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# **Allegheny County**

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## **THE RETIREMENT BOARD OF ALLEGHENY COUNTY STATEMENT OF INVESTMENT GUIDELINES**

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## TABLE OF CONTENTS

<b>I.</b>	<b>INTRODUCTION .....</b>	<b>1</b>
	A. Background .....	1
	B. Goals .....	2
	C. Investment Discretion .....	2
	D. Communications and Responsibilities .....	3
<b>II.</b>	<b>RECOMMENDED POLICY.....</b>	<b>4</b>
	A. Asset Allocation.....	4
	B. Time Horizon .....	5
	C. Investment Manager Program for Alpha Creation Tactics .....	5
<b>III.</b>	<b>INVESTMENT GUIDELINES .....</b>	<b>5</b>
	A. Types of Securities.....	5
	B. Diversification.....	6
	C. Quality.....	7
	D. Duration .....	8
	E. Alternative Investment Portfolio.....	8
	F. Prohibited Investments.....	9
<b>IV.</b>	<b>OBJECTIVES.....</b>	<b>10</b>
	A. Return Requirements.....	10
	B. Performance Benchmarks .....	11
<b>V.</b>	<b>PRIMARY CONTACTS.....</b>	<b>12</b>

## APPENDIX

## I. INTRODUCTION

This document defines the investment policies, objectives and procedures applicable to the Retirement Board of Allegheny County's (the "Board") Retirement Plan (the "Plan") Assets. It was developed by the Board on the basis of recommendations from Yanni Partners, Inc. (the "Investment Consultant").

Experience has shown that the most common and costly error of a fund sponsor is the failure to communicate return expectations, risk tolerances, time horizons, and liquidity needs to its Investment Managers.

Developing appropriate investment strategies and executing prudent decisions requires a thorough understanding of the Plan's investment objectives. Therefore, it is critical for the Investment Consultant to document the Board's investment objectives. Only through this exercise can the Investment Consultant adequately interpret investment activity and results for the Board.

The purpose of this document is threefold. First, it will constitute the plan for investing the assets. Second, it will serve as a communication tool between the Board and the Investment Managers. Third, these guidelines will provide a framework to measure the ongoing progress of the assets.

Within the constraints imposed by this document, the managers will have total discretion to manage the assets according to their professional judgment and fiduciary obligations. Each manager's strategy and performance shall be communicated through written reports to the Board at regularly scheduled review meetings of the Board and verbal presentations at the request of the Board. Periodically, the Board will request personal meetings.

Notwithstanding this Statement of Investment Guidelines, the Investment Consultant and Investment Managers hereby acknowledge their legal obligations as set forth in their contracts with the Board, and further acknowledge that this Statement of Investment Guidelines is not intended to replace or modify any term or condition of those contracts. If there is any conflict between this Statement of Investment Guidelines and any such contract, the contract shall control.

### A. Background

The Plan is funded by contributions from both Allegheny County and the active participants in the Plan. The Plan assets provide the funding of scheduled benefit payments, both current and future obligations, which include; retirement, disability, or death benefits to vested participants and/or their beneficiaries.

The Board is comprised of seven members, the Allegheny County Executive, Treasurer, Controller, one person appointed by the County Executive, one person appointed by County Council, and two persons elected by the participants of the Plan. All communications and reports should be sent through the Executive Director with copies to the Investment Consultant.

In addition, the Plan is administered by the Executive Director who supervises the day-to-day operations of the Plan.

B. Goals

The long-term goals for the assets are to:

- protect the integrity of the Plan's asset base;
- at a minimum, preserve the inflation adjusted value of the Plan assets after all administrative costs and spending needs;
- produce investment results which meet or exceed the Plan's actuarially assumed rate (presently 8.0%, net of all Investment Manager fees);
- prudently invest assets in a high-quality, diversified manner;
- adhere to all applicable laws and statutes relating to Pennsylvania second class counties;
- achieve the optimal return possible within the specified risk parameters;
- maintain at minimum a 110% funded status (Total Assets/Total Liabilities);
- adhere to the established guidelines.

C. Investment Discretion

The Board Members intend to monitor such matters as the long-term asset mix and the retention of professional money managers with guidance from the Investment Consultant. However, detailed investment strategies and the ultimate purchases and sales of securities are deemed to be within the discretion of the professional Investment Managers. The Board recognizes that with multiple managers of varying styles, some leeway on specific issues may require exceptions and/or variances from the stated guidelines. These exceptions must be requested and approved in writing and will be summarized in the Appendix of this Document. Furthermore, the Board Members are aware that the decision to invest in a commingled account or mutual fund may relieve the Investment Managers from strict adherence to certain elements of the guidelines.

D. Communications and Responsibilities

The Board, in adopting the following Investment Guidelines, has relied in good faith on information, opinions, reports or statements, including financial statements, investment data and other financial or investment data provided to the Board by its Investment Consultant, Yanni Partners, Inc. and its representatives, including any such information provided to the Board by Investment Managers with the knowledge of Yanni Partners, Inc. and/or its representatives. The Board in adopting these Investment Guidelines understands that they are designed to maximize the return on the Plan's assets in a prudent and cost effective manner without compromising the security of the fund assets and in a manner designed to meet or exceed the fund actuary's investment assumption for the Plan over time.

The Custodian of the Plan is expected to provide monthly statements of portfolio transactions and invested positions (by cost and market).

The Investment Managers of the Plan are expected to:

- Provide a written statement acknowledging the acceptance of this document or to submit recommended changes.
- Attend a meeting upon request by the Board Members and/or the Investment Consultant to review investment activity and results. During this review, the money managers should indicate current portfolio strategy, as well as comment on the Firm's outlook for the economy and capital markets.
- Provide to the Executive Director of the Plan fifteen copies of all materials sent to the Board, plus one copy sent directly to the Investment Consultant.
- Provide written notification if a material change in any of the following should occur: the organization; ownership structure; key personnel; management; or any other matter for which the manager has an obligation to disclose to the Board. Moreover, written notification must be provided in the event of any change in key or administrative personnel directly related to the Plan, significant client gain or loss, any other factors materially changing the style of portfolio management, or any conflict of interest that should arise affecting or impacting the Investment Manager and its responsibilities in managing assets for The Retirement Board of Allegheny County during the course of business.

The Investment Consultant's role is to monitor compliance to stated guidelines and adherence to investment style, compare performance results to relative benchmark and peer groups, and communicate performance results and suggestions regarding investment strategies and manager retention to the Board.

## II. RECOMMENDED POLICY

Historical performance results and future expectations suggest that common stocks will provide higher total investment returns than fixed-income securities over a long-term investment horizon. However, one can expect an increase in portfolio volatility as the stock percentage is increased.

Based on the investment goals and risk tolerances stated in this document, the following asset mix strategies are appropriate. Investments should not exceed the minimum and/or maximum levels (at market value) without written permission from the Board.

### A. Asset Allocation

<u>Section</u>	<u>Target</u>	<u>Range</u>
<b>Total Plan</b>		
Diversified Equity	50.0%	45% - 55%
Hedge Funds	5.0%	0% - 10%
Venture Capital /Private Equity	5.0%	0% - 10%
Real Estate	5.0%	0% - 10%
Fixed-Income/Cash	30.0%	25% - 35%
High-yield Fixed-income	5.0%	0% - 10%

The equity portion of the Plan will be allocated among the following asset classes: large-capitalization domestic equity – core, value and growth styles; small-capitalization domestic equity – value and growth styles; and a well-diversified international equity portfolio. Target and Range percentages are percentages of the total portfolio.

<u>Asset Class</u>	<u>Target</u>	<u>Range</u>
Large-Cap Core Equity	15.0%	10% - 20%
Large-Cap Value Equity	16.0%	11% - 21%
Large-Cap Growth Equity	10.0%	5% - 15%
Small-Cap Value Equity	4.5%	2% - 7%
Small-Cap Growth Equity	4.5%	2% - 7%
International Equity	5.0%	0% - 10%

At each monthly meeting, the Investment Consultant will provide to the Board, for its review and discussion, the Fund's actual and target allocations, plus the range of allocations permissible under the approved Statement of Investment Guidelines. Following discussion, with Board approval, the Investment Consultant will initiate rebalancing, working through the Executive Director.

B. Time Horizon

Progress toward stated goals will be measured regularly; however, the Investment Managers may need a market cycle (minimum of three years) to fully implement their investment styles.

C. Investment Manager Program for Alpha Creation Tactics

In order to add “alpha” to the Plan, the Investment Manager Program for Alpha Creation Tactics (IMPACT) was created. A maximum of 5% of the Total Fund will be segregated to IMPACT, with a maximum of \$5 million to be initially assigned to any one manager. Assets transferred to IMPACT will be taken from the appropriate asset class, at no increase in fees, incentive-based fees will be utilized whenever possible.

IMPACT manager candidates will be compared to appropriate benchmarks and against its peer universe. Managers who exhibit superior, absolute and risk-adjusted returns will be considered further. While IMPACT offers an opportunity for business growth in the tri-state area, the program is not limited to any location.

The monitoring period for managers under IMPACT will be on a rolling one-year basis. During that period, the manager’s performance will be gauged against its unique benchmarks. If the firm has outperformed its bogeys, upon approval, an additional 50% of the initial contribution will be made. Likewise, if the firm under performs the benchmark, 50% of the initial contribution will be removed. After three years, the firm will be taken off of IMPACT status, either to become a full-fledged Plan manager or to be eliminated.

**III. INVESTMENT GUIDELINES AND DEFINITIONS**

A. Types of Securities

Equities mean high-quality common stocks. Convertible bonds, convertible preferred stocks, preferred stocks, and non-voting stocks are permitted if the risk/return characteristics are favorable versus the underlying common equity. Specific constraints include the avoidance of restricted issues, which have limited marketability, excluding SEC Rule 144A securities.

International securities may include any of the following:

- Equity alternatives: common stock listed on a recognized security exchange, OTC common stock, American Depository Receipts (ADRs), and European Depository Receipts (EDRs)
- Convertible bonds, preferred stock, non-voting stock if the risk/return characteristics are favorable versus the underlying common equity
- Currency hedging

Hedge Fund shall be represented by a pool of investments:

- Hedge Fund “Fund of Funds” shall be utilized
- The “Fund of Funds” is permitted to develop a diversified portfolio of Hedge Fund strategies including, but not limited to, of equity long-short, arbitrage and global-macro investments

Private Equity/Venture Capital shall be represented by a pool of investments:

- Private Equity/Venture Capital “Fund of Funds” shall be utilized

Real Estate securities shall be represented by marketable real estate issues by:

- High-quality, commercial real estate properties including office, industrial, retail, residential, or other property types that meet the high-quality standard
- Sectors should be maintained to be within  $\pm 15\%$  of the NCREIF Index

Fixed-Income securities shall be represented by marketable debt issues by:

- U.S. Treasury or Agencies
- U.S. corporations
- U.S. banks or other financial institutions
- Mortgage or asset backed securities
- Yankee bonds

High-yield Fixed-Income securities shall be represented by marketable debt issues by:

- Investments rated at a minimum of “B-” or equivalent at the time of purchase by one of the established ratings agencies (e.g. Standard & Poors, Moody’s, Fitch)
- All corporate structures and security types in the benchmark index
- Investment grade issues, including US Government securities, dollar denominated credits, payment-in-kind, preferred, and asset backed securities (ABS)
- Cash equivalents

Cash Equivalent investments may be represented by any of the following:

- U. S. Treasury Bills
- U. S. Government repurchase agreements (with a minimum of 102% collateral)
- Money market funds
- Commercial paper

## B. Diversification

Equity Issues-- Each equity Investment Manager should diversify its equity portfolio in an attempt to minimize the impact of substantial loss in any specific industry or issue. Therefore, no more than 5% of a manager’s equity portfolio may be invested in any one company (valued at cost), and no more than 10% of a manager’s equity portfolio may be invested in any one company (valued at market). In addition, investments may not exceed

the benchmark index by 20% of the GICS economic sector allocation.

Core Fixed-Income-- Each fixed-income Investment Manager should diversify its fixed-income portfolio within the quality and maturity guidelines (outlined in the next section) in an attempt to minimize the adverse effects of interest rate fluctuations. Therefore, except for U. S. Treasury and Agency obligations, a manager's fixed-income portfolio may not contain more than 10% (valued at market) of a given domestic issuer. The Investment Managers have the latitude to invest no more than 10% of the portfolio market value in Yankee bonds.

High-yield Fixed-Income--Each high-yield, fixed-income Investment Manager should diversify its high-yield fixed-income portfolio within the quality and maturity guidelines (outlined in the next section) in an attempt to minimize the adverse effects of interest rate fluctuations. Therefore, except for U.S. Treasury and Agency obligations, a manager's high-yield, fixed-income portfolio may not contain more than 5% of its assets (valued at market) of a given issuer.

### C. Quality

Equity Issues-- There are no qualitative guidelines suggested with regard to equity ratings, rankings, etc., except that prudent standards should be developed and maintained by the Investment Managers. Convertible bonds will be considered as an equity investment and must be rated investment grade ("Baa/BBB") or better by at least one credit rating service, Moody's Investment Service or Standard & Poor's. Specific constraints include the avoidance of restricted issues, which have limited marketability, excluding SEC Rule 144A securities.

Fixed-Income Securities-- Domestic bonds held in the core fixed-income portfolios must be rated investment grade ("Baa/BBB") or better by at least one credit rating service, Moody's Investment Service or Standard & Poor's. This guideline is intended to give the core fixed-income Investment Managers sufficient latitude to periodically take advantage of bond swaps. High-yield fixed-income Investment Managers should hold bonds rated at least B- or equivalent at the time of purchase. SEC Rule 144A securities without registration rights considered by the Investment Managers to be within the policy guidelines are limited to 10% of the fixed-income portfolio. Core fixed-income Investment Managers' portfolios should normally maintain an average market-weighted quality of 3.0 based on the following scale, and High-yield fixed-income Investment Managers' portfolios should normally maintain an average market-weighted quality of B:

- |                                 |     |
|---------------------------------|-----|
| • U. S. Government and Agencies | 5.0 |
| • Aaa/AAA Bonds                 | 4.0 |
| • Aa/AA Bonds                   | 3.0 |
| • A/A Bonds                     | 2.0 |
| • Baa/BBB Bonds                 | 1.0 |

Cash Equivalent Vehicles--If commercial paper is used for short-term investments, it must be of high quality, rated at least the equivalent of "A-1" or "P-1" by Moody's or Standard & Poor's.

D. Duration

The maturities of the bonds held in the portfolios are at the discretion of the Investment Managers. However, the effective duration of the fixed-income managers should follow the schedule below:

<u>Fixed-income Class</u>	<u>Index</u>	<u>Duration Limitation</u>
Core	Lehman Brothers Aggregate	±20%
Government/Credit	Lehman Brothers Govt/Credit	±20%
High-Yield	Lehman Brothers High-Yield	±10%
Short-Term	Merrill Lynch One-Three-Year Govt	±20%

E. Alternative Investments Portfolio

1. Role

The role of the Alternative Investments portfolio is to provide diversification of risk as measured by volatility of returns. The objective in selecting these types of investments is to find vehicles with return patterns that maintain low correlations to traditional investment options.

Alternative investment markets are inefficient and often times do not fully reflect the underlying intrinsic values. Managers may opportunistically use both public and private market vehicles and may emphasize different investment strategies depending on economic cycles and market conditions. Alternative investments will generally tend to be illiquid and longer-term in nature. The possibility of high absolute returns will only be achieved by accepting a commensurately higher level of investment risk. Risk will be controlled, however, by diversification of strategies and Investment Managers.

2. Alternative Investments Allocation (percentages are of Total Fund)

<u>Long-Term</u>			
<u>Class</u>	<u>Allocation</u>	<u>Investments</u>	<u>Risks</u>
Hedge Funds	0 - 10%	Stocks, bonds, convertibles and derivatives	Market risk, manager risk
Venture Capital/ Private Equity	0 - 10%	Seed capital, later stage expansion  U.S. buyouts, int'l private equity, energy and natural resources	Management, liquidity, business risk  Management, liquidity, financial risk
Real Estate	0 - 10%	Real estate	Management, liquidity, financial risk

F. Prohibited Investments (Non-Alternative Investments)

Unless specifically approved by the Board Members in writing, in advance, the following categories of securities are not considered appropriate, except as may be inherent in specific commingled accounts or mutual funds:

- Restricted domestic stock
- Commodities
- Margin trading
- Limited partnerships
- Oil, gas, or natural resource properties
- Direct real estate investments
- Private placements – except for SEC Rule 144A securities
- Short selling
- Venture capital
- Leverage is not permitted in the portfolio
- Interest-only CMOs
- Principal-only CMOs
- Inverse floating CMOs
- Structured notes
- Z-Traunch CMOs and other support and component tranches
- Any other investment not specifically mentioned above without prior approval of the Board and the Investment Consultant

See Appendix for all approved exceptions.

**IV. OBJECTIVES**

Investment objectives are intended to provide quantifiable benchmarks to measure and evaluate portfolio return and risk. The following objectives apply to the managed assets and will be measured over a three-year period, on a gross- and net-of-fee basis:

A. Return Requirements

Relative to appropriate indices:

<u>Section</u>	<u>Index</u>	<u>Annualized Expectation</u>
Total Plan	Target Market Index (TMI)*	Exceed Index by 0.1% plus management fees (0.3%)
	Actuarial Rate	Exceed by management fees (0.3%)
	Consumer Price Index (CPI)	Exceed Index by 6.0%
Large-Cap Equity		
Core	S&P 500 Index	Exceed Index
“Deep” Value	Russell 1000 Value Index	Exceed Index
“Relative” Value	S&P/BARRA Value Index	Exceed Index
Growth	Russell 1000 Growth Index	Exceed Index
Small-Cap Equity		
Value	Russell 2000 Value Index	Exceed Index by 2.0%
Growth	Russell 2000 Growth Index	Exceed Index by 2.0%
International Equity	Morgan Stanley Europe, Australasia and Far East Index	Exceed Index by 1.0%
Hedge Fund	CSFB/Tremont Index	Exceed
Venture Capital/ Private Equity	S&P 500 Index	Exceed S&P 500 by 5.0%
Real Estate	NCREIF Index	Exceed Index
Core Fixed-Income	Lehman Brothers Aggregate Index	Exceed Index
Gov’t/Corp Fixed-Income	Lehman Brothers Gov’t/Credit Index	Exceed Index
High-yield Fixed-Income	Lehman Brothers High-yield Index	Exceed Index
Short Term Fixed-Income	Merrill Lynch One-to-Three Year Government Index	Exceed Index

\*TMI is constructed with 55% Russell 3000, 5% EAFE, 40% LB AGG.

## B. Performance Benchmarks

Relative to other professionally managed accounts:

<b>Section</b>	<b>GRID® Universe**</b>	<b>3-Year Expectation</b>
Total Fund	Balanced (High Equity) Universe	Top 50%
Large-Cap Equity		
Core	Large-Cap Core Equity Universe	Top 50%
Value	Large-Cap Value Equity Universe	Top 50%
Growth	Large-Cap Growth Equity Universe	Top 50%
Small-Cap Equity		
Value	Small-Cap Value Equity Universe	Top 50%
Growth	Small-Cap Growth Equity Universe	Top 50%
International Equity	International Equity Universe	Top 50%
Hedge Fund	Not Applicable	Not Applicable
Venture Capital/Private Equity	Not Applicable	Not Applicable
Real Estate	Real Estate Universe	Top 50%
Core Fixed-Income	Fixed-Income Universe	Top 50%
Gov't/Corp Fixed-Income	Fixed-Income Universe	Top 50%
High-Yield Fixed-Income	High-Yield Fixed-Income Universe	Top 50%
Short-Term Fixed-Income	Short Maturity Universe	Top 50%

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\* Yanni Partners, Inc. GRID® (Graphical Ranking of Investment Descriptors) Universe is a proprietary database of over 5,000 investment products including performance results, style characteristics, and related statistics.

**C. PRIMARY CONTACTS**

**Retirement Board of Allegheny County**

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**APPENDIX**

<u>Date</u>	<u>Requested Manager</u>	<u>Request and Exception Granted</u>
12/7/00	Fiduciary Management Associates	Individual security weights limitations and economic sector weight limitations are not applicable.
12/7/00	MDL Capital Management	Duration of the portfolio cannot exceed $\pm$ 30% of the LB G/C Index duration.
11/11/04	C. S. McKee Investment Management	Structured notes are permitted up to 5% of the portfolio.