MONTANA BOARD OF INVESTMENTS
CORE INTERNAL BOND PORTFOLIO (CIBP MU40)
INVESTMENT POLICY STATEMENT

INTRODUCTION

The purpose of this policy statement is to provide a broad strategic framework for fixed income investments within the Core Internal Bond Portfolio (CIBP). The CIBP is managed internally by MBOI staff on behalf of the Retirement Funds Bond Pool (RFBP). The portfolio managers are governed by the investment management guidelines contained herein. The broad investment strategy is core-like and is to be benchmarked against the Barclays Capital Aggregate Bond Index.

OBJECTIVES

Strategic: Attain competitive investment returns in the fixed income markets while diversifying investment risk. The primary objective of the Core Internal Bond Portfolio is to provide diversified exposure to the various sectors of the bond market for the benefit of pension fund participants in a prudent and cost effective manner. The internal portfolio will also provide primary liquidity to retirement fund participants. Finally, the CIBP will act as the foundation or core of the fixed income asset class and as a complement to the higher risk mandates run by external bond managers.

Performance: The return objective of the CIBP is to achieve an annualized time weighted total return exceeding that of the Barclays Capital Aggregate Bond Index over a three year rolling period.

PERMITTED INVESTMENTS

- Debt obligations of the U.S. Government, including its agencies and instrumentalities. These include Treasuries, Treasury Inflation Protected Securities (TIPS) and fixed and floating rate agency obligations.
- Dollar denominated debt obligations of developed country foreign governments.
- Dollar denominated debt obligations of index-eligible supranational agencies.
- Dollar denominated debt obligations of domestic and foreign corporations (Yankee bonds) up to 2% of portfolio assets per issuer. These may include trust preferred securities and be fixed or floating rate coupon structures.
- Securitized assets, including U.S. Agency mortgage pass through securities (MBS), non agency MBS (limited to 3% of portfolio market value in total), collateralized mortgage obligations (CMOs), commercial mortgage backed securities (CMBS), hybrid ARMS and asset backed securities.
- When-issued securities.
- Rule 144a securities.
- Medium term notes.

PROHIBITED INVESTMENTS

- Over the counter derivatives, including interest rate swaps and credit default swaps.
- Short sales and securities margin loans.
- Bank loans.
- Interest only (IO) and principal only (PO) mortgage strips.
- Companion/residual/equity tranches of CMOs or other structured securitizations.
- Capital securities (convertible from fixed to floating).
- Inverse floaters.
- Convertible bonds.

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CONSTRAINTS

Credit quality: Securities must be rated investment grade, or no lower than triple-B-minus, by two nationally recognized securities rating organizations (NRSRO) at time of purchase, with the exception of non-rated securities issued or guaranteed by agencies or instrumentalities of the U.S. Government. Securities downgraded below investment grade may be held at the manager's discretion. Non-rated securities will be assigned an internal rating.

Duration: The weighted average effective duration of the portfolio, including cash, must be within 20% of the duration of the Barclays Capital Aggregate Bond Index.

Sector: The portfolio sector exposure will be maintained within the ranges shown in the table below.

ASSET ALLOCATION SECTORS & RANGES
(At market)

Sectors	**Policy Ranges**
U.S. Treasury	**15-45**
Government-Related	**2-10**
Total Government	**20-60**
MBS	**20-40**
Asset-Backed Securities	**0-7**
CMBS	**0-12**
Total Structured	**20-59**
Corporate Credit	**15-40**
Total	**100%**

LIQUIDITY

Liquidity needs for the fixed income program are low, as participant capital allocated to the pool is not expected to change dramatically on short notice. Nevertheless, the underlying assets held are predominantly publicly traded securities which can normally be liquidated in a relatively short period to accommodate broad asset allocation changes between fixed income and other asset categories held by retirement plan participants. Assets considered to be generally illiquid will be limited to 10% of the portfolio's market value.

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ADMINISTRATIVE

Securities Lending:

Section 17-1-113, MCA, authorizes the Board to lend securities held by the state. The Board may lend its publicly traded securities held in the investment pools, through an agent, to other market participants in return for compensation. Currently, through an explicit contract, State Street Bank and Trust, the state's custodial bank, manages the state's securities lending program. The Board seeks to assess the risks, such as counterparty and reinvestment risk, associated with each aspect of its securities lending program. The Board requires borrowers to maintain collateral at 102 percent for domestic securities and 105 percent for international securities. To ensure that the collateral ratio is maintained, securities on loan are marked to market daily and the borrower must provide additional collateral if the value of the securities on loan increases. In addition to the strict collateral requirements imposed by the Board, the credit quality of approved borrowers is monitored continuously by the contractor. From time to time, Staff or the investment manager may restrict a security from the loan program upon notification to State Street Bank. Staff will monitor the securities lending program, and the CIO will periodically report to the Board on the status of the program.

Cash Investments

Cash investments held at the pool level, any managed account within it, or any separate account entail an element of credit risk. Thus, only approved cash investment vehicles are permitted. These include the custodian’s STIF vehicle, STIP, or any SEC-registered money market fund, all of which specifically address credit risk in their respective investment guidelines.