**Equity Hedge Fund Allocation**

Within the larger equity allocation, the equity hedge fund allocation serves as a diversifier, seeking returns from active investment decisions (a.k.a. alpha) with low-to-moderate exposure to the broad equity markets (a.k.a. equity beta). Managers are expected to generate returns through active selection of securities, both long positions that benefit from outperformance and short positions that benefit from lagging or negative price moves. Additional return drivers available to equity hedge funds include sector, geography and instrument selection; gross and net exposure management; and currency exposure. Though primarily focused on equities, funds in the equity hedge fund category may invest in bonds and other instruments when they can generate equity-like returns. Since returns are driven primarily by manager decisions, the allocation is actively managed.

The equity hedge fund portfolio seeks to generate an equity-like return over the long term with less risk than equity markets, targeting roughly half the volatility. Consequently, the equity hedge fund allocation is evaluated on its expected efficiency, seeking higher return per unit of return volatility than the equity index allocation.

The HFRI Equity Hedge index serves as the benchmark. Since the index has more market exposure (beta) than the equity hedge funds in the portfolio, it is to be expected that the allocation will trail the benchmark when equity markets are strong and outperform when they are weak. Over the long term, the allocation is expected to match or outperform the HFRI Equity Hedge index.

*SIC Investment Philosophy -  Equity Hedge Funds*

* The SIC is a long-term investor in equity hedge funds, seeking strong returns and moderate volatility over a full market cycle.
* Equity hedge funds play the following roles for the total portfolio:
	+ Return generation
	+ Alpha capture
	+ Risk mitigation
	+ Moderate liquidity
* Accessing idiosyncratic returns, primarily from individual company securities, is the role of the equity hedge fund portfolio. Hedge funds have broad mandates and the SIC expects equity hedge fund managers to take ownership of all decisions around investments. Long-term, net-of-fees returns and future return potential are the metrics on which the SIC assesses hedge fund investments.
* Since risk mitigation is an important goal of the equity hedge fund allocation and the overall portfolio’s largest risk is equity market exposure (beta), the SIC seeks to build a portfolio of equity hedge funds with limited equity beta (targeting <0.6 collectively across the equity hedge fund allocation).
* The SIC seeks to invest in equity hedge funds in the most effective manner possible, balancing returns, risks and costs. Since equity beta can be achieved more cheaply through index funds, the SIC selects a portfolio of equity hedge funds whose returns are driven by active security-selection decisions (alpha) rather than broad market moves (beta). Successful active management, particularly for returns uncorrelated with broad markets, is rare and costly. The SIC seeks to hire the best managers and uses performance fee structures to incentivize them.
* Equity hedge funds are generally given a broad mandate, with the ability to invest in a wide variety of securities, to manage their market exposure, and to hedge out unwanted exposures. While no strategy works in every environment, the SIC holds equity hedge fund managers to a high bar in terms of using their broad mandates to navigate a wide variety of environments. Assessment of future return potential drives the SIC’s investment decisions.
* Diversification among hedge funds is important, as idiosyncratic decisions drive returns. The SIC seeks to invest with managers that provide diversification to the broader portfolio and to one another. Though each fund will pursue different strategies,  the equity hedge funds can be classified into two basic strategies:
	+ **Equity long/short** – Generate returns through selection of individual securities (generally equities), identifying and going long securities that are undervalued and putting on short positions in securities that are overvalued. The balance of longs and shorts is expected to insulate the portfolio from broad market moves, with performance based on the relative movement of individual securities.
	+ **Event-driven** – Generate returns by anticipating mergers or other events that will produce a change in a security’s value, and either going long or short securities that will benefit. With generally more concentrated exposures, event-driven strategies can be more volatile.
* With its equity hedge funds, the SIC accepts longer lock-ups and less frequent opportunities to redeem. This moderate liquidity is expected to provide hedge fund managers with a longer time horizon over which to execute their strategies.

As of September 30, 2015, the policy allocation to Equity Hedge Funds is 8%.

N.B. Numbers may not add due to rounding. Actual allocations may vary from policy allocations due to market movements, efforts to minimizing trading costs of rebalancing, lags in rebalancing to less liquid asset classes, time required to vet managers, and efforts to diversify vintage year exposures.

**Private investments** (a.k.a. private equity) allocation focuses primarily on return generation and is expected to be the overall portfolio’s highest return generator over the long term. In addition to accepting the economic growth and corporate profitability risks found in the other equity segments, private investments are subject to risks associated with illiquidity, appraised valuations, leverage, and lumpy performance due to reliance on capital gains primarily. Though among the riskiest assets, private equity has low observed volatility due to the infrequency of valuations given the reliance on appraisals.

Private investments achieve their returns through broad exposure to unlisted common and preferred stock, and to a lesser degree, subordinated and senior debt of companies that are, in most instances, privately held. The SIC invests with general partners that, through limited partnership vehicles, pursue a variety of strategies suited to private situations.

Given the diversity of private markets and the idiosyncratic nature of performance, manager resources and skill are crucial; therefore, the private investments allocation is actively managed. Due to the closed-end nature of private-investment funds and defined investment periods (typically 3-7 years to invest a fund and an additional 3-5 years to harvest investments), new commitments are spread out across vintage years to diversify risks associated with underlying economic and market cycles.

The ILPA All Funds Index serves as the benchmark for the private investments allocation.

*SIC Investment Philosophy -  Private Investments*

* The SIC is a long-term investor in private investments, seeking a large positive return over a full investment cycle, typically 10 years.
* Private investments play the following roles for the total portfolio:
	+ Return generation
	+ Idiosyncratic performance
	+ Access to value creation not accessible in public markets
	+ Capture of illiquidity premium
* The SIC seeks to invest in private investments in the most effective manner possible, balancing returns, risks, liquidity and costs. Almost exclusively held in closed-end funds, private investments are among the longest-term commitments that the SIC makes. As such, diversification across vintage years, strategies, industries, investment types and geographies is important when constructing the private investments portfolio.
* Since private investment funds generally hold a limited number of investments, the SIC seeks a variety of approaches in its private investments portfolio. Exposures will vary based on market conditions and the timing of funds. Though each fund will pursue its own unique strategy,  private investments can be slotted into some basic classifications:
	+ **Buy-out** – Capture returns by purchasing companies (either majority share or a minority stake with significant control rights), holding it for a period of years, and then selling it. Value is generated through a combination of buying inexpensively, improving the growth and profitability of the business, using financial leverage, and selling effectively.
	+ **Growth equity** — Capture returns by investing in fast-growing, established companies typically through minority stakes. The companies generate value by deploying the capital to accelerate the expansion of their businesses.
	+ **Venture capital** — Participating in the value creation of start-ups, venture capital typically invests in management teams as they develop new businesses. Investments are typically minority stakes, and can span from early stage (pre-revenue) to late stage (young but established businesses).
	+ **Private debt, including mezzanine and distressed** — Capture returns through privately negotiated, idiosyncratic fixed-income securities. Private debt typically has higher returns than publicly traded fixed income as compensation for the lack of liquidity and often more complex situations. Though returns on performing private debt can be lower than those of private equity, faster and more likely returns of capital produce an attractive risk-adjusted return. Distressed debt has return profiles similar to private equity.
	+ **Secondary funds** — Capture returns through purchases of other limited partners’ stakes in private equity funds, which are typically sold at a discount due to the funds’ illiquidity.
	+ **Other** — Given the idiosyncratic nature of private investments and the goal to capture returns, the SIC will consider new and evolving strategies as long as the risk/return characteristics seem favorable.
* Private investment funds are typically closed-end vehicles, meaning that the purchase and sale of investments typically happen within a limited period. Market conditions during those defined times can have a meaningful impact on the success of a fund and the years that elapse between commitment to a fund and its conclusion make it difficult to predict market conditions. As a result, the SIC seeks to invest in private investment funds in a consistent, steady manner, ensuring vintage-year diversification.
* Private investments, other than when they are bought and sold, do not have market-based valuations. Instead interim values are based on appraisals and other derived valuations that are typically smoother than public market valuations. As long-only investments, often carrying substantial debt, privates are among the riskiest of the SIC’s investments, even if the valuation methodology makes the volatility difficult to observe.
* Given the inconsistent nature of private investments — opportunities to invest are episodic as are return of capital — portfolio weights can diverge substantially from the policy allocation. In these periods, allocations are often held in public equity, due to the asset class’s liquidity and ease of access.
* The goal of the private investments portfolio is to maximize returns for the capital deployed. At times, the SIC may determine that the sale of a stake in a private investment fund, even at a discount to the stated valuation, achieves the goal of maximizing performance, particularly if the capital can be redeployed in investments with higher expected returns.

As of September 30, 2015, the policy allocation to Private Investments is 7%.

N.B. Numbers may not add due to rounding. Actual allocations may vary from policy allocations due to market movements, efforts to minimizing trading costs of rebalancing, lags in rebalancing to less liquid asset classes, time required to vet managers, and efforts to diversify vintage year exposures.

**Absolute Return Hedge Fund Allocation**

Absolute return hedge funds seek to generate performance through active selection of securities and asset classes, with little-to-no consistent bias to broad markets (a.k.a. beta). Investing in a broad range of securities from equities and fixed income to commodities, convertibles, currency and derivatives, absolute return funds serve as diversifiers, seeking returns from active investment decisions, both long and short (a.k.a. alpha). Since returns are driven primarily by manager decisions, the allocation is actively managed.

Taking less consistent market risks, the allocation is expected to generate steadier and lower returns than other allocations, particularly those with exposure to the equity markets. With less volatility, the absolute return hedge fund allocation is expected to be more efficient (higher return per unit of return volatility).

The HFRI Fund of Funds index serves as the benchmark. Since the index has more equity market exposure (beta) than the SIC’s portfolio, it is to be expected that the allocation will trail the benchmark when equity markets are strong and outperform when they are weak. Over the long term, the allocation is expected to match or outperform the HFRI Fund of Funds index.

*SIC Investment Philosophy -  Absolute Return Hedge Funds*

* The SIC is a long-term investor in absolute return hedge funds, seeking solid returns and limited volatility over a full market cycle.
* Absolute return hedge funds play the following roles for the total portfolio:
	+ Return generation
	+ Alpha capture
	+ Risk mitigation
	+ Moderate liquidity
* Accessing alpha, or idiosyncratic returns, from security selection is the role of the absolute return hedge fund allocation. Hedge funds have broad mandates and the SIC expects managers to take ownership of all decisions associated with its investments. Long-term, net-of-fees returns and future return potential are the metrics on which the SIC assesses hedge fund investments.
* Since risk mitigation is a key role of the absolute return hedge fund allocation and the overall portfolio’s largest risk is equity market exposure, the SIC seeks to build a portfolio of absolute return hedge funds with minimal equity beta (targeting <0.4 collectively across the absolute return hedge fund allocation).
* The SIC seeks to invest in absolute return hedge funds in the most effective manner possible, balancing returns, risks and costs. Since betas can be achieved more cheaply through long-only vehicles, the SIC selects a portfolio of absolute return hedge funds whose performance is driven by active security-selection decisions. Successful active management, particularly for returns uncorrelated with broad markets, is rare and costly. The SIC seeks to hire the best managers and uses performance fee structures to incentivize them.
* Absolute return hedge funds are generally given broad mandates, with the ability to invest in a wide variety of securities, to manage their market exposure, and to hedge unwanted exposures. While no strategy works in every environment, the SIC holds hedge fund managers to a high bar in terms of using their broad mandates to navigate a wide variety of environments. Assessment of future return potential drives the SIC’s investment decisions.
* Diversification among hedge funds is particularly important, as idiosyncratic decisions drive returns. The SIC seeks to invest with managers that provide diversification to the broader portfolio and to one another. Though each fund will pursue different strategies, many of the absolute return hedge funds can be classified into basic strategies:
	+ **Credit long/short** – Generate returns through selection of individual securities, mostly corporate bonds, identifying and going long securities that are undervalued and putting on bearish positions in securities that are overvalued. The balance of longs and shorts is expected to insulate the portfolio from broad market moves, with performance based on the price moves of individual securities.
	+ **Macro** – Generate returns through assessment of macroeconomic trends and selection of securities that will move, either up (long positions) or down (short positions) based on these trends. Using primarily broad-based instruments, such as equity indexes, government bonds, currencies, and others, macro funds will take varying directional positions to capitalize on their views.
	+ **Multi-strategy** – Generate returns both through pursuing typical hedge-fund strategies and from actively allocating capital among those strategies. Multi-strategy funds give access to strategies, such as convertible arbitrage, that fluctuate in their attractiveness.
	+ **Relative value** – Generate returns through capitalizing on small, usually temporary price discrepancies between similar securities. By pairing a long position in an undervalued security and a short in a related and overvalued security, relative value funds seek to generate modest, consistent returns that compound to meaningful performance over time.
	+ **Trend-following** – Generate returns by capitalizing on markets’ tendency to continue a price trend (auto-correlate) over the short to medium term. By following trends across a large number of markets, from currencies to commodities to fixed income and equities, trend followers benefit from the average probability of trends continuing, and diversify away the risk that not every security in every time frame will exhibit this tendency.
* With its absolute return hedge funds, the SIC accepts longer lock-ups and less frequent opportunities to redeem. This moderate liquidity is expected to provide hedge fund managers with a longer time horizon over which to execute their strategies. The idiosyncratic returns from security selection are expected over the long term to produce solid returns with less volatility and minimal correlation.

As of September 30, 2015, the policy allocation to Absolute Return Hedge Funds is 7%.

N.B. Numbers may not add due to rounding. Actual allocations may vary from policy allocations due to market movements, efforts to minimizing trading costs of rebalancing, lags in rebalancing to less liquid asset classes, time required to vet managers, and efforts to diversify vintage year exposures.