Individual managers will be provided with written individual investment guidelines providing additional detail, clarification of permissible securities and investment strategies, and performance evaluation criteria.

Investment Manager Monitoring

The SIC's portfolios shall be measured over various and appropriate time periods. A minimum time horizon of three to five years shall be used in measuring the long-term success of the Fund. Longer periods will be used as available.

Shorter time periods shall be evaluated as appropriate and necessary. The SIC shall make every effort to look at all factors influencing manager performance, and attempt to discern market cyclicalities from manager over/underperformance.

On a timely basis and at least quarterly, the Council will review actual investment results achieved by each manager (with a perspective toward a three to five-year time horizon or a peak-to-peak or trough-to-trough market cycle) to determine whether the investment managers performed satisfactorily when compared with the established objectives and in relation to other similarly managed funds.

The Council will re-evaluate, from time to time, its progress in achieving the total fund, equity, fixed income, and international equity segment objectives previously outlined.

The periodic re-evaluation will also involve an assessment of the continued appropriateness of: (1) the manager structure; (2) the allocation of assets among the managers; and (3) the investment objectives for the SIC's assets.

The SIO and Council will utilize the General Investment Consultant to assist in the ongoing evaluation process. The Consultant is expected to be familiar with the investment practices of similar retirement and endowment plans and will be responsible for suggesting appropriate changes in the SIC's overall investment program over time.

Differential Rate Investment Guidelines, Policies and Goals

The Differential Rate Programs in the Severance Tax Permanent Fund have two objectives in the statutes: first, to obtain a risk-adjusted rate of return under the Prudent Investor Rule, and second, to enhance the economy of New Mexico. To achieve these two objectives, the following specific goals will apply to the differential rate (DR) portfolio. The staff will ensure that:

- credit quality is maintained and risk is minimized;
- market-based yields that are proportional to the assumed risks are obtained;
- each investment will stimulate the economy of New Mexico on a continuing basis;
- each investment will expand business activity in the state; and
- each investment will promote the creation and preservation of jobs.

Summary of Economically Targeted Investments

All Economically Targeted Investments exist only in the Severance Tax Permanent Fund. The nature, types, amounts and restrictions of these investments are controlled by statute. The following table summarizes these investments by statute citation. Additional information follows.

Item No.	Statute	Description	Values @ 5/31/10		Restrictions on Investment (US\$/Percent)
			Cost	Market Value	
1.	7-27-5.3	Mortgage Pass-Through Securities Secured by New Mexico Real Estate	\$111,665	\$111,665	\$100 MM Face per Year
2.	7-27-5.4	New Mexico Business Investments	\$2,610,898	\$2,610,898	20% of STPF
3.	7-27-5.5	Educational Loan Notes	None	None	\$10 MM/Yr 10% of STPF
4.	7-27-5.13	Educational Institution Research & Development Facilities Revenue Bonds	None	None	10% of STPF
5.	7-27-5.15	New Mexico Private Equity Funds and Business Investments	\$272,839,996	\$161,006,826	9% of STPF
		Small Business Investment Corporation	\$47,042,781	\$45,037,206	1% of STPF Required by Statute
6.	7-27-5.17	Employers Mutual Company Revenue Bonds	None	None	\$10 MM
7.	7-27-5.22	Investments in Obligations Issued under Section 33-1-19 for Corrections Facilities	None	None	None Stated
8.	7-27-5.24	Investments in Obligations Issued for State Capitol Buildings and Renovations	\$4,115,000	\$4,086,483	\$10.155 MM
9.	7-27-5.26	Investment in Films to be Produced in New Mexico	\$97,036,854	\$97,036,854	6% of STPF
	Totals		\$423,757,194	\$309,889,932	

Economically Targeted Investments Statutes

Economically Targeted Investments exist only in the Severance Tax Permanent Fund and are those deemed to be "differential rate" investments as listed in 7-27-5. Following is list of these investments by statute citation:

1. **7-27-5.3** Conventional Mortgage Pass-Through Securities Secured by New Mexico Real Estate
 - a. Limited to \$100 million face amount each fiscal year
 - b. Yield based on comparable GNMA securities
 - c. Eligible securities are limited to those created and issued by a mortgage pooling corporation which has purchased eligible mortgages from mortgage lenders authorized to originate mortgages in New Mexico and which maintains a permanent manned office within New Mexico, although the Council may also purchase such conventional mortgage pass-through securities directly from such qualified mortgage lenders.
 - d. Conventional mortgage pass-through securities eligible for purchase are limited to such securities issued by the Federal National Mortgage Association or issued by a governmental agency representing an undivided ownership interest in a pool of mortgage loans.
 - e. Both the mortgage pooling corporation and the qualified mortgage lender are subject to regulations promulgated by the Council shall enter into written agreements specifying the powers and duties of each.
 - f. Eligible securities shall be based on mortgage loans that are:
 - i. Originated by a qualified mortgage lender
 - ii. Secured by a single-family dwelling to be occupied by the owner
 - iii. A conventional mortgage, deed of trust or other security instrument creating a first lien against the fee simple in real estate situated in New Mexico upon which there is constructed a permanent structure
 - iv. Not to exceed a thirty year original term
 - v. Made by a person domiciled in New Mexico
 - vi. Without prepayment penalties
 - vii. Not to exceed the dollar limit for Federal National Mortgage Association approved mortgages
 - g. Eligible securities are based on mortgage loans on new construction for at least sixty percent of the dollar amount of the securities.
2. **7-27-5.4** New Mexico Business Investments
 - a. No more than 20% of the book value of the Severance Tax Fund may be invested in the following investment.
 - b. No more than 10% of book value of the severance tax permanent fund can be invested in notes or obligations securing loans to New Mexico business made by Farm Credit Entities, Banks and Savings & Loans and mortgages approved by HUD under the SBA Act of 1953 or the Farmer's Home Administration Act of 1946
 - c. The investment is limited to the extent that both principal and interest are guaranteed by the United States government.
 - d. The effective yield of these loans shall not be less than the yield available on the planned amortized class tranche of collateralized mortgage obligations guaranteed by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation with an average life comparable to the maturity of the loan.
 - e. Servicing fees are not to exceed 150 basis points and the rate paid by the borrower on the loan together with the servicing fees are not to exceed the maximum rate permitted by the applicable federal guarantee program
 - f. In addition, no more than another 10% of the book value of the severance tax fund may be invested in bonds, notes or debentures or other indebtedness, excluding commercial paper, rated not less than Baa or BBB or the equivalent by a national rating service, of any

corporation organized and operating within the United States, excluding regulated public utilities, that will use the proceeds to establish or expand business outlets or ventures in New Mexico

- g. The investment shall not exceed 100% of the cost of the expansion venture or new outlet or \$20 million, whichever is less
- h. The rate of interest to be paid shall not be less than the equivalent yield available on US treasury issues of a comparable maturity plus 100 basis points
- i. The investment shall be approved prior to purchase by the Council and guidelines for initiation of the purchase and the terms shall be established by the Council.

3. 7-27-5.5 Educational Loan Notes

- a. The Severance Tax Permanent Fund may be invested in educational loan notes issued pursuant to the Educational Assistance Act [21-21A-1 to 21-21A-23 NMSA 1978]
- b. The principal amount of the notes purchased in any 12 month period shall not exceed \$10 million.
- c. The total of such notes shall not exceed 10% of the book value of the Severance Tax Fund
- d. Any such notes sold are done so without recourse to the Fund or the state.

4. 7-27-5.13 Educational Institution Research and Development Facilities Revenue Bonds

- a. No more than 10% of the book value of the Severance Tax Fund can be invested in educational institution revenue bonds
- b. These revenue bonds shall have been issued by one of the following educational institutions:
 - i. University of New Mexico
 - ii. New Mexico State University
 - iii. New Mexico Highlands University
 - iv. Western New Mexico University
 - v. Eastern New Mexico University
 - vi. New Mexico Institute of Mining and Technology
- c. These bonds must be issued under the authority of Chapter 6, Article 17 NMSA 1978
- d. The bonds must provide funds for the construction, furnishing and equipping of a research or development facility, including any infrastructure improvements necessary to the construction.
- e. The facility must be one that will:
 - i. Provide space for operations of an already funded research or development project
 - ii. Be income-producing when completed and occupied
 - iii. Provide both the local community in which it's located and the state generally with economic benefits including, but not limited to, employment for students of post-secondary educations institutions.

5. 7-27-5.15 New Mexico Private Equity Funds and Business Investments

- a. No more than 9% of the market value of the Severance Tax Fund may be invested in New Mexico private equity funds or New Mexico businesses.
- b. These investments or enterprises must enhance the economic development objectives of the state
- c. The State Investment Officer shall makes such investments only upon approval of the Council, upon review of the recommendation of the Private Equity Investment Advisory Committee (PEIAC) and within guidelines and policies established by the Council
- d. A "New Mexico business" is a corporation or limited liability company with its principal office and majority of its full-time employees located in New Mexico. If a limited partnership, its principal office and 80% of its assets must be located in New Mexico.
- e. A "New Mexico private equity fund" means a limited partnership, limited liability company or corporation organized and operating in the US and maintaining an office in New Mexico staffed by a full-time investment officer in New Mexico that:

- i. Has as its primary business activity the investment of funds in return for equity or debt of businesses for the purpose of providing capital for start-up, expansion, product or market development, recapitalization or similar business purposes
 - ii. Holds out the prospect for capital appreciation from such investments
 - iii. Has at least one full-time manager with at least three years of professional experience in assessing the growth prospects of businesses or evaluating business plans and who has established residency in the state
 - iv. Is committed to investing or helps secure investing by others, in an amount at least equal to the total investment made by the state investment officer in that fund, in businesses with a principal place of business in the state and that hold promise for attracting additional capital from individual or institutional investors nationwide for businesses in the state
 - v. Accepts investments only from accredited investors as defined in the federal Securities Act of 1933.
- f. The State Investment Officer is also authorized to make investments in New Mexico businesses to create new job opportunities and to support new, emerging or expanding businesses in a manner consistent with the New Mexico constitution if:
 - i. The investments are made in conjunction with cooperative investment agreements with parties that have demonstrated abilities and relationships in making such investments in new, emerging or expanding businesses; or
 - ii. In New Mexico aerospace businesses that have received an award from the US government or one of its agencies in an amount not less than \$100 million and that is equal to at least ten times the investment from the Severance Tax Fund and is for the purpose of stimulating commercial enterprises
 - iii. An investment in any one business does not exceed 10 percent of the amount available for investment pursuant to this section
 - iv. The investments represent no more than 51% of the total investment capital in a business
 - 1. Provided, however, that nothing prohibits the ownership of more than 51% of the total investment capital in a New Mexico business if the additional ownership interest:
 - a. Is due to foreclosure or other action by the State Investment Officer pursuant to agreements with the business or other investors in that business
 - b. Is necessary to protect the investment; and
 - c. Does not require an additional investment of the Severance Tax Fund.
- g. Also, the State investment Officer is required to make a commitment to the Small Business Investment Corporation (SBIC) pursuant to 58-29-1 NMSA 1978 of 1% of the market value of the Severance Tax Fund to create new job opportunities by providing capital for land, buildings or infrastructure for facilities to support new or expanding businesses in a manner consistent with the New Mexico constitution
 - i. This commitment must be evaluated every July 1 and if the cumulative invested capital in the SBIC is less than 1% of the market value of the Severance Tax Fund, further commitments shall be made to bring the total invested capital to 1% of the market value of the Fund
 - ii. If the cumulative invested capital in the SBIC is greater than 1%, no additional investment by the State Investment Officer is required
 - iii. Annually, the SBIC must return to the Severance Tax Fund an amount equal to the net excess of funds held by the SBIC
 - 1. "Net excess of funds" means the return on investments to the SBIC in the amount of dividends and interest actually received plus any capital gains actually realized, less the operating expenses of the SBIC and less amounts reasonably reserved for losses.
 - 2. The SBIC has only returned net excess funds once in December 2004 in an amount of \$126,294.38.

6. **7-27-5.17** Employers Mutual Company Revenue Bonds
 - a. The Severance Tax Fund may invest in revenue bonds issued by the Employers Mutual Company under the authority of 52-9-1 NMSA 1978
 - b. The amount invested shall not exceed \$10 million
 - c. The bonds shall bear interest at a market rate not less than the yield for 10 year treasury bonds on the date on the bond sale.

7. **7-27-5.22** Investment in Obligations issued under Section 33-1-19 NMSA 1978 for Correctional Facilities
 - a. Allows the Council to approve the investment in bonds, certificates of participation or other obligations issued pursuant to Section 33-1-19 for corrections related facilities by the Severance Tax Fund.

8. **7-27-5.24** Investment in Obligations Issued for State Capitol Buildings and Renovations
 - a. Allows the Council to approve investment by the Severance Tax Fund in revenue bonds issued by the New Mexico Finance Authority for State Capitol buildings and relocation-associated renovations in the state capitol
 - b. The amount invested can not exceed \$10,155,000

9. **7-27-5.26** Investment in Films to be Produced in New Mexico
 - a. No more than 6% of the market value of the Severance Tax Fund may be invested in New Mexico film private equity funds or a New Mexico film project
 - b. No more than \$15 million shall be invested in any one New Mexico film private equity fund or any one New Mexico
 - c. Such investments can only be made by the State Investment Officer upon approval of the Council after a review by the PEIAC and the New Mexico film office
 - d. The investment may be equity or debt and must meet the following:
 - i. The film project is wholly or substantially filmed in New Mexico
 - ii. The project has shown to the satisfaction of the New Mexico Film Office that a distribution contract is in place with a reputable distribution company
 - iii. Has agreed that a majority of the production crew will be New Mexico residents
 - iv. Has posted a completion bond approved by the New Mexico film office. A completion bond is not required if the fund or project is guaranteed by one of the following:
 1. From an entity that has a credit rating of not less than Baa or BBB by a national rating agency
 2. From a substantial subsidiary of an entity that has a credit rating of not less than Baa or BBB by a national rating agency
 3. By providing a full, unconditional and irrevocable letter of credit from a US incorporated bank with a credit rating of not less than A by a national rating agency
 4. From a substantial and solvent entity as determined by the Council in accordance with its standards and practices; or
 - v. If not guaranteed as described above, the fund or project must obtain no less than one-third of the estimated total production costs from other sources as approved by the State Investment Officer
 - vi. A "film project" is defined as a single media or multimedia program, including advertising messages, fixed on film, videotape, computer disc, laser disc or other similar delivery medium from which the program can be viewed or reproduced and that is intended to be exhibited in theaters; licensed for exhibition by individual television stations, groups of stations, networks, cable television stations or other means; or licensed for the home viewing market.

Fund Allocation – Severance Tax

Severance Tax Fund	Market Value	Current Allocation	Prior Target	Range	Current Target ^	Range
Domestic Equity						
<i>U.S. Large Cap Equity</i>	\$1,251,264,632	31.7%	39.0%		36.0%	
<i>U.S. Small/Mid Cap Equity</i>	\$264,308,769	6.7%	9.0%		9.0%	
<i>University Equities</i>	\$7,526,456	0.2%	n/a			
Total Domestic Equity	\$1,523,099,858	38.5%	48.0%	37-60%	45.0%	29-48%
Non-US Equity						
<i>Non-U.S. Developed Markets Equity</i>	\$458,213,739	11.6%	7.0%		5.0%	
<i>Non-U.S. Emerging Markets Equity</i>	\$178,808,512	4.5%	3.0%		10.0%	
Total Non-U.S. Equity	\$637,022,251	16.1%	10.0%	0-15%	15.0%	7-23%
Total Equity	\$2,160,122,108	54.7%	58.0%	<65%	60.0%	<65%
Fixed Income						
<i>U.S. Core Bonds</i>	\$467,266,113	11.8%	6.0%		14.0%	
<i>Credit & Structured Finance</i>	\$175,433,515	4.4%	5.0%		6.0%	
Total Fixed Income	\$642,699,628	16.3%	11.0%	3-21%	20.0%	13-30%
Alternatives						
<i>Absolute Return</i>	\$174,028,189	4.4%	15.0%	5-20%	5.0%	0-10%
<i>Private Equity - National</i>	\$468,734,889	11.9%	12.0%	6-18%	10.0%	7-12%
<i>Real Estate</i>	\$180,653,346	4.6%	3.0%	0-6%	5.0%	2-8%
Total Alternatives	\$823,416,424	20.8%	30.0%	11-44%	20.0%	9-40%
Cash	\$24,500,215	0.6%	0.0%	0-10%	0.0%	0-10%
ETI Investments						
<i>Economically Targeted Investments</i>	\$119,991,661	3.0%	1.0%		na	
<i>Private Equity - State</i>	\$181,667,696	4.6%	na		na	
Total ETI Investments	\$301,659,357	7.6%	na		na	
Total Assets	\$3,952,397,732	100%	100%		100%	

Note: All asset classes were within investment policy ranges as of March 31, 2011.

^Long-Term Targets effective July 1, 2010

*Total Equity, Total Fixed Income & Absolute Return pool asset values include cash held in investment pools.



Performance Summary

	Weight	New Mexico State Investment Council	Market Value (\$ in Millions)	Quarter	Rank	Fiscal YTD	Rank	1 Year	Rank	3 Years	Rank	5 Years	Rank	10 Years	Rank	15 Years
1	70%	Land Grant Permanent Fund ¹	\$10,682	5.0%	10	22.0%	8	14.2%	17	3.2%	32	4.2%	60	5.4%	68	7.2%
2		Land Grant Allocation Index ²		5.1%	7	22.5%	5	15.2%	7	3.1%	34	3.8%	68	5.1%	73	n/a
3		Land Grant Policy Index ³		5.5%	6	23.6%	6	15.9%	5	3.3%	32	3.9%	67	5.2%	72	6.8%
4	26%	Severance Tax Permanent Fund ⁴	\$3,952	5.5%	6	22.0%	8	13.5%	26	1.9%	61	3.2%	73	4.6%	79	6.8%
5		Severance Tax w/o ETI ⁴	\$3,651	5.5%	6	23.4%	6	14.3%	17	2.8%	45	3.8%	68	5.1%	73	7.3%
6		Severance Tax Allocation Index ²		5.3%	7	22.9%	5	15.4%	7	2.2%	56	3.4%	72	4.9%	74	n/a
7		Severance Tax Policy Index ³		5.5%	6	23.6%	6	16.2%	4	3.1%	34	4.0%	66	5.3%	72	7.0%
8		60% S&P500 / 40% BC Aggregate Index		3.7%		18.4%		11.8%		4.1%		4.4%		4.6%		6.9%
9		90 Day T-Bills		0.0%		0.1%		0.2%		0.5%		2.2%		2.2%		3.3%
10		ICC Endowments / Foundations > \$250 M Median		3.3%		16.2%		12.4%		2.6%		4.5%		6.2%		—
11	5%	All Other Funds	\$715													
12	100%	Total NMSIC Investments	\$15,350													
13		Land Grant Permanent Fund ⁵	\$10,728	4.9%	10	21.6%	9	13.8%	23	3.5%	21	4.4%	57	5.5%	66	7.2%
14		Severance Tax Permanent Fund ⁵	\$3,937	5.5%	6	21.0%	9	12.5%	47	1.9%	62	3.2%	73	4.6%	79	6.8%

1 Performance reflects unrealized gain/loss due to securities lending. Rank is versus the ICC Endowment & Foundations > \$250 M Universe.

2 Allocation Index is calculated by taking the actual manager allocations and multiplying by the return of the respective manager's benchmark.

3 Policy Index is calculated by taking the investment policy target asset class weights and multiplying the return of the respective investment policy benchmarks.

4 Performance and market values reflects Severance Tax Permanent Fund without ETI & State PE allocation.

5 Performance does not reflect unrealized gain/loss due to securities lending.

Note: Returns are gross of fees