Final

MONTANA BOARD OF INVESTMENTS
DEPARTMENT OF COMMERCE

Montana State University
Strand Union Building (SUB), Ballroom C
Bozeman, MT.

November 12 & 13, 2008

MINUTES

BOARD MEMBERS PRESENT:

Terry Moore, Chairman
Elouise Cobell
Teresa Cohea
Karl Englund
Maureen Fleming
John Paull
Jack Prothero
Jon Satre
Jim Turcotte
Senator Dan Weinberg

BOARD MEMBERS ABSENT:

Representative Tom McGillvray

STAFF PRESENT:

Jason Brent, Investment Analyst
Geri Burton, Deputy Director
Richard Cooley, CFA, Portfolio Manager
Kim Dallas, Program Assistant/Board Secretary
Ed Kelley, Portfolio Manager
Herb Kulow, Portfolio Manager
Rande Muffick, CFA, Portfolio Manager
Clifford A. Sheets, CFA, Chief Investment Officer
Carroll South, Executive Director
Steve Strong, Investment Analyst
Dan Zarling, CFA, Director of Research

GUESTS:

Jim Voytko, R.V. Kuhns and Associates
Steve Hahn, R.V. Kuhns and Associates
Stephen J. Weeks, Vice President, Columbus Circle Investors
Thomas J. Bisighini, CFA, Sr. Vice President, Columbus Circle Investors
Matt Egenes, CFA, Principal, Barrow, Hanley, Mewhinney & Strauss
Mark Gianbrone, Principal, Barrow, Hanley, Mewhinney & Strauss

CALL TO ORDER

Chairman Moore called the regular meeting of the Board of Investments (Board) to order at 10:05 a.m. at Montana State University, Strand Union Building, Ballroom C. As noted above, the meeting convened with seven members of the Board present. Member Terry Cohea arrived at the completion of roll call and Member Karl Englund arrived later in the day, as noted in the minutes. Rep. Tom McGillvray was absent from the meeting.

Motion: Member Fleming motioned for approval of the August 19 & 20, 2008 minutes and the September 24, 2008 Special Conference Call minutes; Member Cohea seconded the motion and the motion was passed 8-0.

ADMINISTRATIVE BUSINESS

Chairman Moore presented the following Administrative Business:

Loan Committee Report

Member Jack Prothero, Loan Committee Chairperson, reported that the Loan Committee reviewed staff recommendation to participate in a Qualified Zone Academy Bonds Request. Member Prothero will present Loan Committee recommendation during the Bond Program portion of the agenda.

In addition, Member Prothero reported that the Loan Committee reviewed and approved two INTERCAP loan requests for Cascade County on October 30, 2008 via email. The Loan Committee authorized staff to proceed with processing and closing these loans using the Board's standard Bond Program Office procedures.

Borrower:	Cascade County
Purpose:	To finance costs associated with (1) completing its Public Works Facility (PBF) and (2) remodeling the County's downtown campus.
LC Approval Date:	October 30, 2008
Board Loan Amount:	$1,250,000
Term:	10 years

Borrower:	Cascade County
Purpose:	To purchase two (2) new motor graders and one (1) new loader and to refinance eight (8) existing motor graders.
LC Approval Date:	October 30, 2008
Board Loan Amount:	$750,000
Term:	7 years

Public Comment

Chairman Moore called for Public Comment of Board-Related Items. *No Public Comment made.*

EXECUTIVE DIRECTOR REPORTS

Legislation Update

Mr. Carroll South reported that to date there have been 789 requests for draft legislation submitted to the 2009 Legislature, and request for legislation will increase significantly following the election. Staff is tracking the following drafts with special focus on the **bolded** requests:

LC0016	Transfer $30 million from general fund to work comp old fund
LC0017	**Revise laws governing state fund**
LC0021	Public school fund asset exchange
LC0033	**Split short term investment pool between state and local government**
LC0052	**Require solar panels on all state-owned buildings**
LC0053	Wind power pilot project to store compressed air
LC0062	**Fund older Montanans trust fund using oil and gas production tax**
LC0066	Revise or eliminate certain statutory appropriations
LC0085	Transparency in government act
LC0101	**Revise volume cap bond laws**
LC0102	**Retroactively revise laws governing state leasing of buildings**
LC0120	Revise volume cap bond allocation from MHESAC to Board of Regents
LC0121	Revise volume cap bond procurement laws
LC0144	**Revise law for acquisition of state office space**
LC0146	State rainy day fund
LC0147	Study student loan system
LC0155	**Repeal termination date for coal tax trust-funded economic development programs**
LC0166	General Appropriations act
LC0177	**General Obligation bonds for state government**
LC0209	**Allow low-interest coal tax trust fund loans to expand rail passenger service**
LC0261	Eliminate automatic trigger that decreases employer contribution
LC0273	**Revise definition of enterprise funds**
LC0358	Best value contracting
LC0369	Revise and clarify local government laws
LC0371	Revise local government laws
LC0449	**Transfer police and fire pension payment function - department of administration**
LC0457	**Repeal termination on coal trust funding for economic development programs**
LC0518	Study comparable worth for state employees
LC0576	Transfer office of economic opportunity to Department of Commerce
LC0637	TIF for county roads
LC0659	**Authorize local governments to form investment pool**

Chairman Moore encouraged Mr. South to contact the Board regarding the upcoming session and introduction of bills if and when there is a need or concern.

Proxy Voting Update

Mr. Carroll South reported that the current Proxy Policy, approved in December 2004, was adopted when the Board staff invested all actively-managed domestic stock and was solely responsible for voting proxies. Since the internal domestic stock portfolio was liquidated in August 2007, all public equity securities are managed externally by managers who have been delegated the responsibility to vote proxies. Currently, the Board's Proxy Policy is not being utilized because the external managers are not required to vote in compliance with the policy.

Recently staff subscribed to a service provided by State Street Bank that will permit them to monitor external manager proxy voting whether it is performed directly by the manager or contracted to one of the vendors that specializes in voting proxies. An additional service is available from State Street Bank which would provide notice of dates and subjects of all proxy votes for stocks held by the Board's external managers. The service will provide a gauge of how labor intensive it would be for staff to vote all proxies. If internal staff resources are adequate to vote proxies, they could be voted electronically by staff. If not, a third party could be engaged that specializes in voting proxies for institutional investors.

Mr. South stated that staff intends to make a recommendation on a voting process at the February Board meeting as well as present a revised Proxy Policy for review.

<u>Socially Responsible Investing</u>
At the August Board meeting, staff presented a report on socially responsible investing. At that time, the Board asked that staff and R.V. Kuhns, the Board's consultant, obtain additional information on socially responsible (SR) investing and to determine if and how other public funds may be targeting a portion of their portfolios to SR investments. Staff also asked R.V. Kuhns to survey the database it uses to compare investment performance to ascertain if dedicated SR investment managers report performances, and if so how their performance compares to other managers.

The database search conducted by R.V. Kuhns for SR investment manager performance did not result in definitive data that would allow a direct comparison of SR manager performance to non-SR managers.

The memorandum provided by R.V. Kuhns and Associates states:

> *"The capability of eVestment Alliance (EA) to monitor and compare SRI manager performance directly to non-SRI managers is somewhat limited. Investment managers can input their socially screened composite data into EA, but EA does not readily identify or create a universe of these products. However, RVK's Manager Research Group creates a universe of these products based on knowledge of each manager, screening for SRI benchmarks and key words in the product description."*
>
> *"Our research shows there are about 65 SRI composites in the EA database across all asset classes accounting for $34 billion in assets. In contrast, the database holds over $800 billion in US active large cap core composites alone. Approximately 50% of these SRI mandates are Large/All Cap US Equity, 30% are Non-US or Global Equity, and the residual 20% includes US Small Cap, Mid Cap and Fixed Income. Many of these strategies are global or all-cap or balanced, highlighting the difficulty of using these strategies from a "fill the boxes" asset class approach."*

Mr. South also provided a list of public funds identified as having an investment in SR investment products. The list does not specify the type or amount of SR Investments the funds may be pursuing and on what basis the funds were selected for the list. Another contributing problem may be that the definition of SR investing may not be clearly defined.

The US Department of Labor on October 16, 2008 published a news release announcing the issuance of new guidance for pension plans covered under the Employee Retirement Income Security Act (ERISA), pertinent sections of which are cited below:

> *"Today the department reiterates and clarifies its longstanding view that workers' money must be invested and used solely to provide for retirements, not for political, corporate or other purposes."*
>
> *"The guidance reiterates that plan fiduciaries, who are charged by law with the responsibility for operating employee benefit plans on behalf of plan participants, may never increase expenses, sacrifice investment returns, or reduce the security of plan benefits in order to promote legislative, regulatory or public policy goals that have no connection to the payment of benefits or plan administrative expenses."*

Mr. South stated that while public funds are not subject to ERISA, the Montana Constitution and Montana law imposes a similar fiduciary responsibility on the Board as part of the "Prudent Expert Principle", which requires it to discharge its duties solely in the interest of and for the benefit of the funds forming the unified investment program.

It was the consensus of the Board and staff that if there are concerns or suggestions regarding socially responsible investments that it be brought to each others attention.

Hedge Fund-of-Funds RFP - Update
Mr. South updated the Board on the Hedge Fund-of-Funds RFP process. The RFP was issued on August 6, 2008 and 24 responses were received on September 19.

Taking current conditions into consideration the period since June 30 has reportedly been the worst period in history for hedge funds, including major losses, liquidations, significant redemptions, and forced selling of assets at depressed prices.

Member Jim Turcotte stated that he has had conversations with members of the Teachers' Retirement Board and there is a concern about allocating to hedge funds.

Chairman Moore appreciates Member Turcotte's comments and emphasized that the Board has moved very cautiously in this area of investing and that there has been no allocation of funds made.

Mr. South stated in his memo that against this deteriorating background, staff and the Board's consultant will not only review respondent information from the five-year period ending June 30, but will keep abreast of current conditions which may temper much of the information provided by the RFP respondents.

Staff will have enough information to make a recommendation to the Board on hedge fund-of-funds at its February meeting.

ARCO Settlement
Mr. Carroll South provided a verbal update to the Board regarding the ARCO Settlement. The State recently settled with ARCO for approximately $165 million. Currently staff is reviewing the cash flow analysis to determine how the money will be used over the next 15 – 20 years. Depending upon the cash flow analysis, some of the money will be invested in the Trust Fund Bond Pool (TFBP) and Investment Policy Statements will be drafted and presented for approval. Approval of the Investment Policy Statements will require a conference call meeting since the money cannot be invested in the TFBP without Board approval of the Statements.

QUARTERLY PERFORMANCE REPORT

(A complete copy of this report is kept on file with the documents of this meeting)

The Quarterly Performance Report for the period ending September 30, 2008 was presented by Mr. Jim Voytko.

He stated that the focus of the report will not be on individual managers because of the extreme events, which makes it difficult to draw very good conclusions. Focus will be on the actions and decisions made by the Board over the past three years. This report will show that even with the rather depressing performance report, there are signs that show some of the things that the Board has done have made a difference.

Fixed Income in general continues to be an issue given stress in the spread sectors of the market. Security Lending has recently been in the news as well. The lending of the securities is not the issue, but the investment of the collateral. Investment of the collateral is an investment product very similar to the short term investment pool, and the issues, types of investment and the kinds of problems that can arise are almost identical. To the credit of this Board, this issue has been addressed far in advance.

Hedge fund of funds showed a decline of -9.91 for the quarter and -9.65 for the year. This is the biggest negative decline for this investment type since the industry was created. The Board of Investments has completed an RFP process for this asset class; however no investments have been made.

Mr. Voytko also pointed out that in the Domestic Equity sector, there has been so much focus on the disasters taking place in the financial sector that it should be pointed out that during the third quarter, it was Energy and Materials that had the largest decline in the S & P 500. Financials experienced their greatest decline during the second quarter.

Mr. Voytko continued with his review of the Retirement Plans. There are three perspectives of comparison on which to judge the performance numbers. The three comparisons are versus peers, fund benchmark and the actuarial benchmark. At the end of the day from an economic perspective the actuarial benchmark is the most important, followed by peers and fund benchmark which tells more of how the fund is doing relative to the universe. The comments relating to these comparisons apply to both the quarter as well as the year. With respect to peers, a positive comparison - BOI was in the second quartile, which is a significant improvement of where the comparison was five years ago. The diversification that has been done has had a positive effect; diversification inside the asset classes and in general, to add real estate and to continue with the private equity program. With respect to the benchmark comparison – not as well. The problem is lodged in the quarter; longer term comparisons are OK. As compared to the actuarial benchmark – again, not as well. If you compare the need for a positive 7.75% – 8.00% return to a negative 15.6% return over a year that is a very tough comparison. The returns simply are not there.

The performance of the Investment Pools is not great news, which is not unexpected. The various pools are under their benchmarks. However STIP is on target, the Real Estate Pool has a positive return and the Private Equity Pool experienced outstanding relative returns. Private Equity has been a very positive contributor to the fund over the years and particularly during recent years. Mr. Voytko did point out that the big relative return is driven much more by the decline in the S&P 1500 than a positive return in the private equity pool and in fact there are widespread expectations of write downs in private equity funds in the coming quarters.

In a review of the external managers, Mr. Voytko pointed out that approximately five of the seven of the weakest managers who had particular poor performance have a very strong reliance on quantitative methodology. This dates back to August of 2007 when quantitative methods lost their ability to extract small amounts of excess returns from the market place. The method should not be abandoned; rather it is another way to diversify.

In conclusion, Mr. Voytko suggested consideration of the following over the next year:

1. In the very near term the private equity allocation is an issue because of the denominator effect of declining plan assets due to the large negative public equity returns. There is a recommendation and an action strategy on the table now.
2. Risk monitoring of external managers - Mr. Voytko stated that he is very impressed with the conference call schedule and what staff is doing in respect to monitoring and staying on top of the external managers.
3. Complete the consideration of absolute return strategies, or hedge fund of funds.
4. In an asset allocation sense, consider whether or not capital market assumptions for asset classes should change going forward. The 10-year trailing return on public equity securities is negative right now, and that is a far cry from an 8% long term return assumption.
5. In particular, consider return assumptions for asset classes using embedded leverage, including private equity, hedge fund of funds, and real estate, and whether or not those are going to affect the ability to produce returns either in the immediate future or over a 10-year period.

6. There is enough evidence in place, unless the fourth quarter shows a completely different story, that the diversification program that the Board has had underway has shown some material progress under circumstances that were worse that anyone could have imagined. He suggested the Board continue the diversification within asset classes and in the fund as a whole, as much for risk mitigation as for return enhancement purposes.

INVESTMENT ACTIVITY

Asset Allocation Report
Mr. Cliff Sheets presented the Retirement Systems Asset Allocation Report as of September 30, 2008.

Member Karl Englund arrived at this time.

Private Equity Allocation
Mr. Cliff Sheets reported that the allocation to the Montana Private Equity Pool (MPEP) within the pension plans has grown above the allocation range as the denominator of total pension assets has declined in the wake of sizeable public equity market value declines.

The Board has been an investor in private equity partnerships for twenty years as a means of bolstering pension fund returns and further diversifying plan assets, and in particular reducing the dependence on public equity exposure. The partnerships invest in a variety of underlying investments including corporate buyouts, venture capital, distressed securities, mezzanine, and industry-focused special situations. The returns for the private equity pool have been very attractive and have exceeded benchmark expectations over time. Over the past year ended September 30 the pool return was 3.14%, as compared to the benchmark which is based off of public equity at negative 17.27%. The return for MPEP has looked especially attractive in recent quarters given the dramatic declines seen in public stocks.

Presently the approved allocation range is 5-10% though the target has been to reach an exposure of 8-10% of total pension assets. The private equity allocation as of September 30 was 11.5%. The fact we are now above the targeted 8-10% allocation range requires action on the part of the Board.

The merits of this asset class argue for an increase in the allocation range to accommodate continued commitments on a regular basis. The most recent pacing study estimates that under various reasonable assumptions for pension asset growth and annual commitments approximating $175 million annually the allocation will range between 11.0% and 16.0%.

Staff recommends that the Board approve a targeted allocation to private equity of 12.0% plus or minus 3.0%, or a range of 9.0% to 15.0%.

At this time the discussion turned to a review of the private equity pacing analysis process. Steve Hahn of R.V. Kuhns presented a review of the pacing analysis recently conducted in conjunction with staff. He discussed the purpose of the analysis and then described several scenarios of the projected allocation to private equity. These projections looked at different commitment budgets and growth rates for total pension assets in projecting a range of likely future allocations to private equity. It also included a scenario which incorporated a more conservative assumption of distributions on existing buyout fund investments given the expected investment environment in the near term. In conclusion the pacing analysis supports the revised allocation range recommended by staff.

Motion: Member Jack Prothero motioned for approval of the staff recommendation as presented; Member Terry Cohea seconded the motion and the motion was passed 9-0.

Private Equity (MPEP)
Mr. Ed Kelly presented June 30, 2008 reports by Private Edge showing by strategy the total exposure by market value and outstanding commitments and the Portfolio Holdings Performance Report, holdings as of September 30, 2008 and investment briefs for the Montana Private Equity Portfolio for commitments made since the last Board meeting, as shown below.

Fund Name	Vintage	Subclass	Amount	Date
Lexington Partners VII	2008	Secondary	$20 M	9/30/2008
HarbourVest Private Equity Int'l – Europe	2008	Buyout	$20 M	9/30/2008
Total New Commitments			**$40 M**	

Real Estate (MTRP)
Mr. Ed Kelly presented June 30, 2008 reports by Private Edge showing the real estate fund commitments made to date and holdings as of September 30, 2008. There were no new investment commitments made by staff since the August Board meeting to report.

Domestic Equity (MDEP)
Mr. Rande Muffick presented the Montana Domestic Equity Pool Report as of September 30, 2008 and a summary of recent market trends.

International Equity (MTIP)
Mr. Rande Muffick presented the Montana International Equity Pool Report for the period ending September 30, 2008 and discussed market trends during the quarter.

Public Equity External Managers Watch List
Mr. Rande Muffick presented the External Managers Watch List – Quarterly Update. The Watch List criteria were established in accordance with the Montana Board of Investments Public Equity Manager Evaluation Policy, adopted by the Board on May 14, 2008.

Manager	**Style Bucket**	**Reason**	**Inclusion Date**
Goldman Sachs	Domestic – LC Enhanced	Performance, Personnel	March 2008
NorthPointe	Domestic – SC Growth	Performance	August 2008
Principal Global	International – LC Growth	Performance	March 2008
Western Asset	Domestic - LC Enhanced	Performance, Tracking Error	March 2008

Fixed Income
Mr. Nathan Sax presented the Fixed Income Overview and Strategy.

Mr. Richard Cooley presented Short-Term Investment Pool, State Fund Insurance and Treasurer's Fund Portfolio Reports.

ADJOURNED
The meeting adjourned for the day at 5:00 p.m.

CALL TO ORDER
The meeting was reconvened Thursday, November 13, 2008 at 9:45 a.m. with nine members of the Board present. Rep. Tom McGillvray was absent from the meeting.

BOND PROGRAM

Activity Report
The Board reviewed this report for the period ending September 30, 2008.

Staff Approved Loans Report
The Board reviewed this report for the period of July 1 – September 30, 2008:

Borrower:	City of Fort Benton
Purpose:	Digital Radio Equip. for Police Department
Staff Approval Date	July 31, 2008
Board Loan Amount:	$50,000.00
Term:	5 years

Borrower:	Dept. of Transportation
Purpose:	Motor Pool- Sedans
Staff Approval Date	July 31, 2008
Board Loan Amount:	$197,991.00
Term:	6 years

Borrower:	City of East Helena
Purpose:	Reconstruction of Municipal Swimming Pool
Staff Approval Date	August 7, 2008
Board Loan Amount:	$692,958.00
Term:	10 years

Borrower:	City of Helena
Purpose:	Sidewalk, Curb, Gutter, and Driveway/Ally Approach Replacement
Staff Approval Date	August 8, 2008
Board Loan Amount:	$350,000.00
Term:	10 years

Borrower:	Jefferson County
Purpose:	RID # 2506 Road Improvements
Staff Approval Date	August 14, 2008
Board Loan Amount:	$80,000.00
Term:	15 years

Borrower:	Winnett School District #1
Purpose:	Short Term Cash Flow Loan
Staff Approval Date	September 26, 2008
Board Loan Amount:	$100,000.00
Term:	Short Term through June 30, 2009

Commitment Date	Borrower	Project Description	Amount
8/8/2008	U of M Missoula	Replace Astro Turf at Washington Grizzly Stadium	$250,000.00

9/18/2008	MSU-Bozeman	Purchase Motion Based Driving Simulator	$280,000.00

QZAB Bond Resolution No. 221

Ms. Geri Burton presented to the Board a request from Billings Elementary School District #2 to issue a Qualified Zone Academy Bond in the amount of $773,250 to finance the purchase of the District's bonds.

The proceeds of the District's bonds will be used to finance all or a portion of the costs of improving, repairing, or rehabilitating Beartooth Elementary School, Riverside Middle School, and Ponderosa Elementary School by replacing, upgrading, adding, or repairing heating, air conditioning, and ventilation units and related controls; boilers and hot water systems; and related improvements

Resolution No. 221 authorizes the issuance and sale of the QZAB for School District #2 in the amount of $773,250. This authorizes the purchase by the Board of School District #2 bonds and the sale of the Board bonds to the purchaser for QZAB credit. The Resolution also authorizes the execution of various bond closing documents.

Ms. Burton presented staff recommendation for 1) approval of Resolution No. 221; 2) Authorize staff to proceed to complete the QZAB financing if it is determined to be in the best interest of the Board; and 3) Authorize staff to execute the bond closing documents.

Motion: Member Jack Prothero reported that the Loan Committee had met earlier and approved the QZAB Bond and Resolution No. 221. On behalf of the Loan Committee, Member Prothero motioned for approval of the staff recommendation as presented; Member Jim Turcotte seconded the motion and the motion was passed 9-0.

MONTANA LOAN PROGRAMS

Commercial and Residential Portfolios Report

Mr. Herb Kulow presented and the Board reviewed this report for the period ending September 30, 2008.

In addition, Mr. Kulow reported that the Board has been approached by a lender asking if the Board would consider buying back $12 million in Commercial Loans. Approximately 1 year ago, this lender paid the loans off in order for the loans to be managed in-house. This lender is now asking the Board to repurchase the loans.

Mr. Kulow stated that the lender will complete the required loan application process and a review of the credit will be completed by staff prior to the funding of these loans.

The record shows that Member Fleming abstained from this discussion.

ADMINISTRATIVE BUSINESS

Chairman Moore presented the following Administrative Business:

Human Resource Committee Report

Member Terry Cohea, Chairperson of the Human Resource (HR) Committee, reported that the HR Committee met prior to the board meeting and approved the Exempt Employee Salary Ranges.

Motion: On behalf of the Human Resource Committee, Member Cohea motioned for approval of the HR Committee recommendation; Member Jack Prothero seconded the motion and the motion was passed 9-0.

Member Terry Cohea, Chairperson of the Human Resource (HR) Committee, reported that the HR Committee has also reviewed and approved the proposed salary increases for the exempt staff.

Motion: On behalf of the Human Resource Committee, Member Cohea motioned for approval of the HR Committee recommendation; Member Jack Prothero seconded the motion and the motion was passed 9-0.

PRESENTATIONS

Columbus Circle Investors
Mr. Rande Muffick introduced Mr. Stephen J. Weeks and Mr. Thomas J. Bisighini. Mr. Weeks and Mr. Bisighini reviewed their firm and management style. Columbus Circle Investors manage a domestic large-cap growth account held in the Domestic Equity Pool.

Barrow Hanley, Mewhinney & Strauss
Mr. Rande Muffick introduced Mr. Matt Egenes and Mr. Mark Giambrone. Mr. Egenes and Mr. Giambrone reviewed their firm and management style. Barrow Hanley, Mewhinney & Strauss manage a domestic large cap value account held in the Domestic Equity Pool.

NEXT MEETING

The next regularly scheduled meeting of the Board will be February 10 & 11, 2009.

ADJOURNMENT

There being no further business, the meeting was adjourned at 11:55 a.m.

BOARD OF INVESTMENTS

APPROVE:____________________________________
Terry Moore, Chairman

ATTEST:____________________________________
Carroll South, Executive Director

DATE:____________________________________