MEMORANDUM

Montana Board of Investments
Department of Commerce
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To: Board Members

From: Carroll South, Executive Director
Clifford Sheets, Chief Investment Officer

Date: September 24, 2008

Subject: Update on Financial Markets

Since the beginning of September, investors have witnessed extreme volatility in the public equity markets. Although the federal government has stepped in several times to settle the markets, as of this date the equity markets remain in turmoil. The Administration and Congress are attempting to hammer out a broad comprehensive plan to unfreeze the debt markets and bring some stability to the equity markets. The public presentation of the federal plan caused the S&P 1500 Index to surge nearly 8.5 percent on September 18 and 19 only to fall nearly 4.0 percent on the 22nd due to uncertainty about the composition of the final plan and the ability of Congress to enact it in a timely manner. At this time it is not clear who the corporate beneficiaries of the final plan might be.

During such a period of extreme volatility, it is important that pension fund investors focus on the goal of achieving the actuarial assumptions over long time periods, rather than daily “paper” losses or gains. The attached slides depict; the long-term pension investment performance compared to the actuarial assumptions, the difference that just one month’s performance made in Fiscal Year (FY) 2008 performance, and the recent daily volatility in the equity markets and how that volatility impacts pension fund daily performance.

Slides 2 and 3 – These slides depict the Public Employees’ and Teachers’ Retirement Systems (PERS) and (TRS) investment performance from FY 1995 through FY 2008. ***Investment performance at the pension fund level was not calculated prior to January 1994***. During the period, the investment performance for PERS was 8.47 percent annually compared to the actuarial assumption of 8.00 percent. The return for TRS was 8.49 percent compared to the actuarial assumption of 8.00 percent through FY 2004 and 7.75 percent beginning FY 2005.

Slide 4 – This slide depicts the significant difference one month can make in pension fund performance during volatile markets. Through May 31, 2008, the PERS investment performance for FY 2008 was slightly positive, only to plummet 4.81 percent in June. Based on the fair value of all nine pension funds on May 31, 2008, this resulted in an unrealized loss of approximately $385.3 million in just 30 days. Had the 12 month rolling period ended on May 31, the performance results would have been completely different.

Slides 5 and 6 – These slides depict the volatility of the public equity markets from September 4, 2008 through September 22, 2008. The first slide depicts the Standard and Poor's (S&P) 1500 Index, which represents approximately 85.0 percent of all domestic stock. From September 17 - 18 there was a two-day positive performance swing of 9.11 percent, from 4.66 percent negative on the 17th to 4.45 percent positive on the 18th. Over the weekend there was a performance swing of negative 7.93, percent from 4.02 positive on the 19th to 3.91 negative on the 22nd.

The second slide depicts the volatility of the global stock market, excluding the US. While not quite as volatile on a daily basis as the S&P 1500 Index, on the Friday after the federal government announced a plan to intervene in the financial markets the index surged 7.86 percent.

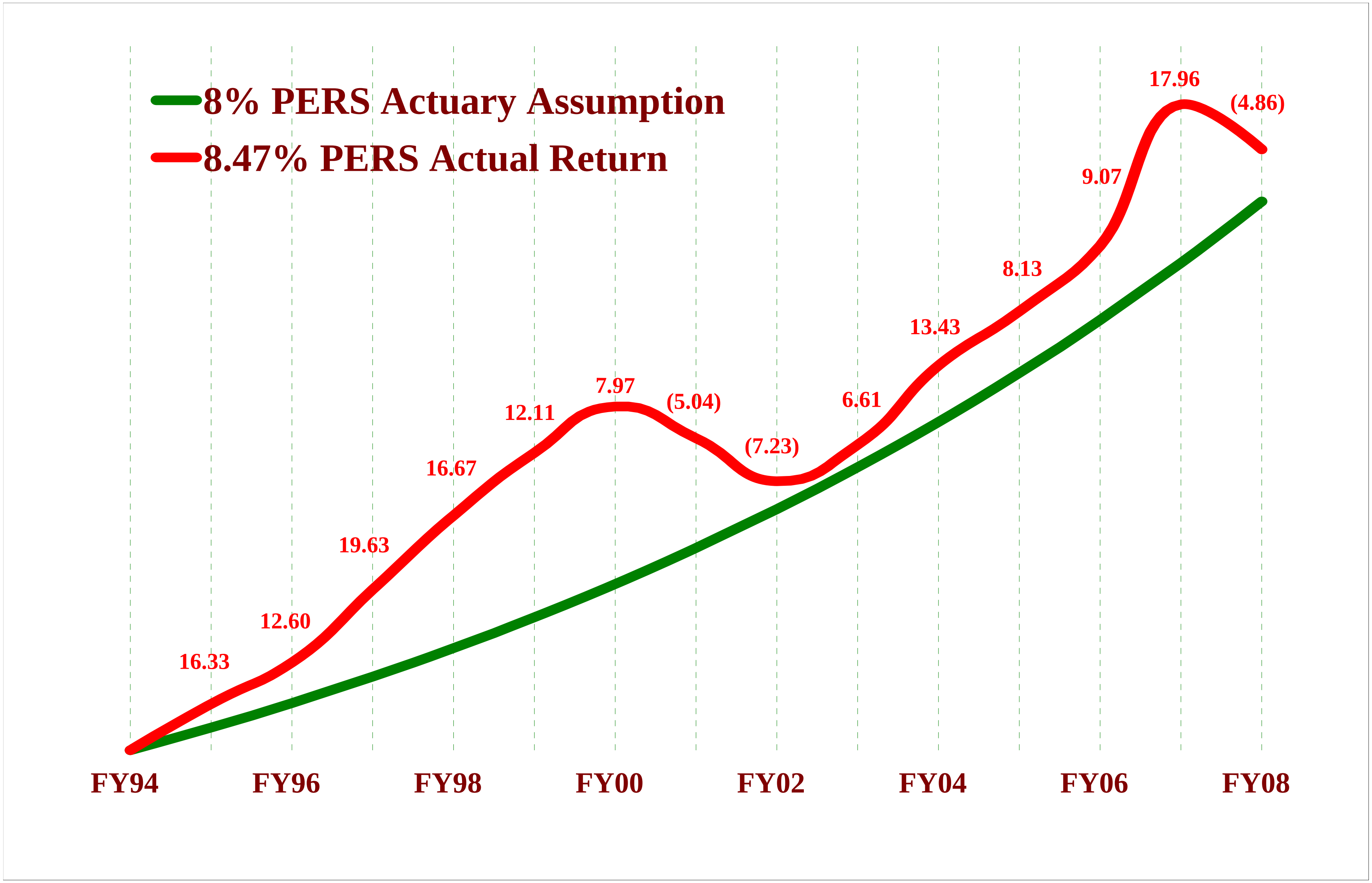
Slide 7 – This slide depicts the volatility in PERS investment performance during the same period. While the performance volatility was dampened significantly compared to the equity markets due to the fixed income, private real estate, and private equity components of the portfolio, there was a two-day performance swing of a positive 3.42 percent from September 17 – 18, and an over-the-weekend performance swing of negative 4.01 percent. When extrapolated into unrealized gains or losses this volatility can be significant. Based on total pension fund portfolios of $7.5 billion, just a 1.0 percent swing in investment performance equates to $75.0 million.

Summary – It is impossible to predict when the equity market volatility will subside and the uncertainty is reduced. If the Administration and Congress can come to terms on a comprehensive and understandable plan that will unfreeze the debt markets, this could remove some of the uncertainty currently reflected in recent equity market volatility. However, the many other variables that will influence equity prices – from corporate profitability to global growth concerns – will also influence the markets as this plan is implemented. It will take time for market participants to digest the details of the plan and determine if it is going to be effective in resolving many of the problems facing our financial system and the capital markets more broadly.

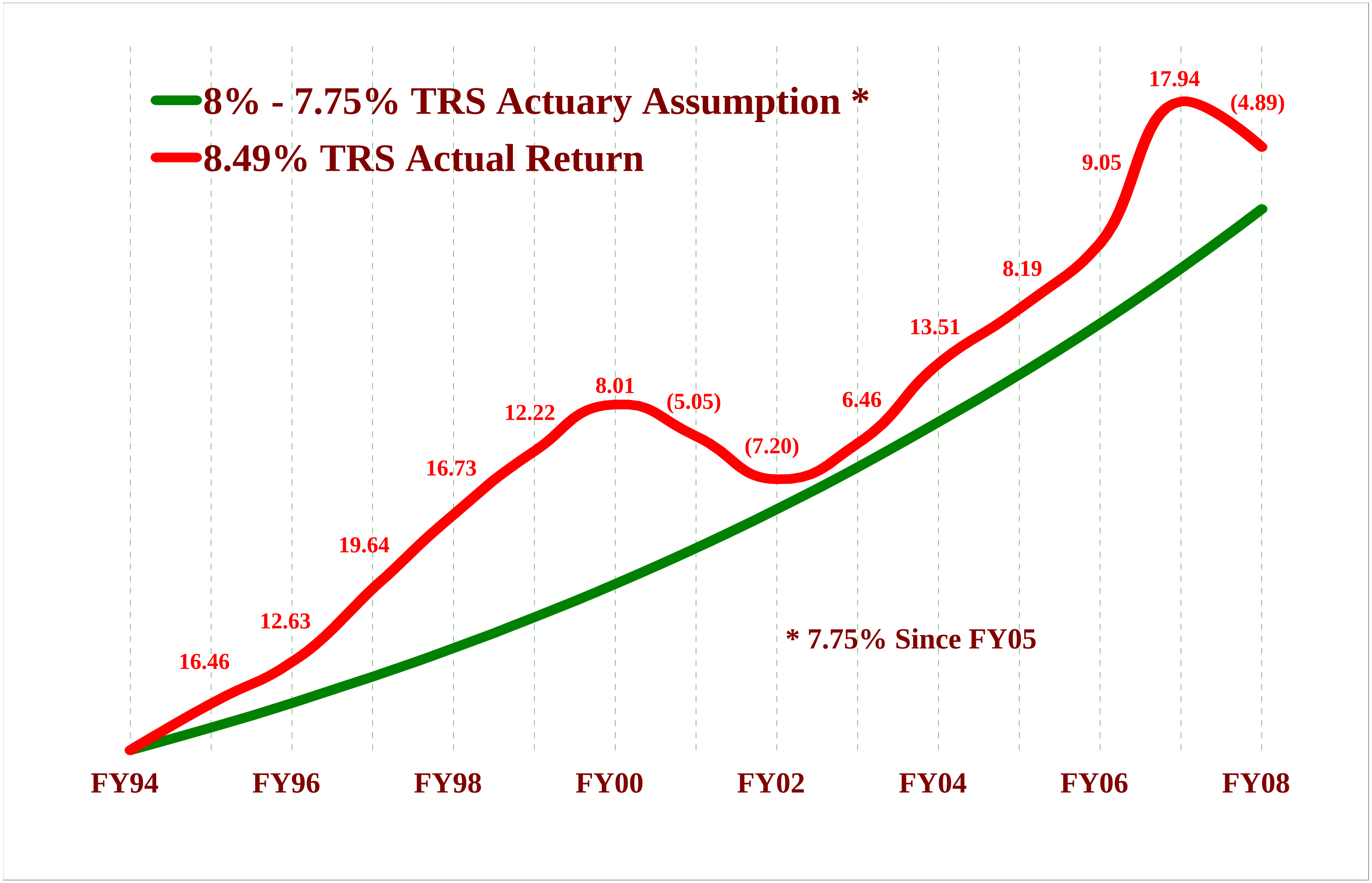
In the meantime, it is important that the Board keep its sights on the long-term investment performance of the pension funds and continue to diversify pension portfolios to dampen the volatility of the public equity markets while achieving the actuarial assumptions.

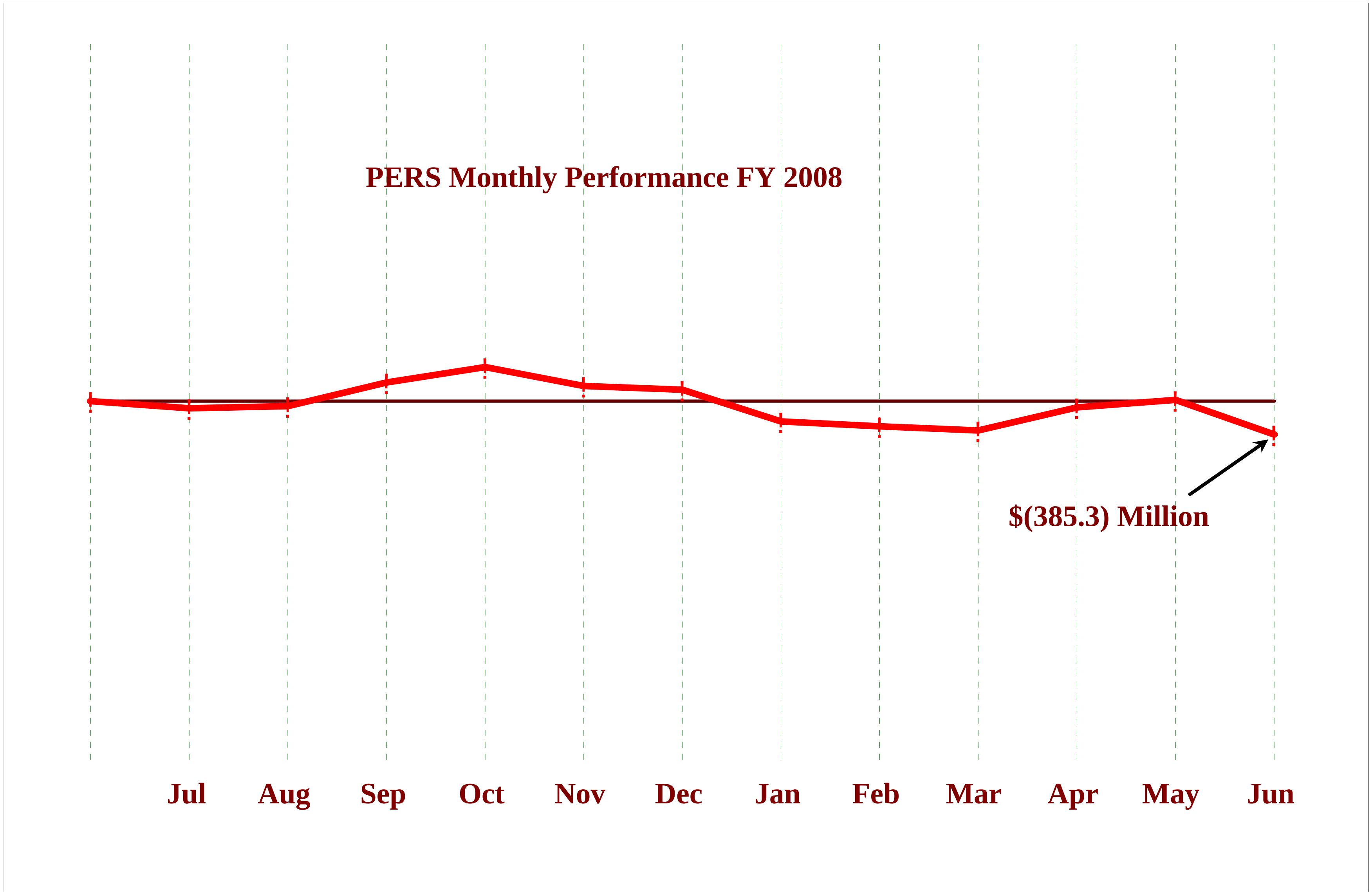
Board of Investments

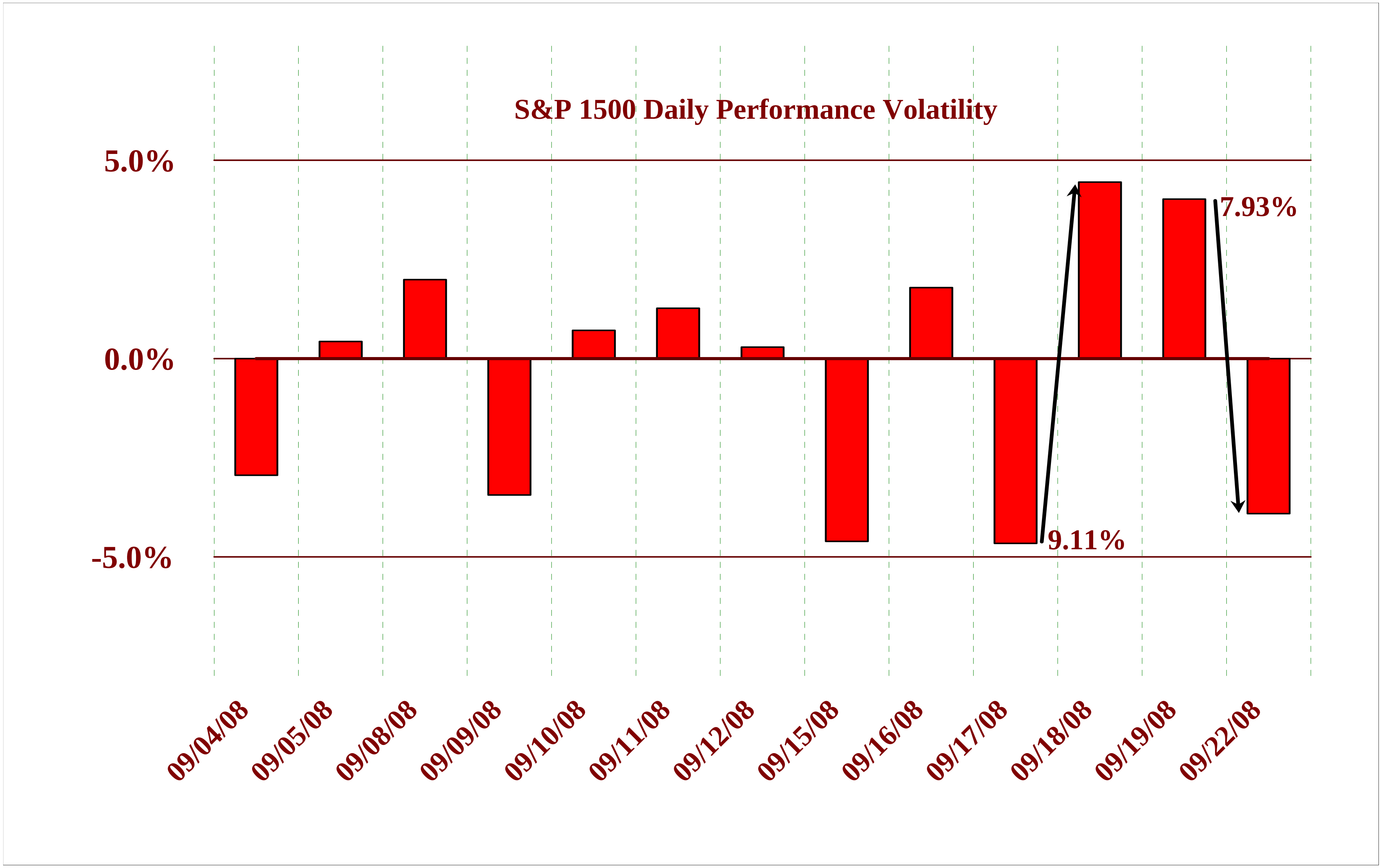
September 24, 2008



8% PERS Actuary Assumption
8.47% PERS Actual Return
16.33
12.60
19.63
16.67
12.11
7.97
(5.04)
(7.23)
6.61
13.43
8.13
9.07
17.96
(4.86)
FY94
FY96
FY98
FY00
FY02
FY04
FY06
FY08


8% - 7.75% TRS Actuary Assumption *
8.49% TRS Actual Return
16.46
12.63
19.64
16.73
12.22
8.01
(5.05)
(7.20)
6.46
13.51
8.19
9.05
17.94
(4.89)
* 7.75% Since FY05
FY94
FY96
FY98
FY00
FY02
FY04
FY06
FY08


PERS Monthly Performance FY 2008
$(385.3) Million
Jul
Aug
Sep
Oct
Nov
Dec
Jan
Feb
Mar
Apr
May
Jun


S&P 1500 Daily Performance Volatility
5.0%
0.0%
-5.0%
7.93%
9.11%
09/04/08
09/05/08
09/08/08
09/09/08
09/10/08
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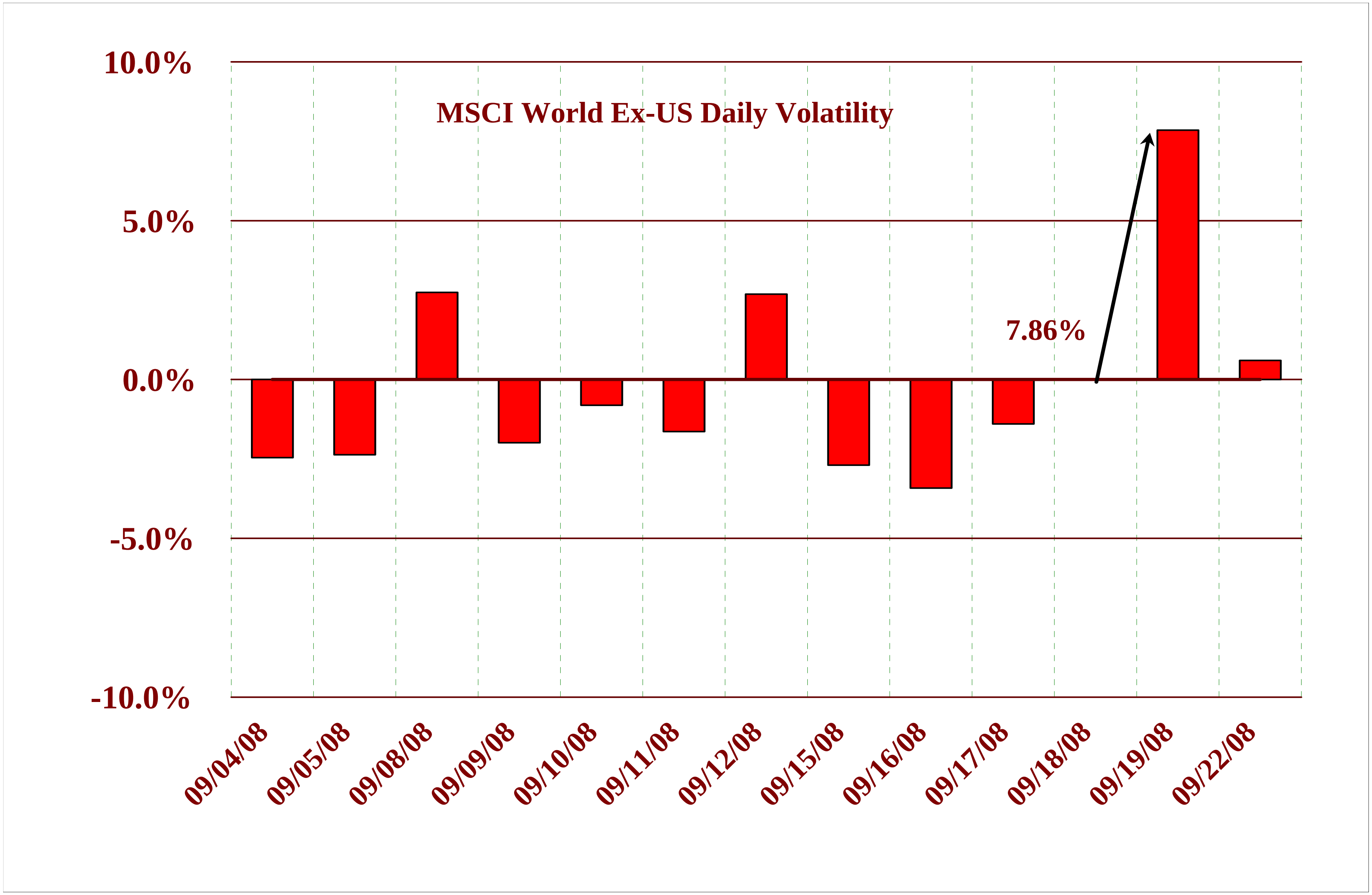
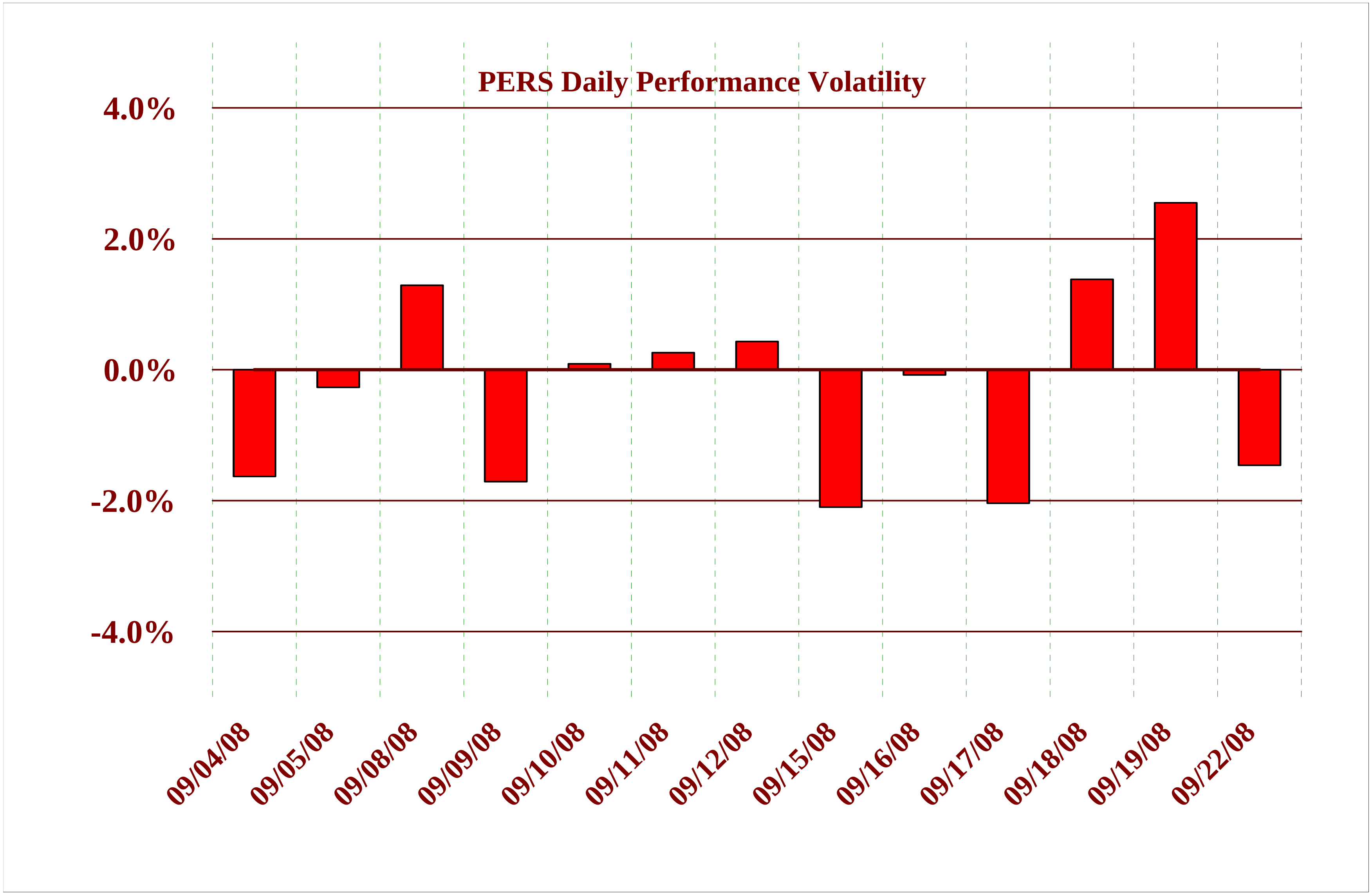
09/12/08
09/15/08
09/16/08
09/17/08
09/18/08
09/19/08
09/22/08


MSCI World Ex-US Daily Volatility
10.0%
5.0%
0.0%
-5.0%
-10.0%
7.86%
09/04/08
09/05/08
09/08/08
09/09/08
09/10/08
09/11/08
09/12/08
09/15/08
09/16/08
09/17/08
09/18/08
09/19/08
09/22/08


PERS Daily Performance Volatility
4.0%
2.0%
0.0%
-2.0%
-4.0%
09/04/08
09/05/08
09/08/08
09/09/08
09/10/08
09/11/08
09/12/08
09/15/08
09/16/08
09/17/08
09/18/08
09/19/08
09/22/08