EMPLOYEES' RETIREMENT SYSTEM

AND ELECTED OFFICIALS' RETIREMENT SYSTEM

OF THE CITY OF BALTIMORE

Hedge Fund/Alternative Risk Premia

Investment Policy Statement

Hedge Funds

Hedge Funds, also known as absolute return strategies, includes event-driven (e.g., merger arbitrage, distressed securities, special situations), relative value (e.g., convertible arbitrage, fixed-income arbitrage, market neutral equity), opportunistic/tactical (e.g., global macro and managed futures), long/short equity and long/short credit. These different strategies and "styles" tend to have low correlations to traditional, long-only equity and fixed-income strategies.

Unlike long-only managers whose returns are substantially explained by capital market movements, Hedge Fund managers seek to achieve returns substantially independent of normal market cycles. With their highly discretionary use of risk capital, Hedge Funds seek to generate profits regardless of conditions in the equity or fixed-income markets. To control risk or enhance return, Hedge Funds will often use short-selling, derivatives, leverage, and, in certain cases, leverage and illiquid securities. While Hedge Fund strategies often seek to mitigate the impact of general market's directional movements, Hedge Fund returns are still heavily influenced by market-related activity, such as trading volume, market volatility, credit spread levels, mergers & acquisitions, bankruptcy, IPOs and other corporate issuance.

In addition to the effectiveness of a particular investment strategy, Hedge Fund returns are dependent upon exceptional manager skill. To attract such talent, it is appropriately compensated. To that end, performance-based fees offering typically 15% to 20% of net profits (above "high water"), plus 1% to 2% annual management fees, generously reward successful Hedge Fund managers while serving to align such managers with vested interests similar to their investors. Helping to further reduce the agency risks found in most long-only manager relationships, Hedge Fund managers typically invest, and are usually expected to invest, a significant portion of their personal net worth alongside their investors. Nevertheless, incentive fees on upside performance can, at the margin, adversely motivate Hedge Fund managers to consider riskier opportunities, thus warranting careful ongoing review of investments in funds of such managers.

Alternative Risk Premia

Alternative Risk Premia consist of investment strategies that systematically seek to capture the long-term returns of certain well-known risk premia (e.g., value, carry, momentum, low-volatility) without being exposed to the markets where these risk premia reside. Over time these various risk premia are expected to produce positive returns that are generally unrelated to the other major market risk premia (e.g., equity, interest rates, inflation, etc.). Markets and instruments used by Alternative Risk Premia strategies are highly-liquid, but capturing long-term returns may require significant leverage.

The due diligence process of evaluating on Hedge Funds or Alternative Risk Premia is particularly challenging and requires significant experience and knowledge of this portion of the investment management universe. As such, it poses certain challenges to a potential investor with limited resources. Therefore, to invest in Hedge Funds or Alternative Risk Premia without the internal resources necessary to evaluate, hire, and monitor such funds individually, the City of Baltimore Employees Retirement System ("the System") recognizes the need to delegate this responsibility. Accordingly, the Board of Trustees of the System ("the Board") will select, with assistance of its investment consultant, an Investment Manager ("Investment Manager") who is qualified to properly assemble and manage a diversified portfolio of Hedge Fund or Alternative Risk Premia investment. The Board's responsibility will be to establish the scope and guidelines for a Hedge Fund program, properly select one or more Investment Managers consistent with that program, and appropriately evaluate and review such manager(s) with respect to their stated investment objective(s) and peer group of managers with similar mandates.

Investment Objective

The System's aggregate Hedge Fund/Alternative Risk Premia program seeks to achieve consistent positive real returns and to maximize long-term total return within prudent levels of risk through a well-diversified portfolio of Hedge Fund or Alternative Risk Premia strategy that, in aggregate, does not materially rely upon the direction of the equity or fixed-income markets. This program's value-added return will be primarily derived from manager selection and, to a lesser degree, strategy allocation. However, for purposes of risk diversification, the Investment Manager is not expected to create concentrated exposures.

Our approach is to largely focus on Investment Managers who perform exhaustive quantitative and qualitative research to identify undervalued and overvalued assets that can be owned long or sold short. When coupled with disciplined portfolio management, long and short positions can drive returns that are independent from broader market movements. This diversification is critically important.

The Hedge Fund program may also allocate to emerging hedge fund managers. Emerging managers can access a different set of investment opportunities providing further diversification opportunities while maintaining flexibility on fees, transparency, revenue share and capacity terms.

Performance Objectives

Evaluation of quarterly performance is necessary to assess the program's progress toward its long-trm investment goals. It is understood that there will likely be periods during which performance deviates from long-term return objectives. During such times, greater emphasis shall be placed on performance attribution and comparisons with peer managers that employ similar styles or strategic allocations.

The long-term performance benchmark for the program shall be the return of the 3-month treasury bills Index plus a [500 basis point risk premium], net of all fees.

Commingled Accounts

In the case of a group trust, mutual fund, or other commingled account, the Board understands that strict adherence to the investment guidelines set forth within this section is impractical. Accordingly, the Board waives such strict adherence, and the commingled account's investment objectives, policies and restrictions, as set forth in its current prospectus and statement of additional

information (as amended from time to time), shall govern the investment of the System's assets.

The commingled account shall also exercise prudent care in managing the portfolio.

Investments in commingled accounts by Investment Managers shall be subject to the following restrictions:

1. The Investment Manager of the commingled account shall be a Registered Investment Advisor under the Investment Advisors Act of 1940.
2. All persons or entities responsible for the management, control, custody, maintenance and investment of the assets of the commingled account shall be legally bound to function in a fiduciary capacity in their relationship to the management, control, custody, maintenance and investment of the assets of such commingled account.
3. Funds and assets of the commingled account shall not be subject to claims or attachments made by any creditors of, or governmental regulatory agencies having authority over, all persons or entities responsible for the management, control, custody, maintenance and investment of the commingled account, except to the extent that any such claims or attachments directly and materially relates to the group trust or its operations.
4. Fees paid to the manager of the commingled account shall be part of, and not in addition to, fees paid by commingled account participants to their respective Investment Manager. Commingled account participants shall not incur fees or expenses for participating in the group trust in excess of fees paid to Investment Managers as set forth in the governing documents of such commingled account.

If a separate account is used in lieu of a commingled account, the selected Investment Manager will be granted full discretion to invest the System's allocation in a manner consistent with the objectives and guidelines set forth in this document. In such case, the Investment Manager is required to submit a written statement to the Board acknowledging its role as a fiduciary, and any limitations thereof.

Investment Manager Hiring Guidelines

When conducting a search for an Investment Manager, the Board shall apply the following guidelines for qualifying an Investment Manager:

- The Investment Manager of the vehicle shall be a bank, insurance company, or a registered investment adviser under the Investment Advisers Act of 1940.

Risk Management – Hedge Funds

While specific investment guidelines for commingled vehicles are determined by the Investment Manager's legal documentation for each fund offering, the Board shall apply the following measures of diversification and risk management for evaluating and reviewing a hedge program based on a [broadly diversified] mandate involving one or more Investment Managers:

- *Strategy Risk:* To be broadly diversified by strategic allocations, the program shall contain exposures to the five broad investment categories of Hedge Funds: relative value, event driven, long/short equity, long/short credit and opportunistic/tactical strategies.
- *Economic Sector Risk:* To be broadly diversified by economic sector allocations[1], the maximum allocation to any one sector-specific strategy within the long-short equity strategy shall be 40% of assets. Maximum allocation to non-U.S. equity strategies within the long-short equity strategy shall be 40% of fund assets.
- *Leverage Risk:* While financial leverage (i.e., assets in excess of equity capital) is useful for enhancing returns, the portfolio shall use leverage in a prudent manner that, (i.e., programs broadly diversified across both directional and non-directional strategies).
- *Liquidity Risk:* While investments in illiquid securities, or Hedge Funds with long lock-up periods, are often key to enhancing returns, it is preferable that a majority of the underlying funds provide quarterly or better liquidity. Notwithstanding the stated redemption schedule of the Investment Manager and its underlying managers, the Board recognizes that such timetables for liquidity may be suspended by the Investment Manager under certain circumstances, such as periods of unusual financial stress within the markets or within underlying Hedge Funds.
- *Derivative Risk:* Unless otherwise approved by the Board, the Investment Manager may not elect to engage in derivatives transactions to offset, or hedge, unintended market exposures in underlying funds.
- Alternative risk Premia portfolios using both cash and derivatives-based instruments to capture well-researched/documented non-market risk premia (e.g., momentum, carry, value, low-volatility) on a continuous basis, using an array of liquid global markets. Risk/volatility is calibrated to a pre-determined level using cash and derivatives-based leverage.

Reporting Requirements

Each Investment Manager should note that the Systems operate on a fiscal year basis, from July 1st through June 30th; therefore, all performance reports should be prepared on a fiscal year basis. The Board requires continual awareness of the System's activity and position, both absolute and relative. To accomplish this, the following reports should be sent to the Board:

A. Quarterly Report

1. The Investment Manager will provide to the Board quarterly written reports which present the following information:

[1] As defined under the Global Industry Classification System (GICS) provided by S&P and MSCI.

- Calculation of estimated net asset value on a monthly basis, with a summary of discrepancies, if any, with the Fund Sponsor's custodian bank outstanding more than 90 days.
- Performance results.
- Listing of strategic allocations as a percent of the Investment Manager's total fund assets as of quarter end.
- Disclosure of any positions of financial or market leverage,
- Notice of changes in organizational structure, ownership, key personnel, and investment strategy of the firm. Material changes shall be reported in a timely manner to both the Executive Director and the investment consultant by at least two means of communication (e.g., phone call, email, fax, and/or letter).
- Dealings with minority and woman-owned businesses for separate accounts.
- Clients gained or lost for the strategy invested in by the System.

On an annual basis, the reports should also include:

- Annual filing of Form ADV with the Securities and Exchange Commission.
- Annual audited financial statements related to the Fund Sponsor's investment.
- Firm composition specifying majority, minority, and women personnel by management category.

2. Brokerage Report – Separately Managed Accounts

In order to assist the Board in tracking compliance with their brokerage policies, Investment Managers are required to provide a quarterly summary report of the brokerage activity for each System showing a breakdown by firm of amounts and percentages of brokerage commissions, commissions and discounts through recapture brokers and through City of Baltimore majority, minority-owned, and woman-owned brokerage firms. These reports should also reflect fiscal year-to-date amounts and percentages.

3. Report of Firm Officers and Directors Serving as Directors of Publicly Traded Companies

For the purpose of full disclosure for any perceived or potential conflict of interest, Investment Managers are required to report quarterly information regarding the firm's policy, firm officers and directors serving as directors of publicly traded companies, and System and firm investments in those companies. The report must set forth:

a. The Firm's Policy

The Investment Management firm's written policy governing the ability of firm officers and directors to serve as directors of publicly traded companies; OR, a statement that no written policy exists. Any changes to the policy are to be noted quarterly.

b. Information about Directors

For firm officers and directors serving as directors:

- The date the firm officer or director became a director of the publicly traded company;
- The name of the officer or director; and
- The name of the publicly traded company;
  OR,
- A statement that no firm officer or director serves as a director of a publicly traded company.

c. Information on System Investments

Information regarding System investments made by the Investment Manager in Hedge Funds of which a firm officer or director serves as a director, to include for any fund shares purchased or sold:

- Transaction dates
- Cost basis
- Sales proceeds
- Gains and losses on the sale of shares
- Market value of shares held at the end of each quarter;
  OR,
- A statement indicating that the System is not invested in any of the Hedge Funds of which a firm officer or director serves as a director.

d. Information on Firm-Wide Investments

Information regarding investments made firm-wide by the Investment Management firm in funds of which a firm officer or director serves as a director, to include as of the end of each quarter:

- Cost basis
- Market value
- The Investment Management firm's percentage of ownership in the fund, or
- A statement indicating that the Investment Management firm is not invested in any of the funds of which a firm officer or director serves as a director.

4. Report Submission

Written quarterly reports are to be submitted within 45 days of the end of each quarter (September 30th, December 31st, March 31st, and June 30th) and mailed directly to the members of the Board, the System's Executive Director, Deputy Executive Director, Chief Investment Officer, and-Accounting Manager. The System will supply each Investment Manager with a current mailing list. When necessary, a revised list will be sent to each Investment Manager.

B. Annual Most-Favored Nation Fee Compliance Report

On July 1 of each year, the Investment Manager shall certify, by letter of its legal counselor compliance officer, compliance with the most-favored nation clause in its Investment Management Agreement.

C. Performance Review Presentation before the Board of Trustees

It is the Board's intention to formally review Investment Manager performance on a regular basis. Investment Managers are expected to personally appear annually, or at the Board's request, at regular monthly or special meetings of the Board to discuss performance results, economic outlook, investment strategy, organizational changes, and other pertinent matters. The written and oral presentations at these meetings should include the following:

- *Performance for Past Period:* Standard time periods for each report should include at least: Last Quarter, Year to Date, Latest 12 Months, 3 Years and Since Inception. Returns should be annualized for periods over one year and calculated on a time-weighted basis for the total portfolio. All returns should be net of all management and incentive fees.

- *Rationale for Performance Results:* Discussion of the rationale for performance results, relating specifically to strategic and manager allocations during the current review period.

- *Specific Near-Term Strategy:* Discussion of the Investment Manager's strategy for the portfolio over the near-term period.

- *Changes in the Investment Manager's Firm:* Discussion of any changes in the Investment

  Manager's firm including, but not limited to, organizational structure, ownership, key personnel, investment strategy and philosophy.

- *Changes in the Fund's Requirements:* Discussion of any changes in the Investment Manager's fund objectives or guidelines, particularly in relation to the Fund Sponsor's above stated objectives and guidelines.

In a month when an Investment Manager is scheduled to personally appear before the Board, the written quarterly reports are to be mailed directly to the members of the Board of Trustees, the Executive Director, Deputy Executive Director, Chief Investment Officer and the Accounting Manager at least one week in advance of the appearance date. Ten (10) additional copies of the reports should also be mailed to the Executive Director one week prior to the appearance date. If the additional copies cannot be delivered in this manner, then the reports can be personally delivered on the appearance date. The additional copies are only required for review meetings with the Board and are not required any other time.

D. Telephone and Written Communication

Immediate telephone and written communication should be made by the Investment Manager to the Executive Director when information of an important nature, such as unusual market activity (oil embargo, monetary crisis, SEC Regulatory issues, etc.) may have a material impact on the System's assets.

Major changes in personnel and organizational structure should also be communicated in writing to the Executive Director.

AMENDMENTS

If at any time these objectives cannot be met, or these guidelines constrict performance, the Board should be notified in writing. The Investment Manager is encouraged to suggest changes to these guidelines at any time.

Accepted by:

____________________________________ _____________________

Name Date

____

Firm

APPENDIX

HEDGE FUND STRATEGY DEFINITIONS

Relative Value

Within the relative value, or arbitrage, style of Hedge Funds, the three principal strategies as defined by Standard & Poor's are:

Equity Market Neutral

Funds take both long and short positions in equities. Stock positions are usually diversified, so that no one position has a disproportionate effect on the portfolio. Related short positions hedge out much of the systematic risk in the long positions on either a dollar-or beta-adjusted basis so that the overall portfolio has a limited exposure to market moves.

Stocks are selected for inclusion in market neutral equity portfolios according to fundamental company specific factors, factor characteristics and the expectation of future returns to the factors, and statistical modeling of short-term anomalies created by supply and demand factors for individual stocks.

Specialties within this strategy are:

- Statistical Arbitrage: Anomaly-driven, quantitative, double-alpha strategy. Statistical Arbitrage usually engages in very short-term trading and usually focuses on residual mean reversion.
- Quantitative: A quantitative application of fundamental analysis, using Barra factor and other models, that are often momentum, earnings, or valuation based. Quantitative Equity Market Neutral is a longer term strategy [than Statistical Arbitrage].
- Fundamental: A bottom-up, fundamentally driven stock picking approach with a longer time horizon.

Fixed Income Arbitrage

Fixed Income Arbitrage funds exploit the relative values of fixed income instruments. The manager takes positions in government bonds and investment-grade corporate bonds, government agency securities and swap contracts, and futures and options on fixed income instruments. The manager generally constructs the portfolio on a market neutral basis and often constrains it to be duration neutral within a given country (often developed countries).

A distinct sub-specialty within Fixed Income Arbitrage is U.S. Mortgage Arbitrage, where the manager takes positions in mortgage-backed securities such as residential pass-through securities and derivatives, and commercial mortgage securities. The manager attempts to neutralize the impact of interest rate changes and prepayment behavior of borrowers by combining long and short positions in mortgage securities with different characteristics and other hedging positions such as shorts in U.S. Treasuries and interest rate options and swaps.

Convertible Arbitrage

Convertible bonds range from investment-grade credits to busted convertibles, and a fund may concentrate on one or more of the high-delta, middle-delta, and low-delta convertible strategies.

Convertible Arbitrage funds attempt to exploit the mispricing in convertible securities. As the mispricing in convertible securities is typically small, this strategy will usually employ leverage. A convertible bond's valuation is dependent on the stock price and volatility of the underlying share,

the credit rating of the issuer, the maturity and coupon of the bond, the expected future dividends of the underlying share, and the interest rate. A convertible manager takes an exposure to the volatility

and/or the credit risk of the bond, hedging out the other factors. The stock exposure is typically hedged out with a short position in the underlying company shares. The strategy is thus typically market neutral.

Specialties within this strategy are by region and type of strategy:

- Geographic: Global, U.S., Japan, and Europe.
- Delta Spectrum:
    - High-delta: deep in-the money convertibles (a synthetic put strategy);
    - Middle-delta: optionality/volatility exposure;
    - Low-delta: busted converts (high yield).

Event-Driven Within the event-driven style of Hedge Funds, the three principal strategies as defined by Standard & Poor's are:

Merger Arbitrage

The Merger Arbitrage strategy involves taking positions in companies that are either currently or likely to be engaged in corporate mergers and acquisitions. Merger Arbitrage funds typically buy shares in the target and sell an appropriate quantity of shares in the acquirer in a merger deal. In a completed deal they will typically have an equal and opposite position in the acquirer, and will have earned a spread in the meantime. Factors that affect returns include the extent of the spread that can be earned through this transaction, the likelihood of a deal coming to fruition (it may break for regulatory, financial, or company-specific reasons), and the likely date of completion of the deal. Variations occur when the acquirer is bidding for the target with cash, or when the ratio of shares of the acquirer to be offered is dependent on the price of the shares.

Distressed

Distressed security funds generally invest in securities of financially troubled companies (companies involved in bankruptcies, exchange offers, workouts, financial reorganizations, and other special credit event-related situations). These managers may identify distressed securities in general or focus on one particular segment of the market (e.g., senior secured debt). Investments may be accumulated with a view to an exit via the secondary market, or with the expectation that the company will be recapitalized, restructured, or liquidated, where the fund manager may either seek to be actively or passively involved in the process. Managers may receive equity after the restructuring of a distressed company.

High-yield funds price more easily and have more long/short activity; thus they have reasonable transparency. Bankruptcies, which are not necessarily correlated with other events in the market, form a major portion of this strategy class. Long-only funds seek capital gains by holding long-term stakes in bankrupt or financially distressed (or stressed) firms, while Long/Short funds take positions either within the capital structure of a firm or long and short positions in the debt of different companies, seeking to both add value and hedge out some market/systematic risk.

Special Situations

Special Situations encompasses funds that seek profit opportunities from a broad range of corporate

events. Managers are either generalists, who engage in trading keyed to corporate events such as a merger, distressed finances or share prices, and changes to an index, or specialists who concentrate on a specific niche they can exploit. Value-oriented funds invest in undervalued obligations including bank debt, high-yield bonds, trade claims, and equity securities created by discrete and often extraordinary events. Niche strategies include Capital Structure Arbitrage (which includes

investing long and short in different parts of the capital structure of the same firm) or other relative-value trades, such as trading between ADRs and local shares or voting versus non-voting shares, as well as strategies involving trading a holding company versus positions in its listed subsidiaries (a "stub" trade). It also includes Closed End Fund Arbitrage, which involves the purchase and hedging of closed-end funds that may be trading at a significant difference from their net asset values.

Directional/Tactical

Within the directional, tactical or opportunistic style of Hedge Funds, the three principal strategies as defined by Standard & Poor’s are:

Long/Short Equity

Long/Short Equity funds take long and short stock positions. The manager may attempt to profit from both long and short stock positions independently, or profit from the relative outperformance of long positions against short positions. The stock picking and portfolio construction process is usually based on bottom-up fundamental stock analysis, but may also include top-down macro-based views, market trends, and sentiment factors. Long/Short Equity managers specialize by region (e.g., global, U.S., Europe, or Japan) or by sector.

Managed Futures

Managed Futures funds take long and short positions in liquid financial futures such as currencies, interest rates, stock market indices, and commodities. Managed Futures programs typically base their investment decisions on strict quantitative methods, notably, trend-following models; other programs are more discretionary and based on fundamentals of the underlying commodity.

Global Macro Macro funds take long and short positions in currencies, bonds, equities, and commodities. The manager tries to exploit perceived divergences between and within these various asset classes. The investment decisions are based on a manager’s top-down or macro views of the world, economy, government policy, interest rates, inflation, market dynamics, and sentiment. The manager may also base investment decisions on relative valuations of financial instruments within or between asset classes.

Emerging Managers

Strategies may include providing seed or acceleration capital to emerging managers in exchange for a share of fee revenue and the ability to invest more later at favorable terms.

RISK PREMIA STRATEGY DEFINITIONS

Value

This strategy seeks to exploit the tendency for relatively cheap assets to outperform relatively expensive ones. It is currently employed for developed market stocks/industries, equity indices, fixed income, and currencies, based on various measures of fundamentals to price.

Momentum

This strategy seeks to exploit the tendency for an asset's recent relative performance to continue in the near future. Various measures of recent relative performance are used, including both price-based and fundamental momentum measures. It is currently employed for developed market stocks/industries, equity indices, fixed income, and currencies.

Carry

This strategy seeks to exploit the tendency for higher-yielding assets to provide higher returns than lower-yielding assets. It is currently employed for developed market fixed income and currencies, based on various measures of yield.

Defensive

This strategy seeks to exploit the tendency for lower-risk and higher-quality assets to generate higher risk-adjusted returns. It is currently employed for developed market stocks/industries, equity indices, and bonds, based on various measures of riskiness and quality.

Trend

This strategy seeks to exploit the tendency for an asset's recent price performance to continue in the near future. Various measures of recent price performance are used. It is currently employed for equity indices, fixed income, and currencies.

Volatility

This strategy seeks to exploit the tendency for options to be richly priced due to a premium for financial insurance. Buyers of options who are seeking financial insurance often overestimate the likelihood for tail events, and sellers need to be enticed to underwrite this insurance since losses may be correlated to other parts of the portfolio in bad periods. It is currently employed for equity indices.

The System will consider additional Alternative Risk Premia strategies and the asset groups for which they are employed as the Alternative Risk Premia market evolves and as further research is carried out.