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September 26, 2017

The Honorable Terence R. McAuliffe
Governor of Virginia
1111 East Broad Street
Richmond, Virginia 23219

The Honorable Thomas K. Norment, Jr.
Co-Chairman, Senate Finance Committee
Senate of Virginia
P.O. Box 6205
Williamsburg, Virginia 23188

The Honorable Emmett W. Hanger, Jr.
Co-Chairman, Senate Finance Committee
Senate of Virginia
P.O. Box 2
Mount Solon, Virginia 22843-0002

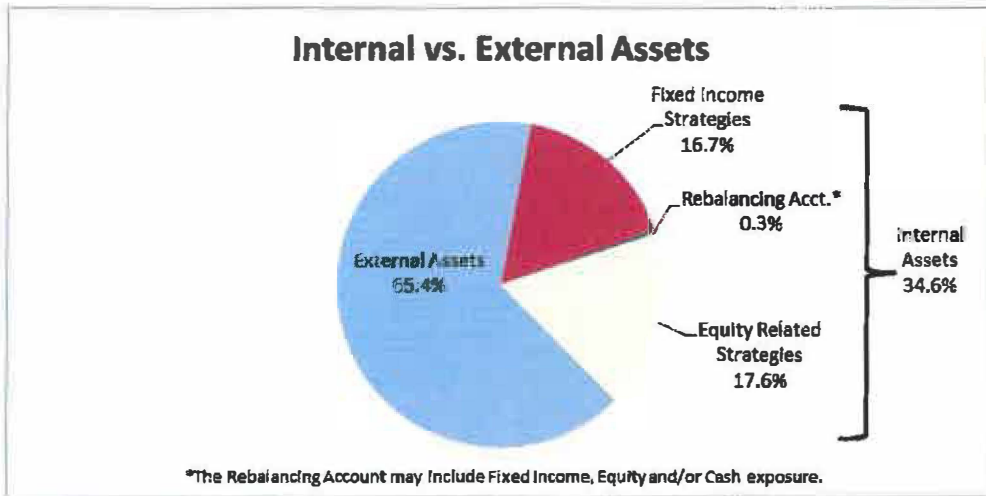
The Honorable S. Chris Jones
Chairman, House Appropriations Committee
House of Delegates
P.O. Box 5059
Suffolk, Virginia 23435

Re: Report on Virginia Retirement System Internal Asset Management

Dear Governor McAuliffe, Co-Chairman Norment, Co-Chairman Hanger and Chairman Jones:

Pursuant to Item 490 of Chapter 836, 2017 Session Acts of Assembly (the "Appropriation Act"), I am pleased to provide a report on the fiscal 2017 results obtained by the internal investment management program at the Virginia Retirement System ("VRS").

The VRS internal investment management program continues to make an important contribution to the total fund. As of June 30, 2017, the internal investment management team managed a total of approximately \$25.7 billion in assets (excludes the Currency Hedge Account), representing approximately 34.6% of the fund. This amount consisted of approximately \$13.3 billion managed in equity related strategies, and approximately \$12.4 billion managed in fixed income strategies. The following pie chart provides the breakdown between internally and externally managed assets as of June 30, 2017. In addition, I am attaching, as a supplementary exhibit, a schedule that shows the various investment mandates being managed internally by VRS staff at fiscal year-end.



The VRS Board of Trustees has established certain external benchmarks for evaluating portfolio managers and believes that intermediate time frames of 3 to 5 years are most useful for evaluating performance. I am pleased to report that the internally managed funds continued to demonstrate strong performance relative to policy benchmarks across both the 3 and 5 year periods ending on June 30, 2017, as demonstrated in the following table. We estimate that the value added to the total fund from these excess returns over the last 10 years is approximately \$1 billion.

IAM Track Record as of June 30, 2017			
		3 Years	5 Years
Equity Mandates	Portfolio	7.8%	13.0%
	Benchmark	7.3%	12.3%
	Excess	0.5%	0.7%
Fixed Income Mandates	Portfolio	2.9%	2.7%
	Benchmark	2.5%	2.2%
	Excess	0.4%	0.5%

In addition to strong performance relative to policy benchmarks, the internal asset management team continues to operate at a low level of cost when compared to fees that would be charged by outside managers who offer similar strategies. By managing these strategies internally, VRS is saving approximately \$41 million annually based on an outside consultant's analysis. (The consultant provides benchmarking information for large pools of capital including pension funds, endowments/foundations and sovereign wealth funds and serves over 350 blue-chip corporate and government clients worldwide.)

The Board of Trustees is proud of the efforts and results of the internal asset management team at VRS, and we are confident that the fund will continue to benefit from their work in the years ahead.

Sincerely,

Mitchell L. Nason
Chairman, VRS Board of Trustees

EXHIBIT A

VRS Internal Mandates as of June 30, 2017		
Asset Class	Objective	Assets (MM)
Equity	Passive, Emerging Market Small Cap	\$60.7
	Passive, Global Energy	\$168.7
	Low Tracking Error, U.S. Large Cap	\$5,228.7
	Low Tracking Error, Non-U.S. Large Cap	\$3,048.3
	Low Tracking Error, U.S. Small Cap	\$676.2
	Low Tracking Error, U.S. REIT	\$548.3
	Low Tracking Error, Emerging Market Large Cap	\$415.9
	Low Volatility, U.S. Large Cap	\$1,206.2
	Low Volatility, Non-U.S. Large Cap	\$1,721.4
	Rebalancing Account	\$233.2
	Currency Hedge (Overlay)	\$5,093.4
		Subtotal
Fixed Income	Securitized	\$4,192.0
	Credit	\$3,990.4
	Government Related	\$4,131.3
	Opportunistic	\$127.5
	Rate Overlay	\$8.7
	Subtotal	\$12,449.9
	Total	\$30,850.9